Institutions, behaviour and economic theory

A contribution to classical-Keynesian political economy

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To the Memory of my Father

'But look', the Rabbi's wife remonstrated, 'when one party to the dispute presented their case to you you said "you are quite right" and then when the other party presented their case you again said "you are quite right", surely they cannot both be right?' To which the Rabbi answered, 'My dear, you are quite right!'

A. P. Lerner, The burden of debt, *Review of Economics and Statistics*, 43 (1961), pp. 139–41. Reprinted in R. W. Houghton (ed.), *Public Finance*. Harmondsworth: Penguin (1970), pp. 312–17.

The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes.

Maynard Keynes, *The General Theory of Employment, Interest and Money*. Collected Writings, vol. VII. London: Macmillan (1973), 1st edition 1936, p. 372.

Keynes evidently did not make much of [Sraffa's 1928 draft of *Production of Commodities by Means of Commodities*] and Sraffa, in turn, never made much of the *General Theory*. It is the task of the post-Keynesians to reconcile the two . . . Post-Keynesian theory has plenty of problems to work on. We now have a general framework of long- and short-period analysis which will enable us to bring the insights of Marx, Keynes, and Kalecki into coherent form and to apply them to the contemporary scene, but there is still a long way to go.

Joan Robinson, Keynes and Ricardo, *Journal of Post Keynesian Economics*, 1, no. 1 (Fall 1978), pp. 14, 18.

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Preface

The history of economic theory is also the history of its increasing fragmentation. The remarkable unity of the subject to be found in Ricardo's *Principles*, the masterpiece of classical political economy, has vanished in the course of time. The classical system, built upon François Quesnay's physiocratic foundations, already contained the seeds of divergence and gave birth to alternative grand systems. Adam Smith's emphasis on behaviour and exchange favoured the development of neoclassical economics, as first comprehensively systematized by William Stanley Jevons, Léon Walras, Alfred Marshall and Carl Menger. David Ricardo started from the social process of production to tackle the fundamental problems of value and distribution. His labour theory of value and his surplus principle of distribution became parts of a fundamental critique of capitalism within the wider framework of the economic theory of socialism, sketched by the early French socialists and by Karl Marx and Friedrich Engels, and elaborated by a variety of economists, prominent examples being Maurice Dobb, Oscar Lange and Paul Sweezy. Large parts of liberal (neoclassical) and socialist economics are strongly normative in character in that the functioning of markets and of the planning mechanism are studied under conditions which are ideal in certain respects, and where real-world imperfections are interpreted as deviations from the norm. However, the occurrence of periodic crises maintained the doubts over Say's law on the impossibility of *general* overproduction, even among the classical economists, as the example of Thomas Malthus shows. Subsequently these doubts gave rise to the elaboration of comprehensive positive systems aimed at explaining the functioning of free and mixed market economies. Here, the work done by Karl Marx and by Maynard Keynes towers above other attempts to understand the way in which capitalist societies work.

Out of these comprehensive designs variations have developed, and specialization has increased. As a consequence the grand systems have been divided into compartments. The doors linking these are getting narrower leads to other professionals taking over important tasks that ought to be performed by economists. Historians, philosophers, lawyers and experienced managers are, in many instances, successfully explaining what is going on in the real world with respect to economic phenomena. In some countries, the most respected advisers to governments on economic affairs are not economists proper but social scientists in a wider sense of the word. The pure economist who develops highly sophisticated mathematical models during the day is simply not mentally prepared to give sound policy advice on real-world problems in the evening. It may be objected here that policy-making is not the domain of the theorist. However, theory, if it is not to remain sterile, must prepare the terrain for policy action, which may include systems policy aimed at shaping the socioeconomic system by the creation of new institutions or the modifications of existing ones.

Finally, the dominance of neoclassical equilibrium economics has grave consequences for socioeconomic policy-making in many countries. Some policy-makers think almost exclusively along microeconomic lines as is illustrated by supply side economics. The only macroeconomic problem of major importance seems to be the quantity of money and its regulation. This very simple policy approach stands in strange contrast to complex neoclassical theorizing. To the Keynesian observer it seems evident that the neoclassical approach to economic policy-making involves much unnecessary hardship, mainly in terms of severe unemployment and growing inequality accompanied by increasing poverty. As is well known, the situation is particularly striking in many underdeveloped and heavily indebted countries (which will perhaps be joined by some of the formerly socialist countries), most of which are desperately short of foreign exchange while being asked by international monetary institutions to perform so-called structural adjustments which, from a socioeconomic and political point of view, are not rational policies. But even in some of the rich and very rich countries ruthless competition on world markets involves increasing pressure on workers, employees and managers, for the struggle is not about relative positions in a full employment situation linked with sound competition but is about avoiding the precipice of involuntary unemployment which usually means social as well as economic deprivation. Nor is the pressure confined to adults; schoolchildren and students preparing for the struggle for survival are equally concerned. All this is not to blame policy-makers facing these pressures. Rather, dominant economic theory simply cannot provide a sound basis for long-term policies. In some instances, the latter are based on stubborn fundamentalism in which the main problems of unemployment, distribution and poverty are largely ignored; instead, attempts are made to regulate the 'quantity of money' and to manage the foreign exchange rate and the foreign balance position by

means of variations of the rate of interest and of austerity policies respectively – an approach Keynes called 'foolish and highly dangerous', because it encourages short-run economic policies which frequently resemble financial tightrope-walking and leaves governments helpless in the face of high unemployment levels.

These are some of the problems that arise from the neglect of important theoretical approaches and from the excessive diversification of economic theory within one approach. Yet, any attempt to unify economics would be foolish and unnecessary. Today's world is profoundly pluralistic. This should advance the progress of science in general and of economics in particular if scientists are sufficiently open-minded to respect the merits of alternative and, even, rival points of view. What can be done, however, is to bring out the nature of the basic approaches which characterize broad groups of theories, for example socialist, neoclassical and classical-Keynesian theories. In fact, the approaches in question are based upon differing visions of society and man which, in turn, largely depend upon social philosophies and their associated value systems. These and the respective conceptual approaches are too complex to be readily discriminated by empirical and/or theoretical means. Consequently each economist will, consciously or unconsciously, choose the approach which, in his view, seems most appropriate to tackling real-world problems. The choice will be influenced not only by basic values but also by theoretical and practical experience. The latter involves the continuous comparison of some theory with reality, while the former involves constantly confronting one's own theory with rival theories. Such a 'testing' of theories should be comprehensive in that it should take into account the wider implications that arise from the premises of the various theories. To organize complex ways of reasoning social scientists may again have to ask metaphysical questions; for example: What is the vision of society and man implied in some theory? What is society? What is the position of the economy within society? How is economics related to ethics? This may sound archaic. Yet true progress in the social sciences will be possible only if the relationship between metaphysics and science is redefined. Some outstanding recent books, Brown (1986), Eccles (1984), Fitzgibbons (1988), Hodgson (1988), Lloyd (1986), and O'Donnell (1989), illustrate the need to give up, partly at least, the familiar positivistic way of looking at things.

Constructive mutual criticism should result from comprehensive and open-minded testing of economic theories. This process may facilitate a broad classification of economic theories reflecting the basic positions held by economists. Teaching, decision-taking and policy-making should be clarified when the flow of empirical and theoretical information is broadly systematized.

