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The Theoretical Features of Post-war Keynesianism

8.1 Introduction

I regard the passage from Keynes to the Neo-classical Synthesis as a refinement of the theoretical tools provided by economics corresponding to a historical situation in which new institutions for the management of the class conflict were set up. The original theoretical apparatus of Keynes and the refined one of Keynesianism, or the Keynesian orthodoxy in the form of the Neo-classical Synthesis, differ because of the changing conditions of the class relations. Keynes was writing at a time in which the problem of working-class autonomy and its channeling was urgent and social experiments for its control such as the New Deal were relatively new. In the post-Second World War era, the practices of social regulation theorized and experienced earlier became a central feature of the capitalist regime. A gravity center for the class struggle was established through the productivity deals and the establishment of a reference point against which to measure the social proportion between surplus and necessary labor. Thus, whereas in the theoretical apparatus of Keynes, the subsumption of working-class autonomy is assumed as political project, in that of Keynesianism it is assumed as a fundamental institutional condition. This obviously had the limitation of any capitalist strategy of subsumption, founded on the belief that social conflict can indeed be frozen and the newly established institutions of capitalism are able to deal once and for all with the contradictions of the capitalist mode of production. The basic pillar of the Neo-classical Synthesis, the IS–LM model, assumes a concept of aggregate and a concept of time and equilibrium that corresponds to this new class situation.
8.2 The analytical framework of the neo-classical synthesis: the IS–LM model

The analytical framework used by the Neo-classical Synthesis was, as it is well known, grounded on the IS–LM model originally introduced by John Hicks' famous paper “Mr Keynes and the ‘Classics’” in 1937. Further development attempting to integrate Keynes’ analysis into the Neo-classical framework within the IS–LM model saw the contribution, among others, of Franco Modigliani (1944), Lawrence Klein (1947), Don Patinkin (1948), and Alvin H. Hansen (1953). The IS–LM model became not only the main tool through which economic theory was popularized in intermediary textbooks, but also the framework to organize and develop economic thinking\(^1\) as well as empirical research and operational techniques.\(^2\)

The effort to integrate Keynes in the equilibrium framework resulted in the formulation that long-run persistent unemployment can be generated if one of the following three conditions holds (Dow 1985): (1) investment demand is inelastic with respect to the interest rate; (2) the economy is caught in a liquidity trap; (3) money wages are downward rigid. Pigou (1941) was more restrictive, arguing that the first two conditions would have been neutralized by a fall in the general level of prices following a downward shift in aggregate demand below the full employment level for a given aggregate supply. With lower prices, real money balances would rise, thus increasing wealth and consumer demand. The only condition therefore which should be seen as responsible for keeping the long-run state of the economy below full employment was the rigidity of money-wages. Patinkin (1956: 65) was able to show the existence of a value of the general price level corresponding with a level of aggregate demand that was consistent with full employment. This assumed a given supply of money, the stability of key functional relationships of the system, and the independence of their position from the path toward equilibrium.

As a result of this analytical refinement, Keynes’ theory of income determination and its emphasis on aggregate demand was framed in a general equilibrium model, a “Grand Neo-classical Synthesis” (Arestis 1992). In this model, there is an inherent tendency toward a stable equilibrium of full employment in the absence of wage rigidity. However, in presence of this rigidity, there will be disequilibrium on the labor market. Working-class power is thus recognized at the same time that its subsumption is modeled.