

POLITICAL ECONOMY AND THE OUTLOOK FOR CAPITALISM

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**THE ESSAYS IN PERSUASION OF JOHN MAYNARD KEYNES AND THEIR
RELEVANCE FOR THE ECONOMIC PROBLEMS OF TODAY+**

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Preface

In this work, which is organized in two parts, we wish, in the first, to point out the distinctive role of the *Essays in Persuasion* in the elaboration of his far-reaching perspective, which lies at the heart of the theoretical formulation later on expounded in *The General Theory*. In the second part, also by building on these insights, we outline that the steady increase in public spending and credit creation has little to do with the “failure” of “Keynesian policies” but is significantly related to their role as the main drivers of aggregate profit. We then try to highlight, also by employing a number of psychoanalytic concepts, the major contradictions of the system and the reasons for their persistency.

Finally, in the last chapter we point out the role of policy coordination and of an interdisciplinary perspective for building a more equitable and sustainable society.

Introduction and Synthesis

As is known, John Maynard Keynes occupies a central position in economic and social sciences.

In treating these issues, Keynes challenges mainstream economics’ conventional wisdom not in abstract terms but by employing a new method of research, based on the analysis of the salient aspects of the economic, social and institutional structure.

In this way, fundamental aspects of the economic system — and, in particular, the notions of effective demand, expectations, economic and social interrelations — which could hardly be detected through the mainstream lens of perfect equilibrium, were finally brought to surface and adequately theorized.

In this regard, a central insight of the *Essays* is the link they establish between short term and long-term policies. Contrary to a rather common view, holding that Keynes paid most attention to short term macroeconomic problems, in *The Essays* the long term perspectives of economy and society were given special attention. A radical and progressive solution is proposed for the problems of our societies. In a not very distant future, the economic motive could realistically be set aside and replaced by the full development of human personality and of social relations.

Such transformation, however, is not easy to realize as it demands a major shift in our way of appraising social life. For this reason, the study of these issues demands an

interdisciplinary approach involving also other fields of social and psychological sciences.

Our main conclusions are that the economic and social crisis of today, with its stagflationary dimension, does not depend on the “failure“ of the “Keynesian” policies of the past, but on the growing contradictions of the system, which render public spending and credit creation more and more necessary for ensuring aggregate profit.

For these reasons, attempts to reduce public spending at any cost are unlikely to solve our economic and social problems. Rather, a more effective process of participation and policy coordination is needed, which involves a better use of public spending and is less focused on the agenda of interest groups and more on the real needs of the society.

PART I: THE MAIN ISSUES OF THE ESSAYS IN PERSUASION

1. The Treaty of Peace and the Issue of Reparations

The first part of the *Essays* addresses the main aspects of weakness of the Treaty of Peace stipulated in Versailles in 1919. What is lacking in the Treaty and in the international relations is a vision of economic and social progress based on harmony and cooperation.

The Treaty, in providing a heavy schedule of reparation payments for Germany, went in the opposite direction. This is expressed in the following passage,

“Moved by insane delusion and reckless self-regard, the German people overturned the foundations on which we all lived and built. But the spokesmen of the French and British people have run the risk of completing the ruin, which Germany began, by a Peace with, if it is carried into effect, must impair yet further, when it might have restored, the delicate, complicate organisation, already shaken and broken by war, through which alone the European peoples can employ themselves and live.”, [*Essays in Persuasion*, 1963 (1931): 3-4].

In highlighting the inadequacy of the Treaty, he wonders how Germany can afford to pay a total sum, in the course of thirty years, between 5 and 8 billions sterling.

By elaborating a detailed macroeconomic analysis — which introduces the notion of effective demand — Keynes made evident the impossibility for Germany to fulfil this target.

In fact, in order to obtain the sums for the annual payments, there is no other way that to increase the net balance of exports, by raising the monetary value of exports and/or by diminishing that of imports.

Considering that prior to the first world war Germany had a slight commercial deficit, which were the real possibilities of achieving this objective?

First, increasing the monetary value of exports was a task anything but easy, especially for a Country, like Germany, which had been recently defeated. But, paradoxically, the attainment of this objective would have caused to the victorious nations more harm than benefit. As a matter of fact, the increase of Germany's share of total export would have entailed a correspondent reduction of the share of victorious

Countries. Hence, in this case, the reparation payments would have been obtained at the expenses of income and employment of victorious Countries.

The same reasoning can be applied for the monetary value of imports, which can hardly be reduced without affecting the income and employment of exporter Countries.

Not even a forceful transfer of German workers to the Allies would have secured a gain for them: in fact, these workers, owing to their lower wages, would have crowded out the indigenous workers, with all the implied negative consequences, while in Germany a correspondent reduction in consumption, and then in import, would have occurred.

In short, the only way for Germany to pay the debts was to realize an economic growth neatly superior to those of the Allies. But this objective, of course, was not much appealing for the Allies.

However, notes Keynes, even supposing that a real transfer of resources were made possible through reparation payments, this would not be advisable for moral reasons,

“The policy of reducing Germany to servitude for a generation, of degrading the lives of millions of human beings, and of depriving a whole nation of happiness should be abhorrent and detestable....even if it enriched ourselves....Justice is not so simple. And if it were, nations are not authorised, by religion or by natural morals, to visit on the children of their enemies the misdoings of parents or of rulers.” (*ibidem*: 17,18].

Furthermore, he sets out an interesting reasoning on the importance for Europe to put aside vindictiveness and prevarication and to foster a harmonious system of international relations. This is even more true on the account of the bonds which have tied together especially the Countries of continental Europe. In this regard, he observes that,

“Europe is apart and England is not her flesh and body. But Europe is solid with herself. France, Germany, Italy, Austria, and Holland, Russia and Roumania and Poland, throb together, and their structure and civilisation are essentially one....In this lies the destructive significance of the Peace of Paris. If the European Civil War is to end with France and Italy abusing their momentary victorious power to destroy Germany and Austria-Hungary now prostrate, they invite their own destruction also, being so deeply and inextricably intertwined with their victims by hidden psychic and economic bonds.”, (*ibidem*: 5).

In this sense, the victorious nations were unable to realize that the reparation mechanism, devised by them in order to get a retribution from Germany and put its economy under control, has triggered the incentive for an intensive reindustrialization of German economy. And, even worse, this aspect had contributed to the creation of a climate of intolerance and nationalism, which ended up with the emergence of nazism.

The Relations between Victorious Countries

The interesting aspect of this analysis is that, in considering the problems of war debts, actually deals with the wider issue of economic international relations.

In fact, the reparations constitute only an aspect of a system of credits and debts between states based not on commercial transactions but on political obligations.

With regard to the situation of the years following I world war, one of the reasons why the Allies put pressure for receiving payments from Germany lay in the circumstance that these Countries were heavily indebted also among themselves. In particular, the UK with the USA, and the nations of continental Europe with the UK.

Also in this case, Keynes underscores that a system of artificial transactions would alter and reduce the room for economic transactions and would spoil the complex institutional framework necessary for their unfolding. These concepts are expressed in the following passage,

“The equilibrium of international trade is based on a complicated balance between the agriculture and the industries of the different countries of the world, and on a specialisation by each in the employment of its labour and its capital. If one country is required to transfer to another without payment great quantities of goods, for which this equilibrium does not allow, the balance is destroyed....The *organisation*, on which the wealth of the world so much depends, suffers injury. In course of time a new organisation and a new equilibrium can be established. But if the origin of the disturbance is of temporary duration, the losses from the injury done to organisation may outweigh the profit of receiving goods without paying for them.”, (*ibidem*: 59).

2. The Great Crisis and the Macroeconomic Policies

The second part of the Essays deals with the issue of macroeconomic policies. As is known, in the 1920s one of the major issue, also in its relations with the war debt, was whether or not to join the system of gold standard.

