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KEYNES' DENIAL OF CONFLICT: WHY *THE GENERAL THEORY* IS A MISLEADING GUIDE TO CAPITALISM AND STAGNATION

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ABSTRACT

Keynes' *General Theory* was a massive step forward relative to classical economics, but it was also a step backward in its denial of the conflictual nature of capitalism. There is need to understand Keynes' technical contributions regarding the workings of monetary economies, but also need to understand the flaws within his thinking and the consequences thereof. Keynes made a fundamental contribution elucidating the mechanism of effective demand, and he also has claim to be the preeminent monetary theorist. However, owing to his denial of conflict, he had a flawed view of capitalism which is why establishment Keynesianism struggles to explain contemporary stagnation. That flawed view also undermines the case for Social Democracy. Contrary to conventional wisdom, his view of capitalism is supportive of Neoliberalism and Keynes can be viewed as a compassionate (Third Way) Neoliberal.

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Keynes' denial of conflict: why *The General Theory* is a misleading guide to capitalism and stagnation

Abstract

Keynes' *General Theory* was a massive step forward relative to classical economics, but it was also a step backward in its denial of the conflictual nature of capitalism. There is need to understand Keynes' technical contributions regarding the workings of monetary economies, but also need to understand the flaws within his thinking and the consequences thereof. Keynes made a fundamental contribution elucidating the mechanism of effective demand, and he also has claim to be the preeminent monetary theorist. However, owing to his denial of conflict, he had a flawed view of capitalism which is why establishment Keynesianism struggles to explain contemporary stagnation. That flawed view also undermines the case for Social Democracy. Contrary to conventional wisdom, his view of capitalism is supportive of Neoliberalism and Keynes can be viewed as a compassionate (Third Way) Neoliberal.

Keywords: Keynes, The General Theory, conflict, capitalism, stagnation, bastard Keynesians.
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1. Preamble: the lamp post and the drunk

This paper is about Keynes' denial of conflict and how that denial renders *The General Theory* a misleading guide to capitalism and stagnation. There is an old story about a drunk and a lamp post. A passerby sees a drunk crawling around a lamp post. He stops and asks the drunk what he is doing, and the drunk replies: "I'm looking for my keys". The passerby responds: "Where do you think you lost them?". The drunk points to the grass lawn and replies: "Over there." The passerby then asks: "Why are you looking for them under the lamp post?", to which the drunk replies "Because that is where the light is."

In many ways that story captures the message of the paper. The lamp post is Keynes' *General Theory*. The drunk is the economics profession, which keeps looking under the lamp post to find the keys (i.e., an explanation of capitalism and stagnation). They cannot be found in *The General Theory* (i.e., under the lamp post) because they are not in it owing to Keynes' denial of conflict. Indeed, the situation is slightly worse. The missing keys are "conflict and power", and the economics profession is not even aware that is what it is looking for.

2. Introduction: conflict, stagnation, and the shortcomings of Keynesian economics

The US and Western European economies remain beset by stagnationary tendencies that set in after the Great Financial Crisis of 2008 (Palley, 2009, 2012; Summers, 2014). That emergence of stagnation has prompted calls for revival of the economics of Keynes, as evident in a steady stream of books published over the last fifteen years. Those books include Robert Skidelsky's (2009) *Keynes: The Return of The Master*; Paul Davidson's (2009) *The Keynes Solution: The Path to Global Economic Prosperity*; Lance Taylor's (2010) *Maynard's Revenge: The Collapse of Free Market Macroeconomics*; and most recently Stephen Marglin's (2021) *Raising Keynes: A Twenty-First-Century General Theory*.

This paper argues those calls are misplaced and Keynes' economics is unable to explain the current proclivity to stagnation. The inability is rooted in the "original sin" of Keynesian economics which was Keynes' denial of conflict in capitalist economies. The conflictual nature of capitalist economies has driven changes in income distribution, economic organization, and economic policy that are the root cause of the stagnation problematic (Hein, 2016; Palley, 1998, 2002, 2012, 2016; Stockhammer, 2015). That conflictual character is entirely absent in Keynes's (1936) *General Theory*.

The confusing twist is, though Keynes' was fundamentally mistaken in his denial of conflict, his economics remains profoundly relevant in its identification of the significance of aggregate demand (AD) and the monetary nature of interest rates. The trap is thinking AD and problems with interest rate adjustment are the "deep" causes of stagnation, when the reality is they are the "surface" causes. Furthermore, Keynesian economic policies are also needed to counter the macroeconomic conditions created by stagnation, but those policies cannot cure the underlying causes of stagnation. That requires a "structural Keynesian" policy response that addresses the economy's structural deficiencies (Palley, 1998, 2012, 2016), particularly unequal income distribution brought about by capital's triumph over labor.

There are two principal motivations for the paper. One motivation is an exercise in the history of economic thought that reinterprets and reframes Keynes' *General Theory*. The second and more important motivation is to loosen Keynes' grip on economics. Keynes' thinking about capitalism is significantly flawed owing to its denial of conflict. Yet every time a crisis occurs, there is a reflex to return to Keynes for explanation. That reflex needs to be tamed. *The General Theory* provides "light" regarding the mechanisms by which stagnation propagates, but it does not provide the explanatory "keys".

The great difficulty exposing the limits of Keynes' critique of *laissez-faire* is that it is half right. It is a critique centered on the phenomenon of money, which he framed as a "monetary theory of production" (Keynes, 1933a). It is blind to the phenomenon of conflict. A critique of the phenomenon of money leads to repair of the problems arising thereof. It does not lead to a repair of the problems arising from conflict, about which Keynes was in denial. A complete macroeconomics requires attention to both money and conflict (see Palley, 2001). The era of Neoliberal stagnation screams that. However, the economics profession has been resistant as it is trapped by the same denial that trapped Keynes, and the political forces that might compel change are lacking.

The balance of the paper is as follows. Section 3 provides a brief literature review that helps place the paper in a larger context. Section 4 revisits Keynes' (1936) framing of the AD problematic. Section 5 explores the limits of Keynesian economics for explaining contemporary stagnation. Section 6 discusses Keynes' flawed understanding of capitalism. Section 7 discusses establishment Keynesianism's persistent denial of conflict, while Section 8 briefly contrasts Keynes' and Kalecki's framing of the AD problematic and the implications thereof. Section 9 discusses the adverse political consequences of the domination of Keynes' view of capitalism. Section 10 concludes the paper.