Thus the answer to the present diversification of economic theory does not lie in an attempt to restore unity but rather in seeking to broadly classify theories so that eventually a loosely structured body of economic science might obtain. The present study tries to contribute to this undertaking. However, no attempt will be made to tackle the problem of classification of economic theories in general terms since the argument would probably remain vacuous. Instead, a concrete problem will be examined, namely describing the broad meaning of classical-Keynesian political economy and its approximate position within the spectrum of economic theories. It will be argued that this type of political economy seems to be a superior alternative to neoclassical equilibrium theory and that to ground socioeconomic policies on alternative assumptions would entail less hardship than is caused by today's economic policies. By and large, this is tantamount to saying that the economics of Walras and Marshall should, to a considerable extent, be replaced by the political economy of Ricardo and Keynes.

This formulation of the problem inevitably involves a critique of neoclassical equilibrium theory (and, implicitly, of the economic theory of socialism). However, the general tone of the study is conciliatory in the sense that the considerable degree of complementarity existing between the various economic theories is recognized: we do not want to exclude but to combine and to bring ideas together. This implies recognizing the merits of rival points of view and should, it is hoped, allow economists adhering to differing schools to co-operate more closely, which is badly needed in view of the immense socioeconomic and ecological problems facing us on a world scale. In fact, much harm has been done by excessively emphasizing certain aspects of socioeconomic life, frequently with the help of quite sophisticated models which neglect important features of the real world, thus losing sight of society as a whole. Liberal economists praise the virtues of the market and of private initiative while socialist economists have insisted on the necessity of planning and on forging a new, socially minded human being. Historical experience, however, shows that man is a *social* individual in the sense that individuals act within social structures, that is a system of institutions encompassing all the spheres of social and individual life. In this view, the market and the plan (on various levels) are but specific institutions both of which are required to organize socioeconomic life in and between countries or regions, the problem being to blend plan and market in a way properly adapted to a particular historical situation. The main question, then, is not to falsify theories in order to establish the supremacy of one 'correct' theory. This is beyond the reach of the capabilities of the human mind anyway. Rather, it should be recognized that each theory may be useful in explaining some aspect of reality. The crucial issue

is to find out which theory is more fundamental. This requires creating broad and comprehensive theoretical frameworks in which partial theories can be put into perspective, the purpose of such frameworks being to explain in principle how economies and societies *as a whole* function. In what follows an attempt will be made to argue that classical political economy in a broad sense, i.e. complemented by Keynesian elements, constitutes such a framework, alongside liberal and socialist economics.

The necessity to elaborate comprehensive theoretical frameworks implies that classical-Keynesian political economy cannot consist of just one tidy and universally applicable model. Rather, in order to take account of widely varying socioeconomic, political and cultural differences, modern political economy ought to represent a conceptual framework for historical investigations allowing us to draw policy conclusions adapted to specific circumstances. The integration of economic theory and economic history is, indeed, the main methodological point taken up in this study. In this, we may rely on Karl Marx and on Carl Menger. Both masterfully combined theory and history in the spirit of the founder of the social sciences, Aristotle, whom both admired. Marx tackled the evolution of social systems; Menger attempted to ground the social sciences upon the behaviour of individuals.

Accordingly, modern political economy should allow for broadly based co-operation between social scientists. This book attempts to argue that, as a first step, it should be possible to synthesize the various post Keynesian strands of thought actually existing. Subsequently, a properly adapted system of political economy should facilitate the integration of parts of neoclassical microeconomics and of the economic theory of socialism. The two are largely complementary: the former deals with the behaviour of individuals in the economic sphere, the latter with the social structures within which individuals act. Consequently, neoclassical and socialist economists who might find classical-Keynesian political economy attractive would not have to give up all their presumptions. Quite the contrary, by bringing in their analytical powers they could greatly contribute to the construction of a comprehensive system of political economy. 'The truth', Hegel once said, 'is the whole' – '*Die Wahrheit ist das Ganze*'. In a way, this profound insight certainly holds in particular for the various strands of post Keynesianism and in general for economics and for the social sciences taken together. A comprehensive view of social matters is presently more needed than ever.

However, Hegel, in the tradition of Plato, wrote from the point of view of the absolute, an unthinkable undertaking today. In the course of the twentieth century, scientists of all kinds have become more modest than their nineteenth-century counterparts and awareness of the limits of human knowledge has increased. It is more and more recognized that knowledge is scrappy and imperfect, above all in the social sciences. Among the great social scientists of the twentieth century, Keynes has perhaps been most conscious of this fact. Indeed, in a fundamental philosophical work, the *Treatise on Probability*, Keynes strongly stresses the probabilistic and qualitative nature of thinking in the social sciences (see on this Fitzgibbons 1988, and O'Donnell 1989): absolute truth is inaccessible; all that can be done is to attempt to get some clarity about principles to move on in the right direction. To be able to choose the supposedly right way, the social scientist has to make use of *all* the information available: metaphysical, accessible through introspection based on pure reason and intuition, empirical and theoretical, relying on applied reason, and, last but not least, historical, i.e. the history of facts and of ideas. Indeed, insight into socioeconomic affairs can be greatly enhanced by taking due account of the immense intellectual heritage, based on Greek and Roman social and political thought.

This is not a fancy. Some of the founders of political economy, James Steuart, François Quesnay and Adam Smith for example, incorporated historical heritage – in a very broad sense – in their work. The historical development of facts and ideas played a crucial role with German social scientists: Karl Marx, Gustav Schmoller, Max Weber, Werner Sombart and August Oncken, to name but a few. Marshall was very keen on the historical continuity of economic thought: he was anxious to show that there was no marginal revolution, but an evolution of classical political economy; his work on Hegel (Groenewegen 1990) suggests that he took pains to put his economic system into a wider context. Maynard Keynes, too, is deeply rooted in pre-modern thought, as is brought out by Carabelli (1985), Fitzgibbons (1988) and O'Donnell (1989) in particular. In view of the considerable intellectual confusion currently prevailing, there is, it seems, a real need to go back to the great socioeconomic and political thinkers of the past which means that the history of economic, social and political thought will have to occupy a much larger place in future syllabi than is now the case.

The above implies that the social sciences cannot be 'value-free' as is still frequently claimed. (Indeed, on deeper reflection, a value-free science would only be possible if absolute knowledge were already held or could be reached in principle.) Values – material, intellectual, moral, aesthetical, individual and social – are related to all spheres of individual and social life and are embodied in various institutions; specific value structures define the way of life in different countries and regions and in various epochs. As such, value systems not only are closely linked with the organization of societies and with the aims of human actions but also enter the premises of

theories set forth to explain real-world phenomena, the latter reflecting the tentative and probabilistic – in Keynes's sense – nature of thinking. Even today many social scientists see themselves as moral scientists because of the crucial role of values played in social life. This goes along with a growing preoccupation with ethics and politics in the sense of political philosophy (examples are Utz 1964–94, Schack 1978, Brown 1986 and Barrère 1991). In this context, it should be remembered that one of the founders of political economy, Adam Smith, first worked out an ethical system – *The Theory of Moral Sentiments* – before tackling economic issues in the *Wealth of Nations*. Both works are parts of a greater whole, based on the idea that an orderly social life must rest on solid ethical foundations. Similarly, François Quesnay built an elaborate system of political philosophy around his *tableau économique*. Finally, Keynes always understood economics and the social sciences as moral sciences, a fact emphasized by Fitzgibbons (1988) and O'Donnell (1989). In this book, then, some consideration is given to the role of ethics in the social sphere in order to contribute to the elaboration of a complete system of the social sciences of which political economy is a part.

Clearly, however, it is too soon to aim at producing a logically watertight treatise on classical-Keynesian political economy. For, as will become evident from the opening pages of this book, there are different strands of thought in this domain which, at first sight, are not mutually compatible. Thus, before treatises or even textbooks on political economy can be written, a considerable amount of preparatory work has still to be done to clarify the main issues. The following is meant to be a contribution to this preliminary work. The chain of argument forms a loosely connected set of ideas which are not fully explored. Problems may be merely mentioned and connections just hinted at. As such, the present study is only an essay, intended to initiate and to stimulate further work and discussion, and is perhaps best understood as an inventory of some of the problems which arise in attempting to work out a comprehensive system of political economy and its underpinnings, as well as its implications for other social sciences – politics, law and sociology, in particular.