The two alternatives had different implications as regards policy strategies and their underlying theoretical implications.

In this already difficult climate, the eruption of the great crisis has put in full evidence the failure of orthodox policies and the necessity to identify a new course of political economy. Let's now address how these aspects are treated in the Essays.

2.1 Inflation and Deflation

In his account of macroeconomic structures, Keynes analyzes the possible effects of inflation and deflation.

In order to carry an effect on the "real" variables, the changes in prices must be largely unforeseen. In this sense, "It follows, therefore, that a change in the value of money, that is to say in the level of prices, is important to Society only in so far as its incidence is unequal. Such changes have produced in the past, and are producing now, the vastest social consequences, because, as we all know, when the value of money changes, it does *not* change equally for all persons or for all purposes.", (*ibidem*: 80).

If, as it happens in the vast majority of cases, these asymmetries take place, inflation tends to favour debtors, as the real value of debt will be reduced; conversely, deflation will be good for creditors, as the real value of their assets will increase.

Furthermore, inflation is likely to reduce real wages, as they are expressed in monetary terms and only imperfectly incorporate the expectations of inflation.

However, not even deflation is advantageous for workers as it is most often, at the same time, a consequence and a cause of a depressed economic activity.

Deflation, by increasing the real value of credits tends to favour the category of *rentiers*: in this way, it constitutes an additional cost for firms, which carry on with their business also through loans from the banks.

However, the negative effects of deflation on firms are even more far-reaching. In fact, the diminution of prices imply a correspondent reduction of the value of their present

and prospective revenues, with negative consequences on their expectation of profits and their solvency. But this situation for firms, one could argue, can be balanced by a parallel diminution of their costs and/or by an increase of effective demand.

These favourable conditions, however, are unlikely to take place in real situations. In this regard, even if some firms can benefit from a reduction of its costs, the fundamental element is that deflation tends to be accompanied by reduction of effective demand.

The interesting aspect of this analysis is that explicitly introduces the role of expectations. Let's suppose that a restrictive policy has provoked a reduction of effective demand, accompanied by a reduction in prices as an attempt to counterbalance¹ this effect. In this situation, if the producers foreshadow a further reduction of demand, they will decrease even more production and, in this way, will contribute to reinforce such effect. In the absence of an adequate policy strategy, this vicious circle can go on indefinitely. In his words,

“The policy of gradually raising the value of a country's money to (say) 100 per cent above its present value in terms of goods amounts to giving notice to every merchant and every manufacturer, that for some time to come his stock and his raw materials will steadily depreciate on his hands, and to every one who finances his business with borrowed money that he will, sooner or later, lose 100 per cent on his liabilities (since he will have to pay back in terms of commodities twice as much as he has borrowed). Modern business, being carried on largely with borrowed money, must necessarily be brought to a standstill by such a process. It will be of interest of everyone in business to go out of business for the time being....A probable expectation of Deflation is bad enough; a certain expectation is disastrous. For the mechanism of the modern business world is even less adapted to fluctuations in the value of money upwards than it is to fluctuations downwards.” (*ibidem*: 189, 190).

From this analysis a fundamental conclusion ensues: in order to secure the development of economic activities, the prices of goods and services must allow an adequate remuneration of the productive factors. This is expressed by the following aphorism, “When Dr. Johnson, visiting the Island of Skye, was told that twenty eggs might be bought for a penny, he said, ‘Sir, I don't gather from this that eggs are plenty in your miserable Island, but that pence are few’.”, (*ibidem*: 149-150).

¹ In fact, in such circumstances it is unlikely that the elasticity of demand to price will acquire a high value.

In case of inflation, things run in a different way: here, the diminution of the real value of debt and wages, together with the positive expectations which tend to accompany a moderate increase of prices, tend to have a positive effects on economic activities.

For these reasons, although both inflation and deflation are unfair, as they cause an arbitrary redistribution of incomes, inflation is likely to be less damaging, because it tends to be accompanied by an expansion of economic activities.

However, this does not imply, as held by a rather common opinion, that Keynes was a superficial advocate of inflation. Conversely, he points out the importance of the stability of prices,

“Of the two (inflation and deflation) perhaps Deflation is, if we rule out exaggerated inflations such as that of Germany, the worse; because it is worse, in an impoverished world, to provoke unemployment than to disappoint the *rentier*. But it is not necessary that we should weigh one evil against the other. It is easier to agree that both are evils to be shunned. The Individualistic capitalism of to-day, precisely because it entrusts saving to the individual investor and production to the individual employer, *presumes* a stable measuring-rod of value, and cannot be efficient—perhaps cannot survive—without one.”, (*ibidem*: 103).

2.2 The Debate on Gold Standard

In the first post I world war period, in particular in the UK, all the political and economic environment of more orthodox orientation, grouped around the tycoons of banks and financial institutions, made pressure for returning to gold standard.

As is known, the system of gold standard was introduced in the UK after the Vienna Congress, and then was adopted by other important Countries in the course of XIX century. It was suspended during the I world war, reintroduced in the 1920s and then definitely dismissed in the second half of 1930s.

In the 1920s, then, all the discussions centred on the degree of sustainability of gold standard, and its potential costs and benefits.

Before addressing these issues, Keynes underlined the conservative character of such system. In fact, owing to a number of historical and psychological reasons, gold was a symbol of economic power and the idealization of money. For this reason, gold is much more associated to saving than to consumption.

In fact, such a shining and precious money tends to become an object of admiration and idolatry and then should not be spent so easily.

Furthermore, the value of gold is guaranteed by its relative scarcity. However, also for this reason, gold has never played a really relevant role in the organization of monetary systems. In this respect, silver and copper had played a more prominent role as precious coins. The circumstance that gold was introduced as a first money only in the XIX century, observes Keynes, gives to this money the character of a *parvenu*.

The advocates of gold would return to an unattainable past and are, therefore, tendentially conservatives. In this respect, the “friends of gold” believed that the gold standard would contribute to the stability of prices and wages. Their reasoning rested, more or less explicitly, on the neoclassical model which, as is known, assumes as an ideal condition the perfect flexibility of prices and wages. If, then, in a real situation prices and wages are (or are believed to be) too high, the inevitable conclusion is that they must be reduced.

In relation to these aspects, Keynes highlighted that the gold standard and the related restrictive policies are likely to cause many negative effects on the economic system.

In the situation of the UK in the 1920s, this would have implied a substantial revaluation of sterling. But such an objective was virtually impossible to realize, as all the “fundamentals” of economic system had greatly changed over time in favour of the USA. The idea that the UK, by reintroducing the gold standard, could restore its past splendour, was a pure illusion. Hence, the only way to maintain stable the value of sterling was a severe deflation which, however, for the reasons pointed out before, would only worsen the level² of economic activity. These considerations led Keynes to concentrate on the following issue: stability of prices or stability of currency?

² As is known, this really happened in the UK after 1925, when the gold standard was reintroduced.

2.3 Stability of Prices or Stability of Currency?

As a preliminary remark, it is important to note the two variables are structurally correlated: as a matter of fact, exchange rates tend to reflect, however imperfectly, the ratio between internal and foreign prices.

Hence, an increase of internal prices tends to bring about a devaluation of currency, whereas an appreciation of the currency will be triggered by a deflationary process.

This hypothesis, however complicated by numerous other factors, still holds an important aspect of truth. In this regard, Keynes notes that, in order to maintain exchange rates at a sufficient stable level, it is necessary to ensure a substantial stability between internal and international prices.

This implies that the factors of incompatibility between nations should be abated and that a real process of integration among national economies should take place.

