130 YEARS SINCE THE BIRTH OF JOHN MAYNARD KEYNES: A FEW FINISHING TOUCHES TO A PORTRAIT

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Introduction

I’ve given this article the title of “A few finishing touches to a portrait” for the following reasons: first, it is meant to mark an anniversary, it is connected with the fact that it’s been 130 years since the birth of John Keynes (1883 – 1946); second, the article is limited in size and cannot fully explore the wealth of ideas that are covered in his works; and third, as far as I know, economic literature in this country has failed to address the anniversary.

Led by this assumption and by John Keynes’ magnificent work, I decided to express, in a short, concise form, in a few finishing touches, as the saying goes, my deep reverence and respect for him, for his contribution and merit in the development of the idea of the economic crisis.

John Keynes is a great British economist, the father of modern macroeconomics and it is widely considered that the economic theory of the last and present century would be inconceivable if it hadn’t been for his name and the landmark nature of his work, so great is his contribution to economic thought.

John Keynes brought a new life to the prestige of economic thought, turning it into action and practical guidance. While at the end of the 19 century economic theory was mainly associated with the names and works of A. Marshall and L. Walras, the 20 century leading figure was Keynes, no matter how appreciated or rejected he was. His works are so varied in nature, so deep into the hot issues of his time that they were always given front place in the press.¹

1. Short biographical notes

John Keynes was born in 1883 in Cambridge in the family of a renowned logics and economics scholar. Educated in King’s College, Cambridge, John Keynes later held a job at India Office.

In 1909, following an invitation from Alfred Marshall, Keynes started lecturing at Cambridge. At the time he was greatly influenced by Marshall and shared his views and ideas.

In 1913 he published his phenomenal book “Indian Currency and Finances”. He also produced “Economic Consequences of the Peace” in 1919, followed by “A Tract

¹ Part of this is covered in Zoya Mladenova’s study, see “Neoclassical theory at the end of XX – beginning of XXI century: Achievements, Problems, Perspectives”, Varna, STENO, 2011.
on Monetary Reform” (1923), the scathing pamphlet “Economic Consequences of Mr. Churchill” (1925) and “The End of Laissez-Fair” (1926). Because his wife was Russian, he visited Soviet Russia at a time when the country was influenced by Lenin’s New Economic Policy and in 1925 published the article “A Glimpse of Russia”. In 1930 his fundamental two volumes of “Treatise on Money” came out and in 1936 his most influential work “General Theory of Employment, Interest and Money” was published.

2. Keynesian theory – a result of certain economic circumstances

Keynes transfers economic analysis from a micro to a macro level. The need for such an approach stems from the fact that at a macro level there are certain objective laws that cannot be explained by means of microeconomic laws. He did not reject A. Marshall’s economic analysis but found it not comprehensive and applicable enough regarding macroeconomics. In his search for a new solution, Keynes was also driven by the complicated interdependences of social division of labor, the difficulty of selling the goods as well as the Great Depression.

To begin with, the Great Depression (1929 – 1933) shattered the foundations of capitalist economy. Its consequences – stagnation of manufacturing, large-scale bankruptcies, high prices and inflation, huge unemployment, etc., made government officials and economists look for the reasons for the crisis. The Classical school of economic thought failed to provide an answer. Keynes, however, did provide one, by explaining whether an economic crisis is a fortuity or a law, or whether it is an outcome of natural phenomena.

Secondly, the Great Depression disturbed the macroeconomic equilibrium. The question was how to restore it, could this be done by conventional means or was a different set of tools necessary? Microeconomics was unable to deal with this issue, so a macroeconomic analysis was required.

Thirdly, economic equilibrium should be maintained with the help of the state that operates within the economy as an in-built stabilizing agent, protects it from social turmoil, injects it with regulations and thus restores the equilibrium.

In the fourth place, the Great Depression acted as a detonator for socio-economic contradictions. New contradictions were generated and the economic science had to provide a way for them to be resolved. The issues are as follows: economic growth (limits and opportunities); the state and economic growth, inflation, unemployment, mechanisms for regulating economy, turnover of funds, commodities and capital on a national level; analysis of the major drivers of production and the main economic subjects that participate in the economic processes.

