Eastern Economic Journal, volume ix, no. 3, May-September 1983

KEYNES AND THUROW: THE SOCIALIZATION OF INVESTMENT

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In a previous paper,¹ we investigated the relationship between the policy recommendations which John Maynard Keynes (1883-1946) develops in his early writings, writings which are written in response to the important events and issues of his day, and those of his two major works, the Treatise² and the General Theory.³ In this paper we concluded that the policy recommendations of the Treatise, allowing for some institutional differences, are identical to the policy recommendations of his phenomenological writings: namely, the general level of prices can be stabilized in one of three ways: (1) by changing the bank rate, (2) by using a trident of control (the bank rate, the forward exchange rate, and the buying and selling points for gold), or (3) by implementing a loan-financed, government-sponsored domestic investment program.

Although there are scattered references throughout Keynes' early writings to the problem of unemployment, a careful perusal of those writings leads to the conclusion that the term "unemployment" is used in a very different context from that found in the General Theory. In his early writings, the context is strictly Ricardian and Marshallian unfavorable changes in the general level of prices or artificial restrictions of the international terms of trade result in periodic but temporary movements away from an equilibrium at full employment. In the General Theory, however, Keynes perceives a persistence of unemployment and concludes that a developed capitalist economy could reach an equilibrium at less than full employment. This context is completely foreign to the economics of Ricardo and Marshall, as expressed in Keynes' early writings. In none of these writings does Keynes recommend the policy advocated in the General Theory: namely, the implementation of a loan-financed, government-sponsored domestic investment program designed to move the economy from an unemployment equilibrium to one of full employment.

Thus, one theme which is common to Keynes' early writing and to his major works is the development of a set of public policy proposals which is designed either to stabilize or to increase the volume (level) of employment. This theme is the one about which most

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The end of Laissez-faire is the formal statement of Keynes' conceptual framework and a restatement of his political and social views, which with minor amendments, is to last him the rest of his life. In this essay, Keynes restates his vision of the English economy and the laissez-faire method of resolving the problems confronting England in the post-World War I period. The introduction of more management and control into the English economy as a better way of resolving those problems directs the reader's attention to those areas of the economy which are in need of management and control and suggests that it is within the power of the Central Authority to implement his plan.

In the opening statements of this essay Keynes attacks the underlying principles, the set of social institutions and arrangements, and the methodology on which laissez-faire capitalism rests.

Let us clear from the ground the metaphysical or general principles upon which, from time to time, laissez-faire has been founded. It is not true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is no 'compact' conferring perpetual rights on those who have or on those who acquire. The world is not so governed from above that private and social interests always coincide. It is not so managed here below that in practice they coincide. It is not a correct deduction from the Principles of Economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest is enlightened more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does not show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately. We cannot, therefore, settle on abstract grounds, but must handle on its merits in detail, what Burke termed 'one of the finest problems in legislation, namely, to determine what the State ought to take upon itself to do by the public wisdom, and what it ought to leave, with as little interference as possible, to individual exertion.'

Thus, the most important agenda of the State relate not to those activities which private individuals are already fulfilling, but to those functions which fall outside the sphere of the individual, to those decisions which are made by no one if the State does not make them.

Keynes sees his plan as being the only way to offset the stagnating tendencies which are developing in England's aging capitalistic economy. Since laissez-faire cannot solve England's post-World War I problems (unemployment and deflation), the cure for these things is partly to be sought in the deliberate control of the currency and of credit by a central institution, and partly in the collection and dissemination on a great scale of data relating to the business situation, including the full explicitness, by law if necessary, of all business facts which it would be useful to know.

I believe that some co-ordinated act of intelligent judgement is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investment, and whether the present organization of investment mazes distributes savings along the most nationally productive channels.

As we have suggested above, pamphlets like "The End of Laissez-faire" played a role in the intellectual development of the General Theory. While the main purpose of the General Theory is the development of a theoretical structure from which a set of public policy proposals may be derived and whose aim is to affect changes in the volume of employment, Keynes does not ignore the issue of the socialization of investment. There are several passages in the General Theory which address this theme, but we will quote only one for it is the best statement of the theme.

In some other respects the foregoing theory is moderately conservative in its implications. For whilst it indicates the vital importance in matters which are now left in the main to individual initiative, there are wide fields of activity which are
unaffected. The State will have to exercise a guiding influence on the propensity
to consume partly through its scheme of taxation, partly by fixing the rate of
interest, and partly, perhaps, in other ways. Furthermore, it seems unlikely that
the influence of banking policy on the rate of interest will be sufficient by itself to
determine an optimum rate of investment. I conceive, therefore, that a somewhat
comprehensive socialization of investment will prove the only means of securing an
approximation to full employment though this need not exclude all manner of
compromises and of devices by which public authority will co-operate with private
initiative. But beyond this no obvious case is made out for a system of State
Socialism which would embrace most of the economic life of the community. It is
not the ownership of the instruments of production which is important for the
State to assume. 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. Moreover, the
necessary measures of socialization can be introduced gradually and without a
break in the general traditions of society.10

So, even as he was developing a new theoretical structure, a structure which is
specifically designed to provide the basis for a policy set which, if implemented, would
end the Great Depression in England, Keynes was wedded still to the idea of the
socialization of investment.