Hence, in the absence of these conditions is not possible to maintain, at the same time, stability of prices and stability of exchange rates. If so, which objective should we favour? He argues that the flexibility of exchange rates is the better option, as they can easily absorb occasional fluctuations of prices and can provide a corrective for internal imbalances. However, these policies can work only in the short period, what is needed in the long run is a better coordination of fiscal and monetary policies at national and supranational level.

2.4 The Economic and Social Costs of Unemployment

With the eruption of the great crisis and the related problems of poverty and unemployment, there was the urgent issue to find a solution for these problems.

Keynes, in dealing with these issues, started to elaborate in detail his theory of effective demand.

First of all, he notes that unemployment, besides its psychological and social costs, is costly also in economic terms.

For instance, in 1920s at least one million persons received unemployment compensation for a total amount of £ 50.000.000, corresponding to an average individual amount of £ 50.

Such a situation was unsatisfactory in every respect: it worsened the dissatisfaction and demotivation of persons by leaving them with very scant means, as the subsidy was far lower the average wage, already in itself not very high.

However, the total sum of subsidies reached a considerable amount, which could have been put to better use. The sum of £ 500,000,000, equal to ten years' subsidies, was the double of all the postal saving. This sum, observes Keynes, would have been sufficient for building one million new houses, or one third of all the roads of the Country, or for providing an automobile to a third of families or to allow the entire population free cinema for their life span. And, last but not least, there is the cost of the lost output due to the unemployment. Considering that the net value of individual output on annual base was around £ 220, the total loss of product was equal, for a million of unemployed, approximately to £ 2,000,000,000.

Assuming a ten years period, the correspondent product would have sufficed to build twice the entire railway system and to repay twice the debts with the USA. That sum is higher than the total German debt to the Allies.

2.5 Saving, Investment, and the Origin of the Theory of Effective Demand

Once recognized the multiple costs of unemployment, there arises the problem of identifying the causes and the policies for counteracting this phenomenon.

The main cause of unemployment lie in the insufficient level of effective demand related to the potential output.

In order to create employment, with given productive techniques, it is necessary to generate an adequate level of consumption and investment. But in capitalistic economies, there are no "automatic mechanisms" **(i)** able to bring consumption and investment to full employment level and **(ii)** to maintain this equilibrium, once it has been attained.

It is from this reasoning that emerges a central concept of Keynesian theory, namely, the equilibrium of under-employment.

But how can, contrary to what maintained by the so-called Say's law, aggregate demand consistently diverge from aggregate supply? Such divergence stems from the easiness with which aggregate saving tends to exceed aggregate investment. This circumstance reflects the incapacity of a part of aggregate saving to generate effective demand. In his words, "When investment runs ahead of savings we have a boom, intense employment, and a tendency to Inflation. When investment lags behind, we have a slump and abnormal unemployment, as at present.", (*ibidem*: 124).

In this regard, the conventional wisdom according to which in order to promote economic growth we need to increase saving is totally ungrounded, especially in time of depression. In this case, in fact, the main problem is that workers and capital goods are kept idle by lack of investment which, in turn, depends on the lack of effective demand, especially in the consumption sector. In this situation, a further act of saving, while useless for increasing an already overabundant supply of workers and capital goods, will diminish the effective demand, with further negative consequences on income and employment. In his words,

“The best guess I can make is that whenever you save five shillings, you put a man out of work for a day....on the other end, whenever you buy goods you increase employment...For take the extreme case. Suppose we were to stop spending our incomes altogether, and were to save the lot. Why, everyone would be out of work. And before long we should have no incomes to spend. No one would be a penny the richer, and the end would be that we should all starve to death.” (*ibidem*: 152, 153).

The reason why many people believe in the necessity of saving is that they believe that we are too poor, so that we cannot afford too much consumption. This belief is groundless in many cases. As we will see later on, a psychoanalytic explanation can cast much light on the role that *superego*, and the related feeling of guilt for “consuming³ too much”, can play in these dynamics. These feelings are acutely grasped by Keynes,

“I fancy that a reason why some people are a little horrified at my suggestions is the fear that we are much too poor to be able to afford what they consider to be extravagance. They think that we are poor, much poorer than we were and that what we chiefly need is to cut our coat according to our cloth, by which they mean that we must curtail our consumption, reduce our standard of life, work harder and consume less; and that that is the way out of wood. This view is not, in my judgment, in accordance with the facts. We have plenty of cloth and only lack the courage to cut it into coats.”, (*ibidem*: 154-155).

³ Needless to say, it would be appropriate to analyse the responsibilities of our system of development in causing poverty and marginalization and to find the most appropriate policies for these problems. What are we referring now and later is the partly neurotic feeling of guilt arising from the conflicts associated with the emergence of *superego*.

What are the factors which determine these imbalances? Keynes underscores the importance of the marginal efficiency of capital (MEC), which is defined, as is known, as the discount rate which equalizes to the present the expected return of an investment. Hence, a higher level of interest rate would diminish the value of MEC whereas a lower level would increase it. However, there is here an important asymmetry, which constitutes the starting point for his theory of the preference for liquidity. As a matter of fact, the negative effect on investment of an increase of the interest rate is much more certain than the positive effect of a reduction. In the first case, the increase of interest rate will affect the cost of borrowing and then the value of MEC, whereas in the second case, especially when the value of interest rate is fairly low, there is no guarantee that its further reduction would improve significantly profits' expectations.

In Keynes' reasoning, a fairly low level of interest rate can be considered a necessary but not sufficient condition for ensuring an adequate level of effective demand. To that purpose, the role of expectations remains paramount because, as we have just noted, they constitute a central component in MEC's dynamics. The emphasis put by Keynes on the role of expectations has led several observers, more or less explicitly, to stress the role of extra-profits in ensuring an adequate level of MEC. However, ascribing this kind of reasoning to Keynes seems ill-grounded. True, better profit expectations will reinforce positive expectations, but in Keynes two other factors play a paramount role: **(i)** the dynamics of effective demand, which can be negatively affected by an income distribution too favourable to profits, as the marginal propensity to consumption is likely to be lower for higher incomes; and **(ii)** The role of "animal spirits", which can be defined as an instinct or propensity to act which the person pursues on its own sake, and not just out of a "strict and rational" economic calculation. This notion has important parallels with Veblen's instincts of workmanship and parental bent and with many psychoanalytic studies which stress the capacity of "work and love" as important signs of a person's mental health.

From this notion, a fundamental conclusion follows (cf. also the next chapters), whose relevance for policy action can hardly be exaggerated: since persons carry with them propensities and orientations much more complex than a reductive conception of *homo oeconomicus*, this implies that the so-called "economic motive" can and must be replaced in relatively short time by a better expression of the true orientation of the person. If so, extra-profits are not needed, not even today, for increasing the level of expectations: what is needed, is a general optimistic flavour arising from the economic

and social system. In such case, as explicitly highlighted by Keynes (in particular in the final chapter of the *General Theory*), also a lower level of profits can be sufficient for ensuring an adequate level of investment.

2.6 The Role of Expansionary Policies

From these considerations, Keynes highlights the inadequacy of orthodox policies to solve the problems of economic crises.

What is highly needed for overcoming the slump is an expansionary policy, in which public investment in programs of social utility would play a significant role.

A policy of this kind, especially in a situation of marked underemployment of resources, is unlikely to cause the problems of inflation and crowding out of private investment pointed out by orthodox theories.

