Classical Economics and Keynes

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The author of *Macroeconomics: An Introduction* responds to the review of his book titled, "Competing Frameworks of Economic Thought" (*EPW*, 18 December 2021).

The author is grateful to Mohib Ali for his helpful comments.

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In Rahul Menon's largely appreciative review of my book, he states that "there are certain shortcomings in the discussion on Keynes that unfortunately blunts some of the book's more significant propositions" (p 29). Menon's criticisms may be summarised, following his order, as: (i) the differences between the Classical and Keynesian economics "are not stressed nor discussed" (p 30) and that the assumption of less-than-full employment in Keynes is fundamentally different from that in classical economics; (ii) a discussion of "the implications of different values of the marginal propensity to consume on the multiplier" is "essential" "in any introductory work on macroeconomics" (p 30); (iii) drawing a simple correspondence between the proponents of Marginalism and exogenous money and that of Keynesianism and endogenous money; and (iv) lack of "references to relevant literature demonstrating" the "positive relationship between interest rates and inflation" (p 31).

I shall first engage with the substantive issues underlying the points (i) and (iii) and respond to points (ii) and (iv), which are minor, subsequently.

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Since my book's chief aim is to introduce readers to the alternative approach to macroeconomics, drawing on the work of Smith, Ricardo, Marx, Keynes, and Sraffa, I had intentionally eschewed the differences between their theories. A satisfactory elucidation of such differences, I think, is better suited to a history of economic thought textbook and not a macroeconomics one. Of course, Ricardo had dissatisfactions with Smith's value theory, Marx with Ricardo and Smith's understanding of capitalism, Keynes with Ricardo's position on Say's law, and Sraffa with the marginalist elements in Keynes. Despite these differences, the analytical separation of the price and quantity systems in Smith and Ricardo make it logically possible to conjoin Sraffa's restatement of the classical theory of value and distribution and the Keynesian/Kaleckian principle of effective demand. For Sraffa, the relative prices and the rate of profit (or the real wage) are determined, given the size and composition of output, technology, and the real wage (or the rate of profit); this is briefly discussed in Thomas (2021a: 171–72). This analytical separability of the price and quantity systems provides the rationale for Garegnani's key contribution as well as the subsequent literature on demand-led growth theory (outlined in Thomas [2021a: 95–97]; see also Bharadwaj [1989]). More specifically, it is this analytical separation that makes it possible to extend the principle of effective demand to the long run. Therefore, in the context of the Sraffa–Keynes research programme, there does not "exist significant differences between the two heterodox schools" of classical and Keynesian economics contrary to Menon's view (p 30).

It must be noted that, in Smith and Ricardo, neither is the full employment of labour an assumption nor a tendency, or a consequence. While it is true that the principle of effective demand is absent in the theoretical worlds of Smith and Ricardo, as Das (2021) explicitly and perhaps Menon (2021) implicitly note, there is important demand-side thinking in both Smith and Ricardo. Of particular interest is the asymmetrical relationship running from supply to demand, in their discussion of "effectual demand" and the "extent of the market," as an expression of an aggregate demand channel (for a detailed account, see Thomas [2021b]). Moreover, Ricardo is explicit about the unemployment effects of machinery.

Keynes's classification of all economists before him as classical economists continues to remain an important source of confusion. As I note in my final chapter, this is "incorrect" labelling, and his main adversaries are Marshall and Pigou (Thomas 2021a: 189). In any case, an analytically coherent and peaceful resolution is visible in the ongoing Classical–Keynesian research programme (for a comprehensive survey of the literature, see Aspromourgos (2004), also suggested as a further reading in the last chapter of *Macroeconomics: An Introduction*. Unemployment, in this tradition, is a consequence of aggregate demand deficiency and not imperfections—whether wage rigidities or asymmetric information. In short, Keynes is very much alive in the long run.

In my book, while I approvingly mention A K Dasgupta's critique of the applicability of Keynesian economics to the Indian economy (Thomas 2021a: 77–78), it does not entail that I agree with his solutions (p 31, n1):

> It is ironic that though Thomas criticises the marginalist school for an over-reliance on Say's Law, Dasgupta himself believed that the solution to the problem of a reduced incentive to invest in developing economies "… (was) to be sought not in the Keynesian direction but rather in the direction of J B Say." (Dasgupta 2009: 2921)

Citing Dasgupta, Menon writes that "[g]iven a limited capital stock, an increase in aggregate demand beyond the level of full-capacity output would not lead to increasing employment" (p 30). As I had articulated in my chapter on economic growth, "investment plays a dual role: it is a component of current aggregate demand and it also adds to the productive capacity" (Thomas 2021a: 91). In the demand-led growth framework, capacity adjusts to aggregate demand. Consequently, contrary to Menon's argument, an increase in investment raises "the level of full-capacity output" and would lead to an increase in employment.

I would also like to point out, that Dasgupta's interpretation of subsistence wages in classical economics is unsatisfactory because he viewed them "to be rigidly fixed" (Dasgupta 2009 [1942]: 53) and not determined by culture and history (Thomas 2021a: 96–97, 125, 146). Therefore, it would be useful to undertake a critical assessment of Dasgupta's interlocution of classical economics especially in the light of the findings from the Classical–Keynesian research programme.

Menon is right in pointing out that the "dominant macroeconomics framework today—New Keynesian thought—adopts an endogenous money framework, with the central bank targeting the interest rate rather than the money supply" (p 30). This fact goes against my simplistic juxtaposition of exogenous-money-as-marginalist with endogenous-money-as-heterodox (Thomas 2021a: 122–23). Owing to marginalist and non-marginalist elements of thought in Keynes, there are both orthodox and heterodox Keynesian traditions, such as New Keynesian and Post Keynesian respectively. I agree with Menon when he writes that "the adoption of endogenous money does not *ipso facto* imply a non-Wicksellian interest rate" (p 30). But my adoption of the classical/Sraffian theory of value and distribution entails a rejection of the Wicksellian interest rate. Moreover, since I do highlight the idea that the interest rate equilibrating planned saving and planned investment is orthodox/marginalist, I believe that the readers will be able to identify the problematic aspects of New Keynesian macroeconomics despite its endogenous money framework.

Pedagogic Standpoint

While I appreciate Menon's concern—point (ii)—regarding the macroeconomic dynamics arising from changing propensities to import and consume, these were intentionally omitted because these discussions are aplenty in mainstream textbooks. And the more significant reason is found in my "Note to the Reader":

> At several points in this book, you might perhaps wish that I provided an answer to a question or carried out an elaborate discussion. However, such a pedagogy is deliberate, and, this book would have attained its purpose if it motivates discussions both inside and outside the classroom on conceptual and contextual issues in macroeconomics. In other words, it is intended to serve as a critical companion. (Thomas 2021a: xx)

Given this, I am happy to see such a discussion in Menon's review (pp 30 and 31, n2).

Missing Reference?

I am surprised by point (iv) because I did provide the key reference: "For a succinct conceptual statement on the connection between monetary policy, the rate of interest and the general price level, read the 'Summary and Concluding Observations' (pp 128–36) of Massimo Pivetti's 1991 book *An Essay on Money and Distribution* (New York: Palgrave Macmillan)" (Thomas 2021a: 185).

In Conclusion

Overall, while Menon's concerns, visible in the substantive points (i) and (iii), are valid, I do not think that they represent genuine shortcomings concerning the stated objectives and aspirations of my book. Of course, all books necessarily fall short in one way or the other in the eyes of a critical reader, and therefore I remain grateful to Menon for engendering this discussion.

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