

# 1. Introduction

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## INTENT AND MOTIVATION OF THE BOOK

This book is mainly focused on the works of Marx, Keynes and Kalecki, three great economists of the past, but its object is not to provide a historical reconstruction of their thought. The book aims at giving an analytical contribution to the development of a viable alternative to the current mainstream in economics, macroeconomics in particular, by drawing from the founding fathers of two important alternative approaches to economics, the Marxist and the Post Keynesian traditions.<sup>1</sup> Such a declaration of intent, however, requires a number of clarifications and delimitations in order to avoid vagueness and excessive boldness.

First of all, it is necessary to explain why the book concentrates on Marx's, Keynes's and Kalecki's original works rather than on more recent contributions inspired by them. The basic reason for this choice is that Marxists and Post Keynesians have never showed much interest in the study of the analytical relationship among Marx's, Keynes's and Kalecki's original works, in particular in the relationship between the works of Marx and Keynes.<sup>2</sup> But to look directly at their works can be very helpful to better understand which are the elements of similarity between the two traditions and, hence, to develop an alternative based on common grounds. In this sense, considering Kalecki's contribution is of central importance, not only because he represents a sort of 'bridge' between the Marxian and Keynesian traditions but also because he gave answers to several important analytical problems left unsolved by both Marx and Keynes.

It is also necessary to clearly spell out that the book is not concerned with the relationships among the three economists at the ideological and political level. Marx's, Keynes's and Kalecki's ideologies were very different and far from one another, especially in the case of Marx and Keynes. Taking account of their different ideologies would require dealing with problems and issues well beyond the realm of economic analysis, in which the book is situated. The book is concerned only with some economic problems; more precisely, it concentrates on a specific, though very important, issue: the problem of unemployment and effective demand.

We argue that Marx and Keynes come close to one another in dealing with money and the role it plays in the explanation of situations in which the

economy generates a level of effective demand that is insufficient to ensure the full employment of labour as well as the full use of the existing productive capacity. But, in dealing with these issues, Marx and Keynes also exhibit important differences.

Keynes could provide an analytical explanation of 'underemployment equilibria', that is to say, situations in which the economy suffers the underuse of its capacity and unemployment of labour, and there are no forces at work that push it towards full employment. Such situations are not necessarily characterized by significant market perturbations. Marx's analytical framework can only provide the explanation of crises, that is significant market perturbations, during which there is unemployment and unused capacity, but not of underemployment equilibria. The economy recovers from crises in a relatively short time and its process of growth starts again.

Studying Marx's and Keynes's different analytical conclusions, and why they arrived at them, also allows us to realize that there are some flaws in both economists' reasoning. In fact, we argue that neither was able to provide a fully satisfactory treatment of the problem of effective demand and unemployment. A solution to some of the difficulties encountered by Marx and Keynes may be found in the work of Kalecki who, starting from the Marxian tradition, was able to produce results that are similar to Keynes's but based on more solid foundations.

Taking into consideration Kalecki's work brings to the fore the problem of the kind of markets that prevail in the economy. Whereas Marx and Keynes based their analyses on a hypothesis of perfect or, more correctly, free competition, Kalecki abandoned such an assumption and based his analysis on the hypothesis that most markets operate in conditions of non-perfect competition.

In the book, the problem of market forms receives considerable attention. This is not only because it is argued that abandoning the competitive hypothesis helps solve several of the problems encountered in Marx's and Keynes's analyses, but also because the approach to macroeconomics under the assumption of non-perfectly competitive markets is a distinctive feature of the current mainstream. It is therefore interesting to contrast the Kaleckian approach with the mainstream in order to better understand their differences and possible similarities.

The remaining sections of this chapter outline the points and problems mentioned above to introduce the reader to the more thorough treatment in the following chapters.

## KEYNES'S REVOLUTION AND MARX'S ANTICIPATIONS

Keynes tried to demonstrate that a market capitalist economy does not necessarily achieve a full-employment equilibrium. In order to achieve this

result, it was crucial for him to criticize and reject Say's Law, according to which it is impossible to have underemployment equilibria due to insufficient aggregate demand, at least in the long term.