Warning public opinion against these risks is like warning an emaciated patient about the risks of excessive corpulence. In this sense, orthodox policies, by prescribing a strict diet to the emaciated patient, run the concrete risk of killing him. In his words,

“Negation, Restriction, Inactivity—these are the Government’s watchwords. Under their leadership we have been forced to button up our waistcoats and compress our lungs. Fears and doubts and hypochondriac precautions are keeping us muffled up indoors....The patient does not need rest. He needs exercise. You cannot set men to work by holding back, by refusing to place orders, by inactivity. On the contrary, activity of one kind or another is the only possible means of making the wheels of economic progress and of production of wealth go round again....The future holds in store for us far more wealth and economic freedom and possibilities of personal life than the past has ever offered.”, (*ibidem*: 133, 153).

In the next chapter, we will address the long term perspectives of Keynes’ theory and their implications for policy action.

3. The Political Vision and the Long Term Transformations of the System

3.1 The End of Laissez-Faire and the Emergence of “Concerted Capitalism”

In the final part of the Essays, Keynes expounds his vision of politics and society. First of all, he notes, the political ideals and policy proposals should be based on the concrete analysis of the transformations of the economic and social structures.

In his famous essay, “The End of Laissez-Faire”, he remarks that the world has profoundly changed in respect to the individualistic capitalism of XIX century. As a result of the growing complexity of the system, capitalistic societies tend to become more and more dependent for their development on the “agency of collective action”. In his account of this process, he employs the conceptual framework elaborated by John Rogers Commons (one of the main founders of institutional economics) which identifies three stages in the development of capitalism: **(i)** the period of scarcity, in which there was “the minimum of individual liberty and the maximum of communistic, feudalistic or governmental control through physical coercion”; **(ii)** the period of abundance, characterised by “a maximum of individual liberty, the minimum of coercive control through government, and individual bargaining takes the place of rationing”; **(iii)** the third period is that of “stabilization” — which Commons considers a happy medium between the drawbacks of unregulated capitalism and centralized communism — whose main features are “a diminution of individual liberty, enforced in part by governmental sanctions, but mainly by economic sanctions through concerted action, whether secret, semi-open, open, or arbitrational, of associations, corporations, unions, and other collective movements of manufacturers, merchants, labourers, farmers, and bankers.” (*ibidem*: 334, 335).

3.2 What Role for Public Intervention?

Within this growing socialization of capitalistic systems which, for this reason, tend to assume more and more the character of a mixed-economy, Keynes underscores the importance of identifying an appropriate scope for public action.

By pioneering the modern concept of subsidiarity, he remarks that public intervention should be focussed on the areas in which, for various reasons, private action tends to be insufficient. Public action, however, should not assume the character of centralized power: even here, by showing remarkable “prophetic” qualities, he highlights the role of

semi-autonomous bodies, like the Authorities, ideally situated between the person and state, but carrying a public purpose and accountable to Parliament.

Both through the action of these bodies and through direct policies, Keynes considers paramount the involvement of public sector in the following fields: international relations, fiscal and monetary policies, structural policies related to promotion of investment and to the realization of infrastructures and other social objectives.

3.3 The Political Vision

In the essay “Am I a Liberal?” Keynes illustrates his political ideas. In his conception the main goals of human progress should integrate the objectives of technical efficiency, social justice and individual freedom. In this respect, he thinks, neither Conservative Party nor Labour Party has fully succeeded in promoting such development.

The first, because based on the impossible goal of returning to wild individualism and *laissez-faire*, the second because resting, at a greater or lesser extent, on a “philosophy of centralization” which allows little room for individual initiative and creativity.

In his view, and although not fully agreeing with all its policies, he believes that the Liberal Party could constitute a happy medium between the two major Parties. In particular, he hopes in a better collaboration between the Left Wing of the Liberal Party with the Right Wing of Democratic Party. In his words, “I am sure that I am less conservative in my inclinations than the average labour voter....The Republic of my imagination lies on the extreme left of celestial space. Yet—all the same—I feel that my true home, so long as they offer a roof and a floor, is still with the Liberals.”, (*ibidem*: 341).

As appears clearly, one need not agree on this viewpoint for recognizing that Keynes’ position is much articulated and cannot be reduced to easy simplifications.

3.4 The Long Term Perspectives

As is known, Keynes, owing to his proposals for recovering from economic depression, is often considered as the theorist of short period. This opinion tends to be reinforced by his famous expression “in the long run we will be all dead”.

However, from the reading of the Essays we discover that the long term perspectives of economy and society play a paramount role in his analysis.

For Keynes, focusing the analysis also on short-term problems constitutes only a part of more profound awareness of the structural transformations of society. Although it is very difficult to forecast the details of these changes, it is possible to identify a number of significant tendencies. One of them, as noted before, relates to the growing importance of institutions and organizations for the working of the “mixed-economies” of today. This implies a growing socialization⁴ of the system.

The full unfolding of these tendencies can open new avenues of progress, in which the “economic motive” associated with the more detestable traits of capitalism — selfishness, greed, avarice — can gradually become unimportant and be replaced by social and cooperative relations. The focus of these changes will be on a substantial reduction of the working-hours, made possible by the increase of productivity and by less emphasis on over-consumption. The main obstacle to the realization of this potential lies not in technical but in psychological difficulty. He notes, with great psychological insight, that the latter obstacle relates to the difficulty of people to employ leisure time for a better realization of their personalities. This can also be due, (cf. also the next chapters) to an unconscious feeling of guilt related to the presence of *superego*.

⁴ These aspects were acutely addressed, in particular, in John Kennett Galbraith’s *The Affluent Society* and in Fred Hirsch’s *Social Limits to Growth*.

PART II: IMPLICATIONS FOR CONTEMPORARY ISSUES

Introduction

As we have seen, the *Essays* develop a rich theoretical framework for the analysis of the major economic problems of post I world war period, which remains relevant even in our days. In fact, the concepts elaborated — in particular, the role effective demand, expectations, public intervention — pinpoint the importance of economic and social interdependencies⁵ and the consequent need to realize an adequate institutional and policy coordination for ensuring a balanced development of the systems.

However, in our time the Keynesian revolution is regarded with much more⁶ diffidence than before. In fact, the “conventional wisdom” of today is that Keynesian theories can have a validity in the case of the underfed patient but no longer in the case, as it seems to be today, in which the patient seems to have grown too fat. This conclusion has been reinforced, especially after the first shock oil of 1973, by the emergence of a stagflationary situation, which was promptly taken as an “obvious” evidence of the failure of Keynesian theories.

However, as we will try to make evident later on, the reasons for stagflation do not depend on the supposed “failure” of Keynes’ theories—even if it can be true, that under the label of “Keynesianism”, the policies of public spending were not always well directed.

In reality, the reasons for the emergence of these phenomena are much more complex and are strongly related to the role of public spending and credit creation as the fundamental drivers of aggregate profit of private sector.

⁵ As elaborated in more detail in the *General Theory*, the concept of effective demand was virtually non-existent in classical and neoclassical theory as they utterly adhered to the so-called Say’s law, according to which every supply would “automatically” create a corresponding demand. For this reason,, in mainstream economics only individual demand and supplies are considered, which are supposed to reach their level of “maximizing equilibrium” through the working of an abstract concept of market.

Conversely, in Keynes’ theory the micro and macroeconomic imbalances — which tend to cause a structural tendency of effective demand to diverge from effective supply — are considered as the normal way of functioning of modern economies. For this reason, it becomes relevant, in order to devise adequate policies, the study of economic system in its real features. This implies a thorough account of the institutional and social framework within which the economic system is “embedded”.

⁶ True, as it happens for many new theories, the process of assimilation is very complex as the old theories are “reluctant” to being dismissed. In this regard, also in the heyday of Keynesian revolution there was a silent attempt to minimize its theoretical and policy impact.

Hence, also in our days, the crux of the problem lies in the underemployment of resources. The main difference is that now the problem is more widespread, as it involves the structural transformations of the “fundamentals” of the economic system. In the next chapters we will address some aspects of these issues.