Finally, it has become clear that crises are not a fleeting, temporary phenomenon, but an attribute of market economy. The reasons for them should be sought not in natural processes, but deep in the essence of economy itself, in unemployment, inflation, in the imbalance between savings and investments, etc. Economic equilibrium can also be achieved under conditions of underemployment as there isn’t a mechanism to completely eliminate unemployment, and economic development is perfectly possible and justifiable under certain levels of unemployment and inflation.
3. Basic principles of Keynesian theory

Keynes seeks the reasons for the crisis in the following areas:
- reduced aggregate demand;
- low marginal efficiency of capital;
- high interest rate.

Income grows proportionally faster than consumption. With the rise in employment, aggregate real income also rises; aggregate consumption, however, does not rise to the same degree as income. This is a psychological law, as Keynes points out.

Given that income grows faster than consumption, then consumption’s share in income decreases, aggregate demand falls, economic proportions are shifted, the desire to invest wanes and all of this reduces employment and crises are born. Reduced consumption makes aggregate demand shrink and discrepancies appear between aggregate demand and aggregate supply and as a result, goods cannot be sold.

This is what classical economists were unable to predict. Keynes overturned their postulates of macroeconomic equilibrium and in particular Say’s Law. Say believes that every supply is met by a corresponding demand and consequently economy is not threatened by instability. No disparities are possible between them. Supply itself creates demand and this viewpoint precludes any catastrophes in the functioning of economy.

According to Say, if demand exceeds supply in a given sector, there will always be another sector where supply exceeds demand and thus economy will be balanced. Income resulting from output sold is equal to the production costs for these goods, which automatically ensures the purchase of said goods. Every manufacturer is also a buyer. In other words, there is no difficulty in selling output, as there is always equality between output and consumption and between demand and supply. Money, as Say claims, is nothing but a medium of exchange, it is consumed and then disappears in the process of exchange. Goods are exchanged for money and money for goods. For this reason neither under-consumption nor overproduction are possible.

Ricardo also agreed with this statement. In his work he wrote: “Everyone produces only to consume or sell and always sells with the intention to buy another product that will be directly useful to him or will help future production. Therefore, by producing, one is bound to become either a consumer of one’s own output, or a buyer, a consumer of someone else’s goods. Products are always bought in exchange for products or services; money only serves as a unit of measurement with the help of which the exchange is performed”.

Ricardo saw no contradictions between output and consumption. He believed that every output is consumption, which absolutely excludes crises.

The thesis above suffers from some major flaws: first, the worker buys (here capitalist output is meant) only those goods that are within the range of the worker’s individual consumption in order to restore his ability to work; second, as far as goods

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2 Keynes, J. General theory of employment, interest and money. ., Progress, 1978, p. 61.
are concerned that are productively used and consumed in order to manufacture new
capital goods – means of production, they are neither bought nor used by the worker.
So it is not every manufacturer who is also a buyer – a worker does not buy the means
and subjects of labor. On this basis we should not assume that a manufacturer equals
a consumer.

This theory cannot be applied to simple commodity production either. It could
perhaps be valid on a desert island, whose only inhabitants are Robinson and Friday;
Robinson manufactures and Friday consumes. But life is a complicated matter. It
does not happen on a desert island but within a social system with multitude of
manufacturers and consumers and with people involved in manufacturing activities
where thousands invisible economic strings are pulled.

Keynes overturned the classical postulates. Not every purchase is a sale. With
the advent of money, the link between a purchase and a sale is no longer a direct one,
while Say’s theory boils down to the following: recipients of income spend their entire
income on buying goods, so there cannot be crises.

Well, it’s different in real life. Income can be used not only to buy goods, it can
be saved. People making the decision to save, are not the people who decide to invest.
Savings holders and investors are two entirely different categories of people with
different interests and objectives throughout their lifetime.

So, the Great Depression demonstrated that the theory of the classical school of
economic development could not stand the test of time. Keynes overturned it and
offered a viewpoint of his own. Other theories came to the foreground.

Keynes believed that the times of automatic regulation of economy were gone.
We cannot let things follow their natural course. It does not always lead to the best
results. We cannot, he emphasizes, let people suffer and starve, if nature itself does
not provide a solution; wealth cannot be appropriated by certain individuals only and
the living conditions of the rest be reduced to the bare minimum. In such cases the
state must interfere. The strategy of economic policy should be tied up to the social
ideal.

