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A contribution to a Keynesian-Sraffian synthesis: Kregel on financial macroeconomics

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Abstract:
As a review of Kregel's book Financial Macroeconomics (London: Anthem Press, 2024), the article illustrates Kregel's original interpretation of Keynes and its compatibility with a Keynesian-Sraffian approach alternative to both mainstream economics and other heterodox theories. Kregel's analysis focuses on the analytical relations between own rates of own return and own rates of monetary return for commodities and the rate of interest.

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Kregel's 2024 book *Financial Macroeconomics* (Kregel, 2024) is a collection of his own essays on monetary and financial theory and policy, with two main characteristics. First, most of the essays will be a new discovery for most readers, having been published as book chapters or in nonmainstream journals; even the opening chapter, originally published in the *Economic Journal* in 1976, notwithstanding its importance, may be unknown to younger generations. Second, the set of essays as a whole contributes to the building of a nonmainstream approach, based on Kregel's original interpretation of Keynes as well as on his own contributions to monetary and financial theory and policy.

The topics tackled are complex, and Kregel's prose is dense: the book requires – and deserves – careful study more than a superficial reading. It is difficult, if not impossible, to synthesize it; in these brief notes I will touch on only some points, leaving completely aside, for instance, all issues concerning monetary and financial nonconventional policies, which constitute the topic of the three final essays of the book. I will instead focus on the first essay and on the essays dealing with an analysis based on own rates of return for commodities as well as for money. But before doing this, we need to briefly recall the background scenario, to which Kregel briefly hints in the introduction to the volume.[1]

[1] For the sake of brevity, I shall refer, for more detailed treatment of some issues, to previous writings of mine, rather than trying to summarize complex issues in a few sentences. Thanks for useful comments are due to Mario Tonveronachi and to an anonymous referee.

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1. Contending approaches to economics

Economic research is today, and has been for the past few decades, characterized by a fragmentation in nearly independent segments, ranging from consumer theories to industrial organization or such specific issues as auction theories.[2] This fragmentation may be reconnected, among other things, to the crisis of the traditional theory of value, based on the counter-position of resource scarcity to consumers' final demands.[3] Notwithstanding its shaky foundations, this approach remains, implicitly if not explicitly, the underlying reference framework of nearly all research areas.

Within the traditional approach, the method of searching for the equilibria between supply and demand originated the myth of the invisible hand of the market, namely the idea that the regular functioning of the market would bring the economy to an equilibrium situation characterized by full employment of available resources and to a unique equilibrium income distribution between wages and profits that is compatible with full employment. (The single exception has been the presence of obstacles hindering competition; such obstacles have been, and are, the subject of many lines of research, among them the so-called neo-Keynesian theories, which have been rewarded with a few Nobel prizes).

The myth of the invisible hand has fallen to pieces under the destructive criticisms advanced by Keynes (with his 1936 theory of employment, interest and money) and Sraffa (with his 1960 critique of traditional capital theories and his 1925 critique of the Marshallian approach underlying neo-Keynesian theories, among others). The ensuing fragmentation of economic research may be explained by the strength of the mainstream tradition on the one side (that, unable to answer the criticisms of its value-theory foundations, obscures them behind sets of implicit assumptions focusing on the analysis of specific issues), and, on the other side, the inability/unwillingness to build a novel approach covering the full range of economic issues and to include in a coherent system the various extant heterodox contributions.

Specifically, the main objective underlying Kregel's analysis consists of connecting the two main research lines originated by Keynes and Sraffa, concerning, respectively, the theory of value and the theory of employment and money, in such a way as to make it possible to connect them with heterodox analyses of technological change, of the role of institutions, of market forms and so on.

In doing this, we cannot adopt the method of building a unifying mathematical model. There have been attempts in this direction, the most advanced of which (such as Pasinetti, 1981) have reached important results: starting from Sraffa's analysis, they have established the conditions that must be satisfied for an economic system to maintain full employment over time. However, these are normative theories, indicating conditions required for obtaining optimal results (specifically, full employment), not positive interpretations of the working of real economies. In particular, such analyses totally leave out of their horizon the influence of money and finance on real variables, which constitutes a foundational element in Keynes's analysis.[4] The method to which Kregel instead implicitly refers is that of Wittgenstein's 'language games', namely separate theories dealing with specific issues but connected by reference to an underlying, possibly implicit, common conceptual framework.[5]

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[2] On this, cf. Roncaglia (2019).

