

## *The General Theory: a neglected work?!*

*The General Theory* (Keynes, 1936, hereafter *G.T.*) a neglected work? Am I joking? Few books have been subject to so much review, criticism and interpretation. Yet I suggest that its impact on modern economic theory, both neoClassical and Post Keynesian, has in fact been minimal. This theoretical neglect has also limited Keynes's impact on policy, other than as a poster boy for a traditional policy of public works which predated *The General Theory*. My aim in this lecture is to try and justify these claims.

When I am not in Cambridge, I live just outside the border of an empire, appropriately enough for a Post Keynesian economist. My home is just north of Hadrian's Wall, the northern border of the Roman Empire. In a similar way, the wall surrounding the citadel of neoClassical economics is its methodology. Attempts to engage or challenge neoClassical economics by outsiders with different methodologies, have been ignored or repelled. Conversely, when the imperial citizens have sought to colonise their neighbours, they have, despite their military discipline, met fierce resistance from the unruly painted tribes. Some of whom I see represented here in Roskilde today ... in this place that, fittingly, was never conquered by the Romans.

*The General Theory* is the only gateway we know, between the neoClassical citadel and the rest of Political Economy, although the gateway has remained locked for many years and its bolts and hinges are rusty. Keynes claimed that it was a major step forward in the development of the theory of competitive equilibrium, or supply and demand, that ought to have transformed that tradition and increased its scientific value. For many historical reasons, *The General Theory* was not received as a platform for development, but as a revolution that has fractured the study of

economics for three generations. The wholesale rejection of ‘supply and demand theory’ by many of Keynes’s followers was, I think, premature, and the subsequent counter-reformation has merely reinstated an intellectually more powerful version of the *status quo ante* Keynes.

The implications of *The General Theory* for neoClassical theory are indeed fairly devastating. One can understand why the immediate followers of Keynes sought to rebuild economic theory on entirely different foundations. One can also understand the refusal of neoClassical scholars to accept that the previous century of formalisation of economic thinking since Ricardo had been fundamentally misguided. In the ensuing cacophony, Keynes’s own voice has been drowned out.

There is, on the one hand, a great deal more common ground between the formal methods of Keynes and the modern Classics than is generally allowed. That is the main area I wish to address today. Nevertheless, *The General Theory* demonstrates that neoClassical theory depends upon the special assumption of a constant and reliable state of expectation. Therefore the re-unification of Political Economy requires movement on both sides. NeoClassicals would need to accept, for example, that competitive equilibrium theory has no place in the theory of growth over time. Post Keynesians and other heterodox economists would need to accept that equilibrium theory remains useful as a theory of value at a point in time, the present. This is still very much unfinished business, despite the passage of 75 years.

When I say that *The General Theory* has had minimal impact on modern theory, I cannot avoid the need to state what I think *The General Theory* is. The neglect stems from the fact that each school thinks it has Keynes taped. It is well known that neither the neoclassical Keynesian synthesis nor Post Keynesian economics, let alone the current New Keynesian consensus, are the economics of Keynes. Each school has

taken from Keynes what they think is important and left the rest. It is my contention that we are much the poorer for that. There is still much to be gained from reading *The General Theory* and using it as a starting point for research.

I have boiled down my own understanding of *The General Theory* to five propositions (see Table 1) that have helped me to make sense of Keynes, and I hope will help you. This is, of course, yet another interpretation and a contentious one at that, which is set out in full in my book *The Economics of Keynes* (Hayes, 2006). Yet the history of science tells us that it can take several generations for truly original thinkers like Keynes to be fully understood. For my part, I do not think we are finished with *The General Theory*.

My five propositions relate to key concepts in economic theory. They relate to matters on which Keynes was either silent or cryptic, I think because of an implicit framework that he inherited from Alfred Marshall and believed would be shared by his readers. This belief turned out to be, for the most part, quite wrong.