Keynes developed a general theoretical model of the economic system, the factors
and conditions that maintain its stability and sustainability. He stood up for the state’s
multidirectional, active policy concerning the market, brought persuasive arguments in
its defense, pointing out that the market mechanism is only an observed fact and not
an inevitable principle that cannot be modified and, consequently, equilibrium can be
altered and restored⁵. Keynes joined state regulation and the market system.

As we can see, market self-regulation is not discarded. It is however, not effective
enough and needs to be supplemented by state regulation. If left uncontrolled by the
state, market self-regulation can deteriorate social outcomes. People don’t possess
complete freedom on the market, nor the ability to realize this freedom and therefore
market self-regulation cannot develop in an arbitrary manner. No automatic mechanism
exists for self-regulation of the economy. The market is incapable of such self-regulation.
The laws that regulate it generate imbalance and injustice. The crisis-engendered

economic imbalance further deteriorates the situation. Under the influence of the market the natural and social environment are damaged, becoming an object of commercialization.

This is precisely what calls for the market self-regulation being augmented by state regulation. The government should focus its attention on activities that cannot be covered by private enterprise. The state is to do what now nobody does. There are certain economic activities which are not attractive to private capital and investment. There is no motivation available. It is the state that has to find and strengthen this motivation. The government may also work towards lowering the uncertainty of risk and create an atmosphere of security, whereas private capital is not always able to achieve that. The state is also able to develop an anti-inflation programme. Inflation can hardly be regulated without the state’s interference. Instead, all facts point out that the role of the state in the development of the economy these days should not be underestimated.

So, the state’s interference in economy is justified from the point of view of macroeconomics. Keynes finds the question of the character of interference to be very important, as well as the concrete forms of participation, of the compatibility of one or another method with the basic principles of democracy. When in 1933 free markets forces were discredited, Keynes wrote that in the field of economic activity, unlike that of centralized control, he favoured the preservation of private assessment, private initiative and private enterprise. He was not against them but was for an interference guided by the principle of economic efficiency. Interference is justified if it is economically viable\(^6\).

According to Keynes, the economic system retains the viability of its elements and in particular that of their foundation. If they give in, the system’s sustainability is compromised. The state should restore it. This is achieved by striking a balance between aggregate demand and aggregate supply, that is, between the volume of output and the volume of consumption. If output falls, the state should stimulate it by means of investment. This is also true about consumption.

The second reason for the insufficient aggregate demand is low marginal efficiency of capital – an outcome of a high interest rate. If the margin for this rate exceeds the profit margin, entrepreneurs will no longer invest their capital in production but will instead keep it in a liquid state. This will weaken the willingness to invest, will lower aggregate demand, will generate disparity with aggregate supply and goods will not be sold. As a result, a crisis occurs, employment declines, unemployment grows, the economy is in stagnation.

If marginal efficiency of capital surpasses the interest rate, aggregate demand grows, the economy is booming, consumption increases. The higher the income, the stronger the stimulus for saving and investing.

Marginal efficiency of capital determines the conditions for demand of borrowed funds in order to invest, and the interest rate determines the conditions under which loan funds are currently supplied\(^7\).

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\(^6\) Again there, p. 453.

\(^7\) Again there, p. 230.
Interest rate depends on marginal efficiency of capital and current loan funds, on their supply and demand. Depending on their correlation a psychological proclivity to saving is manifested. The state has to keep the interest rate low. Keynes links this necessity to the weakening tendency of liquidity and a rising willingness to invest, which can be achieved by increasing the amounts of money in circulation.

The basic instruments for regulating the economy are monetary and credit policy and the interest rate. They can largely mitigate the severity of crises – inflation, stagnation, etc. Marginal efficiency of capital is placed in a dependent position towards state-regulated interest rate. However, Keynes believed that not many hopes should be set on the interest rate, particularly under conditions of falling output. No direct link is found between the changes of the interest rate and investment, which generates a certain doubt as to the use of monetary and credit mechanisms as an instrument for regulating the economy. Keynes certainly observed this weakness. He pointed out that these mechanisms are not reliable enough to overcome crises.

Keynes stated “I expect to see a state which, being able to calculate the marginal efficiency of capital goods in a long-term perspective and on the basis of common social benefit, should assume the growing responsibility for directly organizing investment”. The state should exercise a leading influence on the willingness to consume, partly through its taxation policy, partly through setting the interest rate and perhaps partly through other mechanisms.

