2. Against twisting *The General Theory*

Maria Cristina Marcuzzo

INTRODUCTION

It is well known that Keynes’s masterpiece is a controversial book, which raises questions about the nature of its assumptions and conclusions, such as: should it better be understood in a Marshallian or a Walrasian framework? Do the assumptions of a given level of money wages and exogenous money supply really matter? Is the inverse relationship between the rate of interest and investment a by-product of the notion of marginal productivity of capital or just an ordering based on decreasing yields, like Ricardo’s land of decreasing productivities?

The answers to these questions led to different interpretations of *The General Theory*, which in some cases were not mutually compatible and therefore gave rise to controversies, each of the contending parties claiming that the others had the ‘wrong’ interpretation.

In a paper in collaboration with Tily, Chick made an interesting point, which I take as the focus of the present chapter: ‘When a piece of work is as distorted by the author’s contemporaries and successors as is Keynes’s masterwork, one has to enquire into the reasons’ (Chick and Tily 2014, p. 693, emphasis added).

In fact ‘wrong’ and ‘distorted’ are not the same thing. When a piece of work is distorted, not only are its purpose and relevance missed, but also it is transformed into something completely different. The transformations may be performed with the justification of a gain in clarity, of consistency with the received view or simply for ideological reasons.

Distortions originate from superimposing extraneous elements on the original, as Chick explained in the Preface to her *Macroeconomics After Keynes*, which she described as ‘an exercise . . . in restoration, stripping off layers of “Keynesian” varnish so that the original object could be seen’ (Chick 1983, p. vii).

This seemed to me a good starting point to trace out Chick’s life-long endeavour to un-twist what had been and is still being twisted in interpreting and putting *The General Theory* to use. For the sake of simplicity, I
have listed a few of the distortions to which Chick, together with others, has drawn attention over the years. The list is not meant to be exhaustive and some of the distortions are interrelated, but I hope that my catalogue captures most of the issues which have been at the centre of the debate and indeed of Chick’s life-long engagement with *The General Theory*.

Before I present my catalogues of distortions, I would like to put forward a suggestion of why *The General Theory* might have been liable to be misinterpreted. The reasons are not just at the receiving end – an audience ingrained in a different framework of mind – but also at the point of delivery. The language of the book is not easy to master, nor are the ideas always presented as in fact they are, namely really subversive of the established doctrine. Keynes wanted to persuade his fellow economists and to do so he thought he needed a common ground to engage them in a battle, in which he hoped eventually his point of view would win the day. As a consequence, as is well known, he did not discard some of the assumptions of the classical theory – such as perfect competition, increasing marginal costs, decreasing marginal productivity of labour (and possibly capital) – which led several heterodox economists to charge him as guilty of not having severed all the ties with neoclassical economics, but also misguided others into believing that the whole *General Theory* could be re-cast in more orthodox terms.

The key to the question of why *The General Theory* has been (and is) often distorted may be found in the role assigned to persuasion by Keynes. Persuasion was essential to his conception of economics as a method of moulding ideas and opinions in an exchange with others, as he explained in a celebrated passage: ‘It is astonishing what foolish things one can temporarily believe if one thinks too long alone, particularly in economics (along with the other moral sciences), where it is often impossible to bring one’s ideas to a conclusive test either formal or experimental’ (Keynes 1936, pp. vii–viii; emphasis added).

Keynes was embedded in the milieu of the highly educated British class, for which clubs, debating societies and learned fellowships represented the bulk of social life. He formed his ideas in the process of submitting them to others, and we have ample evidence of his style of work and reasoning intertwined in close personal relations. In order to be convinced himself and to persuade another of an argument, Keynes needed to engage in exchanges that had a strong emotional side (affection, trust, respect), affording a ‘meeting of minds’ (one of Keynes’s favourite expressions) that for him was conducive to fruitful interaction (Marcuzzo 2008).