[3] On this, cf. Roncaglia (2005, particularly §§ 10.1-10.2).

[4] On this, cf. Roncaglia (2009, chapt. 8).

[5] On this, cf. Wittgenstein (1953); Roncaglia (1975, chapt. 6; chapt. 7 in the English edition); Kregel and Roncaglia (2020).

2. Kregel's volume

Let us come back to Kregel's book. It includes 23 essays by the author that were originally published between 1976 and 2013: five on methodological issues, five on the notion of effective demand, ten on price theory, money and financial markets theory, and three on nonconventional monetary policies and their relation with Keynes's theory.

The author is a well-known post-Keynesian economist, both as editor of the *Journal of Post Keynesian Economics* and for his original position of mediation between different groups in that area, often in harsh confrontation between them, such as the so-called (and internally variegated) American Keynesians and the Cambridge Keynesians. In the introduction to the volume, the author recalls his formative stage, equally divided between Sydney Weintraub's and Paul Davidson's American Keynesism (or, better, Keynesism*s*: Weintraub and Davidson were by no means homozygotic twins, although they collaborated in the founding of the *JPKE*) and Cambridge UK with Nicky Kaldor, Joan Robinson, Micha□ Kalecki, enriched by the 'Ricardians', Piero Sraffa and some of his disciples.[6]

With these experiences and an open mind, Kregel is building over time a theoretical edifice that constitutes an original synthesis between the different post-Keynesian streams and the Classical ('Ricardian') school. The first foundational stone for this enterprise is an interpretation of Keynes's *General Theory of Employment, Interest and Money* that is different from the traditional one, supported in particular by Keynes's pupils Richard Kahn and Joan Robinson, as Kregel recalls in the introduction. This latter interpretation relies on grounding Keynes's analysis within a Marshallian short-period context (and a dynamic short-period context for *A Treatise on Money*), while considering the analysis of growth and income distribution as separate issues to be tackled in a long-run context.[7]

Kregel suggests instead (in the first essay of the book) to interpret Keynes utilizing the categories of i) static, ii) stationary, and iii) shifting equilibria, relying on different assumptions concerning expectations: i) long-period expectations are given and constant, short-period expectations are realised, while long- and short-period expectations are independent from one another; ii) long-period expectations are given and constant, short-period expectations may be disappointed, while long- and short-period expectations are independent; iii) long-period expectations shift over time, short-period expectations are disappointed, while long- and short-period expectations are interdependent. Then, in chapters 2 and 3, and again in chapter 9, Kregel, focusing on the notion of liquidity preference, criticizes the "neoclassical synthesis" re-elaboration of Keynes's analysis in terms of a static equilibrium simultaneously determined for the commodity, money, and bonds markets (Hicks's IS-LM model).

The second decisive step in Kregel's interpretation of Keynes's theory is provided in chapter 6, with additional elaborations in chapters 10-14. Chapter 6 focuses on the notion of effective demand in pre-Keynesian authors and in Keynes, and on the central chapters of the *General Theory* (16-18); hence, he addresses the notions of own rates of return for money (namely, the interest rate, which is the rate of return of money in terms of itself) and for commodities, both in terms of money and in terms of themselves (namely, own rates of money return and own rates of own return). The origins of this kind of analysis are traced back to Irving Fisher, who interprets the rate of interest – followed in this by Keynes – as an arithmetical relation connecting spot and forward prices. However, Fisher remains within the framework of the traditional marginalist

[6] Kregel arrived in Cambridge in the late 1960s – not the 1980s as indicated by a misprint in the book. Kregel's meetings with Sraffa in those years are attested in Sraffa's diaries (preserved in the Sraffa Papers, Trinity College, Cambridge).

[7] On this, cf. for instance Kregel (2024, pp. 98 ff).

theory of value; thus, according to him, arbitrage activities drive the economy towards an equilibrium where the own rates of return (in terms of money) of all commodities are equal among themselves and to the money rate of interest. Such an equilibrium also implies full employment of available resources, a wage rate equal to the marginal productivity of labour, and a rate of interest equal to the rate of growth of the economy; money and financial variables do not affect real variables.