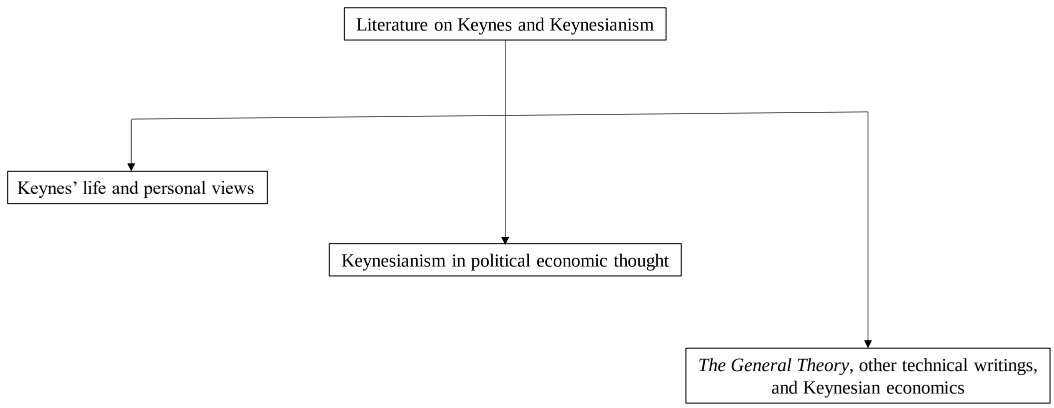
3. Keynes and Keynesian economics: a very brief literature placement review

There is a vast amount of literature on Keynes and Keynesian economics. This section presents a simple frame that identifies the principal components of that literature. The frame may help readers understand the paper's relation to the literature and its contribution.

3.a The literature on Keynes and Keynesianism

Figure1 provides a schema consisting of three categories which comprise the literature. It is important to emphasize that the categories represent dominant tendencies, and each is often deeply informed by the others.

Figure 1. Organizing the literature on Keynes and Keynesian economics.



The first column is labelled "Keynes' life and personal views" and it substantially consists of biographical history. The classic first biography was that of Harrod (1951) who identified Keynes as a political liberal, and who also covered up his homosexuality. Also in this category is Skidelsky's (1983, 1992, 2000) magisterial three volume biography of Keynes. Another recent excellent addition to this category is Carter's (2020) *The Price of Peace: Money, Democracy, and the Life of John Maynard Keynes*. It is biography in that its organizing spine is the chronology of Keynes' life, but it integrally includes both analysis of the socio-political context in which Keynes developed his ideas and engagement with the theory behind them. That illustrates how the biographical approach to Keynes is influenced by the other categories in Figure 1.

Keynes' Sphinx-like political identity is a cause of controversy as he exhibits a mix of liberalism, conservatism, and radicalism. The conventional view identifies Keynes as a liberal (in the English sense of the word). He identified politically with the Liberal Party which was the original party of *laissez-faire* and free trade. In the late 19th and early 20th century, the Liberals came to recognize the need to modestly ameliorate social inequalities and extreme misery. Keynes accepted that position and pushed it further. Not only is there a need to ameliorate *ex-post* outcomes, but there is also need for *ex-ante* policy interventions to prevent those outcomes. For Keynes (as discussed in section 4 below) the principal problem was unemployment due to demand shortage, and he advocated radically innovative policies to remedy the problem while retaining the substance of the existing system.

Keynes' interest in retaining and saving the system connects him with conservatism, which also lays claim to his ideas. That interest in saving capitalism is also why he is rejected by Democratic Socialists such as Foster and McChesney (2011) and Magdoff and Sweezy (1983) who see the Keynesian problematic as intrinsic to capitalism, rendering Keynes' project contradicted.

The conservative claim on Keynes has been made most forcefully by Bartlett (1984, 2009) who documents how Keynes self-identified with the ruling class and had a conservative philosophical temperament; was disparaging of the Labor Party and Socialist Russia; against state ownership of industry and economic planning; against activist redistribution and looked to market forces to generate a more egalitarian income distribution, albeit in the long-run; was a fiscal conservative in his recommendation that budgets be balanced over the business cycle, and was very opposed to inflation; was supportive of the price system, the profit motive, and maintaining an economic environment favorable to business to induce investment; and also recognized the logic of supply-side economics predicated on low taxes.

The principal *prima facie* non-conservative feature in Keynes' thought is his advocacy of massive state intervention. However, that advocacy was in the context of the depressed inter-war years (1919-1939), and Bartlett interprets that as fully consistent with conservatism. The interventions were contingent on a depressed economy and would be modest at other times, being restricted to offsetting demand fluctuations. That renders them consistent with pragmatic conservative philosophy in which government has a duty to protect the system.

Lastly, Crotty (2019) has recently claimed Keynes was a Socialist – or more explicitly a liberal socialist. Liberal because of his ethical values. Socialist because of his deepening turn to using instruments of the state to manage the economy - including managing AD, encouraging investment, managing trade, implementing capital controls, and major state involvement in slum clearance, home building, and highway infrastructure construction.[1]

The second column in Figure 2 refers to the placement of Keynesianism in political economic thought. Within economics, the history of economic thought has historically been dominated by a Whiggish tradition of onward and upward progress. According to that tradition, future generations of economists correct the mistakes of prior generations. The tradition is illustrated by Blaug's (1962) *Economic Theory in Retrospect* in which "the approach was to be 'absolutist' – addressing the question of whether theories were right or wrong – rather than 'relativist', evaluating them simply as reflections of the time at which they were formulated (O'Brien, 2013)."

That approach continues to be held by many economists – who seem to think that context, subjectivity, and self-interest applies to others but not themselves. It is also sustained by

[1] The Marxist economist Michael Roberts (2019) rejects Crotty's (2019) claim, arguing the attribution of socialism is explicitly at odds with what Keynes wrote (as also documented by Bartlett, 1984, 2009), and many of Keynes' positions were developed in the context of the emergencies of the Great Depression and World War II. Roberts

the institution of the economics textbook and by economists' misunderstandings regarding the epistemic nature of math and mathematical modelling. However, among historians of economic thought it has been increasingly challenged by the penetration of ideas from critical studies.

Applied to Keynes and Keynesianism, biographers have always recognized how events of the 1920s and 1930s shaped the development of Keynes' ideas. They also recognized how those events created a political opening for his ideas. There has also been significant realization of the role of interests in displacing Keynesianism and sustaining Neoliberalism (for instance see Harvey, 2005; Burgin, 2012; Mirowski, 2013).

That leads to recent contributions by Mann (2016, 2019) who seeks to place Keynesianism within a much longer liberal intellectual tradition aimed at saving civilization by civilizing capitalism, thereby also justifying capitalism and saving it from itself. That perspective embeds Keynesianism within the history of liberal political economy, rather than being an episodic production of the 1920s and 1930s. The Keynesian project introduces its own novel technical analysis, buts its political and social traction is rooted in its consistency with and usefulness to the historic liberal project.