III

One modern day writer, Lester C. Thurow, has continued the tradition started by
Keynes: the development of a set of public policy proposals designed to affect changes
in the composition of employment. In The Zero-Sum Society,11 Thurow argues that
our political and economic structure isn't able to cope with an economy that has a
substantial zero-sum element. A zero-sum game is any game where the losses
exactly equal the winnings. When there are large losses to be allocated, any
economic decision has a large zero-sum element. The economic gains may exceed
the economic losses, but the losses are so large as to negate a very substantial
fraction of the gain. What is most important, the gains and losses are not allocated
to the same individuals or groups.12

After stating his thesis, Thurow examines five economic problems which the United
States must resolve: energy, slow economic growth, proliferation of rules and
regulations, distribution of real income, and deterioration of the environment. In each
case, the origins of the problem are revealed and the solutions proposed by the
government are examined but the direct intervention into the political policy making
process by a vested interest group has resulted in the "gutting" or the "shielding" of each
proposed solution. To break this log-jam, Thurow develops a four point program.

First, we do not need central economic planning in the sense of any agency that tries to
make all economic decisions, but we do need the national equivalent of a corporate
investment committee to redirect investment flows from our "sunless" industries to
our "sunsense" industries - Major investment decisions have become too important
to be left to the private market alone, but a way must be found to incorporate
private corporate planning into this process in a nonadversary way.13

Second, when one reviews what must be done - massive public investments, surpluses
to generate more savings, large compensation systems, increases in income transfer
payments, and tax cuts for the lower middle class - it is clear that one of the basic
ingredients of future progress is a tax system that can raise substantial amounts of
revenue fairly.14

This tax system would abolish the corporate income tax, would integrate corporate and
personal taxation,15 and would rest on two principles: (a) wherever possible, reforms
should be taken to reduce the dispersion in tax rates, and (b) "the appropriate degree of
equality is dependent upon how closely we come to achieving an equitable distribution
of market earnings."16

Third, Thurow suggests that "our general equity goal should be to establish a

10 John Maynard Keynes, The General Theory of Employment, Interest, and Money
did not ignore the socialization of investment aspect of the employment problem.
12 Idem, p. 11. It is unfortunate that Thurow confuse, at times, the difference between a
positive-sum game - which is the reality of his remarks which I have quoted - and a zero-
sum game where the costs and benefits, assuming they are homogeneous and measurable,
are exactly equal. I suppose that flashy titles do well better than dull ones.
13 Ibid., pp. 95, 192.
14 Ibid., p. 193.
15 Ibid., p. 97. I found it quite alarming to watch the reaction to President Reagan's
suggestion concerning the abolition of the corporate income tax. I guess it does make a
difference who makes such proposals.
16 Ibid., p. 207. It is of interest, at this point, to compare Thurow's 1980 tax proposal to that
of Evans' 1983 tax proposal. According to Evans
What is needed is a tax system which (a) raises the total amount of revenue
collected relative to the present system; (b) continues to keep pace with the
increase of GNP; (c) eliminates counterproductive deductions and loopholes; (d)
lowers marginal tax rates in order to encourage work effort and individual
incentive; and (e) increases the proportion of personal income saved. The flat-rate
income tax accomplishes all of these goals.
distribution of earnings for everyone that is no more unequal than that which now exists for fully employed white males. The attainment of this distribution of income is dependent upon the successful implementation of the other three parts of his policy.

Fourth,

Since private enterprise is incapable of guaranteeing jobs for everyone who wants to work, then government, and in particular the federal government, must institute the necessary programs. A guaranteed job program must have several characteristics in order to achieve the objectives for which it is intended. First, it cannot be a program of employment at minimum wage rates. Second, the program must be open-ended, providing jobs to everyone who is able and willing to work regardless of age, race, sex, or education. Third, the program should not be viewed as a temporary anti-recessionary measure.

IV

Thus, the first parallel which may be noted in these essays is the existence of three common ideas. First, Keynes and Throow argue that the solutions to the problems which plague capitalism can be found within the basic framework of capitalism; it is not necessary to adopt the ideology of socialism to solve these problems. Second, they both argue in favor of managed capitalism, i.e., for an increased role of the government. Keynes sees explicitly Throow does so in a more subtle way. In either case, however, both agree that an increased role for the central authority must be clearly differentiated from the need to adopt the socialist ideology. Third, the socialization of investment, the making of individual investment decisions by a national blue-ribbon board for the good of the entire economy as opposed to the adoption and implementation of a plan and national planning agency, is a key element of their respective public policy proposals. So, while the problems, the audiences, and the time frames have changed, the basic thrust of the proposals have remained the same: the addition to the nation's agenda of the increased role of the central authority is required if this nation is to achieve the stated goals of the agenda.