[Table 1 here]

### *Equilibrium*

There are at least four ways of defining equilibrium and a clash between them produces terminal confusion. Keynes is a Marshallian, he believes in equilibrium analysis but he uses it in a highly original and quite unique fashion. For the most part, *The General Theory* is good old mechanical comparative statics, with some dynamics between different static equilibria, for reasons that will become clear.

Accordingly, the first important, almost certainly contentious, idea to establish is that the key variables in *The General Theory* are continuous equilibrium values. Income, effective demand and employment are in continuous equilibrium.

This may be because Keynes recognises that equilibrium must be observable if equilibrium analysis is to be of any scientific value. Curiously he shares this conviction with Lucas, of all people, although their notions of equilibrium are quite different. Yet how can the system be in continuous equilibrium, in a theory which contains disequilibrium dynamics and, of course, unemployment?

Here it is Keynes's treatment of time that is crucial. He takes up Marshall's distinction between the market, short and long periods and resolves how these should relate to calendar time. Recall that in Marshall, market period equilibrium is based on stocks of finished goods on hand; short period equilibrium allows for employment and production to change, given the aggregate capital stock; and long period equilibrium allows for the adjustment of the aggregate capital stock by the production of new capital-goods, i.e. investment. In both Marshall and Keynes market prices are the only prices that are actually observable. The short-period and long-period prices are expectations in the minds of entrepreneurs.

Now Marshall linked the market period to a calendar day, the short period to a calendar period of months and the long period to a calendar period of years. Yet both the short and the long period are for him of indefinite length, merely logical constructions showing the way things are heading. Marshall is quite realistic that we may never reach a given short or long period equilibrium; expectations may be disappointed on the way. Yet he retains a faith in the full employment stationary state as the long-term anchor of the dynamic adjustment.

Keynes introduces greater rigour into Marshall's approach. First of all, think of the terms market-period, short-period and long-period as adjectives, not substantives. Thus, each term refers to a type of equilibrium adjustment. The market period relates mainly to the clearing of goods markets, and income. The short period relates to the employment of labour and the other existing factors of production, and effective demand. The long period relates to the production of new capital goods, and the capital stock. It is a subtle point, but we need to distinguish the nature of the adjustment to equilibrium from the interval of time in which the adjustment takes place. We also need to distinguish the nature of the adjustment from the time horizon of the expectations which prompt the adjustment.

In *The General Theory*, the production and employment decision involves two separate units of calendar time, which Keynes defines as the *day* and the *period of production*, which is a number of *days*. The day is Keynes's quantum unit of time, 'the shortest interval after which the firm is free to revise its decision as to how much employment to offer' (*G.T.* p. 47, footnote 1). It does no harm to think of this as a calendar day. The *period of production* is the macroeconomic counterpart of the period between starting and finishing an individual production process, or *production period*.

In terms of equilibrium, the day has two aspects, the market-period and the short-period aspects. Each day, equilibrium market prices are struck for the finished goods delivered, thus determining current income. Also each day, equilibrium expected prices are struck for the production in which today's labour is employed. The principle of effective demand is itself a theory of the formation of expected prices as equilibrium values. The prices are necessarily expected prices because today's output of various products will not be finished until the end of their various production periods. These expected prices correspond to the effective demand, meaning the income expected to result from today's employment. Employment is adjusted in accordance with the expected prices, so that effective demand determines employment. Current income and effective demand are not the same thing, yet both income and employment are separately in equilibrium each day, which for all practical purposes means, continuously.

In a further departure from Marshall, Keynes defines the long period in a unique and strictly *short-term* technical sense, to mean the equilibrium on which employment will in theory converge, if a new state of expectation persists for the full length of the period of production. Note that this long period is *not* the same as the long term.

Finally, how can we have an equilibrium with unemployment? In what I will now follow Keynes in calling the Classical sense, unemployment is always a sign of *disequilibrium*. This is because the Classical notion of general equilibrium is a state in which all parties make their preferred choices, meaning that factor markets clear.