Viewed in that light, Keynesianism is part of the default meta-creed of liberalism, which explains why it is resurrected every time there is a crisis. Despite economists' widespread ruminations about "the death of Keynesian economics", Keynesian economics never went away. It is embedded in Neoliberal theory and praxis, ready to be called upon whenever there is a crisis.

The third column in Figure 1 refers to "*The General Theory*, other technical writings, and Keynesian economics". That column constitutes by far the largest by volume, and it covers

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counters that Crotty's claim of "liberal Socialism" is neither liberal nor socialist but is elitist and capitalist. One economists' "inside baseball' technical discussions of Keynes' economics. The lodestone is Keynes' (1936) *The General Theory*. The substance is the commentaries thereon, the analytical traditions (e.g., Neo-Keynesianism, Post Keynesianism, old Keynesianism) it spawned, and the views of those traditions regarding their relation to *The General Theory* and Keynes' thought.

3.b What's missing from The General Theory: the dog that did not bark

The current paper fits squarely into column three. However, as discussed below, it is connected to and has implications for the other columns. The novelty in the paper is its focus on what is missing in *The General Theory*. Sometimes focusing on what is missing is as revealing as what is included. That is the lesson from the Sherlock Holmes story involving the dog that did not bark. In *The General Theory* conflict is entirely absent and is the missing bark.

Anticipating some of the arguments to come, the absence of conflict has multiple significant implications. First, it is relevant to the issue of income distribution and Keynes' characterization of the problematic of AD. That has direct implications for the ability of Keynesianism to explain contemporary proclivities to stagnation.

Second, it connects with Mann's (2026, 2019) meta-framing of Keynesianism. Recall, in Mann's view, Keynesianism is part of the liberal project to civilize and save capitalism. That project emphasizes mutually beneficial production and exchange, and conflict is existentially problematic for that vision. Had Keynes made conflict an important component of *The General Theory* he would have placed himself outside of the liberal project, which would have been counter to his views and impeded the acceptance of his ideas. As it is, the book still managed to provoke establishment opposition despite being intrinsically pro-establishment (see section 8.a below).

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might say it reflects the Marxist slogan that the state serves as the managing committee of the bourgeoisie.

Third, the absence of conflict connects with biographers' dispute over Keynes' political identity. Conflict (especially class conflict) is primitive in Socialist thinking. The absence of conflict is another body blow to the argument (Crotty, 2019) that Keynes was a Socialist.

4. *The General Theory* revisited: Keynes' framing of the AD problematic

The essence of the argument that is developed below is Keynes correctly identified capitalism's "fundamental problematic", but he failed to identify correctly and fully the "deep causes" thereof. The problematic is capitalism's proclivity to demand shortage (which has again reared its head with the re-emergence of stagnation). The deep causes are rooted in the conflictual nature of capitalism. Keynes' failed to identify the deep causes due to his attachment to liberal political economy and denial of conflict.

4.a A brief digression

Before engaging the main argument there is need for a brief digression to clarify a point of potential confusion. *The General Theory* is about the role of effective demand in determining current economic activity. However, in the last chapter (chapter 24) Keynes turns to a discussion of the ultra-long run, in connection with his speculations about "the euthanasia of the rentier (Keynes, 1936, p.376)" and possible need for future "socialisation of investment (Keynes, 1936, p.378)" to secure full employment. Those speculations suggest a secular stagnationist underside to Keynes' thought, but they are not the focus of the current paper. Moreover, Keynes' speculations about stagnation rest on faulty economic logic.

There are two elements to Keynes' long-run stagnationist thinking: his theory of consumption and his thinking about the impact of capital accumulation on the marginal efficiency of capital (MEK). Keynes got both wrong. His theory of consumption is stagnationist because it predicts a secularly falling average propensity to consume (APC) and a rising average propensity to save. That prediction was empirically disproven by Kuznets (1946) who documented the APC for the US economy was approximately constant over the long-run, and that stylized fact has been repeatedly confirmed for the US and elsewhere.

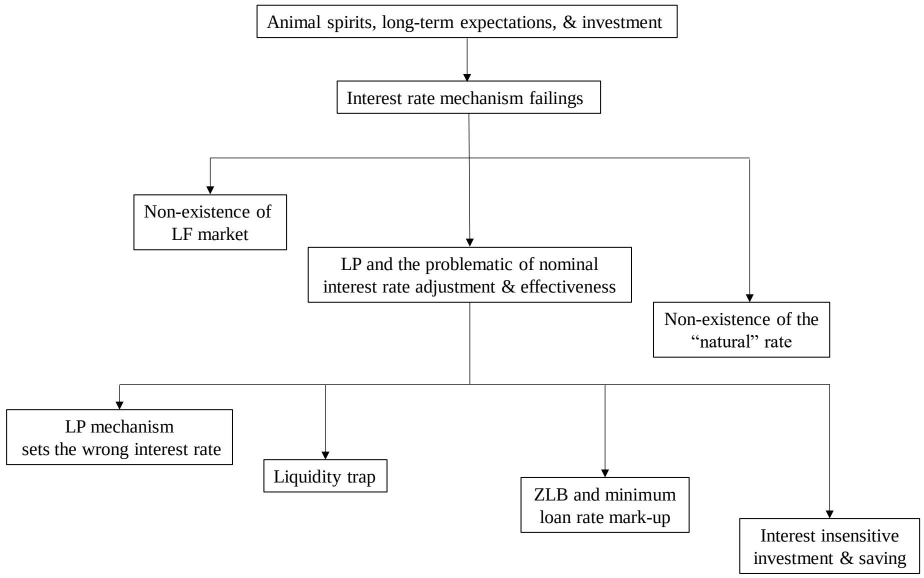
His theory of capital accumulation is stagnationist because it assumes capital deepening systematically lowers the MEK, thereby leading to the gradual euthanasia of the rentier and diminishing the incentive for investment. Hence, the potential need for socialisation of investment. However, Keynes was wrong in terms of his own logic, as shown by Solow (1956). In Keynes' Neoclassical theoretical framework, capital-deepening is limited by the forces of depreciation and population growth, which together work to put a ceiling on the capital-deepening process and to provide a floor for the MEK. Consequently, according to Neoclassical logic, the rentier is not euthanized and the incentive for investment remains.

4.b The main argument

Keynes explained capitalism's proclivity to unemployment through his theory of effective demand determined output, and his theory is important and enduring. If there is deficient demand, output will adjust downward and reduce saving, thereby eliminating the demand shortfall – albeit, resulting in an equilibrium with lower output and employment. The reverse holds if there is excess demand.