4. The Impressive Increase of the Ratio of Public Spending on GDP

Available⁷ data from the OECD underscore a sharp increase in public intervention.⁸ The average value of Public Spending to GDP on GDP has increased from 20-30 percent during the 1970s to 40-50 percent today for the overwhelming majority of OECD Countries. This phenomenon was first highlighted by Adolph Wagner, who observed⁹ that economic and social progress requires enlarged and diversified functions of the public sector, including law enforcement, welfare provisions, and also more proactive functions such as research and innovation.

⁷ This part is based on the article “Policy Responses to Economic and Financial Crises: Insights from Heterodox Economics and Psychoanalysis”, forthcoming in *International Journal of Pluralism and Economics Education*.

⁸ The same phenomenon applies to credit creation for the firm and consumer, which has constantly increased during the post-war period. For an illuminating analysis see [Galbraith (1998) (1958)].

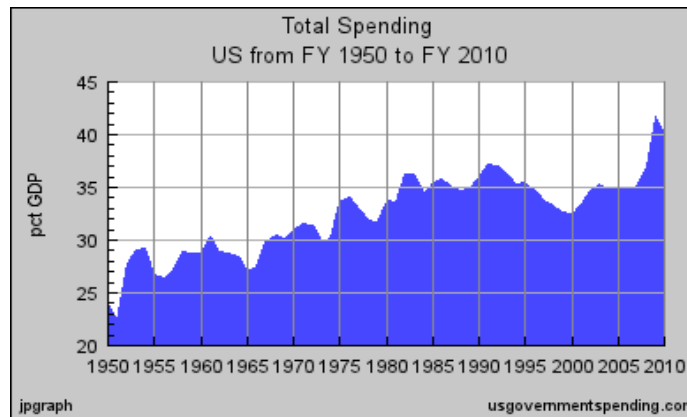
⁹ Adolph Wagner (1835-1917) was a German economist and politician — belonging to the tradition of German historical school and of State Capitalism — who highlighted the role of public spending as a way to mitigate the most negative and disruptive effects of capitalistic development. For this reason, he predicted a steady increase of public spending and, on that basis, formulated its famous law of the growing importance, both in absolute and relative terms, of public sector. Most of his contributions are German-written, the most salient aspects of his theory are contained in Jürgen G. (ed.), *Essays in Social Security and Taxation. Gustav von Schmoller and Adolph Wagner Reconsidered.*, Marburg, Metropolis, 1997.

TABLE 1
Total Public Spending
as a Share of GDP

Nations	2009
Australia	37.19
Austria	52.97
Belgium	54.11
Canada	44.37
Chile	24.62
Czech Republic	45.95
Denmark	58.42
Estonia	45.17
Finland	55.86
France	56.74
Germany	47.50
Greece	52.85
Hungary	50.54
Iceland	51.05
Ireland	48.17
Israel	44.27
Italy	51.83
Japan	42.03
Korea	33.08
Luxembourg	42.19
Mexico	23.51
Netherlands	51.35
New Zealand	42.33
Norway	47.31
Poland	44.51
Portugal	49.85
Slovak Republic	41.54
Slovenia	49.16
Spain	45.80
Sweden	55.15
Switzerland	34.15
Turkey	39.44
United Kingdom	51.45
United States	42.18
Euro Area	50.84

Source: OECD

GRAPH 1



Source: usgovernmentspending.com

These insights have triggered three lines of research: **(i)** public choice, chiefly belonging to neoclassical¹⁰ economics, which pinpoints the role of interest groups in lobbying the political system for obtaining more public resources in their favour. This research tends to consider public spending negatively—an unwelcome departure from the perfect world of neoclassical economics. **(ii)** Theories of institutional and evolutionary economics, which investigate the potential of the institutional framework for developing a national system of science and innovation, along with human and social capital. **(iii)** Keynesian theories, which investigate the role of public spending and credit creation in ensuring macroeconomic stability and the full employment of the labour force.

Especially in the last two decades, strands **(i)** and **(ii)** have received more attention than the third. In particular, both critics and advocates of public spending implicitly agree that today's level of public spending is too high¹¹ and should be reduced.

¹⁰ As is known, neoclassical economics belongs, together with classical economics, to the field of orthodox or mainstream economics. Although mainstream economics is still “mainstream” in many respects, the last two decades have witnessed a growing importance of heterodox economics which, as is known, include the fields of Institutionalism, Marxism, Keynesian theories, Green economics, Austrian economics.

¹¹ It can be interesting to try to foresee the medium and long- term trends in the ratio of public spending to GDP. We believe this trend will likely continue, but at a diminishing rate. In fact, the tendency of our mature economies is toward a lower level of growth — which can also become a de-growth in the long run — for a number of structural reasons. Thus, the focus should shift toward the qualitative side of development, also for ensuring a better environmental sustainability. As foreshadowed within different theoretical contexts by Keynes, Galbraith and many others, the future society must substantially depart from present-day economic organization, to be based less on a notion of work as toil; and more on **(i)** participation and creativity in the workplace and **(ii)** social and cultural activities within an increased amount of leisure time. This evolution is likely to be accompanied by a growing relevance of the so-called “mixed forms” of economic activities, based on a complex intertwining of

Nevertheless, since the data indicate that such large increases in the PS/GDP ratio is fully compatible with the evolution of capitalistic systems, i.e., “mixed economies”, a macroeconomic explanation along Keynes’ insights is highly needed.

It should be stressed that Keynes was never a blind advocate of public spending as such. He investigated the importance of public spending as a component of aggregate demand and was well aware of the contradictions of the system. He argued in *Essays in Persuasion* (1931) and in *The General Theory* (1936) that any increase in public spending should minimize its impact on **(i)** the real interest rate and **(ii)** the level of taxation on productive activities.

Public spending is relevant for private sector not only as a component of aggregate demand but also because it plays (along with credit creation) an important role in the formation of the aggregate profit of firms. Since this aspect, however central in Keynes’ theory, remains partly implicit in his analysis, in the next section we try to “disentangle” the macroeconomic components of aggregate profit.

different actors and institutions. One obstacle to the realization of this potential rests in the role of *superego* (see below).

5. Public Spending and Credit Creation as the Drivers of Aggregate Profit

Let us consider some macroeconomic effects of public spending and credit creation. As can be inferred from Keynesian theories¹², these elements become vital for generating the aggregate profit¹³ for private firms. Aggregate profit can be defined as the amount of profit which exceeds the “normal” incomes of all the workers (in the sense of all the waged and salaried people) engaged in the private sector, and then also including the “executive-salaries”. Labour incomes constitute an aggregate cost for the system of firms, which reaches zero if the workers spend all their earnings but can never become a source of profit. But, interestingly, not even the entrepreneurs’ investment expenses can create an aggregate profit for firms as a whole. As a matter of fact, to the profit of one entrepreneur must correspond the expense of another, so that the net result for the firms is zero.

Consequently, aggregate profit must derive from sources external to the system of firms: these sources — not considering, for the sake of simplicity, international trade whose balance¹⁴ is zero at the world-level — take two interrelated forms: public spending and credit creation. We can express these relations as follows:

¹² For an analysis of relevant aspects of Keynesian theory, see to (Lee 1998); and (Arestis and Sawyer 2010).