Classical authors (old and new) see disequilibrium in terms of shocks to a long-period equilibrium based on preferences, technology and endowment. In *The General Theory*, the level of employment at any time reflects a position of short-period equilibrium conditional upon, not only that standard Classical list of parameters, but

also upon the state of psychological response of consumers and owners of wealth to an unknown future. In Keynes's equilibrium analysis, these psychological factors are as exogenous as the Classical parameters. Furthermore, they are independent *variables*, liable to discontinuous, short-term variation. This is a kind of variation not shared, or fully determined, by the Classical parameters. Therefore Keynes's system is not 'closed' like the Classical system, in which the level of employment is fully determined by the parameters. Keynes's system is 'open' in the sense that the key independent variables are not endogenous, that is, not part of the equilibrium theory. Nevertheless, *The General Theory* remains a theory of the level of employment as an equilibrium value. Disequilibrium exists only in the sense that a short-period equilibrium position converges to a long-period equilibrium.

Keynes has a notion of general equilibrium, of the equilibrium of industry as a whole as he puts it, which differs from the Classical. For Keynes, it is possible for the system as a whole to be in a state of competitive equilibrium even though not everyone is in their preferred position. Entrepreneurs may have no reason to change their employment decisions and labour has no power to make them do so. To avoid confusion, I use the term 'system equilibrium' to cover the still more general case. System equilibrium encompasses both Classical full-employment general equilibrium and Keynes's equilibrium of 'industry as a whole', with or without full employment.

### *Competition*

There can be little doubt that Marshall saw competition as a force similar to natural selection and gravity. In mechanical statics, the problem is always related to being *in* equilibrium. Marshall uses the analogy of a basin, containing a number of balls, which is tilted. The balls move smoothly and instantaneously to a new position of equilibrium, without an intervening position of *dis*-equilibrium. In a similar way,

Marshall's and Keynes's product prices are always equilibrium prices. Any tendency to diverge from market-period equilibrium is prevented by the countervailing forces of competition, and a change in the conditions of supply or demand leads not to disequilibrium, but to a change in the equilibrium price. Competition in supply and demand is the force that holds the system continuously in equilibrium.

This is easier to see with market prices than with the expected prices of effective demand. Yet the same approach applies: competition holds employment in equilibrium, each day we move instantaneously to a new equilibrium position.

Clearly what I am describing is a state of perfect competition with instantaneous price adjustment and clearing goods markets, though not, please note, clearing factor markets. What about fixed/sticky prices, nominal and real rigidities preventing adjustment? They are not there, or at least, they are not part of the main story. Much confusion has been caused by reading imperfect competition into *The General Theory*, partly through a misreading of a single phrase, the degree of competition.

What Keynes calls 'the degree of competition' (*G.T.* p. 245) refers to the conditions of supply rather than to the slope of the demand curve faced by an individual firm. Joan Robinson wrote that 'Keynes did not accept the "perfect competition" of the textbooks, but some vague old-fashioned notion of competition that he never formulated explicitly' (Sawyer, 1992, p. 107). Taking her slightly barbed words with a due pinch of salt, Keynes's degree of competition refers to competition among entrepreneurs and workers. It is a matter of the obstacles to the free movement of resources into and between industries and occupations. These obstacles are associated with what Keynes calls 'closed shops' (Keynes, 1973, p. 639, footnote 1) of either employers or workers, together with the other social and institutional resistances connected with



voluntary unemployment. So here are the real rigidities so dear to New Keynesians, but they have nothing to do with Keynes's central argument.

The degree of competition and the degree of monopoly are not the same thing. *Pace* Davidson and Kregel, *The General Theory* is not compatible with monopolistic competition. *The General Theory* necessarily assumes that the degree of monopoly is zero, so that individuals take prices as given and independent of their own actions. In other words, you must approach *The General Theory* as written on the assumption of perfect competition in the modern sense. Prices are fully flexible, in the short run as well as the long: we will address why factor prices tend to be stable in a moment.

