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Book Reviews

Paul Davidson, ***John Maynard Keynes***
Palgrave Macmillan Basingstoke, 2009 [Rev. ed.]
Paperback, 256 pp., ISBN 9780230229204
RRP AUD 31.50 (also available as eBook)

Davidson's book is to be welcomed for its attempt to confront popular wisdom (both inside and outside of the economics profession) about the writings of John Maynard Keynes, and for its attempt to shed light on their relevance in understanding even the most recent economic events, such as the global financial crisis. As he notes in the preface, Davidson's book is, like others in the series, intended for an audience wider than the professional economist.

Davidson does endeavour to keep the lay readers of his book with him through what at times would be difficult terrain. As Davidson suspects, for the younger professional economist educated in the last decade, whether in an academic position or other, this terrain will probably be a world largely unfamiliar and distinctly different from what they would have encountered under the heading of 'Keynesian'.

Indeed, the plan of the book appears very much about carrying along the interested lay reader and young economist with little knowledge of Keynes' work. The discussion of the major stages of Keynes' intellectual life is interspersed with detours into the wider significance of the ideas which are crystallised in these stages. So for example there is a discussion of Keynes' *General Theory*, and what is for Davidson its intellectual advance — the significance of uncertainty manifest in the desire for liquidity and the impediment this provides to an inherent market driven tendency to full-employment. This is followed by a long discussion contrasting mainstream views of liquidity, uncertainty and financial markets with the inferences to be drawn from Keynes' *General Theory*. Such a contrast resonates in a sobering way against unbridled faith in the efficacy of financial markets, particularly on a global scale. So do Keynes' views about the appropriate architecture of the international monetary system, and the representations he made in this regard in the planning of what was to become the Bretton Woods era of managed exchange rates.

Davidson's discussion draws over a wide canvas, demonstrating how pervasive Say's Law is within the mainstream of the profession across many areas, including international trade and open-economy macroeconomics. And by implication, Keynes' rejection of Say's Law and his emphasis on demand-determined output have a relevance for economics that goes far beyond the simple closed-economy confines of the formal part of the *General Theory*.

For the interested lay person and younger economist also, this discussion will be thought-provoking and signal the existence of serious and long-running dissent within a profession that typically does its best to ignore dissent.

Whilst Davidson's extensive coverage probably suits the lay reader and less well acquainted professional, for those knowledgeable of Keynes, of his *General Theory*, and of the plight of its arguments at the hands of the mainstream of the profession in the subsequent 75 years, it may be less satisfying. It will do nothing, for example, to hose down the controversies particularly amongst heterodox economists over the central message of the *General Theory*; the extent to which it departs from orthodoxy; and whether the formal argument in the *General Theory* was sufficiently strong to carry the weight of that message.

Davidson's own answer to the latter two questions is given in Chapter 12 of his book. The intention of the chapter is really to work out who or what was primarily responsible for the failure of the mainstream of the economics profession to fully appreciate the message of the *General Theory*; that no automatic market mechanism existed to push effective demand to a level sufficient to absorb the full-employment level of output, even in the presence of wage and price flexibility. As Davidson notes, the case for asserting that Keynes would have viewed his argument as resting on either wage/price or interest rate rigidities is unconvincing given the intellectual lineage of Keynes and his own statements in the *General Theory*.

So why then was Keynes' claim seen by the majority of the profession as coming to rest on such rigidities? This is the interesting question. Ultimately for Davidson, it is above-all a failure of the mainstream interpreters of the *General Theory* to appreciate that 'the demand for liquidity is the fundamental source of involuntary unemployment' (p. 87); the latter in turn reflecting the existence of fundamental uncertainty or economies characterised by non-ergodic processes. And this is the crux of Davidson's theoretical defence of Keynes against orthodoxy: that uncertainty and the resulting store of value role for liquidity are incompatible with the neutrality of money, and this opens the door to persistent involuntary unemployment independent of market imperfections.

Some other heterodox economists however, including this reviewer, would note that Davidson's argument downplays the significance of weaknesses in Keynes' own argument. In particular, Davidson does not appear to consider the view that the formal apparatus of the *General Theory* was not strong enough to carry the weight of Keynes' claim that no market mechanism could be relied on to correct involuntary unemployment.

In this alternative view (probably most clearly articulated in Garegnani, 1978–79)[1], the desire for liquidity cannot avoid a tendency to full-employment in the absence of the above-mentioned rigidities. In other words, the desire for liquidity was by itself insufficient to ward-off the 'classical' argument and Keynes himself was cognisant of this difficulty in Chapter 19 of the *General Theory.* There, adverse impacts of deflation on effective demand via expectations or via changes in income distribution are the last ditch obstacle to 'classical' full-employment restoration, notwithstanding the existence of a liquidity motive.

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In other words, in this alternative view, what undermined Keynes' claim was his inability to fully escape from the orthodoxy of his day; his inability to escape from orthodox capital theory and the associated concept of a full-employment rate of interest; orthodox arguments we now know are without logical coherence.

For this reviewer, the absence of any consideration of this alternative interpretation — which, like Davidson's, ultimately finds the principle of effective demand to be the basis of a viable, alternative, non-orthodox theory of output — or to engage with it in any serious way in the book, is at the very least curious.

Interestingly, Davidson also refers to correspondence with distinguished orthodox economists such as Robert Solow who have praised his (Davidson's) emphasis on non-ergodic processes. This is also curious, and I would have thought not something that actually helps the case which Davidson seeks to prosecute. Such praise has not stopped Solow from pigeon-holing Keynes' principle of effective demand into the short-run and to continuing to adhere to Say's Law for the long-run (Solow 1997: 232).

As implied above, Davidson's book is to be welcomed as a part of the continuing effort to alert the younger generation of economists and lay person to dissenting thought in economics and the important place in this regard for Keynes' ideas. For some of us that are as equally convinced as Davidson of a role for Keynes' ideas in a non-orthodox alternative economics, the precise nature of that role continues to be a matter of debate.

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Notes

1. One should also consider similar arguments in the volume by Eatwell and Milgate, 1983.

References

Eatwell, J. and Milgate, M. (eds) (1983) *Keynes's Economics and the Theory of Value and Distribution*, Duckworth, London.

Garegnani, P. (1978, 1979) 'Notes on consumption, investment and effective demand' I and II, *Cambridge Journal of Economics,* 2(4), pp. 335–353, and 3(1), pp. 63–82.

Solow, R. (1997) 'Is there a core of usable macroeconomics we should all believe in?', *The American Economic Review: Papers and Proceedings*, 87(2), pp. 230–232.

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