The present study is based on the presumption that to bring some order into the system of social sciences a social philosophy is needed. This springs from the simple fact that each society is an immensely complex entity, the broad functioning of which cannot be captured by partial models based on specific hypotheses. Whenever socioeconomic macroissues – employment, value and distribution – are considered there are no realistic hypotheses to start with (Keynes). Therefore, the analysis of such issues must necessarily start from a 'pre-analytic vision' (Schumpeter) which governs, to an important extent, the way of reasoning, whether this is made explicit or not.

Visions rest on social philosophies. The latter constitute the unifying frameworks for *all* systems of social sciences.

Two great social philosophies have, in various versions, dominated the intellectual scene since the French Political Revolution and the English Industrial Revolution: liberalism and socialism. The neoclassical system of economics grew out of the former, the economic theory of socialism out of the latter. It is precisely the solid social philosophical foundation which has given both neoclassical economics and the economic theory of socialism their tremendous intellectual and political strength. If, now, classical-Keynesian political economy is to succeed in at least partly supplanting neoclassical economics and the economic theory of socialism, then it will have to be put on equally solid social philosophical foundations. This amounts to elaborating an appropriate third-way social philosophy which is, obviously, an immense task that can only be undertaken by experienced social scientists; this is the main reason why social philosophical issues will be merely touched upon in the following pages. Nevertheless, it is felt that in developing a third-way social and political philosophy, it will be possible to rely upon a rich intellectual heritage, ranging from Aristotle to Keynes, as is implied by Brown (1986), de Laubier (1987), Fitzgibbons (1988) and O'Donnell (1989), among others. (The term 'third-way' is auxiliary and provisional and is used interchangeably with 'intermediate' and 'middle-way'; a more informative notion, i.e. 'humanist', is provided in chapter 2, where the fundamental approaches in social philosophy are broadly defined.)

If a comprehensive and solidly based system of political economy could be established as a rival to liberal and socialist economic theory, political implications would also emerge. For, given that, broadly speaking, liberal (neoclassical) economics may be seen as the economics of the political right (based upon an élitist liberalism) and the economic theory of socialism as the political economy of the left, classical-Keynesian political economy could be interpreted as the socioeconomic theory of the progressive centre, that is of social democracy, and of similar and associated movements, including, for example, conservatives who care about people and do not bother too much about abstract doctrines. Incidentally, this was Keynes's and Kaldor's political position, too. Most importantly, 'Keynes's system was consciously cast as a third alternative to both [socialism and liberalism]' (Fitzgibbons 1988, pp. 1–2). So there is no need to invent the third-way alternative (which, incidentally, attracts growing attention in recent post Keynesian literature; see for example Dutt and Amadeo 1990).

There is some hope that many politicians and social scientists, not necessarily economists, will sympathize with the attempt to establish a classical-Keynesian system of political economy of the centre. In fact, in the course of recent history, social and political action of the centre has, time and again, been hampered by the weakness of its conceptual foundations. Consequently, there has been, in accordance with the currently prevailing *Zeitgeist*, a strong and persistent tendency for the universalist and clear-cut liberal and socialist arguments, frequently in a fundamentalist dress, to win through, a fact at present confirmed by the events taking place in many of the formerly socialist countries who want to convert, by a stroke of magic so to speak, centrally planned systems into free market economies.

Modern liberal and socialist fundamentalisms are both essentially materialistic – society and nature are, in fact, subordinate to the economy. The race for ever higher levels of material well-being has resulted in immense inequalities and is one of the main reasons for the currently disastrous socioeconomic and ecological situation worldwide. The few islands of material well-being, embellished at times by cyclical upswings, should not deceive us when assessing this statement. Moreover, those living in these islands of affluence should bear in mind that markets and private initiative are but necessary, not sufficient, conditions for economic success. Human actions may indeed not bring about the effects desired if objective historical conditions are not favourable.

It is quite evident that we are today living in a neo-mercantilist world where foreign trade, associated with a strong position in key industrial and service sectors, is crucial for economic development, and, in some instances, for exercising political influence. Since, in open economies, everything has to be done to remain competitive on world markets, far-reaching economic, social and ecological policy actions are rendered very difficult in the presence of severe unemployment. Hence full employment, or near-full employment, seems indispensable if more social justice is to be brought about worldwide and if our environment is to be preserved, since aggressive trade policies would then no longer be required. In the course of the argument set forth in this book it will be seen that this typically Keynesian assertion gains its full force only if Keynesian employment theory is combined with a theory of value and distribution based upon the classical (Ricardian) surplus approach.

1 Introduction

Observations on the state of alternative economic theory

In the fifties and sixties the evolution of the Keynesian message resulted in an alternative approach in economic theory which was first labelled neo-Keynesian economics and subsequently post Keynesian economics or political economy. Some of the founders of the new school clearly sought to reconcile the classical (Ricardian) theory of production, value and distribution based upon the surplus principle with the Keynesian theory of employment and output determination through effective demand; others mainly tried to preserve and to elaborate Keynes's heritage which was considered anticlassical because of its rejection of Say's law. In general, the post Keynesians wanted to overcome the neoclassical orthodoxy and consequently considered their approach to be progressive.

The notion 'post Keynesian' immediately gives rise to a definitional problem related to the title of the present book which is about 'classical-Keynesian political economy'. At this stage, it is sufficient to note that the latter is a historically based elaboration of the former, in which Quesnay, Ricardo, Marx and Keynes are of particular importance. The term 'post Keynesian' is defined in this section. At the end of the next section a working definition of 'classical-Keynesian' is provided. This notion is examined more fully in chapter 3 (pp. 76–81).

The return to classical economics starting from Keynesian ground is, indeed, the common theme in much post Keynesian work, for example some of Michal Kalecki's essays written as early as the thirties and forties (Kalecki 1971), Joan Robinson's *Accumulation of Capital* (Robinson 1965; 1st edn 1956), Nicholas Kaldor's articles on growth and distribution (for example Kaldor 1955/56) and, most importantly, Piero Sraffa's *Production of Commodities by Means of Commodities* (Sraffa 1960). More recently, Luigi Pasinetti presented a fundamental framework of analysis (Pasinetti 1977, 1981, 1993), in which Ricardian and Keynesian theoretical elements are combined and elaborated. Kregel also sees the 'reconstruction of political economy' as a synthesis of Keynesian and classical elements of analysis (Kregel 1975). The same is true of Garegnani (Garegnani 1970, 1978/79, 1983, 1984, 1987). Geoffrey Harcourt greatly contributed to the spread of post Keynesian ideas (Harcourt 1977, 1982, 1986, 1992, 1993, 1995). The effort made by the late Krishna Bharadwaj to reappraise classical political economy deserves a special mention here (Bharadwaj 1986, 1989).

Since large parts of neoclassical equilibrium economics have moved quite far away from reality, as, for instance, the 'rational expectations' system clearly shows, one would have expected post Keynesian economics to gain ground with the change in the economic situation in the mid seventies when the post-war era of growth and optimism had come to an end. After all, Ricardo, Keynes and the post Keynesians have always endeavoured to explain aspects of the real world and to propose appropriate policy measures.