Keynesian theory contains elements of general economic analysis. The theory justifies the need for state regulation which could easily adapt to the modified production conditions. Keynes argues that the state should turn into an in-built stabilizing agent for the economy.

Budget and credit mechanisms are the key factors of this incorporation. The budget plays the role of an inflow and outflow channel in the fluctuations of the economy. In boom times the budget expropriates parts of funds by means of taxes. In bust times the budget assumes the opposite role. When the economy is in decline, because of the low marginal efficiency of capital, entrepreneurs are not interested in investing in production. To avoid this, income tax rate should be reduced. This will encourage investment and thus ensure an economic boom. The same refers to workers income. In other words, in boom times taxes should go up and in bust times they should go down.

John Keynes is a supporter of direct socialization of investment as the only means of providing approximate full employment. In his opinion ownership over instruments of production is not of greatest importance for the state. The state authority should co-operate with private initiative. He emphasizes that if the state is capable of defining the aggregate value of resources aimed at increasing the means of production, then the state will have performed everything that was necessary.

So Keynes should be given credit for overturning, though with considerable delay, the neoclassical school of thought in the economic theory, which denied the need for

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8 Again there.
9 Again there, p. 229.
government interference in the economy. He not only revealed the logical flaws in the analyses created by the representatives of this school of economic thought but suggested practical working mechanisms for overcoming the imbalance of macroeconomic system. Keynes was a supporter of reform but he was not a dictatorial reformer. He endeavoured to prove that when the economic system makes judicious use of the levers of state power it can preserve and stabilize itself. Keynes, however, never questioned the economic system postulates. He himself observed that his recommendations concerning economic policies are only valid in times of crisis.

4. A critical view

Every theory is imperfect and liable to development. This is also true about Keynesian theory. Until the mid-1970s this theory gave results, but it then came across obstacles, determined by time. Many scientists expressed their doubts in the credibility of Keynesian theory. New theories appeared, some of which overturned Keynesian theory and others tried to embed it into new theories. We shall enumerate some of them, without elaborating on the details and intricacies of the problem:

a) Samuelson’s neoclassical synthesis. Essentially it puts forward the following arguments: After the state has stabilized the economy, old “classical laws” must gain the upper hand. Adam Smith’s theory of the ‘invisible hand’, retains its significance. Many scientists adopt this theory as an unshakeable principle (an axiom) of economic analysis. It is to demonstrate that the economy can function effectively even without state interference.

b) Neoclassical models. Unlike Samuelson’s, this approach does not combine Keynesian analysis with neoclassical analysis - the notion of “synthesis” is absent. According to this theory macroeconomic analysis has to be based on the microeconomic one. There is a lot of similarity between macro and microeconomics. In recent times the theory of rational expectations is also covered.

c) Neo Keynesian models adjust the microeconomic principles to macroeconomic analysis. Macroeconomics is to be built on the foundations of microeconomics but it should be augmented with imperfect competition, asymmetrical information and other mechanisms regulating the movement of capital.

With regards to the above mentioned alternatives, I would like to express some concerns and disagree on certain points:

First, one cannot accept the thesis of neoclassical synthesis that on some occasions the old ‘hidden’ laws function and on other occasions they don’t. Society is not a technical system but a complete organic one. While a machine, for example, is built according to certain principles of functioning and another machine is constructed following quite different principles, the same cannot be assumed to be true regarding the economic system. All economic laws within the economic system act as a whole and generally form a system of subordination. The fact that certain laws occupy central position in the hierarchy and other laws a lower one, does not mean that the
lower-level laws stop functioning.

**Second**, the claim that laws developed in Adam Smith’s time fully retain their power and significance today leads us to believe that no changes occur, that capitalism now is the same as capitalism then that no socialization occurs. However, this is not the case. A law is an aspect of essence and in the essence there is a substratum. The essence changes and the law also changes, enriched by new content.

**Third**, the idea that macroeconomics has to be built on microeconomic foundations, with the latter adapting to the imperfect competition, asymmetrical information, etc., needs further clarification. Microeconomics is part of the whole, it could even be the foundation of the whole, but it is not the entire whole and does not exhaust the content of the whole. The 1970s attempt of this country, for instance, to experiment with a new system of management of the national economy (an economic mechanism) in certain business enterprises, ended in failure. This fact comes to show that a microeconomic analysis cannot be mechanically transferred to macroeconomics. The weakness of macroeconomics science lies in the fact that it views macroeconomics as a mechanical sum of microeconomic units.