In fact, in the often-quoted letter to G.B. Shaw, we find confirming evidence: ‘When my new theory has been duly assimilated and mixed with politics and feeling and passions . . . there will be a great change’ (Keynes...
[1935a] 1973, pp. 492–3). Far from appealing to the scientific superiority of his own theory, he entrusted ‘politics, feelings and passions’ to get the message through.

Politics, feelings and passions varied among his readership, and Keynes’s style of working by forming and refining his argument vis-à-vis his interlocutors show an ample range of cases in which the ‘meeting of minds’ was thwarted, intermittent and very rarely successful. With few exceptions, this was also the fate of The General Theory.

NO 1. THE GENERAL THEORY AS A MODEL

The distortion of translating The General Theory into a closed system of simultaneous equations, stemming from the belief that the main expression of a theory is a model, has been denounced by Chick several times, and in particular on two counts:

One: ‘A theory is broader than a model and can contain many models, depending on how the models (sub-systems) are created by assumptions and ceteris paribus conditions’ (Chick 2004, p. 14).

Two: ‘The models are closed systems’ and ‘The General Theory is an open system’ (ibid.).

The main implication of the open system notion in this context is: do not get hopelessly entangled in translating The General Theory into a closed model.

A classic example is the attempt to make The General Theory compatible with the mechanics of equilibrium analysis and its automatic forces. This was, of course, Joan Robinson’s line of attack against bastard-Keynesians, who were very rightly accused of discarding those very distinctive aspects of The General Theory, which, if retained, would make it impossible to encapsulate it into the neoclassical kernel. Chick herself has made a list of such aspects in several papers and in her books.

Keynes is often quoted as saying that he was open to ways in which his theory could be read, and even went so far as to write to Hicks that he found the latter’s version of The General Theory, ‘very interesting and I really have next to nothing to say by way of criticism’ (Keynes [1937] 1973, p. 79). This evidence has been used to provide support to the IS–LM distortion and it has been a matter of puzzling disappointment to many of us as to why Keynes did not oppose it. However, an unpublished letter by Beatrice Webb to William Beveridge of the same year (1937) unveils a different story: ‘I lunched [. . .] with Keynes the other day’, she wrote, ‘and
found him very depressed about the reception of his book, and the hopeless disunity of opinion among abstract economists’ (Webb 1937).

Keynes’s reactions to his critics have been reviewed in detail by his biographers, who have brought out his valiant defence and ability to rebut distortions and misunderstandings. What this letter reveals is that he may have foreseen others which were yet to come; or maybe it was just that feeling he described to Joan Robinson, while giving the finishing touches to *The General Theory*: ‘author’s melancholy did come on at the last. In the final proof reading it seemed so flat and stale’ (Keynes 1935b). Certainly, the aftermath of the book was a bit of an anti-climax, and besides Keynes’s fatigue and the sign of the imminent heart failure, there might have been the perception that the book was going to be misunderstood and misrepresented.

**NO 2. THE GENERAL THEORY AS A PLEA FOR DEFICIT SPENDING**

At the right wing of the political spectrum, or sometimes even in conservative academic quarters, *The General Theory* is presented as the Manifesto of deficit spending. This is clearly serving the specific political agenda of fuelling the anti-Keynesian sentiment in favour of the neoliberal policies. An extreme example can be found in Buchanan and Wagner, who asserted in their *Democracy in Deficit: The Political Legacy of Lord Keynes* without a grain of doubt: ‘The legacy or heritage of Lord Keynes is . . . political bias toward deficit spending, inflation, and the growth of government’ (Buchanan and Wagner 1977, p. 24).

Less extreme accounts of the Keynesian revolution as providing justification for the need of a large public sector in the economy are still to be found, notwithstanding the message, explicitly delivered in *The General Theory*, to sustain the level of investment by ‘stabilising business confidence’, rather than through debt-financed public works. There is plenty of evidence of Keynes’s reliance on ‘socialising investment’ rather than a fiscal policy aimed at smoothing out consumption levels over the cycle, showing his concern over the size of the deficit, and the importance ascribed to market incentives to bring about the desired level of employment. Here is an example: ‘If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary’ (Keynes 1936, p. 378).