The argument developed below is that Keynes' (1936) framing of the causes of demand shortage is inadequate. That framing is illustrated in Figure 2 and is based on Book IV (chapters 11 – 18) of *The General Theory*. The first cause is animal spirits and the state of long-term expectations which Keynes' (1936, chapters 11-12) identified as the primary problem in capitalist economies. In a world of fundamental uncertainty in which the future is fundamentally unknowable, business decisions about investment are substantially guided by gut feelings. Those feelings are ruled by animal spirits. If animal spirits are low, long-term expectations are correspondingly diminished, which in turn negatively impacts investment spending and AD.

Figure 2. Keynes' framing of the of the demand shortage problematic.



The primary problem then collides with secondary problem which is failings of the interest rate mechanism. In classical economics, fluctuating animal spirits were of diminished consequence because the LF interest rate mechanism ensures saving and investment adjust and equilibrate at an unchanged level of income (i.e., full employment output). Lowered animal spirits lower investment but do not cause lowered output and employment.

The General Theory demolishes that classical claim through three arguments. First, it exposes the fallacy of LF theory (Keynes, 1936, chapters 14 and 16). The simple argument would be that the LF market is a fiction and does not exist. However, Keynes does not go that route. Instead, he argues in terms of absence of a co-ordination mechanism between current decisions to save, future decisions to consume, and investment (Keynes, 1936, p.211). Consequently, equalization of saving and investment is brought about by adjustment of output.

That argument is important. Though Keynes was right about the fallacy of loanable funds interest rate theory, his argument retains the classical construction of the macroeconomic problem as one of interest rate determination, while his co-ordination frame lends itself to interpretation as a "market failure" which has become the hallmark of New Keynesian economics.

Second, Keynes' (1936, chapter 13) presents his novel replacement liquidity preference theory of interest rate determination whereby interest rates (i.e., asset prices) adjust to equilibrate asset markets. Money is part of the constellation of assets, but since money pays no interest, rates on other assets must adjust to equilibrate the money market. Disequilibrium in the money market, caused by changes in LP, spills into other asset markets and triggers asset price and interest rate adjustments. Consequently, money demand (i.e., liquidity preference) becomes critical for interest rate determination, making the interest rate an intrinsically monetary phenomenon. However, with that come major problems (about which more below).

Third, Keynes (1936, p.236) makes an argument that there may not exist a "natural" rate of interest that can deliver full employment (see Palley, 2019).[2] That argument has tended to be overlooked because of its technical complexity.[3] Additionally, there may have been confusion between "no" natural rate and a "variable" natural rate. Keynes argued there may sometimes be no natural rate, and he also maintained that even if it existed it fluctuated in accordance with fluctuations in AD.

The major body of argument in *The General Theory* concerns LP theory and the problematic of nominal interest rate adjustment, which is illustrated by the bottom branch in Figure 2. The core point is that LP theory has interest rates set to clear financial asset markets

[2] Keynes (1936, p.183) also refers to the "natural" rate as the "neutral" rate.
[3] Keynes' (1936, p.236) argument is that non-produced assets can be an obstacle to increasing investment by lowering interest rates. If the marginal efficiency of investment falls below the return on non-produced assets, firms will prefer to accumulate non-produced assets rather than invest.

rather than the goods market. Consequently, financial markets will usually not determine an interest rate consistent with full employment.

That fundamental argument is supplemented by three pathologies. The first is the liquidity trap (Keynes, 1936, p.207) when interest rates can fall no more because they are equal to the own liquidity yield on money. The second is when there are floors to the nominal interest rate. Keynes (1936, p.208) focused on floors to the loan rate to cover transactions costs and default risk. Contemporary macroeconomics focuses on the zero lower bound (ZLB) which is supposed to constrain the central bank's policy interest rate. The third is interest insensitivity of AD. Keynes (1936, p.164) briefly mentions this possibility, but it is more associated with the case of a vertical IS schedule that was emphasized later by Neo-Keynesians.

5. The limits of Keynes' economics for explaining contemporary stagnation

The importance of the above analysis is it shows the centrality of the interest rate mechanism in *The General Theory*. Keynes was trained in the classical economic tradition in which the interest rate was the central analytic phenomenon. He never escaped that. His understanding of economics was framed by classical theory, and his contribution was a response to classical theory.

For Keynes, the macroeconomic problem begins with dampened animal spirits and depressed long-term expectations which lower investment and AD. The interest rate mechanism is unable to sufficiently counter that, and the result is an equilibrium below full employment. That raises the question whether that is an adequate characterization of capitalism? The argument in the rest of this paper is it is not.

Keynes' schema of capitalism has been challenged by both by subsequent developments and by identification of technical shortcomings (e.g., his theory of consumption). The focus here is subsequent devolopments whereby both the problematic of animal spirits and the failings of the interest rate mechanism have been substantially solved since the publication of *The General Theory*, yet capitalism's macroeconomic problems persist. That suggests something is amiss with Keynes' analysis.

5.a Big Government

The first development, emphasized by Minsky (1986), is the emergence of "Big Government" which has substantially stabilized AD. That has diminished the significance and impact of fluctuations in animal spirits. In 1930 US Federal government outlays were 3.4 percent of GDP; in 1950 they were 15.3 percent; in 2000 they were 17.7 percent; and in 2019 they were 21.0 percent. In the covid pandemic they peaked in 2020 at 31.3 percent.[4] Prior to the Great Depression, US government spending was a minor part of GDP. After World War II that changed dramatically with the advent of the welfare state and military-industrial complex. In Western European economies government outlays are an even larger share of GDP. The important point is increased government spending ("Big Government") stabilizes AD, leaving a far smaller base that is subject to the impact of fluctuations of animal spirits.

5.b The technocratic corporation

The second development, articulated by Galbraith (1967), is the emergence of the modern technocratic corporation which fundamentally diminishes the significance of animal spirits for planned investment spending. In Galbraith's schema the modern corporation is an institutional mechanism that helps tame the problematic of fundamental uncertainty, a feature emphasized by Dunn (2011, chapter 7). The corporation plans growth of demand via advertising, product innovation, and policy advocacy, while investment is planned to accommodate demand growth.

[4] Source: 2023 President's Budget, OMB, White House, Table 1.2. [Historical Tables | OMB | The White House](#).

Whereas Keynes' (1936) entrepreneurial firm is vulnerable to fluctuations in entrepreneurs' animal spirits, Galbraith's (1967) technocratic corporation purposefully seeks to remedy that vulnerability.