¹³ For the purpose of this work, we can define aggregate profit as the difference between the overall proceeds and costs of the system of firms. It can be interesting to note this definition acquires a distinct evolutionary nature, as it depends on the complex evolution of the legal, economic, social and institutional framework within which the concepts of cost and proceeds have been created and evolve therein. Within this context, aggregate profit can exist in a hypothetical pure private economy, but it is unlikely that it would acquire the nature of the extra-profits, typical of expansionary periods, driven by public spending and credit creation. In a pure private economy, the income differences between persons and classes reaches a limit in the principle of the effective demand. For instance, if the entrepreneurs want to increase their profits by reducing real wages, they must make up for the resulting reduction in the effective demand. In a private economy, as investment goods are intrinsically related to consumption goods, the only available way for increasing the effective demand is to attain a higher level of the entrepreneurs’ consumption. However, this process finds many limitations, especially in the presence of scale-economies associated with mass consumption (the entrepreneur can buy himself a yacht, but for the class of entrepreneurs buying, say, one thousand iPods in order to sustain aggregate demand is likely to be a bit a less practical). It is important to underscore that all these economic relations embody, at the same time, also a social, cultural and psychological aspect, the study of which becomes paramount for a full understanding of the real features and problems of the examined contexts.

¹⁴ This is a gross simplification: in fact, as well underscored by the theories of unequal exchange, the total effects of international trade tend to adversely affect the weaker countries.

$$1. \quad \mathbf{P} = \mathbf{a}\mathbf{m}\mathbf{G} + \mathbf{b}\mathbf{m}\mathbf{CD} + (\mathbf{1} - \mathbf{a})\mathbf{m}\mathbf{G} + (\mathbf{1} - \mathbf{b})\mathbf{m}\mathbf{CD} + \mathbf{C}_p + \mathbf{I}_p - \mathbf{L}$$

where **P** denotes gross¹⁵ aggregate profit for the system of private¹⁶ firms; **C** and **I** aggregate consumption and investment; **G** public spending and **CD** the amount of demand generated by credit creation; **L** the sum of gross labour incomes, including the “executive salaries”; **m** the value of income multiplier $\frac{1}{1-c}$ where **c** is the marginal propensity to consumption; the two pairs **a** and **b**, and **(1- a)** and **(1 - b)** the ratios of the aggregate demand generated by public spending and credit creation accruing to private profits and to labour incomes; **C_p + I_p** the sum of consumption and investment originated in the private sector. **CD** indicates that, in a monetary economy, credit (both short and long-term) is created through the provision of new purchasing power (e.g., money creation) made available to borrowers. In this context, **P** constitutes a fraction of the aggregated income, expressed by the familiar identities:

$$2. \quad \mathbf{Y} \equiv \mathbf{C} + \mathbf{I} + \mathbf{G}$$

$$3. \quad \mathbf{C} + \mathbf{S} \equiv \mathbf{Y} \equiv \mathbf{C} + \mathbf{I} + \mathbf{G}$$

Assuming that private income is distributed between profits, and wages and salaries, the above identities can be expressed as:

$$4. \quad \mathbf{P} + \mathbf{L} \equiv \mathbf{C} + \mathbf{I} + \mathbf{G} \equiv \mathbf{a}\mathbf{m}\mathbf{G} + \mathbf{b}\mathbf{m}\mathbf{CD} + (\mathbf{1} - \mathbf{a})\mathbf{m}\mathbf{G} + (\mathbf{1} - \mathbf{b})\mathbf{m}\mathbf{CD} + \mathbf{C}_p + \mathbf{I}_p$$

Now, considering a “pure system” of private agents, we obtain:

¹⁵ In this simplified analysis, we do not assume particular hypotheses as to the level of taxation and the corresponding level of public budget’s balance. It is important to recall from the “Haavelmo’s theorem” (1945) that public spending is likely to positively affect aggregate demand even with a corresponding level of taxation, since the marginal propensity of consumption of the public sector is likely to equal unity, whereas that of private sector is likely to be less.

¹⁶ The multifarious aspects of the growing complexity of the system also find expression in a parallel articulation of the structure of ownership of the firms, with the presence of many “mixed” forms. It is interesting to note that the above analysis also applies to the case of state-owned enterprises, provided they are organized as administratively independent bodies.

5.
$$P + L \equiv C_p + I_p \equiv C + I$$

which implies that in a private system, without public spending and credit creation, the sum of consumption and investment tends to equal wages and salaries; thus there is little room for aggregate profit, for the reasons described above.

Another implication of this analysis is that in the familiar identity $Y \equiv C + I + G$ the terms I and G are not mutually replaceable. For instance, let us suppose that, at the time zero:

6.
$$Y_0 \equiv 800 + 50 + 150 \equiv 1000$$

In this case, neoclassical theories posit that a reduction, say, by 100 in public spending would entail a parallel increase in I . In the opinion of many, if 1000 is an equilibrium of underemployment, the reduction in public spending could generate an increase in I even higher than the correspondent reduction in public spending. In this way, the new level of Y_1 would be higher than Y_0 . By assuming, for the same marginal propensity to consume of 0.8, that the decrease in public spending by 100 is accompanied by an increase of I equal to 150, we obtain:

7.
$$Y_1 \equiv 1000 + 200 + 50 \equiv 1250$$

However, this idyllic result for neoclassical economics is hard to be attained as the hypothesis of perfect substitutability between I and G is unrealistic, since public spending and credit creation are the main drivers of aggregate profit. Furthermore, perfect substitutability between I and G finds a limit since the amount of investment goods is functional to the amount of consumption goods that firms plan to produce which, in turn, depends on the available income of the labour force. We can represent this situation with the general equation:

8.
$$C = f(I)$$

We define this equation general in order to imply that to produce a given amount of consumption goods many methods are possible. However, the possibility of choosing different productive techniques does not imply perfect flexibility of productive factors as postulated by neoclassical economics. Quite the contrary, our formulation takes into account that any productive process — with their present and prospective techniques — is highly evolutionary and path-dependent as it is fully ingrained in the complexity of the social and cultural context. In any event, for whatever productive technique employed at the time, a fundamental implication of the Keynesian theory of effective demand is that investment expenses are made to produce a programmed amount of consumption goods; hence, the trend of the demand for consumption goods will affect, positively or negatively, the demand for investment goods.

This analysis implies that a “perfect” private economy is unlikely to be attained in the modern world. Such an economy, in allowing little growth, little innovation and little change, is similar to the steady state familiar in economics textbooks. Such economy is compatible only with very simple¹⁷ economic systems, based on vicinity and direct personal relations. But, as soon as these systems start growing, the role of the public sector becomes crucial. Both public spending and credit creation originate from public intervention. In fact, public sector (meant in a broad sense and then including also the Central Bank) plays an exceedingly pivotal role in creating and guaranteeing the value of money. The reason why we accept banknotes of intrinsic minimal value is that we are fairly confident that their real purchasing power is monitored and guaranteed (up to a certain degree, of course) by public action; thus money is a highly institutional phenomenon.

Public spending and credit creation can contribute to the formation of aggregate profit in numerous ways. For public spending, in particular, **(i)** classic multiplier effects related to public consumption, public investment and civil servants’ incomes; and **(ii)** subsidies and incentives to firms, which can accrue to firms’ investment expenses. And, for credit creation, the various types of consumer credit and investment credit, which also combine to shape the level and forms of public spending.

On the basis of this analysis, the so-called *crowding out* effect of public spending — which constitutes a central tenet of neoclassical theory — has only, if any, a limited effect on the economy. In a “pure private economy” aggregate profit is unlikely to be

¹⁷ According to neoclassical hypotheses, in this kind of economy everybody can, like in the Garden of Eden, maximize their utility function. However, human societies have always been, even in the simplest economies, more complex. For this reason, the Garden of Eden is unlikely to be attained by the neoclassical shortcut of tending to deny the complexity of human mind and human societies.

very high since public spending and credit creation play the fundamental role for system growth, and each contributes a relevant part of the aggregate demand which accrues to the private sector.

For instance, decreasing values of the multiplier (and/or of the parameters a and b of the expression 1) demand a higher level of public spending and/or credit creation in order to ensure the same level of aggregate profit.

