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Reply to Garegnani's Comment

Athanasios Asimakopulos

Some of the criticisms of my paper made by Garegnani are based on a misreading of it, while others may be due to the difference we attachs to the term "long-period analysis". I view the latter as being concerned with the examination of a sequence of short periods, while he apparently identifies it with the view that long-period equilibrium values serve as strong centres of attraction for actual values. Keynes's analysis, even though it is only concerned with short-period equilibrium values, does have long-period implications. He considered the factors which determine investment to be "most unreliable", a condition that continued over a sequence of short periods. He judged experience to show that these factors result in fluctuations "round an intermediate position appreciably below full employment and appreciably above the minimum employment, a decline below which would endanger life".[1]

Garegnani agrees with my position on the nature of Keynes's formal analysis. It is concerned with short-period equilibrium employment. In Keynes's model this equilibrium value serves as a centre of gravitation for the actual level of employment, and the latter is implicitly assumed to be sufficiently close to the former that it can be represented by it. Keynes thus begins his chapter on the trade cycle as follows: "Since we claim to have shown in the preceding chapters what determines the volume of employment *at any time*...".[2] The level of employment in any actual, historical, short interval of time, is unlikely to be equal to the short-period equilibrium level of employment for that interval, because entrepreneurs' short-term expectations that determine employment are likely to be disappointed by unforeseen changes. Keynes states that entrepreneurs "endeavour to approximate to the true position by a method of trial and

[1] J. M. Keynes, *The General Theory of Employment, Interest and Money*, London, Macmillan, 1936, p. 254.
[2] *Ibid.*, p. 313; italics supplied.

error... It corresponds precisely to the higgling of the market by means of which buyers and sellers endeavour to discover the true equilibrium position of supply and demand".[3] But it is with this "true position" of short-period equilibrium that his analysis is concerned, since he believed that "the theory of effective demand is substantially the same if we assume that short-period expectations are always fulfilled",[4] and the "higgling of the market" is ignored.

This attribution of strong powers of attraction to short-period equilibrium values which leads to the identification of actual and short-period equilibrium values, is made by Keynes, and not by me.[5] Garegnani's comments in his section 2 are thus misplaced. The quotation he gives there from my paper is incomplete. It should read: "Production and employment always occur in a short-period context, *with given equipment and technique being utilized*".[6] Reference here is being made to actual production and employment, and the words italicized (which Garegnani omits) make clear what is meant by "short-period context". There is nothing in my text that should have led him to assume that I consider short-period equilibrium employment to be anything but a theoretical construct. The difference between it and long-period equilibrium employment — and it is a significant difference — is that for long-period values to be "centres of attraction" conditions must be stationary for long periods of time. Marshall pointed out that stationarity is required for the doctrine of Adam Smith and other economists that the normal, or "natural", value of a commodity is that which economic forces tend to bring about *in the long run*. It is the average value which economic forces would bring about if the general conditions of life were stationary for a run of time long enough to enable them all to work out their full effect.

"But we cannot foresee the future perfectly. The unexpected may happen; and the existing tendencies may be modified before they have had time to accomplish what appears now to be their full and complete work. The fact that the general conditions of life are not stationary is the source of many of the difficulties that are met with in applying economic doctrines to practical problems".[7]

It is with "practical problems" that Keynes was concerned in his theory of employment, and given his vision of irregularly changing capitalist economies, he made no use of long-period equilibrium. Garegnani points

[3] J. M. KEYNES, *Collected Writings*, vol. XIV, *The General Theory and After: Part II, Defence and Development*, London, Macmillan, 1973, p. 182.

[4] *Ibid.*, p. 181.

[5] See my critical presentation of Keynes's implicit assumption that the full multiplier effects of changes in investment were completed within the short period (A. ASIMAKOPULOS, "Keynes and Sraffa: Visions and Perspectives", *Political Economy*, vol. 1, n. 2, 1985, p. 38) and my reference to Hicks (footnote 26).

[6] *Ibid.*, p. 48; italics supplied.

[7] A. MARSHALL, *Principles of Economics*, 8th edn., London, Macmillan, 1920, p. 347.

out that Keynes defined "long-period employment", but this was no more than an "aside". Its definition follows his explanation of short-term and long-term expectations, and represents the very special situation where all the employment at a point in time is consistent with the long-term (and short-term) expectations at that point in time. For this to be the case a state of long-term expectations had "to continue for a sufficient length of time for the effect on employment to have worked itself out so completely that there is, broadly speaking, no piece of employment going on which would not have taken place if the new state of expectation had always existed...".[8] This constancy of long-term expectations over a lengthy interval of time was recognized as a *logical* possibility, and thus Keynes referred to it. But it was not seen as a *practical* possibility, and it had no place in his analysis.