5.*c Central bank interest rate targeting*

The third development is the adoption of interest rate targeting by central banks, which can be interpreted as remedying the problematic of the interest rate mechanism. Interest rate targeting can be viewed as establishing a form of surrogate loanable funds market, thereby substantially remedying Keynes' (1936) fundamental critique. In the absence of the loanable funds market, the central bank steps in to establish a natural rate of interest consistent with its inflation target. In contemporary central bank parlance, that natural rate is R^*. If classical economics was right, targeting R^* should guide the economy to full employment. The same holds for Keynes' economics. For Keynes, the absence of a loanable funds market and the fact that interest rates are determined via the liquidity preference mechanism is the core failure of the market system. Having the central bank step in and target R^* (i.e., the natural rate) with an adjustment for the output gap (i.e., $y - y^*$) should therefore remedy that core failure.[5]

5.d Significance

The significance of the above arguments is they implicitly show the flawed nature of Keynes' characterization of capitalism – and by extension, the flawed nature of mainstream New Keynesian economics' characterization. If Keynes was right in his diagnosis of the failings of

[5] That said, Keynes might have quarreled with central banks regarding their estimates of R^*. Central banks see it as structural and stable, whereas Keynes argued it (the neutral rate) fluctuated with AD conditions. Additionally, both Keynes and classical economists might argue central bank set R^* too high owing to their political economic prejudices. Ironically, having central banks target interest rates and act as a surrogate LF market opens the door for a revised version of the Friedman and Schwarz (1963) argument that central banks are the problem. Friedman and Schwartz argued the Federal Reserve caused the Great Depression by mistakenly contracting the money supply in 1929. Now, it can be argued central banks are repeating that mistake by setting R* too high. In that fashion, the ghosts of Friedman and Schwartz can be revived.

capitalism, the combination of Big Government, the technocratic corporation, and central bank interest rate targeting should have eliminated the Keynesian problem of AD shortage. However, it has not. Instead, the problem of stagnation due to demand shortage has reasserted itself, exposing the shortfall in Keynes' thinking.

6. Keynes' flawed understanding of capitalism

The less read last chapters of *The General Theory* (Book V) provide the clues to Keynes' flawed understanding of capitalism. Keynes was a liberal bourgeois who came of age in the Edwardian era (1901 – 1914) which marked the apogee of the British empire. He was committed to that order and looked to improve it and save it from its internal failings. Throughout his adult life he identified politically with the Liberal Party, was a confirmed reformer of capitalism, and disapproved of revolution. That political economic stance is captured in the closing chapter of *The General Theory* in which Keynes writes:

> "To put the point concretely, I see no reason to suppose that the existing system seriously misemploys the factors of production that are in use. There are, of course, errors of foresight; but these would not be avoided by centralising decisions. When 9,000,000 men are employed out of 10,000,000 willing and able to work, there is no evidence that the labour of these 9,000,000 men is misdirected. The complaint against the present system is not that these 9,000,000 men ought to be employed on different tasks, but that tasks should be available for the remaining 1,000,000 men. It is in determining the volume, not the direction, of actual employment that the existing system has broken down (Keynes, 1936, p.379)."

The statement is not just an acceptance of market capitalism, it is also a statement of approval. Keynes recognized the serious failings of *laissez-faire* but sought to remedy those failings by policy interventions, which is what makes him a reformer.

Side-by-side with his qualified endorsement of the Manchester System, Keynes also rejected the Marxist construction and characterization of capitalism. *The General Theory* (p.3, 32, and 355) contains three references to Marx, two of which are cursory and the last of which is dismissive. Marx is dismissed as insignificant relative to Silvio Gesell with his construct of stamped money as a solution to the problems of capitalism:

> "I believe that the future will learn more from the spirit of Gesell than from that of Marx. The preface to *The Natural Economic Order* will indicate to the reader, if he will refer to it, the moral quality of Gesell. The answer to Marxism is, I think, to be found along the lines of this preface (Keynes, 1936, p.355)."

Keynes' disdain for and disinterest in the Marx's characterization of capitalism was already evident a decade earlier in his *The End of Laissez Faire* pamphlet:

> "But the principles of *laissez-faire* have had other allies besides textbooks. It must be admitted that they have been confirmed in the minds of sound thinkers and the reasonable public by the poor quality of the opponent proposals – protectionism on one hand, and Marxian socialism on the other. Yet these doctrines are both characterized, not only or chiefly by their infringing the very presumption in favour of *laissez-faire*, but by mere logical fallacy. Both are examples of poor thinking, of inability to analyse a process and follow it out to its conclusion. The arguments against them, though reinforced by the principle of *laissez-faire*, do not strictly require it. Of the two, protectionism is at least plausible, and the forces making for its popularity are nothing to wonder at. But Marxian socialism must always remain a portent to the historians of opinion – how a doctrine so illogical and so dull can have exercised so powerful and enduring an influence over the minds of men and, through them, the events of history (Keynes, 1926, p.14-15)."[6]

Preference for reform and aversion to revolution is understandable as revolution has tended to not work out well. However, the causes of revolution must still be recognized. Those causes are rooted in the conflictual nature of capitalism, and Keynes was unwilling to go to the dark places of capitalism except for the issue of unemployment.

Keynes was trapped in a classical/liberal construction of the economy that prejudiced his view of capitalism, thereby making *The General Theory* a work of "rescue" as much as a work of "critique". First, he was trapped in the classical view that the interest rate is the critical price and

[6] Ironically, Keynes (1933a) later came to support protectionism. Joan Robinson (1973, p.9) seems to suggest that Keynes never really engaged Marxism. According to her, he seems to have identified it with "Stalinism".

the locus where things go wrong. Second, he was trapped in the liberal Manchester System view that the economy is a system for harvesting mutually beneficial production and exchange opportunities. Consequently, conflict is absent in *The General Theory*. Its closest appearance is the pastel possibility of worker versus worker conflict whereby workers may resist nominal wage reductions for reasons of relative wage concerns (Keynes, 1936, p. 264).

7. The suppression of conflict, Neo-Keynesianism, and the bastard Keynesian fallacy

Keynes' *General Theory* identified the fundamental problematic of capitalism which is proclivity to demand shortage in a world of demand determined output. However, it also denied the fundamental fracture in capitalism which is proclivity to conflict, and conflict can cause demand shortage. That denial has had profound consequences which continue to ripple through economics.