In the recent so-called ‘Return to Keynes’ euphoria, we have seen this distortion at work, dragging discussion mainly onto the efficacy of fiscal
policy; this narrow focus took us back to the 1970s and the clash between Keynesians and Monetarists on the shape of the IS and LM curves, which Chick had so lucidly exposed in her *Theory of Monetary Policy*. It appears today to be just as unfruitful as it was then. As in the 1970s, testing the values of the elasticity of the IS–LM curves helped neither of the contending parties to win their case; today’s estimates of the value of the multiplier associated with each fiscal measure, as a test of the soundness of a Keynesian policy, are not settling the issue between economists of the two opposing camps.

NO 3. THE MULTIPLIER DOES NOT MULTIPLY

A small digression on what has happened to the estimates of the multiplier is instructive. The multiplier has had a story of alternate acceptance and rejection in the over 70 years of its existence. After more than 20 years of neglect and suspicion by the majority of the profession, we have seen it come back into favour.

In the 1950s and 1960s, when Keynesianism was at its height, the multiplier was generally assumed to be about 2. Then, in the 1990s and 2000s, these estimates gradually dropped, leaving the consensus in a range of about 0.5–0.7. We had to wait until 2009 to see the IMF raise the figure to 0.9–1.7; although their model may be still far away from *The General Theory*, we have the multiplier multiply again (see Marcuzzo 2014).

The point is that different types of models will deliver fiscal multipliers of almost any magnitude, depending on underlying parameter values and assumptions regarding monetary policy reaction functions and so forth.

Chick dedicated an entire chapter to the multiplier in her *Macroeconomics After Keynes*, arguing that there are three possible interpretations of it in *The General Theory* (dynamic: ‘what will occur if autonomous expenditure changes’; static: ‘a statement of the necessary condition for expansion of income to some predetermined new level or the maintenance of income at any particular level’ (Chick 1983, p. 253). The third, in her understanding, is the logical multiplier, which – in Keynes’s own words – ‘holds good continuously, without time-lag, at all moments of time’. According to Chick this representation of the working of the multiplier is just an *ex post* relationship between Y and I – not a theory at all.

Be that as it may, the validity of the principle of the multiplier – the induced expenditure mechanism – is not challenged by the above-mentioned empirical estimates, because the specifications of the models used to test it are often derived from the standard consumer theory framework, rather than from Keynes’s consumption function. In most
cases, consumption is modelled on individual maximising behaviour, over an infinite time horizon and with perfect foresight, relegating real income as a determinant of aggregate consumption – which was Keynes’s main concern – to a negligible role.

I offer this digression as a nice illustration of the outcome of unwise attempts to translate The General Theory into the neoclassical language of consumer’s utility maximisation.

NO 4. MISUNDERSTANDING THE DIGGING HOLES ARGUMENT

Keynes’s point – it does not matter how public money is spent, as long as it is spent, since it will generate income and, through the multiplier, the savings necessary to finance the initial expenditure – is meant to illustrate a principle, not to provide a blueprint of ‘useful’ public work schemes.

Expenditures on goods which have no useful purposes from the point of view of consumption, do nevertheless produce the desired effects on income and employment because they yield fruits that ‘could not serve the needs of man by being consumed’ and therefore do not ‘stale with abundance’ (Keynes 1936, p. 131). Keynes then writes:

Just as wars have been the only form of large-scale loan expenditure which statesmen have thought justifiable, so gold mining is the only pretext for digging holes in the ground which has recommended itself to bankers as sound finance; and each of these activities has played its part in progress – failing something better (Keynes 1936, p. 130, emphasis added).

In a 2013 paper with Dow, Chick wrote that the much misunderstood ‘digging holes in the ground’ passage ‘is a piece of satire aimed at ridiculing the government view that everything should earn a full profit or not be done at all’ (Chick and Dow 2013, p. 15).