The contrary has happened, however. Explanation of reality has been widely replaced by a dogmatic belief in the blessings of an unrestricted free market system. In the field of economic policy, deregulation has become one of the key notions. This return to liberal fundamentalism, accelerated by the recent downfall of the centrally planned systems, has, quite naturally, been accompanied by sweeping successes of the traditional neoclassical school, that is of the neoclassical synthesis, general equilibrium theory, neo-Walrasian disequilibrium theory, monetarism, rational expectations, supply side economics and neo-Austrian economics. The neoclassical tide has not only swept away large parts of what has remained of Keynesianism proper but has also seriously hampered the rise of post Keynesianism. As a consequence, the post Keynesian alternative is not widely appreciated today. Only a tiny minority of economists adhere to it, and the movement even seems to have lost some ground in recent years.

In fact, it is normal that there should have been a neoclassical reaction against post Keynesianism. After all, post Keynesian economic theory is, in some respects, in direct opposition to neoclassical mainstream economics. What is worrying, however, is that there are deep cleavages within post Keynesianism. These have prevented the emergence of a coherent post Keynesian system until now. Presumably, this is the main reason why the new approach to economic problems has not yet found the recognition it deserves: 'few professors of economics seem aware of [the post Keynesian] alternative – and fewer still seem willing to expose their students to it' (Eichner 1978, p. vii).

This state of affairs has not changed in the recent past. In a recent German textbook (Felderer and Homburg 1989) post Keynesian economics and some leading authors are barely mentioned and post Keynesian

theory is not dealt with at all. The authors argue that this is impossible because a coherent post Keynesian system simply does not exist (Felderer and Homburg 1989, pp. 100–1). This important proposition is complemented, quite ironically, with a quotation from R. M. Solow who asserts that post Keynesianism is more of an ideology (*Weltanschauung*) than a science (p. 101n).

Certainly, there are, besides a possible lack of coherence, other reasons why post Keynesianism is widely ignored. One of these might be the difficulty of 'escaping from habitual modes of thought and expression' (Keynes 1973a, p. xxiii). There is also the Marxian point of view stating that theories find acceptance only if they serve the vested interests of some social group. Finally, one could argue with Thomas Kuhn that those who adhere to an old paradigm have to retire in order that a new paradigm may be established.

The problem of coherence seems particularly important because post Keynesian economists disagree, in a fundamental way, on the nature of their system. There are rather acrimonious discussions between post Keynesian subgroups going on. Harcourt distinguishes three different strands of post Keynesianism (Harcourt 1981). In the first place, there are the Keynesian Fundamentalists: Paul Davidson, Hyman Minsky and Sidney Weintraub, for example. A second group are the Robinsonians: Joan Robinson, Richard Kahn, Michal Kalecki, A. Asimakopulos, Jan Kregel and a group of Australian economists (Harcourt 1981, p. 5). Finally, there are the neo-Ricardians: Krishna Bharadwaj, John Eatwell, Pierangelo Garegnani, Heinz Kurz, Murray Milgate, Alessandro Roncaglia, Bertram Schefold and Piero Sraffa.

These lists are far from being exhaustive, nor is the classification set forth here something definite, since it could presumably be refined and rearranged in various ways. The point is simply to illustrate the variety of the post Keynesian movement. Well-known authors, like Phyllis Deane, Alfred Eichner, Donald Harris, Kenneth Galbraith, Nicholas Kaldor, Edward Nell, Luigi Pasinetti, Josef Steindl and Paolo Sylos Labini for instance, have not been included simply because of the difficulty in classifying them. The same is true of the German group of political economists around Adolph Lowe, for example Harald Hagemann and Peter Kalmbach.

A brief look at the basic tenets of each of these post Keynesian groups may help to bring the main divergencies into the open. The Keynesian Fundamentalists aim at preserving and developing the legacy of Keynes, that is the *Treatise on Money* and *The General Theory of Employment, Interest and Money*. Paul Davidson formulates their motto as follows: '[Our] analysis will be developed on the basic assumptions that in the real world (1) the future is uncertain . . . (2) production takes time and therefore . . . someone must make a contractual commitment in the present involving performance and payment in the uncertain future, and (3) economic decisions are made in the light of an unalterable past, while moving towards a perfidious future. It is only under these three basic assumptions that the role of money in the real world can be analysed' (1978, pp. 7–8).

The Robinsonians see the essence of the Keynesian revolution in the fact 'that Keynes's *General Theory* smashed up the glasshouse of static theory [i.e. equilibrium economics]' (Robinson 1965, p. v). Equilibrium analysis ought, in their view, to be replaced by historical analysis where history is seen as a sequence of short-term events. This implies that 'the long period has no independent existence' (Harcourt 1981, p. 5). 'The long-run trend is but a slowly changing component of a chain of short-period situations' (Kalecki 1971, p. 165). The essential analytical tool of the Robinsonians is a two-sector model linking investment and profits or the rate of growth of capital and output and the rate of profit. This relationship between profits and growth is a familiar theme in classical economic theory. It is also present in the Marxian reproduction schemes of volume two of *Das Kapital* (Marx 1973/74a [1867–94], vol. II, pp. 391ff.) and in Keynes's Fundamental Equations set forth in the *Treatise on Money* (Keynes 1971b, vol. I, pp. 111ff.).

The neo-Ricardians strongly emphasize the classical origins of their theoretical views. Their starting point is the capital theory debate, the outcome of which has put to the fore the fundamental differences between neoclassical and neo-Ricardian theory in the fields of long-period value, distribution and employment (Garegnani 1970). The analytical core of neo-Ricardianism is the classical surplus approach to distribution (Garegnani 1984). The division of a given social product into real wages and the surplus (profits and rents) is essentially a social, not an economic or market phenomenon. Once distribution is determined normal prices are also fixed. These depend on the technical conditions of production and on distribution, i.e. equal profit rates everywhere or a hierarchy of desired rates. The given output need not equal full employment output, owing to a lack of effective demand. The neo-Ricardians also stress the importance of long-period analysis. Normal prices are supposed to be stable in the long run and are consequently seen as centres of gravity, around which short-period or temporary market prices fluctuate.

There are crucial differences between the three strands of post Keynesian thought. The Keynesian Fundamentalists emphasize uncertainty and the role of money in an uncertain world. They reject the importance of the capital theory debate and the various problems related to it, e.g. reswitching and measuring capital independently of distribution, which Davidson,

quoting F. H. Knight, sees as 'theoretical conundrums which are often debated with great joy and zest by economists who [according to F. H. Knight] essentially "are to make their living by providing pure entertainment" for other economists' (Davidson 1978, p. 7). Moreover, American Keynesian Fundamentalists 'do not want to know about the Classical-Marxian roots' (Harcourt 1981, p. 2) of both the neo-Ricardian and the Robinsonian variants of post Keynesian economics.

On these points the neo-Ricardians would strongly disagree. In particular, they emphasize the crucial importance of the capital theory debate. The neoclassical theory of value and distribution (supply and demand determine prices in both the short and the long runs) is shown to be wrong for the long run; moreover, even under ideal conditions, i.e. perfectly functioning markets, there may be no tendency towards full employment in any neoclassical world. Hence in the neo-Ricardian view, the capital-theoretic critique eliminates neoclassical theory as a long-period approach to economic problems and is a necessary prerequisite for the setting forth of a neo-Ricardian long-period economic theory. Consequently, the neo-Ricardians want to get rid of the neoclassical vestiges in Keynes's *General Theory*, that is the theory of investment contained in chapter 17 and the first (neo)classical postulate (the real wage equals the marginal product of labour). Both might provide starting points for reintroducing neoclassical methods to analyse long-period problems.

Uncertainty and money are, in the neo-Ricardian view, not very important in the long run, where the normal prices are determined by technology and institutions. Uncertainty, indeed, plays a minor role if the normal functioning of institutions is expected to continue with a high degree of confidence.