Keynesian economics has been beset by two principal struggles. One is the struggle to dismiss the claim that downward price and nominal wage rigidity are the cause of macroeconomic unemployment, a claim that was introduced after Keynes' death and which is explicitly counter to his views (Keynes, 1936, chapter 19). The second is the struggle to surface Keynes' own failed analysis regarding conflict and properly incorporate conflict into economics. The economics establishment has persistently resisted making conflict part of the DNA of capitalism for the same reasons that Keynes did. In the post-war era (1945-1975) it was the Neo-Keynesians that rejected doing so. In the Neoliberal era it has been the New Classicals and New Keynesians who replaced the Neo-Keynesians.

7.a Neo-Keynesianism and the denial of conflict

After World War II and with Keynes' death in 1946, the cause of Keynesian economics was led by the Neo-Keynesians. The analytical centerpiece of Neo-Keynesianism was Hicks' (1937)

ISLM model which placed Keynes' (1936) two-part partial equilibrium treatment of the goods and money markets in a unified general equilibrium framework.[7]

Over the next forty-five years the ISLM model was elaborated to include stock-flow effects (Christ, 1968; Tobin, 1982) and much more. That elaboration had theoretical shortcomings, but the framework was substantially true to the economics of *The General Theory* and Keynes' characterization of capitalism. Moreover, shortcomings such as the failure to incorporate endogenous credit-driven money can be remedied (Palley, 2017). The one massive departure from Keynes by the Neo-Keynesians was their acceptance of the claim that downward price and nominal wage rigidity was the cause of unemployment. However, that claim has nothing to do with the ISLM model *per se* and is about model specification rather than model framework. The ISLM model can be easily modified so that price and nominal wage reduction increases unemployment (Tobin, 1980, chapter 1; Palley, 2008).

Most importantly, the Neo-Keynesians embraced Keynes' (1936) framing of capitalism as a system in which conflict was not of the essence. Though profoundly mistaken, there were multiple reasons (good and bad) for doing so. One (bad) reason for Neo-Keynesianism's denial of the essential significance of conflict was political and sociological conditions. This was the era of the Cold War which prompted society-wide denial of capital-labor conflict. To acknowledge such was viewed as providing tacit support for the Soviet Union. For individual economists, doing so could be toxic for their careers.

A second (good) reason was, by accident of history, the period after World War II saw a temporary taming of the problematic of conflict and a moment of relative tranquility and

[7] In a famous letter dated March 31, 1937, Keynes wrote approvingly to Hicks of his ISLM model: "At long last I have caught up with my reading and have been through the enclosed. I found it very interesting and have next to nothing to say by way of criticism (Keynes, 1973, p.79)."

prosperity. One factor was the rise of trade unions and the extension of the welfare state in the wake of the Great Depression. A second factor was the rise of Labor and Social Democratic political parties which channeled conflict into the accepted political process. A third factor was the threat effect provided by the Soviet Union which induced concessions from the Western capitalist order. The net result was a temporarily improved distributional equilibrium that delivered full employment with the assistance of Keynesian counter-cyclical stabilization policy. That outcome appeared to confirm Keynes' characterization of capitalism.

Economists are influenced by the era they live in. Neo-Keynesianism was birthed in the post-war era and that context helps explain the path it took. Given the success of the post-war order, there was little obvious reason to challenge Keynes' characterization of capitalism – and the Neo-Keynesians did not. They downplayed the post-war remaking of corporate power and labor relations and tended to attribute the era's success to Keynesian macroeconomic stabilization policy (see Tobin, 1980, 46-48). With the economy working well, darker critiques of capitalism were dismissed as ideological and anachronistic.

7.b The bastard Keynesian fallacy and distraction

A second source of confusion regarding Keynes' flawed analysis was Joan Robinson's (1973) "bastard Keynesian" polemic. Robinson was clearly dissatisfied with Neo-Keynesian economics, concluding her 1973 paper on the Keynesian revolution as follows:

> "Now, it seems that the bastard Keynesian era is coming to an end in general disillusionment; the economists have no more idea what to say than they had when the old equilibrium doctrine collapsed in the great slump. The Keynesian revolution still remains to be made in both teaching economic theory and in forming economic policy (Robinson, 1973, p.11)."

That polemic is celebrated by Post Keynesians (PKs), but it is significantly misplaced and off-target. The Neo-Keynesians were guilty of the analytic failings that Robinson and the PKs accused them of, but those failings originate with Keynes.

The Neo-Keynesians were substantially true to Keynes and blaming them for the flaws in Keynes' economics fostered intellectual confusion. That is because it created a false double discourse in which Keynes was viewed as "the master" whose teachings had gone unheeded, while his erroneous characterization of capitalism was displaced on to the Neo-Keynesians. That double discourse placed Keynes above critique so that the misunderstanding persists. Worse yet, Keynes' standing became a shield blocking a conflictual approach to capitalism and keeping discourse locked-in the market failure frame, with its origins in *The General Theory*'s critique of classical interest rate theory.

Robinson's "bastard Keynesian" critique was right in substance, but it missed the mark by blaming the Neo-Keynesians rather than Keynes himself. In doing so, it perpetuated misunderstandings about Keynes and *The General Theory*, and it also created unnecessary antagonisms.

8. The return of conflict and the travails of Keynesian economics

The Neo-Keynesian model worked well as long as the post-war distributional equilibrium held. When that equilibrium blew apart in the late 1960s and early 1970s, Neo-Keynesianism confronted the problematic of full employment distributional conflict which Kalecki (1943) had anticipated. That situation produced conflict inflation which neither Neo-Keynesianism nor classical economics was equipped to address. Instead, the economics profession chose to interpret it as being caused by monetary mismanagement, thereby continuing to deny the role of conflict.

The subsequent Neoliberal era (1980 – today) has seen continued conflict, but now it has been from above with capital and the managerial class increasing their income shares at the expense of labor. That has produced a systemic proclivity to demand shortage which is at the base of the proclivity to stagnation (Hein 2016; Palley, 2002, 2009, 2012, 2016; Stockhammer, 2015).