There are two further points I would like to add. The first is trivial, although Keynes felt the need to spell it out: ‘it would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing’ (Keynes 1936, p. 129). The political difficulties arise, Keynes thought, mainly from ‘the education of our statesman on the principles of the classical economics’ (ibid.). The second point is that expenditure on ‘useful things’ may not be as effective: ‘Two pyramids, two masses for the dead, are twice as good as one; but not two railways from London to York’ (ibid.).

Keynes’s argument is that the decreasing marginal efficiency of
investment, ‘unless the rate of interest is falling pari passu’ sets a limit to the possibility of increasing the stock of wealth by means of ‘useful’ forms of loan expenditure. Waste results not when expenditure is directed to objects, which are not ‘economically’ viable, nor when they are not ‘useful.

NO 5. MICROFOUNDERING THE GENERAL THEORY

Chick’s position on the helpless and hopeless attempts to give The General Theory its microfoundations can be found in several of her papers. On this topic there are the 2002 article on Keynes’s Investment theory and a more recent one in the Review of Political Economy (2016). In the first of the two, Chick boldly argues that ‘consistency between a theory of decision making (microeconomics) and the overall outcome of decisions (macroeconomics) cannot, in general, be achieved. Some compromise of internal consistency is bound to arise . . . for individual actions have unexpected consequences’ (Chick 2002, p. 55). In the second article, she reinforces the point, invoking the search for a middle way between micro and macro levels: ‘Economics needs to face the fact that logical consistency between the two levels is not possible except at the two extremes of building from the representative agent or projecting perfect knowledge of macro-outcomes down to individual agents’ (Chick 2016, p. 112).

The legitimate question as to ‘what is the relationship between macroeconomic variables and decentralised, individual decisions’ in The General Theory has been tackled in the literature in a way that distortions are likely to arise. One has been to recast the entire structure of The General Theory in Walrasian language, and have the auctioneer do the job. But the more subtle and to me more distortive attempts come from modelling individuals’ behaviour (be they consumers or firms) on the maximising paradigm. If we need to explain behaviour, we are told, we need to bring in incentives, preferences and constraints, and this also entails the question of whether individual choices are compatible in an equilibrium configuration. In this way The General Theory becomes a paradigm of coordination failure among agents who otherwise act and perform according to the standard Walrasian model. Coordination failure needs, then, to be explained, and most of the time this is done by invoking some kind of rigidity (mostly wages) or missing market (the saving–investment nexus).

Even resorting to a Marshallian framework, with its more sensible world inhabited by various type of agents (middlemen, brokers, housewives, industrialists) in very specific markets, although certainly best suited to support the macroeconomic picture of The General Theory, does not solve the conundrum.
NO 6. RATIONALITY

Uncertainty and bounded rationality have been at the core of much of the ‘Return to Keynes’ plea in the aftermath of the crisis.

Uncertainty is to be interpreted as the need to take on board Keynes’s division of economics between ‘the study of those economic activities in which “our views of the future are . . . reliable in all respects” and the study of those in which “our previous expectations are liable to disappointment and expectations concerning the future affect what we do today”’ (Keynes 1936, pp. 293–4). The former study allows for probability calculation, while the latter is dominated by the notion of uncertainty.

The well-grounded interpretation that Keynes’s uncertainty is not calculable risk, however, has led some to infer that, failing the possibility of assigning probability values to future outcomes, choice and decision-making are voided of any rationality.

I think this is a distorted interpretation of Keynes’s approach. In my opinion, Keynes’s uncertainty still allows for rational behaviour, although the term ‘reasonable’ is better suited to represent it. In her 1978 Australian Economic Papers article, Chick refers approvingly to Clower’s contrast between Walrasian rationality (being perfectly informed about the future as well as the past) with Marshallian reasonableness (doing the sensible thing given one’s limited knowledge), but I hope Chick would agree to carry this connotation even further.