Keynes pointed out that the law could hold good only in an economy with characteristics far removed from those of a real capitalist economy. In particular, in order for the law and all its corollaries to apply, the analysis has to refer to a postulated 'non-monetary economy', in which money is never kept idle, so that all savings are invested.

For Keynes, however, the characteristics of a capitalist economy are such that a demand for idle money can exist, and this can prevent the system as a whole from achieving full employment. Keynes regarded his criticism and rejection of Say's Law as a radical break with the whole previous tradition in economic thought.

From the time of Say and Ricardo the classical economists have taught that supply creates its own demand. ... As a corollary of the same doctrine, it has been supposed that any individual act of abstaining from consumption necessarily leads to, and amounts to the same thing as, causing the labour and commodities thus released from supplying consumption to be invested in the production of capital wealth. ... The doctrine is never stated to-day in this crude form. Nevertheless it still underlies the whole classical theory which would collapse without it.<sup>3</sup> (Keynes, 1936, pp. 18–9)

For Keynes, only Malthus and a few other minor economists, questioned – though not very successfully – the validity of Say's Law. Ricardo 'conquered England as completely as the Holy Inquisition conquered Spain'. As for Marx, Keynes recognized that the 'great puzzle of Effective Demand' lived furtively in Marx's underworld, but he much preferred Gesell's work to Marx's theory of capitalism (Keynes, 1936, p. 355).

Keynes's interpretation of economic theory before the *General Theory* is neither accurate nor correct. On the one hand, he failed to see that there were significant differences between the classical approach of Ricardo and the marginalist approach of Marshall, Pigou and others. On the other hand, Keynes overestimated the analytical relevance of Malthus's attempts to reject Say's Law, while he underestimated Marx's contribution. Marx's critique and rejection of Say's Law are based on the introduction and use of analytical concepts that bring him much closer to Keynes than Malthus.<sup>4</sup>

Marx argued that Ricardo could consider Say's Law valid only because of his inadequate concept of money and its role in a capitalist economy. Ricardo held that money is a mere means of circulation. In so far as this concept is accepted, Ricardo's reasoning is correct: supply necessarily creates its own demand, and effective aggregate demand can never fall short of aggregate supply. But in a capitalist economy, for Marx, money is not a mere means of circulation.

Money is also a store of value and as such can be hoarded and kept idle. The very logic of the capitalists' behaviour may induce them to hoard money instead of using it to start productive processes and to invest. If this happens, aggregate demand falls short of supply and, as a result, the economy suffers the simultaneous existence of unused productive capacity and unemployed labour; that is, it experiences a general overproduction crisis. Thus, in criticizing Ricardo, Marx had already introduced analytical concepts that very closely resemble those used by Keynes.

Marx was able to offer an explanation of unemployment that is different from the Ricardian explanation. In Ricardo's theory unemployment is never due to insufficient effective demand, but to a rate of growth lower than the rate of growth of population, or to technical progress. In both cases, however, the existing productive capacity is fully used. Marx too, as is well known, was very much concerned with the problem of technological unemployment, and in his analysis he was certainly influenced by Ricardo. Here, however, we do not deal with technological unemployment in Marx's theory in order to emphasize his other explanation of unemployment, which is closer to the Keynesian explanation.

## THE DIFFERENCES BETWEEN MARX AND KEYNES

Both Marx and Keynes rejected Say's Law and held that it is possible to have unemployment of labour along with underuse of productive capacity. However, for Marx and Keynes, such a phenomenon may occur in significantly different ways.

Within the Marxian analytical framework, one can show that unemployment of labour can coincide with underutilization of capacity only during, and as a consequence of, a general overproduction crisis, that is to say a relevant market perturbation. In Marx's theory it is not possible to demonstrate that we can have underemployment equilibria, that is situations in which there are no automatic forces at work pushing the economy towards the full use of its capacity and the corresponding level of employment.