Indeed, the structural tendencies of modern economies strongly suggest an increasing difficulty of public spending and credit policies to generate aggregate profit. This constitutes a key reason for today's negative orientation toward public spending. In fact, such reduced effectiveness of public spending in generating aggregate profit tends all too easily to be attributed to a (supposed) failure of Keynesian theories. However, the reality is much more complex and simply indicates that, as repeatedly stressed by Keynes himself, the increase in public spending *per se* is unlikely to solve the long-standing contradictions of the systems.

These tendencies and contradictions are not deterministic in nature, but reflect the multiple linkages between economic, social and cultural evolution. Obviously, these relations do not take place in a *vacuum* but are heavily embedded in the social and cultural domain; thus an interdisciplinary approach can investigate more deeply into the microfoundations of the macroeconomic aggregates.

6. The Growing Contradictions of the System

As we have seen, the increasing need of public spending and credit creation for ensuring an adequate level of aggregate profit engenders many problems. Thus, the present financial crisis does not depend on past Keynesian policies and/or on an alleged inefficient and lobbistic nature of public intervention — even if, of course, it is true that public spending is likely to be driven, by a greater or lesser extent, by the dynamics of various interest groups — but on the failure to properly locate and manage the growing contradictions of the system which, for this reason, tend to become more and more unmanageable.

For instance, there is a macroscopic and disruptive contradiction — which has paved the way for the eruption of the present-day economic and financial crisis — between **(i)** most credit policies, which aim to increase, also through well organized advertisement strategies, an individual's spending capacity well beyond their real earnings; and **(ii)** business strategies which, in order to gain price competitiveness, tend to reduce workers' incomes and guarantees to a minimum.

Under these growing burdens, personal distress and bankruptcy are likely to arise, with the spreading of their negative social consequences to the whole system.

In this way, it becomes possible to look more deeply into the relations of accumulation in a monetary economy, expressed by the familiar relation $\mathbf{M} \rightarrow \mathbf{C} \rightarrow \mathbf{M}'$, which means that, in a capitalistic economy, all economic transactions are, at the same time, monetary transactions, and hence, for a growing economy this involves, for the same level of prices, a continual accrual of the monetary value of transactions. As is known, this formulation was proposed by Marx and then elaborated by Keynes and other scholars and is a cornerstone of economic theory. It is also interesting to note that the Keynesian theoretical framework has significant parallels¹⁸ with the Marxian theory of the falling rate of profit.

¹⁸ As is known, in Marx's analysis the rate of profit is equal to $\frac{S}{v + c}$ where S is the total surplus value, v is

the variable capital and C is the constant capital. As the surplus value originates only from the variable capital — and is equal to the total hours of labour minus the hours of work necessary to reconstitute the workforce — the rate of profit will diminish owing to the increase of the relative importance of constant capital C . This phenomenon is mainly due to technological innovation which aims to substitute more automated systems of production for workforce. In order to counteract this negative effect on aggregate profit, an increase in public spending and credit creation can become even more necessary.

As these aspects become more complex and interrelated, an adequate level of policy coordination becomes paramount for moving along new avenues of economic and social progress. In fact, owing to this complexity, policy measures taken in an uncoordinated and piecemeal way are unlikely to be successful. As a result, a feeling of frustration and pessimism can ensue, with a falling back to a “market fundamentalism” attitude.

This situation can trigger a vicious circle: as a result of the structural tendency towards increase in public spending, the opinion develops — even amongst progressives — that the only remedy to the present crisis consists in a substantial reduction of public spending and the public sector deficit. Although these targets¹⁹ are quite different, in the conventional wisdom, and also in the unconscious perception, they tend to be equalized. The basic and widespread perception is that public spending is too high and so must be abated at any cost.

6.1 A Psychoanalytic Interpretation

In these situations, in which the only faith in economic progress rests on a kind of a wild and unregulated competition, the market tends to be psychologically perceived as an inflexible and punitive *superego*. As is known, the *superego* arises from the internalization of the prohibitions and of the moral and cultural values — as perceived by the child — of his/her parents and also of later institutional figures such as teachers and other opinion leaders. The *superego* is mostly unconscious, in contrast to the *ego* which plays, chiefly at a conscious level, the role of coordination and synthesis of the different instances of the mind. The *superego* certainly stems from a normal human tendency to establish sound interpersonal relations, and, accordingly, to behave with affection and solicitude towards each other and continually improve the positive aspects of personality. However, whereas in non-neurotic situations the code of conduct emerging from such tendencies asserts itself as a genuine behaviour, in neurotic situations leading to the formation of *superego* things run in a completely different way: here, the tendency of improving personality tends to be, under an appearance of goodness and morality, subordinated to the expression of neurotic contents at cross-purposes with such tendency.

If so, we should comply with the needs of the market, without further enquiry on the

¹⁹ As a matter of fact, public budget's deficit can be reduced not only by cutting expenses but also by increasing taxation.

adequacy of the system to respond to the profound needs of economy and society. By contrast, public spending, owing to its (more or less real) protective and reassuring character, can easily be likened to a maternal figure. In this light, are we sure that the continual reduction of the workers' incomes and welfare provisions will really help to sort out the problems? Our impression, instead, is that these measures are likely to worsen a vicious circle of economic and social crisis, most often accompanied by an increase of phenomena of xenophobia, racism, intolerance and disruptive rivalry in the international relations.²⁰

Psychoanalytic theories can provide significant explanations for the emergence of these phenomena. As noted by Freud and subsequent psychoanalysts, group cohesion tends to be based on the following processes: **(i)** emotional links among the members of the group; **(ii)** projection of individual aggressiveness into people and/or institutions lying outside the group; **(iii)** identification with the group leader — who symbolizes the parental instance (typically, the father) — in order to repress the conflicts related to the *Oedipus* complex.

These processes — which operate partly at an unconscious level and may be partly driven by neurotic conflicts — can help explain the scission that often occurs within groups between the good and right, lying inside the group, and the bad and mistaken, lying outside its boundaries.

These contributions stress the role of groups and organizations for expressing the needs and conflicts of the person. For instance, to the person, the group may represent an idealized *ego*; and, in this connection, its morals and code of conduct symbolize parental figures who, through a process of internalization, play the role of *superego*.

Quite often, however, the severity of superego leads — through the so-called paranoid and narcissistic transformation of personality, extensively studied in psychoanalysis — single individuals, groups or societies toward nasty and persecutory actions against other individuals, groups or societies into which their aggressiveness has been projected, and so to sabotage, in the meaning reviewed before, the possibility of establishing sound interpersonal relations. These psychological processes can help explain — and history is full of such instances — the neurotic roots of many

²⁰ For more details about the main psychoanalytic contributions, with particular attention to those dealing with collective phenomena, see Freud (1912-13, 1921, 1942, 1930, 1933); Klein (1964, 1975); Bion (1970); De Board (1978); Fine (1979); Gabriel (1999); Gay (1985), Kernberg (1998); Pervin and John (1997); Sandler and Dreher (1996); Sullivan (1964).

phenomena of violence, exclusion and marginalization, which tend to be reinforced, in a kind of vicious circle, by economic and social crises.

In order to better understand these complex phenomena, an enquiry into how people perceive market phenomena becomes pertinent: for instance, if, as just noted, the market is appraised as an inflexible and punitive *superego*, this means that persons try to repress their neurotic aggressiveness, which, however, can find expression in the marketplace and other institutions²¹ in a more or less disguised way.

Thus, a psychoanalytical interpretation can cast new light on the unconscious reasons behind the need of reducing public spending: such need may refer to the child's desire of possessing his/her mother's affection and nourishment and to the guilt that often arises in relation to such a desire. In fact, as well expounded by the contributions of Sigmund Freud, Melanie Klein and many others, the child, in his/her early relations with the parents, is likely to experience complex feelings — which can include anger, rivalry, ambivalence and frustration — related to his/her desire²² of being nourished and protected.