The assumption of perfect competition explains a number of important aspects of *The General Theory*, including its abstraction from financial and industrial structure and the distribution of income. Nowhere is Keynes's method more clear than in his treatment of capital-goods as if they were individually traded on the stock exchange. All finished goods, whether capital or consumption, new or second-hand, have equilibrium market prices that can be realised at any time. Here again I disagree with Paul Davidson. The assumption of perfect competition therefore has implications for the meaning of liquidity in *The General Theory*, and I will return to this later.

In Marshall's theory, it is competition that holds market prices in equilibrium and then drives this temporary equilibrium, as he calls it, towards the short-period and long-period equilibrium positions over time. In respect of competition, Keynes's theory is no different, even though his definitions of the short and long period equilibrium positions are quite different, as we have seen. The microfoundations of *The General Theory* are laid squarely upon those of Marshall, and it was not on the question of competition that Keynes differentiated himself from the Classical school.

## *Money*

If *The General Theory* is a theory of continuous equilibrium under perfect competition, how and why does it differ from Classical theory? If what I have said is true, should we not always be in the Classical long run, where only relative prices matter in the allocation of resources, and money is neutral in real terms? Why does *The General Theory* not lead to the same 'Classical dichotomy', if it shares with Classical theory the concept of competitive equilibrium?

Well, as we have already noted, Keynes's system equilibrium is different from the Classical general equilibrium. In Keynes's equilibrium, entrepreneurs are centre-stage. The equilibrium position is determined by the spending decisions of employers, investors and consumers, and not by the optimal allocation of factors of production. Put another way, it is entrepreneurs who make the hiring decisions, not the owners of the factors of production. Unemployed factors cannot insist on being employed in return for the value of their marginal product.

There are good reasons for preferring Keynes's concept of equilibrium. The existence of a wage-dependent workforce is a sufficient condition. The monetary economy is an entrepreneur economy, not a co-operative or self-employed economy. It is a monetary production economy, meaning that production depends on the payment of wages and wages must be paid in money. The heterogeneity of output makes it unacceptable to pay workers in final product. Heterogeneity is not a minor detail of *The General Theory*, it is a direct consequence of the division of labour. Income is intrinsically monetary outside a corn model. This is why the appropriate concept of system equilibrium for a monetary production economy is the principle of effective demand.

Furthermore, there is a subtle, but far-reaching inconsistency in Classical theory. The current orthodoxy is that Classical theory describes the long-run equilibrium, which would be reached immediately if prices were perfectly flexible and agents fully competitive, while Keynesian or 'business cycle' theory describes the short run, since prices are in practice sticky. The stickiness of prices, we are told, reflects both nominal and real rigidities, the latter including obstacles to competition, slow adjustment of expectations, and in more recent theory, asymmetric information. This view of things should be called New Pigovian, not New Keynesian.

On the contrary, Keynes's principle of effective demand also assumes competitive, flexible prices in goods and asset markets. Only relative prices matter in the determination of employment; the problem is that the relative prices are 'wrong' as Leijonhufvud pointed out. The principle of effective demand can be (and is) worked out using the money-wage of a standard unit of labour as the unit of account: the employment of labour is determined completely independently of the price of labour.

Keynes devotes most of *G.T.* Chapter 2 to refuting, on entirely Classical grounds, the idea that involuntary unemployment is the result of a failure to allow money-wages to clear the market. Keynes's notion of system equilibrium does not include the clearing of factor markets as a necessary condition. If it did, *The General Theory* would no longer be a theory of a monetary economy.

The inconsistency is not in Keynes's definition of equilibrium, but in Classical theory. The basic tenet of Classical theory is that money is neutral; yet how are markets to clear, except through changes in money-prices? Relative prices are ratios of prices in more than one market, and there is no reason to think that a change in one price will leave prices in other markets unchanged.