This result of Marx's theory is due to the specific micro-framework that he adopted. The economic system works under conditions of free competition and firms, in order to maximize their profits, tend to produce and invest at the highest possible rates, in that they have flat short-period cost curves (up to capacity) and the expected return on investment is not a decreasing function of the level of investment itself. Under such conditions the economy normally tends to the full use of its productive capacity and the corresponding level of employment, which, however, is not necessarily the full employment of labour, because the existing capacity could be insufficient to employ the total labour force.

When aggregate demand falls short of aggregate supply, a general overproduction crisis occurs, and both labour and capacity remain partly idle. But, for Marx, crises are not permanent. The economy as a whole overcomes the crisis, and a new upward phase begins towards the full use of capacity, associated with an increase in employment.

Marx's results are different from Keynes's analytical conclusions. In Keynes's theory, general overproduction crises are not necessary to produce a situation of unemployment combined with unused productive capacity. Underemployment equilibria are possible. Keynes could achieve these results because he based his analysis on different microfoundations, strongly influenced by Marshall.

Keynes's microfoundations postulate competitive markets in which firms are characterized by increasing short-period cost curves and downward-sloping investment functions. In such a case it is possible to have underemployment equilibria: firms maximize their profits, while the economy as a whole experiences less than full employment. There is no force at work that pushes the economy towards full employment.

Marx's theory of effective demand allows us to demonstrate that capitalist economies are subject to fluctuations. The process of accumulation and growth is interrupted by crises which imply a temporary underutilization of capacity and an increase in unemployment. Keynes's theory of effective demand allows us to achieve another relevant analytical result. Not only do capitalist economies experience fluctuations around their equilibrium positions (Keynes, of course, recognized the existence of cycles) but the equilibrium position itself is not necessarily found at full employment. Such a result allows us to give an account of protracted periods of low employment, low output and unused capacity.

## FLAWS IN MARX'S AND KEYNES'S ANALYSES. KALECKI'S SOLUTION

The divergence between Marx's and Keynes's results is largely explained by their differing microfoundations. Therefore, this topic receives considerable attention in the book. I argue that, on the whole, Marx's hypothesis about short-period returns and cost curves is more satisfactory than Keynes's assumption of decreasing returns. Moreover, I argue that Keynes's theory of investment is flawed.

But another issue arises. On the one hand, we have Marx's more acceptable micro-framework that yields analytical results partly inconsistent with reality. On the other hand, Keynes's analytical results seem to be more consistent with observed reality, but they are founded on a micro-framework that proves to be

either unrealistic or inconsistent. Once Keynes's mistakes and inconsistencies are eliminated, we are left with an analytical framework not widely divergent from that of Marx – one in which it is no longer possible to demonstrate the possibility of underemployment equilibria.

It was Kalecki who offered the solution to this paradox. Kalecki, on the one hand, criticized Keynes's microfoundations and adopted a micro-framework that, on the whole, is closer to Marx's but, on the other hand, he was able to provide a demonstration of the possibility of underemployment equilibria. From this point of view, Kalecki's abandonment of the hypothesis of free or perfect competition, which both Marx and Keynes made, is crucially important.

Kalecki postulated a capitalist economy characterized by non-perfect competition and oligopoly. Within this context, firms are not necessarily spurred either to produce to capacity, despite constant returns, or to invest at the highest possible rate, even though new investment would lower production costs (increasing returns to scale). The obstacles to firms' growth are demand (downward-sloping demand curves) and 'imperfections' in financial markets that prevent them from obtaining any desired amount of capital.

Marx and Keynes criticized and rejected their predecessors by claiming that their theories were based upon assumptions and hypotheses which were too far removed from the essential characteristics of the actual capitalist economic system. Both Marx and Keynes rejected the previous theories of money, as based upon a concept that failed to correspond to the real role of money in a capitalist economy. Neither, however, was able to push his innovative developments far enough to give a fully satisfactory analysis of the problem of effective demand and unemployment. Kalecki went further in this direction, by grounding his theory on a still more realistic and adequate set of assumptions and abstractions.