However, the Robinsonians would tell the neo-Ricardians that uncertainty is very important and that, therefore, long-period analysis associated with normal prices and quantities does not make much sense: '[Uncertainty] destroys the basis of [neo]classical economic theory which, in Keynes's words, is "one of these pretty, polite techniques which tries to deal with the present by abstracting from the fact that we know very little about the future". [Thus,] long-period movements are obtained by linking up a sequence of short-period results – they have no independent existence' (Asimakopulos 1983, p. 31), a statement which also applies to neo-Ricardian long-period theory. To this the neo-Ricardians would reply that it is not sufficient to develop a theory of fluctuations. A theory of the long-term trend is also required since it matters whether fluctuations are around trends implying lower or, in contrast, higher levels of persistent unemployment (Garegnani 1983).

This brief review illustrates that there are deep cleavages within the post

Keynesian movement. This largely explains why neoclassical economists, even those who are conscious about the weaknesses of their approach, are reluctant to take post Keynesianism seriously. They simply do not find a coherent system which is ripe for textbook presentation and, thus, for teaching. As a consequence, post Keynesian economics remains, in a way, sectarian.

At the end of her life Joan Robinson clearly perceived the issue at stake. On the one hand, she recognized the need for synthesis within post Keynesianism: 'Keynes evidently did not make much of [Sraffa's neo-Ricardian work] and Sraffa, in turn, never made much of the *General Theory*. It is the task of post-Keynesians to reconcile the two' (Robinson 1978, p. 14). On the other hand, she felt that the undertaking would not be easy: 'Post-Keynesian theory has plenty of problems to work on. We now have a general framework of long- and short-period analysis which will enable us to bring the insights of [Ricardo,] Marx, Keynes, and Kalecki into a coherent form and apply them to the contemporary scene, but there is still a long way to go' (p. 18). Some of it we attempt to cover in the subsequent chapters.

Problems and plan

The aims pursued in this study follow from the above-mentioned lack of coherence of alternative economic theory. First, an attempt is made to argue that there is room for a synthesis of classical and Keynesian elements of analysis on the basis of their respective historical heritages (chapter 4). Consequently, it should be possible in a further step, not to be undertaken here, to set up a coherent classical-Keynesian system by elaborating the present study; this could mean writing treatises on classical-Keynesian political economy. Second, in order to bring out the significance of this approach within economic theory, it seems important to identify the fundamental differences between classical-Keynesian political economy and neoclassical equilibrium economics (chapter 5). Third, and most importantly, it is attempted to argue that the classical-Keynesian system may be considered the political economy of the intermediate or middle way between liberalism and socialism. This argument requires a look at some fundamentals in the social sciences (chapter 2) and in classical and Keynesian political economy itself (chapter 3). In the final chapters, 6 and 7, a wider view is taken of a few crucial problems of economic theory and policy, of the social sciences and of social philosophy.

These aims are related to an extremely complex subject matter comprising various issues of content and method in the social sciences in general, and in political economy and in economics more particularly. As a consequence, the problem posed here cannot, in our view, be dealt with by a series of neatly defined piecemeal studies since this would only aggravate the current confusion in economic theory. A global approach therefore seems indispensable because, in a Keynesian vein, 'society and thinking about society make up an immensely complex organic whole'. Some preliminary explanations with respect to content and method are thus required. From these a more detailed plan of the study will broadly emerge. The study's limitations, mainly its tentative and preparatory character, will also become apparent. In fact, the present contribution merely intends to explore the subject matter in order to point to the direction to move in. This exploration necessarily comprises a historical dimension since the present theories rest on the basic ideas of the great authors of the past.

In this book we conceive of classical-Keynesian political economy as a synthesis of Ricardo and Keynes. This simplifying definition poses two problems. The first is about the relationship between Adam Smith and David Ricardo and is associated with the meaning of 'economics' and of 'political economy' respectively; this problem will be discussed in chapter 3 (pp. 75–89). The second issue concerns Keynes and Ricardo whose theoretical systems are, at first sight, sharply opposed. For example, Keynes mentions that the neglect of 'the aggregate demand function is fundamental to the Ricardian economics' (1973a, p. 32) and conceives his *General Theory* as an attempt to repair this defect of the Ricardian system. Or, the neo-Ricardian equilibrium system pictured in Sraffa (1960) stands in sharp contrast to the *General Theory* where uncertainty about the future figures prominently. Some issues related to Keynes and Ricardo are discussed in chapter 3 and a possible synthesis is suggested in chapter 4. There it emerges that classical and Keynesian theories are complementary rather than mutually exclusive: classical political economy deals with objective and historically grown structural factors – the institutional and technological system – while Keynesian theory focuses on the behaviour of individuals and their co-ordination by the socioeconomic system within given structures. The former deals with normal magnitudes (prices, profit rates and employment levels) associated with stock equilibria and determined by the functioning of the socioeconomic system; the objects of the latter are actually realized magnitudes resulting from the decisions taken by individuals in the past and in the present on the basis of expectations about the future.

The fundamental importance of Ricardo's system and its modern neo-Ricardian elaboration by Sraffa (1960) and Pasinetti (1977, 1981, 1993), on the one hand, and of Keynes's theory and its development, on the other, gives rise to a definitional question. Why not simply call modern political economy either *neo-Ricardian* or *post Keynesian* rather than *classical* or *classical-Keynesian?* The main reason is that the neo-Ricardian theory of value and distribution as developed by Sraffa and his followers has been widely used for critical (negative) purposes. It should be remembered that Sraffa's (1960) book carries the subtitle 'Prelude to a critique of economic theory'. Subsequently, the ideas set forth there have indeed become the conceptual starting point for a fundamental critique of neoclassical equilibrium economics in the course of the capital theory debate. The theoretical discussions on fundamentals have, since the late sixties, turned into a bitter ideological struggle, the significance of which can be understood best by recalling that the subtitle of Marx's *Kapital*, i.e. *Kritik der politischen Ökonomie*, strongly resembles the subtitle of Sraffa's (1960) work. Subsequently, Ricardo and neo-Ricardianism were associated with Marx and Marxism. The sinister atmosphere of the Cold War led to further associations. Marx's work was largely equated with Soviet communism or even with Stalinism. Associations like these are clearly due to sheer ignorance or to fundamental misunderstandings but are, consciously or unconsciously, present in the mind of many social scientists. Therefore, even in the context of generalized *détente*, some care is still required when speaking of Ricardo. Similarly, post Keynesianism was, and still is, associated with criticism and, as suggested in the previous section, does not form a comprehensive and consistent theoretical system.

In the subsequent chapters of this book it will become evident why modern political economy should be termed *classical* or *classical-Keynesian*. Classical political economy in the Ricardian sense implies a vision of society that is entirely different from the conventional liberal vision which is ultimately based upon Adam Smith's system (chapters 2 and 3). In the former the question of proportions, i.e. part–whole relations, is fundamental, and this implies that society is primary and is more than the sum of its parts. This is not the case for the latter where the individual stands in the forefront and society is derived from individual behaviour.