The perception of sticky factor prices (there is nothing in *The General Theory* to suggest sticky goods or asset prices) reflects their exogeneity from Keynes's equilibrium model. Exogenous wages are not rigid or sticky wages; on this point Keynes is quite explicit, both in *G.T.* Chapter 2 and the *whole* of *G.T.* Chapter 19. Yet, in a monetary economy, there has to be an anchor for the price-level if the price system is not to break down. Since the quantity theory assumes away the problem of involuntary unemployment, it cannot be invoked to explain the price-level. Classical theory does not take supply and demand seriously enough.

### *Expectation*

So far I have argued that *The General Theory* is an extension of essentially Classical competitive equilibrium analysis, i.e. supply and demand theory, to a monetary economy. Taking money seriously means taking time seriously, and I have already set out the importance of Keynes's redefinition of Marshall's equilibrium periods.

The understanding of time as irreversible has profound implications for equilibrium analysis. If today's decision to produce, consume or invest is to be described as an equilibrium outcome, the competitive forces bringing about this equilibrium must also act today, in the present. Past decisions and future outcomes are strictly irrelevant.

However, most production takes time. The decision to employ labour or invest in a new capital-good today depends on market prices that are expected to rule in the future. In the absence of a forward contract, decisions must be made on the strength of an expectation, something which already plays an important part in Marshall's system. Keynes makes a subtle, but important, addition to the Classical scheme by distinguishing between short-term expectation, which governs the level of production and employment, and long-term expectation, which governs the investment decision.

The state of short-term expectation turns out to depend upon the state of long-term expectation, so we can follow Keynes in often referring simply to the state of expectation as a whole, but this shorthand must not obscure its compound nature.

This use of the long and short term does *not* correspond to the long and short equilibrium periods. Keynes's *long-period* equilibrium is based on *short-term* expectation and relates to a state of expectation which remains unchanged long enough to allow the capital stock to adjust fully to that state of expectation. Although Keynes's long-period equilibrium is important for theoretical completeness, it is rather unlikely to be observed, since the state of expectation is liable to constant change, far more so than the parameters of the Classical system. Nevertheless, however much the state of expectation may shift from day to day, today's state of expectation determines *in the present* the point of effective demand and the level of employment, as a position of short-period equilibrium, a shifting equilibrium. It is of theoretical, but less practical, importance that the state of expectation also defines today a position of long-period equilibrium, on which the short-period equilibrium will converge if today's state of expectation continues unchanged.

Keynes treats the state of short-term expectation as reliable, or at least discoverable by trial and error,—what we now call 'rational'—*given* the state of long-term expectation; but the state of long-term expectation itself is an entirely different matter. Keynes does not assume long-term expectations are fulfilled even in his long-period equilibrium (where they are merely unchanged), and indeed considers disappointment more than likely. I suggest that the period over which competitive equilibrium analysis is of scientific value relates directly to the time horizon within which expectations can reasonably be treated as determinate. The method cannot be applied

to the long term, thus wholly undermining the Classical concept of long-period competitive equilibrium, i.e. mainstream intertemporal macroeconomics.

To assume ‘rational expectations’ in the long term is heroically to assume a very unheroic world, in which knowledge of the present and the past is a reliable guide to the future. The state of long-term expectation is as exogenous in *The General Theory* as the endowment and other Classical system parameters, meaning that it is beyond the reach of equilibrium theory. It is a close cousin to the propensity to consume and the preference for liquidity, both of which also reflect the historical nature of time.

These three psychological states represent reasonable responses by purposeful individuals to the problems of time, in the real world where the Classical long-period equilibrium is *logically* unattainable, and therefore an objectively optimal response is physically impossible.

So now we are moving into the mysterious area of the forces of time and ignorance, whose analysis falls outside the equilibrium model on which I have so far placed so much emphasis. The particular point I address in the fifth proposition is the nature of liquidity, and how different Keynes’s treatment is to what you might expect.