Keynes systematically applied the term ‘reasonable’ to a guideline not characterised by utilitarian calculation, which may prove only apparently to be in the individual interest. Reasonable action is guided by judgement, taking into account contingent, mutable circumstances as far as our knowledge can encompass the facts; he applies it in contrast to the reasons of the victor or creditor, as in the Economic Consequences of the Peace or in the debt negotiations with the US in the 1940s.

Economic rationality authorises demands to bring debtors to book, impose indiscriminate sacrifices, ignore the pleas of the weakest, invoke rigorous laws and threaten social protection and security. By contrast, reasonableness appeals to judgement on the basis of the circumstances; it is a plea to exercise of the imagination and creativity in seeking solutions balancing consequences from both creditors’ and debtors’ points of view.

In passing I may add that the term ‘reasonableness’ was used by Rawls in defining the characteristics of a plural and just society, and by Habermas, to distinguish between those who accept the principle of fairness and cooperation and those who act rationally on the basis of their own (i.e. individual) conception of what is good and just (see Marcuzzo 2010a).
Thus being *reasonable* for Keynes is a moral quality lacking in those who behave in a solely economically ‘rational’ way.

**NO 7. SPECULATION**

Although ‘animal spirits’ and ‘herd behaviour’ may at times dominate investment decisions or speculations in financial markets, Keynes leaves ample room for rationality bounded by knowledge, judgement and experience. My own work on Keynes as an investor and speculator has convinced me that he was exceptionally gifted as a trader, not because of the gains he made in the Stock Exchange, which were not as large as commonly believed, but by virtue of his profound grasp of the fundamentals underlying commodities, shares and currencies. He showed great ability in gauging the direction of prices, although he did not always get the timing right. He never ceased to gather information on the underlying forces driving prices, and remained first and foremost an economist who based his trading decisions on his professional knowledge.

While he became increasingly concerned about the role of market sentiment, conventions and herd behaviour, and in his mature thinking granted that success of the speculator might rest on the ability to interpret market sentiment, this was never the guiding principle for Keynes’s own behaviour as an investor. He trusted, rather, informed opinion on relevant data and, above all, his own individual judgement. He never lost sight of the complexity of factors behind the surface of price changes; while he progressively lost confidence in the ability to predict their course in the short run, he remained confident that study of the fundamentals of the economy and of what underlies the individual asset would provide a reasonable basis for rational and, in the long run at least, successful choice.

**NO 8. AUSTERITY**

Chick has been in the forefront in the battle against austerity and the devastating measures promoted by the *Troika* in Europe. The output-worsening effects of fiscal austerity programmes implied in the Maastricht Treaty were demonstrated for 100 years of UK history in her joint paper with Pettifor in 2011 and with Dow in 2013, drawing on *The General Theory* for the theoretical explanation.

Let me offer two particularly apt quotations by Keynes in commenting on the Report of the Steering Committee on Employment (1944): ‘It would be a failure to adopt a remedy for severe cyclical unemployment which may
have [the] effect [to unstabilise the national budget] since measures to stabilise the national income are *ipso facto* measures to stabilise the national budget’ (Keynes [1944] 1978: 366, emphasis in original). And he continued:

The Committee give the impression that, whilst the measures they propose to avoid unemployment are admittedly necessary and advisable, a price has to be paid for them in the shape of budgetary deficits and perhaps a consequent weakening in international confidence in our position. Exactly the opposite is the truth. It would be a failure to take such measures, which would inevitably un-stabilise the budget and weaken confidence. Is it supposed that slumps increase the national wealth? (Keynes [1944] 1978: 366).

It is now accepted that the fiscal stimulus to curb the onset of the 2008–09 recession was inadequate; preoccupation with the sustainability of the government debt, triggered by the Greek default crisis, made ‘austerity’ appear as the only viable solution. The pleas by several heterodox economists of various schools, to engage in expansionary policies to sustain aggregate demand are only recently, and only partially, being recognised as appropriate.