Some indication of how Keynes saw employment and output evolving over time, based on his short-period analysis, is to be found at the end of chapter 18 of *The General Theory*, following his summary of the General Theory, and in his notes on the trade cycle. The latter was not intended to be more than a preliminary consideration of the trade cycle, but taken in conjunction with the chapter 18 material, it seems clear that Keynes considered his theory as being capable of sketching out some of the outlines of a time path that combines trend and cycle. In discussing this path Keynes recognized that the "independent variables" of his analysis, such as the "psychological expectation of future yield from capital assets", would be affected by changes occurring in the economy. The last part of Garegnani's final sentence can be restated to accommodate what I see as Keynes's position. Aggregate demand affects the speed of capitalist accumulation, because it affects economic activity and the "climate" in which long-term expectations are formed and investment decisions are made. But investment expenditures are, of course, an important component of this aggregate demand. This interrelation over time between aggregate demand and investment activity, and the consequent changes in productive capacity, lead to growth and cyclical fluctuations. The difference with Garegnani is that he appears to see the trend as independent of the cycle. This is the implication (given his surrounding comments) of the statement that "however wildly the actual and the short-period theoretical variable may continue to fluctuate, it inevitably describes a trend".[9] The ability mechanically to decompose any time series into "trend" and "cycle" components does *not* make them independent.

There is a similar, after the event, breakdown into components in Garegnani's treatment of prices. Important elements in the observed changes

[8] J. M. KEYNES, *The General Theory*, *op. cit.*, p. 48.

[9] P. GAREGNANI, "Actual and Normal Magnitudes: A Comment on Asimakopulos", above, p. 254.

in the relative prices of commodities, over long intervals of time, are the differences in the rates of technical progress in their production. These rates are not independent of other changes occurring in the economy, and the investment expenditures that helped give rise to them were not necessarily based on the expectations of these prices. It is the expectations of prices, which enter into expected returns, that are relevant for a theory of investment, and they cannot be reduced to some mechanical average of past data. (Garegnani's initial reference to the "rate of profits" in footnote 22, should be preceded by the adjective "expected"). The use of "copper" by Garegnani to illustrate the forecasting of the trend price is probably not accidental.[10] He refers to "technical changes in its mining, or ... the fertility of new mines, etc."[11] as "means" used in this process. There are many important factors covered by this "etc.", such as the unforeseen technical changes that affect the production and the suitability of substitutes for copper, with possible feedback effects on the two items noted by Garegnani. Forecasting a trend, as opposed to "explaining" a trend line drawn through historical data — can be very difficult and subject to large margins of error.

Garegnani's proposed "marriage" of Keynes and Sraffa, is really a proposed marriage between the latter and some (still to be developed?) theory of the determination of aggregate demand that is compatible with Sraffa's prices of production. Considerable confusion will be eliminated if Keynes's name is dropped from this "union". The attempts to extend Keynes's theory to deal with accumulation, which tried to observe the fundamentals of that theory,[12] failed because of the incompatibility of this theory and use of the long-period equilibrium values to be found on Harrod's warranted growth path and Robinson's desired rate of growth.[13]

Department of Economics, McGill University, Montreal

[10] J. M. Keynes, *Collected Writings*, vol. XIV, *op. cit.*, p. 113.

[11] P. Garegnani, "Actual and Normal Magnitudes", *op. cit.*, p. 254.

[12] Cf. R. F. Harrod, "An Essay in Dynamic Theory", *Economic Journal*, XLIX, March 1939, pp. 14-33; R. F. Harrod, *Towards a Dynamic Economics*, London, Macmillan, 1948; J. V. Robinson, *The Accumulation of Capital*, London, Macmillan, 1956.

[13] Cf. A. Asimakopulos, "Joan Robinson and Economic Theory", *Banca Nazionale del Lavoro Quarterly Review*, December 1984, pp. 381-409; A. Asimakopulos, "Harrod on Harrod: The Evolution of a 'Line of Steady Growth'", *History of Political Economy*, XVII, Winter 1985, pp. 619-636.