However, the term 'classical' must be complemented by the attribute 'Keynesian', either implicitly or explicitly. Consequently we shall use the notions 'classical' and 'classical-Keynesian' interchangeably in the following, but with a preference for the latter. The point is that classical political economy is intimately associated with Say's law; in fact, Thomas Malthus was not able to convince the political economists of his time that effective demand might limit the accumulation of capital. Consequently, Ricardo and his modern followers have, starting from the circular process of production, worked out a long-period theory of value and distribution (Ricardo 1951 [1821]; Sraffa 1960; Pasinetti 1977, 1981). This means dealing with proportions, *given* the scale of economic activity. Yet, to work out a long-period theory of employment and output along Keynesian lines,

i.e. a theory of the scale of economic activity, is indispensable in establishing a synthesis of classical and Keynesian elements of analysis. Such a theory is, in fact, required to replace the classical and neoclassical long-period full employment theories based on different versions of Say's law. A combination of the classical approach to value and distribution and Keynesian employment theory based on the principle of effective demand will then emerge. Given the overwhelming importance of this principle, which allows one to catch the influence of the *whole* socioeconomic and political system on the scale of economic activity (chapter 4, pp. 142–204), the attribute *Keynesian* to complement the term *classical* is fully justified to denote non-orthodox efforts made to explain what is going on in the real world.

This point is reinforced by the fact that Keynes was not just a conventional economist, but a social scientist in the broader sense of the word who sought to establish a middle-way alternative to both *laissez-faire* and central planning (see Fitzgibbons 1988, pp. 1–2). Keynes's work is based on a clear-cut social and political philosophy and on a fundamental theory of knowledge (Keynes 1971c). The latter adapts traditional metaphysical thinking, based on deductive logic associated with certainty, to modern scientific requirements, taking due account of the tentative and imperfect nature of human intellectual activities. These essential points have been extensively argued by Fitzgibbons (1988) and O'Donnell (1989). Keynes's all-embracing vision of things constitutes a crucial element in laying the foundations for a comprehensive classical-Keynesian system (chapters 2 and 7).

The principal aim of this study is precisely to suggest that classical-Keynesian political economy may be considered the economic theory of the *third-way* alternative to both liberalism and socialism. This requires a wider view of the social sciences that would allow for a search for principles which, on the one hand, could serve as a basis to enhance the coherence within the classical-Keynesian system and, on the other, could establish the position of this system as the political economy of the *middle way*. To prepare the ground, a few fundamentals are examined in the next two chapters. Some basic issues in the social sciences are discussed in chapter 2. Starting from a specific definition of the 'social' and from the concept of 'institution', observations are made on the relationship between social philosophies and the social sciences, on ethics and economics and on determinism and causality. Subsequently, some issues of knowledge about social affairs are sketched. Fundamentals related specifically to classical-Keynesian political economy are set forth in chapter 3 which begins with some definitional issues and continues with a sketch of the classical-Keynesian vision of society and the role institutions play therein.

Institutions are particularly important with the old classicals. Therefore, in the subsequent section, the theoretical heritage of classical, and physiocratic, political economy is briefly examined; there it is suggested that the classical system of thought needs to be complemented by Keynesian economic theory. The final two sections of this chapter are methodological. The former outlines a very general framework to broadly systematize theoretical work; the latter provides some hints as to how a classical-Keynesian synthesis might supply a framework to help organize historical investigations. This important methodological point will be taken up at several places, e.g. in chapter 4 (pp. 241–51).

Subsequently, an attempt is made to clear the way to develop a classical-Keynesian synthesis (chapter 4). Since a large body of classical-Keynesian theories already exists, the emphasis is laid on filling gaps and on suggesting how existing pieces of classical and Keynesian theory might be combined. The latter are not presented explicitly. Only comments will be made and implications brought out.

The most obvious gap is the lack of a comprehensive long-period theory of employment, and this is sketched in the third section of chapter 4. Starting from the basis laid by Pasinetti (1981) it will become evident that, presumably, no major difficulties exist in combining long-period theories of employment and output along Keynesian lines with neo-Ricardian views on value and distribution. This long-period (neo-Ricardian and Keynesian) basis may be combined with Robinsonian or Kaleckian cycle-cum-growth theory. Finally, some suggestions are given as to how uncertainty and money might be integrated into a classical framework.

Chapter 5 deals with some fundamental differences between classical-Keynesian political economy and neoclassical economics. Initially a few divergences with respect to content and method are discussed. Later, some implications hidden behind the premises underlying the two approaches are examined, and the crucial importance of the capital theory debate for discriminating between the classical-Keynesian and the neoclassical approaches on the theoretical level is set forth.

The final chapters, 6 and 7, attempt to uncover the practical relevance and the deeper social and philosophical meaning of classical-Keynesian political economy.

On the methodological level the present study represents an extension and application of Ricardo's *essentialist method* (Pribram 1986, p. 597) put to use in his *Principles of Political Economy and Taxation*. Observable reality, i.e. empirical facts, appearances or phenomena, merely provide the starting point to consider *principles* in various domains of the social sciences, mainly political economy and economics, and, if necessary, in social philosophy, politics, law and sociology. To deal with principles means

looking for essentials and enables the theorist to set up and to combine simple causal models, for example Keynesian multiplier models and production models of the Sraffa–Pasinetti type.

Principles and the associated essentials are perfectly general and hold at all times and places. For example, Keynes's multiplier principle – a short-period specification of the principle of effective demand – aims to explain the determination of the short-period level of employment in general, not for some specific country or region. The 'general' is the domain of pure theory. If the level of abstraction were lowered to consider particular cases, clarity would be lost and exposition would become exceedingly complex because specific applied models which reflect the different institutional set-ups prevailing in various countries and regions would have to be developed. This is the task of practical and specialized social scientists who are familiar with particular situations, not of the theoretical economist. Hence to identify fundamentals and to discuss principles allows us to keep the size of the present study manageable.

In the social sciences, perhaps even more than in the natural sciences, the complexity of the object of inquiry, i.e. society, requires dealing with principles. Society is an interrelated whole which, as will be suggested, is something more than the sum of its elements. Individuals act within social structures, i.e. systems of (complementary) institutions, having laws of their own whereby actions and structures mutually influence each other. Aspects of the social structure and of the behaviour of individuals may be analysed separately, but links between these different aspects of reality have to be established continuously in the light of the broad functioning of society as a whole, whereby account has to be taken of how the latter is perceived. Moreover, since each historical situation is unique, analysis and synthesis on the theoretical level have to be complemented by an understanding of unique socioeconomic phenomena if specific historical investigations are undertaken. Given the complexity of the object, the premises underlying social theories cannot be found empirically. These are derived from the vision held by the theorist; however, empirical facts, i.e. real world phenomena, initiate, as a rule, systematic reasoning.

The highly complex subject matter considered, combined with the fact that the study of principles is primary, has various implications. First, it will be seen in chapter 4 that classical-Keynesian political economy cannot consist of a single all-purpose basic model – such as the general equilibrium model – to be put to use mechanically to explain *all* economic events on the basis of a single principle, e.g. supply and demand. Purely theoretical and fundamental models (e.g. Pasinetti 1981), which picture *essential* features of some sphere of reality, are merely *part* of a comprehensive classical-Keynesian framework, which consists of pure *and* applied theory; the structure of Keynes's *Treatise on Money* provides a good example of this classification: volume I is denoted 'The pure theory of money', volume II 'The applied theory of money'. The body of pure theory is perhaps best seen as a combination of a set of causal models, each of which is designed to explain on a fundamental or essential level – that is, in principle – some important socioeconomic phenomenon, for example value, distribution or employment (chapter 3, pp. 103–18, and chapter 4, pp. 142–204). Since social phenomena are organically interrelated, classical-Keynesian economics will have to be, essentially, political economy and must, as such, be closely linked to other social sciences (sociology, politics, law, history). To ensure coherence between the various social sciences these must be based on a vision of man and society, which, in turn, requires a social philosophy (chapter 2).