Once again, as in the prior era, mainstream economics has been poorly equipped to explain developments which now also include the emergence of stagnation in the 2010s. New Keynesianism is substantially similar to its predecessor Neo-Keynesianism. Thus, there has been a return to explaining the problems of capitalism in terms of interest rate malfunction, the problem now being the ZLB.[8]

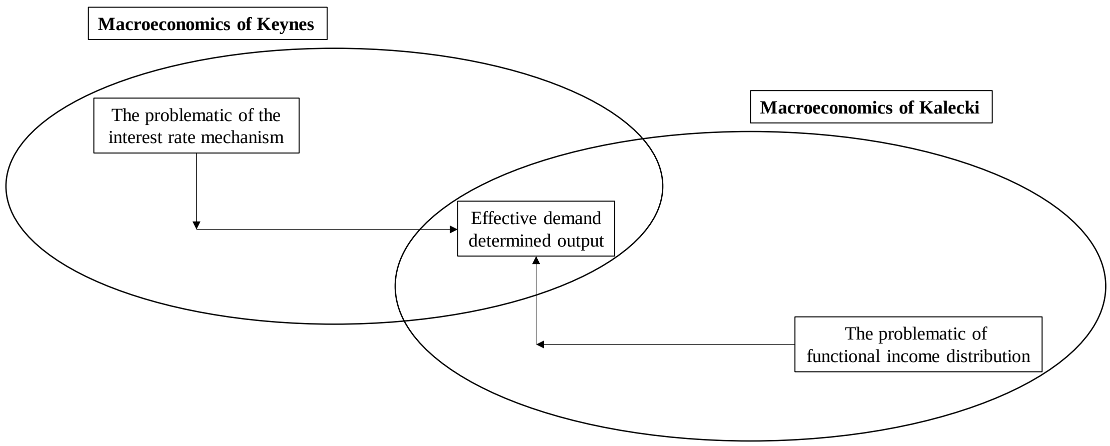
The absence of conflict in Keynes' characterization of capitalism contrasts with Kalecki's (1971 [1933]) near-parallel development of macroeconomics. Whereas Keynes made interest rate determination the central problematic of macroeconomics, Kalecki made functional income distribution the central problematic with his focus on the AD implications of functional income distribution. The corollary of that is the determination of income distribution, which provides a natural avenue for putting conflict and power in the picture. That leads to the important research agenda pioneered by Bowles and Gintis (Bowles, 1985; Bowles and Gintis, 1990)

Figure 3 illustrates the relation between Keynes' and Kalecki's approaches to macroeconomics. For Keynes there is no loanable funds market to clear the goods market and balance saving and planned investment. With the interest rate mechanism directed elsewhere, output contracts (expands) when saving exceeds (is less than) planned investment. For Kalecki

[8] The major differences between Neo-Keynesianism and New Keynesianism are methodological rather than analytical. Thus, Neo-Keynesian aggregate macroeconomic modelling has been replaced by microeconomic representative agent general equilibrium modelling. Additionally, Neo-Keynesianism's AD constraint has been replaced by a representative imperfectly competitive firm with temporarily fixed prices. As regards representative agent behavior, New Keynesians use the micro-founded theory developed by Neo-Keynesians to explain consumption behavior, investment behavior, money demand, and portfolio behavior. Both the Neo-Keynesian and New Keynesian approach to production and distribution are based on the Neoclassical theory of the firm and marginal product theory, which Keynes also accepted subject to the addition of an effective demand constraint.

there is no income distribution market to clear the goods market and balance saving and planned investment. With the wage share determined elsewhere, output contracts (expands) when saving exceeds (is less than) planned investment.

Figure 3. The competing macroeconomics of Keynes and Kalecki.



The structural parallels between the two are clear. For each there is a missing mechanism for clearing the goods market at full employment output. A surrogate mechanism can be imagined. For the Keynesian model it is having monetary policy target the natural interest rate. The problem is interest rate targeting does not appear to solve the macroeconomic problem and deliver full employment, which suggests Keynes' economic analysis was incomplete. For the Kaleckian model it is some form of full employment incomes policy. Here, the problem is it is difficult to imagine an incomes policy that is politically acceptable, operationally consistent with current economic arrangements, and sustainable. Consequently, such a policy may not be possible within free market capitalism, which means the Kaleckian problem may not be soluble in a free-market capitalist system.

9. The misreading of Keynes and its political consequences

The above analytical argument is that Keynes' denial of conflict profoundly informed his understanding of capitalism which, in turn, informed *The General Theory*. This penultimate section turns to some of the political consequences. The argument is *The General Theory* was (and still is) misread as a much more socially radical book than it is. That misreading has contributed to misunderstanding of Keynes' own political economic views. More importantly, it has contributed to misunderstanding of the political economic implications of *The General Theory* and Keynesianism.

9.a The misreading of The General Theory

The Keynesian revolution in economics, triggered by *The General Theory*, is widely identified with radical change from the center-left. The reality is it was a conservative revolution (with a small 'c'). It was conservative in that its goal was to save capitalism, and Keynes' economics denied the significance of conflict and retained the classical focus on the interest rate mechanism. It was revolutionary in its rejection of LF theory, its recognition that the interest rate was set by the forces of LP, and its recognition that those forces might not set an interest rate consistent with full employment (even assuming such a rate existed).

The reasons for the political economic misinterpretation of *The General Theory* are multiple. First and foremost, is the genuinely revolutionary critique of classical LF theory and its full employment claims. That revolutionary nature meant it was easy to misinterpret the critique as a socially radical critique when it was a technically radical critique, calling for a technical policy revolution rather than a remaking of the economy.

A second related reason is the policy prescriptions inherent in *The General Theory*. Under the gold standard the interest rate was used to manage gold flows. Now, it was to be used to manage AD and domestic economic activity. Additionally, fiscal policy (especially government spending) was introduced as an essential policy for ensuring full employment. Those changes made activist government policy central for full employment, in stark contradiction to the policy prescriptions of *laissez-faire*.

A third reason was chapter 24, the closing chapter of *The General Theory*, titled "Concluding notes on the social philosophy towards which *The General Theory* might lead". In it, Keynes writes disparagingly of capitalists and talks of:

> "...the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative power of the capitalist to exploit the scarcity-value of capital (Keynes, 1936, p.376)."

To property owners, that sounds politically inflammatory if read without understanding of the logic behind the claim.[9]

A fourth reason is the hostile reaction of the establishment, especially in the USA. Though Keynes approved of capitalism and sought to save it, in business' eyes *The General Theory* committed the cardinal sin of admitting that *laissez-faire* was flawed and needed the helping hand of government. That admission was ideologically taboo.[10] The extreme hostile reaction of the US business community may have had the unintended consequence of making people think Keynes and *The General Theory* were more radical than they were.

9.b Keynes was a compassionate Neoliberal

The reality is Keynes' revolution was conservative, as was his political economy. From a

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[9] Keynes' claim of euthanasia of the rentier was a distant future prospect, the result of a gradual process of capital accumulation whereby capital-scarcity was eliminated and capital-deepening pushed the MEK to near-zero. Moreover, Keynes was wrong in terms of his own Neoclassical logic, as shown by Solow (1956).