## MARX, KEYNES AND KALECKI IN RELATION TO MODERN MAINSTREAM ECONOMICS

It is possible to perceive similarities between the line of reasoning followed in the book and the development of the debate within the mainstream since the demise of the Keynesian revolution of the 1930s; in both cases, the problem of the microfoundations of macroeconomics is central. Keynes and the (old) Keynesians were accused of grounding their macroeconomic analyses on weak, if not altogether wrong, microfoundations. More precisely, the Keynesian results were seen to contradict the basic principles of microeconomics, characterized by rational maximizing agents operating in conditions of perfect competition.

New Classical Macroeconomics, in the wake of Monetarism, provided the most radical and self-consistent response to the Keynesian revolution. The alleged contradiction between micro and macro theory was eliminated by transforming macroeconomics into a mere exemplification of neoclassical microeconomics. Not surprisingly, New Classical Macroeconomics produced results radically different from Keynes and the Keynesians, but also quite incapable of yielding a tenable explanation of the phenomena of the world in which we live.

The New Keynesian approach, which today is the mainstream in macroeconomics, is the reaction to the failures of new classical macroeconomics. The New Keynesians, though accepting the New Classical challenge to provide coherent and rigorous microfoundations of macroeconomic analysis, have developed models that are said to be able to give Keynesian results.

The Keynesian nature of the results obtained from New Keynesians' models is open to discussion. Many Post Keynesians have strongly criticized such models by emphasizing their neoclassical nature and the distance from Keynes's own approach to economic theory. However, it is also significant that the New Keynesian models are based on hypotheses of imperfect competition, with firms that are demand-constrained. The hypotheses of non-perfect competition are regarded as more adequate to deal with the actual economy.

In this respect, the New Keynesian approach seems to show a certain degree of similarity with the Kaleckian approach. Keynesian results are also obtained in Kalecki in a context characterized by non-perfectly competitive markets. It is then interesting to look at the theoretical and analytical relationships between the New Keynesian mainstream and the Kaleckian alternative approach. It is worth considering the extent to which the two notions of (imperfect) competition are really similar to one another. We argue that the distance between the two theoretical systems remains large. However, we also hold that the mainstream's attempt to develop a more realistic analysis of the actual economy may open the possibility to establish more productive and fruitful relations between the two approaches.

## SOME POINTS OF CLARIFICATION

In this introduction, many of the concepts introduced have not been discussed or presented in a detailed way. The following chapters will deal with them more fully. However, it seems necessary at this point to provide further clarification on a number of issues, in order to eliminate some possible misunderstandings right at the outset.

First of all, it may be helpful to clarify the sense in which both classical and neoclassical economists accepted Say's Law. For classical political economists,

the acceptance of the law did not imply that they held that the economy necessarily experiences the full employment of labour. The equality between aggregate demand and aggregate supply implies no more than the full use of existing productive capacity at any time. Moreover, the equality between investment and saving is assumed, not ensured by some adjustment process. Instead, Say's Law in its neoclassical formulation implies that the economy achieves a full-employment equilibrium and that equality between investment and saving is ensured by the working of an adjustment process (changes in the rate of interest).

Marx, of course, criticized Say's Law in its classical formulation and he was never concerned with the problem of full employment. His critique rather aimed to show that the economy can generate insufficient levels of effective demand, which bring about crises characterized by unused capacity and higher unemployment than would be the case if the entire productive capacity were used. Keynes's concern was different: his critique of the neoclassical version of Say's Law seeks to demonstrate that the economy may well experience involuntary unemployment; specifically, that full employment is not necessarily ensured by market processes, like changes in the interest rate and/or the wage rate.

Another issue is the analytical relevance of the concept of equilibrium for Marx's, Keynes's and Kalecki's analyses. The book argues that a satisfactory approach to the problem of effective demand and unemployment must be able to provide the demonstration that underemployment equilibria are possible. This requires some elucidation to avoid misunderstandings.