If classical-Keynesian theory were not put into a wider philosophical framework, there would be the danger of its becoming an auxiliary theory to be used to repair certain defects of liberal or, eventually, socialist economics; for example, Keynesian economics was absorbed by Samuelson's neoclassical synthesis. The reason is that the rival approaches, neoclassical economics and the economic theory of socialism, are themselves based on social philosophies, i.e. liberalism and socialism; this partly accounts for the powerful impact on policy-making of neoclassical economics and of the economic theory of socialism. Hence the social philosophy underlying classical-Keynesian political economy and the way in which it is linked with other social sciences must be sketched broadly if the attempt to establish an alternative to neoclassical and to socialist economic theory is ultimately to succeed (chapters 2, 3, 5 and 7).

Second, given the great number of problems arising, it is inevitable that most of them can only be outlined. For example, at various points, suggestions are made on how to integrate uncertainty into the classical-Keynesian framework (specifically in chapter 3, pp. 103–18, and chapter 4, pp. 220–9). The precise way in which this is to be done on the basis of existing work (by Keynes, Davidson, Minsky and Shackle, for instance) is left to the specialized reader. Thus, whenever issues are simply raised, presentation is necessarily very sketchy, leaving to the reader the task of completing the picture. However, when it seemed clear that gaps had to be filled, a more specific and textbook-like way of presentation was adopted. This especially holds for chapter 4 (pp. 142–204) where a long-period theory of output and employment determination is outlined.

Third, the complexity of the object of investigation renders some repetitions unavoidable in spite of the fact that the analysis is confined to a few fundamentals only. The same point has to be taken up in different contexts, which, it is hoped, will make reading easier. However, since the vision of

society underlying the present study is not mechanical and individualistic, but organic and social in an essential way, the reader must not expect a linear and logically impeccable presentation of the main issues, i.e. an exposition starting from given premises. Rather, the following analysis is circular in the sense that an attempt is made to grasp the main problems by looking at the object – economy and society – from different points of view, while always having an eye on the functioning of society as a whole; given this, there are no realistic premises to start with. This implies that the study is a composition which should be seen as an integrated whole; it would thus not be legitimate to consider sentences and passages in isolation. Moreover, many passages, taken for themselves, may be only partly true or even wrong, although the argument as a whole may be broadly sound. Given all this, 'much goodwill . . . and a large measure of co-operation [will be required from the reader]. [For it is] of the essential nature of economic exposition that it gives, not a complete statement, which, even if it were possible, would be prolix and complicated to the point of obscurity but a sample statement, so to speak, out of all the things which could be said, intended to suggest to the reader the whole bundle of associated ideas' (Keynes 1973b, p. 470).

Fourth, since in this study we deal exclusively with general and abstract principles and pure theories derived therefrom, presentation is bound to be rigid and mechanistic and a dogmatic flavour may be attached to it. This is not to enounce 'absolute truths', however. The subsequent propositions are meant to be tentative and probable in the sense of Keynes's theory of knowledge which will be sketched in chapter 2 (pp. 57–64). Hence the following is not about real world phenomena, but about the principles that might govern these. Statements about the former are merely used to illustrate the latter.

Finally, no attempt has been made to integrate systematically the very extensive secondary and tertiary literature. This would have obscured the argument and swelled the book to encyclopaedic proportions. A few basic works form, then, the background of subsequent argument: Quesnay's *Tableau économique*, Adam Smith's *Wealth of Nations*, Ricardo's *Principles* and Marx's *Kapital*, Marshall's *Principles*, Walras's *Elements* and Keynes's *General Theory*, complemented by modern presentations and variations of classical and Keynesian theories, for example Sraffa (1960), Pasinetti (1977, 1981, 1993), Robinson (1962a, 1965), some of Kaldor's articles on growth, distribution and economic development, and Kalecki (1971). It is hoped that this way of proceeding will facilitate reading, though it must be admitted that many issues dealt with below have been treated more fully, and hence in a more satisfactory way, somewhere else in the secondary literature.

In some instances, we have even refrained from taking account of primary literature and presented very sketchy personal views only. This particularly holds true of chapters 2, 3 and 7 where some fundamental concepts and issues in the social sciences are discussed; for example, the concept of *institution* which enables us to establish links between political economy and other social sciences (sociology, political sciences, law), and *social philosophies* which underlie the various approaches in economics and in other social sciences thus providing a unifying framework for all the social sciences. To discuss systematically the immense amount of literature available on institutions and social philosophies would, on the one hand, exceed by far the capacities of a single author; on the other hand, any attempt to discuss at length some fundamental work of sociology or social philosophy would have been arbitrary and would have diverted too much from the main line of argument. However, the chapters on fundamentals could not have been written without the continuous support provided by Johannes Hirschberger's great history of philosophy (Hirschberger 1984, 1988).

In the present work, the social sciences – politics, law, political economy and sociology – are considered a unity. Each social science deals with a specific aspect of the socioeconomic system; however, the various domains complement each other to make up an entity. This study is, therefore, addressed to all social scientists, including social philosophers and historians. To be sure, there is a considerable danger that specialized social scientists may be disappointed by the following. However, on deeper reflection, specialists should be aware that the significance of their work is greatly enhanced if put into a larger context. Consequently, the present study is essentially constructive. An attempt is made to set up a comprehensive framework that should enable us to broadly classify and to mutually recognize work done in the social sciences. It is our conviction that each serious and well-intentioned theoretical or empirical piece of work is useful and thereby contributes to the increase of knowledge on social matters in the broadest sense.

Nevertheless, in what follows, some critical remarks on neoclassical economics will be made, mainly in chapter 5. To avoid misunderstandings, however, it should be mentioned that the term *neoclassical economics* is used here in the sense of *equilibrium economics* of the Walras–Arrow–Debreu type and the Marshallian textbook simplifications derived therefrom. What will be criticized is *not* the description and analysis of equilibrium situations, but the fact that the question of tendencies towards possible equilibria has been unduly neglected by equilibrium economists. Consequently, equilibrium economics appears to a classical-Keynesian political economist as essentially normative or, eventually, hypothetical: equilibria picture states of the world which are desirable in certain respects because they imply allocative efficiency and, most importantly, full employment. It is very likely that Walras also conceived of the competitive equilibrium as a normative guiding star (see Jaffé 1983b). The concepts used in equilibrium models provide the glasses through which reality is examined. Marshall in particular identified the law of supply and demand as the fundamental principle regulating economic life. Subsequently, neoclassical economists interpret reality in terms of deviations from these ideal (or hypothetical) states of the world, whereby various obstructions may prevent economies from getting into equilibrium, such as rigid money wages, monopolies, and excessive state and trade union activity.

In many instances, however, neoclassical economists, when trying to explain reality in terms of deviations from equilibrium, became involved in explaining reality to such an extent as to forget about the equilibrium model which had served as a starting point. Schumpeter is an important example. His *History of Economic Analysis* focuses on the Walrasian equilibrium system. In large passages of *Capitalism, Socialism and Democracy*, however, Schumpeter gives, among other topics, a brilliant account of capitalist reality which is thoroughly classical-Keynesian in spirit and is, as such, completely independent of equilibrium economics. This dichotomy between pure normative theory and theoretical attempts to explain reality also appears in the work of other neoclassical, or originally neoclassical, authors, Marshall, Wicksell and Keynes being perhaps the most prominent figures in point. Even Walras felt the need to go beyond pure normative theory and to deal with the real world. Some of his writings in this field are gathered in *Etudes d'économie appliquée (Théorie de la production de la richesse sociale)* and in *Etudes d'économie sociale (Théorie de la répartition de la richesse sociale)*. In Jaffé (1983a, pp. 36–52) and Walker (1987) some surprising statements on Walras as an 'applied social scientist' can be found. For example, he proposed that taxes be abolished, and land be nationalized 'and rented by the state to private users, providing it with revenue . . . Arguing that his advocation of nationalization of land and natural monopolies was based upon a scientific analysis, Walras called himself a "scientific socialist"[!]' (Walker 1987, p. 860).