The second parallel which may be drawn in each writer finds it necessary to develop a new theoretical model as a means of providing a better foundation for their policies. In The Zero-Sum Society, Throow uses mainstream economics as a basis for his set of public policy proposals which, if implemented, would result in the socialization of investment. In Dangerous Currents, Throow states that the American standard of living depends on productivity and not on the rate of inflation, but he realizes that in order to develop a better theoretical explanation of productivity not only is it necessary to attack the basic internal contradiction which exists within economics, namely, "What is taught in conventional micro-economics is incompatible with what is taught in macro-economics." Thus, according to Throow what is to be done includes (1) adopting new behavioral assumptions which rely on "some real theory of preference formation" and on the fact that "the desire for power, economic and otherwise, clearly motivates many people"; (2) incorporating the idea of "a more complex vision of the interaction between society and its citizens" and this vision must include theories of social and individual interaction theories as developed in psychology, sociology and politics; (3) building on the idea that "institutions constrain[ing] themselves are a result of pressure from society and culture on economic activity"; and (4) rejecting the philosophy that "because it is the only assumption that is mathematically tractable, economists work almost entirely in terms of risk where all decisions can be made on expected value basis. Economists act as if the world were risky but never uncertain." Given his past work, however, I expect to see in his next book a link established between his new theoretical construct and the socialization of investment.

V

In this paper we have examined "The End of laissez-faire" and the General Theory and have concluded that in both writings Keynes addresses the issue of the socialization of investment. We then examined The Zero-Sum Society and Dangerous Currents and argued that two parallels may be drawn between the essays of Keynes and those of Throow. First, there exists three common ideas which link The Zero-Sum Society to Keynes' essays and second, eventually, both Keynes and Throow found it necessary to develop a new theoretical foundation for their policy proposals.

We would like to conclude this paper, however, with a note of caution. Even though both Keynes and Throow suggest that their schemes for the socialization of investment will not affect fundamental changes in market capitalism (without adopting the ideology of socialism), one can still hear Schumpeter's warnings: The social atmosphere, for the theory of which we have been gathering stones and mortar, explains why public policy grows more and more hostile to capitalist interests, eventually as much as to refuse on principle to take account of the requirements of the capitalist engine and to become a serious impediment to its functioning.

17 Ibid., p. 201, emphasis in original.
18 Ibid., p. 204-205.
20 Ibid., p.4.
21 Ibid., pp. 219, 220.
22 Ibid., p. 222.
23 Ibid., p. 231.
24 Ibid., p. 235.
References


"THE LAWS OF RETURNS UNDER COMPETITIVE CONDITIONS: PROGRESS IN MICROECONOMICS SINCE SRAFFA (1926)?"

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"...the human mind finds it easier to alter the conclusions arrived at within an accepted framework, than to alter the framework itself." (Kolod, 1934a, p.122)

Despite the numerous advances made in microeconomic theory during the twentieth century, the theory of the cost conditions of the firm in a perfectly competitive industry remains mired in contradictions. On some level, increasing, constant and decreasing costs are all incompatible with a partial equilibrium analysis of perfect competition. Although this incompatibility between perfect competition and the entire range of cost functions was first pointed out by Piero Sraffa in a famous 1926 paper entitled "The Laws of Returns Under Competitive Conditions", the theory of perfect competition persists. The purpose of the present paper is threefold: to illustrate the contradictions that persist to this day in this area, to trace those contradictions back to Sraffa's 1926 paper and to suggest why the contradictions have remained unresolved.

The contradictions between the theory of perfect competition and the cost conditions of firms are apparent to anyone who has ever taught undergraduate microeconomics. The contradictions cause some uncomfortable moments when justifying the assumptions of "U-shaped" cost curves underlying the partial equilibrium analysis of perfect competition. Manfield's intermediate microeconomics text (1982) provides excellent examples of the discomfort that arises for both the short run and long run justifications.

In the short run, costs are said to ultimately increase with increasing output because of the "law" of diminishing marginal returns. Manfield argues that this law is an empirical generalization, not a deduction from physical or biological laws. In fact, it seems to hold for most production functions in the real world (pp.159-150). But when the real world results are presented fifty pages later, Manfield notes that an "interesting conclusion of the empirical studies is that marginal cost in the short run tends to be constant. . . . This result seems to be at variance with the theory presented earlier which says that marginal cost curves should be U-shaped" (p.203). Manfield attempts to resolve the contradiction this way:

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