### *Liquidity*

These days, a liquid asset is understood to be one that can readily be exchanged or converted into money at a well-defined market price. My claim is that this does not capture the full meaning of liquidity in *The General Theory*, and that Keynes distinguishes between the attributes of convertibility and liquidity. There is more to his conception of liquidity than convertibility. In principle, an asset with low convertibility may have high liquidity, and *vice versa*, however counter-intuitive this

may now seem. Liquidity is intimately related with expectation in *The General Theory*, and its meaning is fundamental to the understanding of the book as a whole.

The paradox of *The General Theory* is that Keynes so emphasises the liquidity of money within a theoretical framework, based on perfect competition, in which *all* assets are equally marketable or convertible. Why does he then discuss *degrees* of liquidity and, furthermore, suggest that in certain historic environments *land* has ‘ruled the roost’ in the hierarchy of liquidity (*G.T.* pp. 223, 241, 358)? Land can never have been preferred for its convertibility, let alone as the medium of exchange.

Keynes claims that historically land has possessed high liquidity, despite low convertibility. Conversely, in his discussion of organised investment markets, which come closest in practice to the ideal of perfect competition in terms of transaction costs and uniformity of price, he treats their ‘liquidity’ (which he places in inverted commas on no less than five occasions during his discussion in *G.T.* Chapter 12, pp. 153–160) as an illusion and something distinct from true liquidity. Listed equity securities have high convertibility, but low liquidity.

Although Keynes does not provide an explicit definition of liquidity in *The General Theory*, he comes close towards the end of Chapter 17 (*G.T.* p. 240). My view is that Keynes’s implicit definition of liquidity is the degree to which the value of an asset, measured in any given standard, is independent of changes in the state of expectation, as we defined it a few moments ago. Liquidity risk is therefore the possible—not the probable or expected—the *possible* loss of value as a result of a change in the state of expectation, which includes the state of confidence. A constantly shifting and precarious state of expectation means a high liquidity risk.

In *The General Theory*, there is a hierarchy of liquidity risk, in which bonds are superior to capital-goods (for which read equities), and money is superior to bonds.

This hierarchy, which later theory has neglected, is of crucial importance to Keynes's division between consumption and different types of investment decisions. I have argued elsewhere that the hierarchy provides a solid basis for Kalecki's principle of increasing risk and for the dependence of industrial investment on accumulation. Yet very little research has started from GT Chapter 17 in which Keynes expressed his most subtle insights. Hansen, of course, reckoned Keynes should not have bothered. Keynes's conception of liquidity is intimately bound up with his conceptions of the state of expectation and of the historical nature of time. Liquidity has value only because the future is unknown, and its value increases with our fear of what might happen, that we cannot prevent or insure against. In *The General Theory*, money is the liquid asset and dominant store of value, as well as the standard of value, and money's liquidity is the foundation of its non-neutrality.

In summary, I have attributed a number of propositions to *The General Theory* that will, I'm sure, not go uncontested, but that I have found to resolve most of the puzzles and paradoxes that have bedevilled the reading of this book. These propositions would shock anyone accustomed to the New Keynesian interpretation of Keynes: continuous equilibrium, perfect competition, flexible prices, rational short-term expectations, and liquidity as something more than convertibility.

Let me conclude by relating this understanding of *The General Theory* back to my initial claim that Keynes's work has been neglected in both theory and policy. It has taken several decades for New Classical economists to rediscover, without attribution of course, two concepts that are central to the principle of effective demand: continuous equilibrium and rational expectations. However they have never come to grips with the need to redefine equilibrium in a monetary economy. Still less have they recognised the need to distinguish short from long term expectation. While it is



plausible to model short-term expectations as rational equilibrium values, it is nonsense to attempt this with long-term expectation.