Keynesian theory is not immune to certain weaknesses either. In this line of thought we would like to formulate some considerations and express skepticism concerning certain points Keynes made.

**First**, to a degree, we accept the thesis that with the increase of real income the willingness to consume declines, that is, the share of real income in consumption falls. In most cases this is valid about employers, where consumption really lags behind income, while poorer social layers are less concerned by this law. Many individuals from this social group live only on their salary and its raise increases consumption, as many of their needs which had been neglected in the past can now be addressed. Willingness to consume does not fall, it goes up.

It’s a debatable issue whether insufficient consumption is a cause of crisis or whether it is an effect of the system, or whether cause turns into effect and vice versa. Under-consumption being a cause of crisis is nothing new in Keynesian economic theory. Under-consumption was discussed long ago by Sismondi. Elimination of under-consumption, however, does not eliminate crises. The reasons for them ought to be sought in a complex of factors.

The following is not a debatable issue: consumption lags behind production; capital strives to expand production driven by the greed for a higher profit; expanding production, however, cannot be matched by a growth in consumption. Consumption is limited by the value of workforce, by its purchasing power, that is, by its salary.

The faster increase in the share of profit in GNP than the increase in salary means that the consumption share in real income drops, hence the relative shrinking in the purchasing power of the population, or the so-called under-consumption. In our opinion, however, under-consumption cannot fully explain the crisis character of capitalist economy.

There used to be under-consumption as early as in the pre-capitalist forms of production, but there were no crises then; in as much as similar signs did appear, they
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were the result of natural phenomena. Contradiction between production and insufficient consumption is a necessary condition, but not a sufficient one. The reasons should probably be sought in a number of factors beyond the scope of this article.

Crises in capitalism are a product of capital and simultaneously a form of resolving its contradictions; a means of restoring disturbed equilibrium; a prerequisite for renewal of fixed capital, replacing old equipment with a new one, involving new investment in production. In its movement, capital itself sets obstacles before its growth, and as a result crises occur periodically. In times of crises, as Marx said, that part of capital gets forcefully destroyed which allows capital to move without committing a suicide – a condition for capital development and for equilibrium in economy.

Second, one cannot deny that growing income results in growing saving. This is not a psychological law, however, but an objective necessity; a proportion of income is put aside, that is, postponed, for a future purchase of additional goods as well as money for rainy days (old age, illness, emergencies, etc).

Third, not every increase in income is tantamount to a stimulus for investment and an increased demand for labour. A link between them certainly exists, but it is not a direct one. Growing investment does not always lead to growing employment. It depends on the level of technological development and production facilities whereas the size of investment will be determined by the existing technology base. Effects will be different in different situations.

Updating of fixed capital is performed on a qualitatively new basis, the investment made will not result in growing employment but in its reduction instead. The claim that employment grows in proportion to additional investment is not confirmed by modern reality.

Fourth, the link between savings (accumulation of capital) and personal consumption is given a wrong explanation. This link is not a direct but an indirect one. Accumulation of capital can be done without necessarily expanding personal consumption, while the latter can be expanded without accumulation of capital. A number of factors outside personal consumption influence accumulation of capital while consumption is affected by factors beyond accumulation of capital.

So the relation between output and consumption limited by solvent demand is not always expressed in direct proportion.

In conclusion, Keynesian theory has not lost its meaning in modern times. This is the most important assumption resulting from the modern interpretation of his legacy and confirmed by modern practice. We need to find our own general theoretical model of economic development, a model to encompass all conditions and factors for self-development and regulation of economy. This can happen when we base our work not only on Keynesian theoretical legacy, but also on all achievements of the economic thought, enriched by and consistent with our own experience.
130 YEARS SINCE THE BIRTH OF JOHN MAYNARD KEYNES: A FEW FINISHING TO A PORTRAIT

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Abstracts

The article is of a jubilee nature, dedicated to 130th anniversary of John Keynes’ birthday. In broad touches there is outlined his portrait, discussed is his theory as the product of certain historical circumstances; analysis of the main principles of the doctrine, its weaknesses and strengths; their significance to the socioeconomic transformations in the country. There is traced the grand work of John Keynes for the development of economic theory.

Keywords: investments, consumption, marginal propensity, government regulation, crises.