An underemployment equilibrium position (or 'rest state') is a position in which aggregate demand and aggregate supply are equal at levels of employment and capacity use which are below full employment and full-capacity use, and from which the economy does not tend to move away unless changes occur in the relevant variables determining this position. At any given time, the economy may find itself out of its equilibrium position because of accidental disturbances, but it will tend towards it unless in the meantime there are changes in the determinant variables. Equilibrium positions represent, as it were, 'centres of gravitation'.

It is in this sense that Keynes's analysis was more realistic than Marx's. Keynes's results are more consistent with observed reality in so far as real economies do not seem to show any inherent tendency towards full employment and full use of capacity. Quite to the contrary, market economies tend to experience protracted periods of low employment and low output without significant market perturbations. Violent market perturbations (crises) are much less frequent phenomena. It is from this point of view that to show the existence of underemployment equilibria is crucial. Unless one can show it, the conclusion has to be that the economy tends, although fluctuating, to the full use of its capacity and to the corresponding level of employment.



Finally, some remarks about the interpretation of Keynes's theory that is presented here. As it will become clear in Chapters 4 and 5, the interpretation of Keynes in this book can be regarded as Post Keynesian. But there are also other interpretations of Keynes's theory. Much of Keynesian economics after the Second World War has developed within the IS-LM framework first adopted in the 1930s by Hicks (1937).<sup>5</sup> In particular, underemployment equilibrium positions have been explained by the existence of wage rigidities rather than by the specific characteristics of investment expenditure in a capitalist economy.<sup>6</sup> However, to provide a detailed comparison of these alternative interpretations with the one adopted here and to explain why the latter is preferred, is well beyond the scope of this book.

## PLAN OF THE BOOK

The book is organized into eight chapters plus this introduction. Chapters 2 and 3 are concerned with Marx's analysis of money, effective demand and overproduction crises. Chapters 4 and 5 deal with Keynes's analysis. Chapter 4 concentrates on those aspects of Keynes's approach more similar to Marx's (money and Say's Law in particular). Chapter 5 deals with the issues where the differences from Marx are more evident. Particular attention is given to the problem of Keynes's Marshallian microfoundations, which gave him the possibility to have short-period underemployment equilibria.

Chapters 6 and 7 are mainly devoted to criticism of Keynes's microfoundations and to Kalecki's contribution. Chapter 6 deals with Kalecki's position on short-period returns and his criticism of Keynes's theory of investment. Chapter 7 delineates a basic Kaleckian macroeconomic model.

Finally, Chapter 8 is concerned with modern macroeconomics, concentrating on the problem of market forms and their relationship with the Kaleckian approach. Chapter 9 concludes with some considerations that are mainly methodological.

## NOTES

1. There are several traditions of thought that are alternative to the current mainstream in economics. Among these, the Marxian and the Post Keynesian traditions probably are the most significant. Many surveys of the alternative approaches to the mainstream, in fact, pay much attention to them; see, for example, Hamouda and Harcourt (1988), Lavoie (2006) and Harcourt (2006).
2. There are, of course, exceptions. Joan Robinson certainly is the Keynesian economist who paid most attention to the relations between Marx and Keynes; see, for example, Robinson (1951, 1960b, 1965a,b, 1973b, 1980b). In the years immediately following the publication of *The General Theory*, some attempts to compare the two economists in a systematic way were

made; see, for example, Fan-Hung (1939) and Alexander (1940). For more recent contributions, see Dasgupta (1983), Dillard (1984) and Hein (2006).

3. For Keynes, as is well known, 'classical economists' included also Marshall and Pigou (Keynes, 1936, p. 3n).
4. For critical analyses of the relationship between Malthus and Keynes, see, for example, Corry (1959), Hollander (1962) and Garegnani (1978).
5. Which, however, became much less popular with Hicks than many other economists (see Hicks, 1982a,b).
6. Some considerations on the role of wage rigidities in Keynes's analysis are presented in section 5.5 of Chapter 5 and in Appendix B.