As for the Post Keynesians, well, by and large we have abandoned supply and demand theory, following in the footsteps of Joan Robinson and Nicholas Kaldor. Joan always maintained that Kalecki had made a better job of effective demand than Keynes. What maintains the unity of the Post Keynesian school is the recognition that, under either formulation, demand matters in the long run. What we have lost by abandoning supply and demand theory is any hope of breaching the citadel. We have ranged ourselves with the other heretics, outside the wall.

What does this understanding of *The General Theory* mean for policy? Very briefly indeed, consider the following major Classical doctrines: flexible labour markets, floating exchange rates, and financial liberalisation, in terms of both free capital movement and prudential regulation. Underpinning the doctrine of flexible labour markets is the concept of a natural rate of unemployment. In other words, observed unemployment is said to be what Keynes called frictional or voluntary unemployment. Any temporary departure from the natural rate is held to be the result of wage stickiness, so that flexible labour markets are a euphemism for the traditional policy of wage cuts. Keynes's proof that flexible money wages cannot clear the labour market as a whole has been ignored. His policy conclusions are ignored because his concept of equilibrium is not understood, let alone accepted.

The Classical notion of equilibrium also underpins the doctrine of floating exchange rates. Competition is supposed to drive the economy to full employment with balance of payments equilibrium. Without the recognition that competition alone cannot do this and that demand matters in the long run, the concept of balance of payments constrained growth is incomprehensible. The case for a return to a managed exchange

rate system, including an onus of adjustment on countries in trade surplus, cannot be made within the Classical framework. The same applies to the case for the management of commodity prices, let alone for more radical ideas such as an international commodity reserve currency.

Furthermore these policy ideas clash with the third doctrine, of the free movement of financial capital. In all the recent public debate about the role of Wall Street and the City of London, I have heard no challenge to the claim that equity markets allocate capital to best advantage. The incontrovertible evidence that physical industrial investment is almost entirely financed by accumulation is simply dismissed as a spurious correlation. Lacking a solid grasp of the concepts of long-term expectation and liquidity, Classical theory cannot explain convincingly why corporations depend on accumulation. Nor can it explain why equity markets provide an exit for entrepreneurs, a convenience for rentiers, a hunting ground for corporate raiders, and a plaything for speculators, anything indeed, other than an intermediary through which savings are channelled into investment. Yet the social case for the free movement of financial capital depends upon the last.

And finally we come to financial regulation. The carnage of the last three years should have prompted a fundamental rethink. Yet without Keynes's concepts of long-term expectation and liquidity at their disposal, governments are proving unable to resist the demands of powerful banks to maintain unfettered financial liberalisation on the strength of the flawed concept of Value at Risk underpinning Basel III.

This lecture has been about theory rather than policy, because bad theory makes bad policy, as I have just outlined, and also because I do think it is true in economics that it takes a theory to beat a theory. This is particularly so in macroeconomics, where contrary evidence is so easily explained away or ignored. *The General Theory* is a

gateway into the citadel, a careful attempt to refute Classical theory on its own terms and rules of engagement. I believe it has still so far been underestimated, by both friend and foe alike.

I have said little or nothing about the many positive Post Keynesian policy ideas. I know that other speakers are addressing these and I by no means deny the value of working out these ideas. Yet the truth is, that I entertain little hope of their gaining a hearing in the corridors of power at present. Not until the theoretical climate changes, or else the economic system collapses – not something I would wish on anyone, least of all a would-be Post Keynesian policymaker.

Empires do fall and defensive walls are abandoned and tumble down. Perhaps some of you await the internal collapse of mainstream economics. Yet it has weathered the 2008 crisis by keeping its head down. After a brief nod to Keynes from the foxhole, economic policymakers are safely back in the clutches of the Classics. Keynes did not want to set up a rival school of economic thought, he wanted to transform economics. I think his view, and mine, is that the only way to change policy is to change fundamental theory. 75 years on, there is still a long way to go.

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