As it is well known, Keynes instead attributes to monetary and financial variables a relevant influence on real variables, attributing to the rate of interest the role of independent variable in his theory of employment and allowing monetary policies to affect real variables. In fact, Keynes rejects – as Kregel stresses – the notion of a general index of prices, and hence the idea of a real rate of interest that, within the traditional marginalist approach, provides an anchor for monetary theory, with the equilibrium real rate of interest determined by the equilibrium between investments and savings (namely demand for and supply of loans).

Fisher's analytical tool of the own rates of return was utilized by Piero Sraffa, in a 1932 article criticizing Hayek's theory; in it, Sraffa stresses that there are as many own rates of commodity return as there are commodities, thus closing the way to any attempt at determining an equilibrium rate of interest coherent with a tendency to full employment (Hayek's theory of the cycle involved oscillations around a full employment equilibrium). It is likely that Keynes was influenced by Sraffa's article into developing an analysis based on own rates of return in the central chapters of the *General Theory*[8]; Kregel (2024, pp. 74 and 111) also notices that Sraffa's 1960's analysis of relative prices in connection with income distribution turns out to give the same results, under a specific set of assumptions, as Keynes's analysis in chapter 17 of the *General Theory*.

In Keynes's approach (once again, as Kregel stresses), technical change (which, by its nature, cannot be fully foreseen and which affects commodities' own rates of return in terms of themselves) rules out the possibility of generalized arbitrage. Because of this, the economy moves over time on the basis of economic agents' decisions on levels of production and investment, adopted under conditions of uncertainty; such decisions are taken by comparing the expected rates of return of the different commodities in terms of money with the money rate of interest. Commodity rates of return are not equal to the money rate of interest; the link between them is provided by the "liquidity premium" that expresses the preference, in an uncertain world, for keeping activities such as money that are, in different degrees, easier to realize on the market in the case of unforeseen necessities.[9]

In the "shifting equilibrium" model, where the role of uncertainty stemming from the dynamics of technical change embedded in capitalist economies cannot be ignored, both short- and long-term expectations of individual agents are heterogeneous, so that their evaluation of own rates of return for each commodity are heterogeneous. This holds while individual agents are confronted by common market prices and a common money rate of interest. There is thus necessarily a widespread disappointment of individual expectations. Though disappointed, individual expectations may generate an equilibrium price that balances too optimistic and too pessimistic expectations; however, this equilibrium is necessarily temporary, very volatile: agents adjust their own personal set of expectations in different ways, also depending on the dynamics

[8] Kregel (2024, p. 97) affirms: "It was Sraffa who would show Keynes how money could be introduced into his emerging theory of effective demand".

[9] Kregel adopts Minsky's theory of financial fragility and his slogan, "liquidity preference is a theory of asset prices" (Kregel, 2024, p. 33). On Keynes's theory of liquidity preference and his critique of alternative theories, cf. Kregel (2024, pp. 106 ff).

of the economy and, most importantly, the dynamics of technical change. Traditional equilibrium microeconomic analysis must be discarded; in its place, in chapter 17 of the *General Theory* we may find elements for a – still to be fully developed – macro-based Keynesian microeconomic analysis.[10]

These elements (static, stationary, and shifting equilibria; focus on the own rates of return) differentiate Kregel's interpretation from other interpretations of Keynes, including those nearer to his point of view. According to Minsky (1975, p. 57), "Keynes put forth an investment theory of fluctuations in real demand and a financial theory of fluctuations in real investment', where the stress – compared to other interpretations, such as the IS-LM model – is laid on "fluctuations" rather than on "equilibria". Tonveronachi (1983) focuses on Keynes's shift from a disequilibrium analysis of cyclical instability in the *Treatise on Money* (1930) to an analysis of underemployment equilibrium in the *General Theory* (1936). Tonveronachi also stresses that Keynes's method of considering as general not a theory that embodies the most variables with their interrelations but a theory that focuses on a few variables and their links: those displaying a character of systematicity. Other variables and their relations – less systematic in their behaviour – are then added in successive steps, leading from the highest level of generality to the study of specific phenomena. This method, we may here remark, is also different from the Marshallian one, based on the dichotomy between the short period and the long period, to which many refer in interpreting Keynes's choice of endogenous and exogenous variables. In other terms, both Marshall and Keynes prefer short causal chains to long ones (as those implicit in general equilibrium theory); but then they differ in a crucial way, as we have just noted, on the short causal chains on which to focus attention, and this, in turn, entails crucial differences in the results of their analyses.

