

The 80th Anniversary of Keynes' *General Theory*: Time to
celebrate, time to re-evaluate

Gilberto Tadeu Lima
Departament of Economics
University of São Paulo, Brazil

*9th International Meeting of the Brazilian Keynesian
Association – São Paulo (SP), EESP-FGV, September 2016*

- Permanent self-reflection as a tribute to J. M. Keynes.
- Keynes' essential message in the General Theory (I am sorry for any essentialist lapse!): in a monetary economy, short-run production decisions are subject to uncertainty as to forthcoming demand → uncertainty matters in the very immediate future, not only in the more distant one.
- As a such, not a (completely) novel message (e.g., Malthus on overproduction and Marx on realization problems).
- One novelty: principle of effective demand as an expectational equilibrium in a supply-and-demand framework.
 - Preface to the GT: "A monetary economy...is essentially one in which changing views about the future are capable of influencing the quantity of employment and not merely its direction. But or method of analysing the economic behavior of the present under the influence of changing views about the future is one which depends on the interaction of supply and demand."

- Keynes' Principle of Effective Demand: expectations of proceeds
 - *Aggregate supply price* of the output of a given amount of employment: expectation of proceeds which will make it worth the while of the entrepreneurs to give that employment.
 - *Aggregate demand price* of the output of a given amount of employment: proceeds which the entrepreneur expect to receive from the employment of a given amount of workers.
 - Keynes on the "substance of the General Theory of Employment" (Ch. 3): "The value of [the aggregate demand] at the point of the aggregate demand function, where it is intersected by the aggregate supply function, will be called *the effective demand.*"
- However, representative firm/agent framework precludes derivation of a lack of effective demand as emergent property from an uncoordinated process of interaction among heterogeneous firms/agents → need of further research.

- In any case, principle of effective demand demonstrates that an insufficiency of aggregate effective demand (to produce full employment of existing productive capacity) is logically possible.
- However, it does not follow that aggregate effective demand so determined is necessarily insufficient to produce full employment → equilibrium with full employment of existing productive capacity is logically possible instead of logically inevitable.
- Full employment as logical possibility instead of logical necessity.
- It is nonetheless logically demonstrated (demonstrable) that full employment equilibrium is unstable: wage and price flexibility makes for self-aggravating deviations from full employment equilibrium in a downward direction.



A corridor of stability seems to exist though:

- GT (Ch. 18): [I]t is an outstanding characteristic of the economic system in which we live that, whilst it is subject to severe fluctuations in respect of output and employment, it is not violently unstable. Indeed it seems capable of remaining in a chronic condition of subnormal activity for a considerable period without any marked tendency either towards recovery or towards complete collapse. Moreover, the evidence indicates that full, or even approximately full, employment is of rare and short-lived occurrence.”
- Moreover, it does not follow from the lack of aggregate effective demand as a logical possibility that any below-than-full-employment equilibrium can necessarily be raised by expansionary aggregate demand policies without undesirable side effects.
- Supply constraints and the need of more research on a Keynesian theory of aggregate supply: expansion of productive capacity is both demand-led (Kaldor) and supply-driven

- More broadly, need of more research on a Keynesian environmental (or ecological) macroeconomics.
- To some extent, exercise in anachronism: Keynes did not seem to have thought and written systematically about environmental macroeconomics or environmental sustainability issues more broadly.
- However, there is a recent wave of contributions to environmental macroeconomics along Keynesian lines broadly conceived (e.g., Arslan Razmi, Malcolm Sawyer, Giuseppe Fontana, Lance Taylor, Duncan Foley, Armon Rezai).
- What about environmental constraints and balance-of-payments-constrained growth in developing economies?
 - Can environmental constraints become more binding than balance-of-payments constraints?

- If they do, can internationally traded emission permits, for instance, be a source of alleviation of environmental constraints?
- Or, can the balance-of-payments constraint itself become more or less binding in a world with internationally traded permits?
- What are the implications of internationally traded emission permits in their dual role as *factor of production* and *capital flow* for the determination of the balance-of-payments-constrained growth rate?
- More precisely, what would an extended version of Thirlwall's Law including internationally traded emission permits look like? → How do environmental constraints shape the possibilities for diversification in production?
- Can internationally traded emission permits be a source of financial speculation and instability? In some proposals *financial derivatives* of permits can also be traded on secondary markets.

- Important message from Keynes and Minsky: finance plays a crucial role in promoting the capital development of the economy → What about the “environment-friendly” capital development of the economy? What is specific, if anything, about the financing of “environment-friendly investment”? How could it be made less credit constrained?
- Is “green capital accumulation” or “environment-friendly capital accumulation” a mirage in a market, monetary economy?
- According to Keynes (1933), “the same rule of self-destructive financial calculation governs every walk of life. We destroy the beauty of the countryside because the unappropriated splendours of nature have no economic value. We are capable of shutting off the sun and the stars because they do not pay a dividend (...) Or again, we have until recently conceived it a moral duty to ruin the tillers of the soil and destroy the age-long human traditions attendant on husbandry if we could get a loaf of bread thereby a tenth of a penny cheaper” (CWJMK, Vol. XXI, 1982, p. 242).

- If an “environment-friendly capital accumulation” is a mirage in a developing market economy, how feasible is to extend Keynes’ notion of “socialization of investment” to environment-friendly investment?
- Keynes on socialization of investment: if left to its own devices, a market economy will tend to generate an inadequate level of investment (as shown theoretically in the *GT*) → remedy: some form of social control of investment, with the state either accepting responsibility to undertake investment directly or to provide incentives or the right climate for the private sector (the term ‘socialization’ here is a misnomer)



What are the prospects for a “socialization of environment-friendly investment” (in Keynes’ sense)?



More broadly, can policy and/or social norms persuade entrepreneurs to have an “environment-friendly animal spirits”?

- Environmental macroeconomics: scope and need for aggregate demand management and structural policies
- Aggregate demand management and environmental sustainability: how can they be reconciled? For instance, demand expansionary policies needed to deal with a recession may be in sharp conflict with sustainability goals of reducing resource and energy use and carbon emissions.
- New challenges for aggregate demand management under more severe environmental constraints: composition of aggregate demand matters as much as the level of aggregate demand.
- The issue of the composition of aggregate demand has been scarcely studied in Keynesian economics, though there always have been studies of the composition of specific components of aggregate demand (e.g., basic vs. luxury consumption goods, public vs. private investment, capital vs. current spending by the government, etc.)
- Need of a “Structural Principle of Effective Demand”: the composition or structure of aggregate effective demand determines both the level and the composition of aggregate production.