Keynes has many scathing comments on the prevailing attitude against deficit spending, which might well be applied to today’s defenders of the austerity programmes: ‘the man who regards all this [loan-financed public works, particularly public expenditure on housing] as a senseless extravagance which will impoverish the nation, as compared with doing nothing and leaving millions unemployed, should be recognised for a lunatic’ (Keynes [1934] 1978, p. 338). And again:

When we have unemployed men and unemployed plant and more savings than we are using at home, it is utterly imbecile to say that we cannot afford these things. *For it is with the unemployed plant, and with nothing else, that these things are done.* To have labour and cement and steel and machinery and transport lying by, and to say that you cannot afford to embark on harbour works or whatever it may be is the delirium of mental confusion (Keynes [1928] 1978, p. 765, emphasis in original).

**CONCLUSIONS**

The twisting of *The General Theory* took different forms, which led to disregarding its lesson and making very bad use of it. I think it can be fairly summarised as: translating it into models with neoclassical assumptions, neglecting uncertainty, ridiculing proposals meant to illustrate principles, missing the fallacy of composition, emphasising the role of government intervention. The main lesson to be drawn from *The General Theory* is that
markets and economic behaviour are to be guided by a logic of coordina-
tion and rules, rather than left to the pursuit of individual interests and to
the freedom resulting from the lack of public intervention and regulation
by the institutions. But there is more to be learned: a conception of
economics as extension of possibilities, as opposed to the logic of scarcity;
an appeal to judgement on the basis of the circumstances and a plea to
exercise the imagination and creativity.

The difficulty in accepting Keynes’s economics may be accounted for
by the pervasiveness of the mainstream paradigm, which is grounded on
completely different methodological and substantive foundations. But the
three biographers of Keynes agree that there is also something to do with
the book itself: ‘It may both be true that many things said by Keynes [in
*The General Theory*] had been said, or could have been said, in the old ter-
minology, and that his scheme has temped its users into certain errors. . .’
(Harrod 1951, p. 465); ‘I must remind the reader that the book is probably
the least clear of Keynes’s contribution to economics’ (Moggridge 1992,
p. 557); ‘There are many different ways of telling the story of the *General
Theory of Employment, Interest and Money*, and many different stories to
be told about it’ (Skidelsky 1992, p. 537).

I have argued here that the possibility of the book being misunderstood
or distorted is also a consequence of Keynes’s strategy of how best the
economists’ profession could be persuaded. He was well acquainted with
the ethos of the profession and in disagreement with most of it, especially
in the late 1920s and early 1930s when important issues, such as rationali-
sation of the cotton industry, trade and exchange rate policy and remedies
for unemployment, were being debated. He censured the majority of the
economics profession for their inability to change habits of mind which,
when added to the ‘habits and instincts of the ordinary man, bred into him
for countless generations’ (Keynes [1930] 1972, p. 327), made engagement
in experiments conducive to practical results even more difficult.

Economists did not enjoy top ranking in Keynes’s scale of values and
appreciation. The sense of frustration Keynes was experiencing is borne
out in many instances during the drafting of *The General Theory*. A
famous letter to Lydia, in October 1933, gives us a glimpse into Keynes’s
state of chagrin: ‘Are all the economists mad except Alexander [R.F. Kahn]
and me? It seems to me so, yet it can’t be true’ (quoted in Moggridge
1992, p. 566; see Marcuzzo 2010b). It was certainly not true, although this
comment testifies to the difficulties which Keynes perceived in pursuing
his goal. To persuade them he had to meet them on their own ground, and
this required some compromises and a strategy to arouse ‘feelings and passions’ to convince them, which may have been in the end unrewarding.

The ‘meeting of minds’ to which he made reference when he recognised
a sympathetic understanding of the points he was making in *The General Theory* may not apply to many past and present interpreters of Keynes, but it does apply to Chick’s interpretation. Her imagination and creativity, her scholarly dedication and free spirit, made it possible.

REFERENCES


The General Theory and Keynes for the 21st century