We do not need to go deeper into the (technically rather complex) details of this kind of analysis, as Kregel does in some of the papers collected in this volume.[11] What interests us here is the avenue that Kregel proposes for reconstructing a Sraffian-Keynesian approach alternative to the traditional mainstream approach that is also different from other heterodox approaches. The differences consist in the simultaneous rejection of three lines of research that loom large in recent heterodox research but that appear not to lead to meaningful results, such as to constitute a full alternative to the traditional approach.

The first line of research is that followed by those who interpret Keynes's *General Theory* in terms of a short-run equilibrium and simultaneously interpret Sraffa's analysis as aiming at establishing "long-period positions" or "centers of gravity". The theoretical building remains truncated: we have a theory of prices devoid of any connection with the theory of money and income, postponed to a second logical stage of analysis where no general theory is possible, because of the unsystematic nature of the variables and their relations.[12] Moreover, this line of research implies a misleading interpretation of Sraffa's contribution: Sraffa (1960) in fact considers a "photograph" in vacuo of the economy and not a long-period position.[13] Furthermore, the "centers of gravity" interpretation implies the unrealistic assumption that, for all commodities, the speed of adjustment of short-period to long-period prices due to the interplay of supply and demand is higher than the speed of variations in costs due to technological change.[14]

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[10] On this, cf. Tonveronachi (1992).

[11] Thus, we leave aside Kregel's contributions to the theory of finance, such as his treatment of the notion of duration in chapter 13.

[12] Cf. Garegnani (1990, pp. 124-125). As a counter-example, think of Harrod's growth model.

[13] On this, cf. Roncaglia (2009, chaps. 7 and 8).

[14] On this, cf. Roncaglia (1990 and 2009, pp. 147-151).

The second line of research is that followed by the different versions of monetary theory – from the theories of the circuit to the so-called modern monetary theory – that may be reconnected to the Swedish school rather than to Keynes, implying sequences of events that require a well-established ordering of causes and effects and fall under the criticisms he already advanced after the publication of the *General Theory* (cf. Keynes, 1973). These criticisms are reproposed in an updated version in Kregel's book, in a brief but important appendix to the first article.[15]

The third line of research is that common among Cambridge Keynesians, particularly Joan Robinson and Richard Kahn, who remained faithful to the Marshallian method based on the distinction between long- and short-period analyses, occasionally accompanied by an opposition between history and equilibrium analysis. This latter petition of principle does not distinguish between widely different methods of analysis, such as those relying on static supply-and-demand equilibrium, where history is necessarily external to the field of analysis, and those based on the separation between different analytical fields, where economic theories concerning different issues offer to history the tools for interpreting the course of events. In fact, opposing history to economic analysis at the same time closes the door to important and useful streams of heterodox theorizing and deprives history of its most important interpretative tools.

As Bernard of Chartres said, followed by so many others, we may see further than our predecessors since we are as dwarfs standing on the shoulders of giants – in our case, Keynes and Sraffa. However, as the misleading interpretations of our giants show, we will not see anything useful if we look in the wrong direction, or if we remain below their shoulders. Kregel's book helps us understand how difficult it is to reach the shoulders of the giants and to look in the right direction, and it points us to how to get there; it thus constitutes a most important contribution.

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[15] "Keynes rejected this method because the passage of time between the decision and the outcome 'was incapable of being made precise' (C.W. xiv, p. 179)" (Kregel, 2024, p. 18). For instance, in the sequential analysis of modern monetary theory it is assumed that the first step, from which everything else follows, is the creation of money due to the anticipate payment of wages; now, it is true that, in nearly all – but by no means all – activities, wages are paid before the product is obtained and sold, but it is also true – and it is a crucial point in Marx's theory – that wages are paid at the end of the working period, so that it could be said that the origin of the circuit lies in workers' consumption expenditures: the real issue is that in the economy many different periods of time relating to different issues overlap.

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