These conflicts can help explain today's widespread opinion on the necessity to lessen at any cost public spending. However, for the reasons we have tried to set forth, these attempts are unlikely to improve the situation. Conversely, these measures tend, by affecting the many incomes depending (directly or indirectly) on public spending, to exacerbate economic and social problems. In this regard, the real issue is to focus public spending less on the agenda of the various interest groups and more on proactive policies for economic and social progress.

²¹ These issues, and in particular the possibility of establishing a fruitful collaboration between institutional economics and psychoanalysis, have been addressed in Hermann (2008, 2009a, 2010, 2012).

²² As a result of these conflicts, a neurotic-driven predatory and parasitic attitude towards public spending can develop. And these aspects are likely to reinforce, in kind of vicious circle, the unconscious feeling of guilt. Of course, it is also quite true that in today's affluent societies such unconscious feeling of guilt can be reinforced by the highly uneven distribution of income and power, which often ends up in situations of distress and poverty. In this sense, disentangling the various individual and social problems related to these feelings can greatly help to lay the basis for their actual solution.

Concluding Chapter: How To Move Towards a More Equitable and Sustainable Society?

Although public intervention is necessary for building a more progressive and equitable society, this does not imply that every such intervention should be automatically assumed as a headway towards such objective. On the one hand, public action constitutes an essential ingredient for the existence of capitalistic institutions; and, on the other hand, even in a socialist society not every public intervention can be automatically considered — only because it is public — progressive or socialist. This happens especially when such intervention acquires an authoritarian nature, allowing little social participation.

Such participation tends to become even more important on account of the tendency — already set forth by Rudolph Hilferding (1910) through the concept of “organized capitalism” — of concentration of economic power in few dominant companies.

However, as vividly witnessed by recent events, such concentration of power does not eliminate the structural tendency towards economic and financial crises. Rather, owing to the most unregulated competition taking place in the international arena, the “organized capitalism” tends to increase the instability of the system and the inequality at national and regional level.

The Role of Institutional and Policy Coordination

In this evolution, a pivotal role is played by the characteristics of the institutional framework, which displays its effects through many interrelated²³ policies— e.g., macroeconomic, labour, competition, industrial, innovation, social, environmental.

In the analysis of these problems, it seems appropriate to look into the interrelations between macroeconomic policies (typically, more short-term targeted) and structural policies (typically, more long-term oriented). As a matter of fact, on the one hand, macroeconomic policies impinge on structural policies—for instance, labour, environmental, industrial, competition, innovation and regulatory. But, on the other hand, structural policies also bear on macroeconomic policies.

Indeed, structural policies also influence, in a complex link of interactions, **(a)** the effects of macroeconomic policies on the short-term targets of employment, inflation and interest rates; and **(b)** the economic and social framework in which

²³ We have treated the role of policy coordination in promoting economic and social development in particular in Hermann (2009b).

macroeconomic policies are “embedded”. Thus, a systematic collaboration between institutional economics and Keynesian theories could shed more light on the complexity of factors at play in determining the effects of policy action in any given context. Within this perspective, it becomes possible, also through an adequate process of social²⁴ valuing, to identify progressive and sustainable policies for the economic and social problems of today, such as: **(i)** measures to reduce poverty and inequality, and increase opportunities for persons to participate in economic and social life; **(ii)** labour policies aimed at improving the quantity, quality and reliability of employment; **(iii)** progressive taxation, in particular for rent-based incomes and wealth; **(iv)** incentives for firms to introduce green technologies and green consumption; **(v)** policies for the development of backward areas; **(vi)** public spending aimed at fostering human development, social capital, scientific and innovation systems; **(vii)** welfare policies centred on the specificity of individual’s needs and which could actively involve all the persons that, for on reason or another, are not fully employed; and, last but not least, **(viii)** measures for promoting participation of persons in workplace and social life, also through the promotion of the activities of the so-called “third sector”. This would be particularly relevant in all the instances in which the person²⁵ is partially or completely unemployed in traditional productive activities. In this regard, a closer

²⁴ The theory of social value has a long tradition in economic theory. It was introduced by Commons mainly through the elaboration of the concept of reasonable value. Its complexity and evolutionary meaning emerges from the following passage, “The preceding sections of this book brought us to the problems of Public Policy and Social Utility. These are the same as the problems of Reasonable Value and Due Process of Law. The problem arises out of the three principles underlying all transactions: conflict, dependence and order. Each economic transaction is a process of joint valuation by participants, wherein each is moved by diversity of interests, by dependence upon the others, and by the working rules which, for the time being, require conformity of transactions to collective action. Hence, reasonable values are reasonable transactions, reasonable practices, and social utility, equivalent to public purpose....Reasonable Value is the evolutionary collective determination of what is reasonable in view of all changing political, moral, and economic circumstances and the personalities that arise therefrom to the Supreme bench” (Commons 1934, p. 681, 683-684). Following these insights, the theory of social value is one of the core concepts of institutional economics, as appears from the following passage, “To conceive of a problem requires the perception of a difference between ‘what is going on’ and ‘what ought to go on’. Social value theory is logically and inescapably required to distinguish what ought to be from what is....In the real world, the provisioning process in all societies is organized through prescriptive and proscriptive institutional arrangements that correlate behaviour in the many facets and dimensions of the economic process. Fashioning, choosing among and assessing such institutional structure is the ‘stuff and substance’ of continuing discussions in deliberative bodies and in the community generally. The role of social value theory is to provide analyses of criteria in terms of which such choices are made.” (Tool, in Hodgson, Samuels and Tool, 1994, pp. 406-407).

²⁵ One relevant insight of Keynes’ account of long-term transformations is that such structural reduction of “productive employment” — a situation in which, also on account of the increase in labour productivity, it becomes more and more difficult to find and retain a sufficiently remunerative job — will constitute the basis for building a new society no longer based on the centrality of economic motive. These aspects have been expounded with great insight also by John Kennett Galbraith’s *The Affluent Society*. It investigates — in an analysis which has many parallels with Keynes’ perspective — the growing unsustainability of the “affluent societies”, which must rely for providing employment on over consumption and debt pyramids. In order to break this vicious circle, he advocates the radical solution of releasing the dependence of income on production.

synergy with labour, education and welfare policies can create greater opportunities for economic and social development.

In this sense, policy cooperation does not acquire only a technical character but implies a profound cultural revolution involving the historical, political, institutional, social, economic and psychological dimensions of any given context.

The Importance of an Interdisciplinary Approach

In this sense, we wish to conclude this work by remembering the most profound insight of Keynes' analysis: namely, the awareness that short-term problems constitute only a part of a more profound transformation of economy and society, one in which the "economic motive" associated with the more detestable traits of capitalism — selfishness, greed, avarice — can gradually become unimportant and be replaced by social and cooperative relations. The focus of these changes will rest on a substantial reduction of the working-hours, made possible by the increase of productivity and by less emphasis on over-consumption.

Following this pattern has become even more urgent on account of the environmental decay caused by a productive paradigm based on the hypothesis of unlimited natural resources.

The main obstacle to the realization of this potential lies not in technical but in psychological difficulty. He notes, with remarkable psychological insight, that the latter aspect relates to the difficulty of people to employ leisure time for a better realization of their personalities. This can also be due (cf. also the previous chapters) to an unconscious feeling of guilt related to the presence of *superego*.

In this regard, we believe that an interdisciplinary perspective — which lie at the heart of Keynes' theoretical approach — can provide the substantial informational and conceptual background for realizing the policy cooperation which is needed for moving along these avenues of social progress.

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