The case of Keynes is particularly interesting. On the one hand, regarding the long run, he remained a neoclassical equilibrium economist: he accepted the first neoclassical postulate (the real wage equals the marginal product of labour) and used the concept of the marginal efficiency of capital. But Keynes considered long-period equilibria as irrelevant. What is the point of discussing such equilibria if, starting from a heavy disequilibrium situation, it takes twenty, thirty or even fifty years to reach a long-period equilibrium even when the given situation works out without being disturbed – which is never the case anyway? Keynes's answer is well known: since 'in the long run we are all dead', let us concentrate upon the short run where the action takes place. This pragmatic way of looking at things led Keynes to analyse real world problems, e.g. involuntary unemployment. In the process of working out a short-period theory of employment he rediscovered the old principle of *effective demand*, implicitly held by some mercantilists, and formulated it in a theoretically satisfactory way (see especially chapter 23 of the *General Theory*). In doing so Keynes provided one cornerstone of middle-way economic theory – the other was provided by Piero Sraffa who initiated the definitive revival of classical (Ricardian) economics.

Incidentally, Keynes was clearly aware of the double nature of neoclassical economics, i.e. 'normative equilibrium economics' and 'analysis of reality':

So long as economists are concerned with what is called the [neoclassical!] theory of value, they have been accustomed to teach that prices are governed by the conditions of supply and demand; and, in particular, changes in marginal costs and the elasticity of short-period supply have played a prominent part. But when they pass in volume II, or more often in a separate treatise, to the theory of money and prices, we hear no more of these homely but intelligible concepts and move into a world where prices are governed by the quantity of money, by its income-velocity . . . by hoarding, by forced saving, by inflation and deflation *et hoc genus omne* . . . We have all of us become used to finding ourselves sometimes on the one side of the moon and sometimes on the other, without knowing what route or journey connects them, related, apparently, after the fashion of our waking or dreaming lives (Keynes 1973a, p. 292).

It seems evident that the understanding of real world phenomena has been furthered by using the framework of monetary theory, i.e. 'volume II-type work'. Again, Keynes is the best example one can find. Starting from *The Economic Consequences of the Peace* and *A Tract on Monetary Reform*, passing through the *Treatise on Money*, he ended up with the *General Theory*. Many neoclassical economists (Marshall, Wicksell and others), in doing 'volume II-type work', paved the way for Keynes's performance. As such, this type of neoclassical writing has been preparatory to classical-Keynesian theory, too, and is obviously not the target of the critical remarks on neoclassical theory to be found in the following lines. Whenever neoclassical economics is criticized below, we have in mind neoclassical equilibrium theory linked with claims that, in the real world, there should be an inherent tendency towards a state of full-employment equilibrium if markets were functioning satisfactorily.

In criticizing neoclassical equilibrium theory, we do not mean that Walrasian and Marshallian equilibrium economics and its developments are wrong or even useless. Neoclassical equilibrium economics is a great system which had to be worked out in order to clarify the basic issues associated with the economic theory of liberalism. Walrasian economics deals with a very important question: can a social optimum implying full employment, i.e. allocative efficiency, be derived from actions based upon the pursuit of individual aims, that is utility and profit maximization, if the institutional set-up allows for a sufficient degree of competition? This question can be put in other ways. For example, Adam Smith dealt with the implications of the invisible hand. Or, Max Weber and Carl Menger attempted to find out whether methodological individualism could provide a conceptual basis for the social sciences.

This question is of crucial importance and answers had to be attempted, almost of historical necessity. To this end, neoclassical economists of the Walrasian strand worked out equilibrium systems, the logical beauty of which was widely admired. Quite soon, however, it became evident that the possible existence of an equilibrium or of a set of equilibria was one thing, but the tendency towards an equilibrium was another. The terrain became very slippery once disequilibrium situations were faced and dynamic processes investigated. This implies that the Marshallian textbook simplifications aimed at analysing real world problems with the help of 'partial equilibrium models' stand on shaky foundations, especially if macroeconomic problems, like the determination of the scale of output and employment or the distribution of national income are tackled.

All this does not mean that no more work ought to be done in equilibrium economics, but simply that other approaches, like classical-Keynesian-cum-Marxian political economy for example, should get more attention and thus a fairer treatment. What is criticized here is the 'excessive generalization of the principle of exchange' linked up with an equally excessive formalization and mathematization. It is certainly justified to formalize aspects of reality in order to clarify concepts and to delimit the scope for generalization. However, we should not lose sight of the link between a selected aspect of social life and society as a whole. Specifically, the influence of institutions on the outcome of economic and social events should again be given increased attention by economists. It is not sufficient to study only the actions of individuals in the market-place and to take the social structures within which individuals act as given, nor to consider problems of social structure as being the concern of the politician, the sociologist, the lawyer and the historian.

To avoid misunderstandings it ought to be mentioned that, when considering institutions, we do not primarily adopt here the point of view of modern 'institutional economics', or 'new institutionalism', which, in fact, represents the pragmatic application of simplified neoclassical economics to economic, social and political institutions (see, for example, Pies 1993, who deals with the work of Max Weber, Hayek, Becker, Buchanan, Olson and Williamson). While this approach is very useful in explaining the coming into being, the functioning and the desirability of single institutions, it cannot deal with the institutional set-up, i.e. society as a whole, which is something more than the sum of all institutions. In the present book, specifically in chapters 2 and 3, we shall mainly be concerned with the functioning of the social system which is broadly in line with 'old-fashioned' institutionalism. This implies considering single institutions as parts of the entire institutional system.

A broad definition of classical-Keynesian political economy can now be provided, although this definition will be discussed more fully in the next chapter. Negatively, all economists who are neither neoclassical equilibrium economists nor adherents to the economic theory of centrally planned socialism may be considered classical-Keynesians. Positively, this holds for all political economists who, when attempting to explain aspects of socioeconomic reality, recognize explicitly or implicitly the following three principles: first, long-period normal prices are set by adding a mark-up on primary or variable costs at normal capacity utilization so as to cover fixed costs and to achieve some target rate of profit. There may be variations of this general rule: for example, the mark-up may be on total costs at normal capacity utilization. In the short- and medium-term market prices may vary with demand conditions; or, if technical full-capacity utilization is approached prices may increase with 'marginal costs'. Second, functional income distribution is, in the long run, not regulated on factor markets but is governed by institutions, e.g. trade unions, entrepreneurial associations and the state, which may intervene to fix wage minima: distribution is a social, not an economic problem. In the medium and short terms, profits are determined according to the Kaldorian mechanism, i.e. by investment activity. Again, in the short run, market wage rates and realized profits may deviate from their respective long-period normal levels. Third, output and employment are, in a monetary production economy, governed by effective demand. The supply of resources governs economic activity in full-employment situations only when, or if, on account of structural imbalances, bottlenecks occur.

Two broad groups of classical-Keynesian economists may be distinguished. First, there are the empirically and historically minded political economists who primarily describe historical developments and the functioning of institutions in the tradition of the German Historical School and of American Institutionalism. Within this pragmatic strand, theory is pushed into the background which means that the above principles are assumed implicitly. A second group of classical-Keynesian political economists is theoretically minded. Their precursors are Quesnay, Ricardo, Marx, Keynes and Kalecki. This group includes Joan Robinson, Geoffrey Harcourt, Nicholas Kaldor, Luigi Pasinetti and Piero Sraffa and their followers. This book is devoted to both groups, although the theoretical strand is emphasized.