[10] Keynes was very supportive of the New Deal, as evidenced in his correspondence with President Roosevelt. On December 31, 1933, *The New York Times* published an open letter from Keynes to Roosevelt supportive of the New Deal. US business was staunchly opposed to the New Deal, as evidenced by the anti-New Deal campaign of the National Association of Manufacturers. Evidence of the establishment's hostility to Keynesianism is also provided by Parker's (2005, chapter 2 and chapter 11, p.228-232) discussion of Harvard University's economics department's

political economic standpoint, Keynes can be viewed as a compassionate or soft-core Neoliberal, and he would likely have been very comfortable with the Third Way politics of the likes of President Bill Clinton (New Democrat) and Prime Minister Tony Blair (New Labor).[11,12] Keynes accepted the two defining tenets of Neoliberalism, which are that free market economies are the best way to advance economic well-being and that free markets are integral for political freedom (Palley, 2021, p.1). However, he qualified that by recognizing the market economy needed help with the provisioning of full employment. Other than that, the market economy was slowly slouching its way to Utopia, as he argued in his famous essay titled *Economic Possibilities for our Grandchildren* (Keynes, 1930).[13] The same Utopian logic reappears in *The General Theory* with its predictions of the euthanasia of the rentier.

Social Democracy is a significant step to the left of compassionate Neoliberalism. Not only does it hold free market capitalism regularly fails to produce full employment, but it also views free market capitalism as producing unacceptable inequalities rooted in its conflictual character. That calls for interventions to moderate those inequalities and conflicts, which is a far deeper form of intervention. The goal is not just to ameliorate outcomes, but also to restructure the balance of power. That marks Social Democracy as qualitatively different from Keynes' compassionate Neoliberalism. The difference stems from the qualitatively different

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opposition to the New Deal and the controversy surrounding J. K. Galbraith's 1948/9 Harvard tenure case.

[11] The terminology of soft-core vs. hardcore Neoliberalism is used by Palley (2012, p.197-198).

[12] Modern Neoliberalism is closely identified with Hayek. The claim that Keynes was a Neoliberal may seem odd given that Keynes was a severe critic of Hayek, beginning with Keynes' (1931) response to Hayek's (1931) review of his *Treatise on Money* (Keynes, 1930). Keynes agreed with Hayek about the deep economic and political merits of capitalism. His difference with Hayek was technical and about how free markets worked. Keynes was critical of both Hayek's (1933) specific theory of the slump and his general belief that the market would restore full employment automatically and relatively quickly. Misunderstanding of that distinction has led to an erroneous view that Hayek and Keynes were philosophically apart. The reality is they were technically apart. The one place of possible ambiguity concerns government spending in recession where Keynes (Keynes et al., 1932) saw no adverse long-run productive or political consequences, whereas Hayek (Gregory et al., 1932) did.

[13] The expression "slouching its way to Utopia" is loosely borrowed from the title of DeLong's (2022) recent book on the economic history of 20th century capitalism.

understandings of free market capitalism.

Democratic Socialism is a significant further step to the left. Democratic Socialism rejects Social Democracy's claim that the problems of capitalism can be handled through Keynesian macroeconomic stabilization policy, progressive redistribution policy, and modest interventions to rebalance the distribution of power between capital and labor. Instead, it seeks a fundamentally more egalitarian society and calls for a fundamental remaking of the economy that increases public sector production, widespread nationalization of private industry, and redistribution via collective ownership rather than just government transfers and progressive taxation.

Of those three positions, Keynes' views correspond best to compassionate Neoliberalism. He identified with the Liberal Party all his adult political life, and the Liberal Party was the original party of *laissez-faire*. He refused to join the Labour Party which straddled the boundary between Social Democracy and Democratic Socialism. He persistently viewed the failings of market capitalism through the lens of effective demand and failure of the interest rate mechanism, and not through the lens of income distribution and conflict. With the post-war evisceration of the Liberal Party and the experience of the post-war Labour Party government (1945 - 1951), it is possible he might have joined Labour had he not died in 1946. However, to this author, it is more likely Keynes would have joined the Conservative Party, which embraced the compassionate policies of the Liberal Party that had been expressed in the Beveridge Report (1942).

Lastly, even though Keynes was a compassionate Neoliberal (or liberal conservative), it is easy to understand his hypnotic hold on progressives. First and foremost, his policy prescriptions offer a temporary solution to the scourge of unemployment even if they do not address the enduring deep cause, which means progressives always call for Keynesian policies in times of high unemployment. Second, Keynesian demand management analysis will be needed under Social Democracy or Socialism to ensure AD balances with aggregate supply. Third, there is deep enduring insight in his monetary theory of interest rates. Fourth, his critique of classical loanable funds interest rate theory was radical, but it was was technically radical and not socially radical, which promotes confusion. That combination of factors keeps progressives in awe of and need of Keynes at the same time that he is an obstacle.

9.c The unappreciated adverse political consequences of the triumph of Keynesianism

The misreading of Keynes has had significant unappreciated adverse political consequences. Presenting Keynes as more radical than he was, enabled conservatives to tag advocates of Keynesian economics and Keynesian policies as radical. That helped conservatives narrow the available political economic space by disbarring positions to the left of Keynes.

That political crowding-out was not just a product of conservatives' tactical success. It was also a product of Keynes' economic logic. As Keynes' economics became the limit of acceptable critique of capitalism, that squeezed out space for deeper critiques rooted in capitalism's conflictual nature. The squeezing out of conflictual analysis then undermined the case for Social Democratic policy. That is because the rationale for Social Democracy rests in part on the economy's conflictual character, which Keynesianism denied.

Keynes took the sheen off *laissez-faire*, but he believed it could be repaired. Side-by-side, he advocated a compassionate policy configuration, reflecting his ethical disposition – which Robinson (1973, p.9) viewed as reflecting his "aesthetic rather than political" view of life. However, there is no requirement for such a policy configuration. That contrasts with a conflictual view of capitalism which requires deeper Social Democratic reform for modern capitalism to work. That is a qualitatively different position as such reforms are "functionally needed" and are not "normative and discretionary" as in Keynes' view.

10. Conclusion: escaping Keynes' shadow

Keynes' (1936) *General Theory* was a massive step forward relative to classical economics, but it was also a step backward in its denial of the conflictual nature of capitalism. The "underworlds (Keynes, 1936, p.32)" of economics ended up being repressed, not surfaced.

There is need to understand Keynes' techincal contributions regarding the workings of monetary economies, but also need to understand the flaws within his thinking and the consequences thereof. Keynes made a fundamental contribution elucidating the mechanism of effective demand, and he also has claim to be the preeminent monetary theorist. However, he had a flawed view of capitalism which is why establishment Keynesianism struggles to explain contemporary stagnation. That flawed view also undermines the case for Social Democracy. Contrary to conventional wisdom, his view of capitalism is supportive of Neoliberalism and Keynes can be viewed as a compassionate (Third Way) Neoliberal.

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