Study Questions for George Reisman's *Capitalism: A Treatise on Economics*

CHAPTER 18. KEYNESIANISM: A CRITIQUE

1. Explain the implications of the proposition that unemployment can be eliminated by a fall in wage rages and prices for the position of economists vis-a-vis labor legislation and in the minds of those who accepted the Marxian exploitation theory.
2. Describe the essential claims of Keynesianism with respect to the ability of a fall in wage rates and prices to achieve full employment.
3. Explain the implications of your answer to the preceding question for the need of economists to fight for the establishment of a free market in labor.
4. Describe what, according to Keynesianism, is the solution for mass unemployment.
5. On the basis of your answers to the preceding questions, explain why Keynesianism was a source of intellectual relief for many economists.
6. Explain the contention that Keynesianism is incompatible both with common sense and with the love of liberty.
7. Explain why Keynesianism is incompatible with the quantity theory of money.
8. Describe the developments that had taken place in economic theory in the two generations prior to the appearance of Keynes that undercut his critics' ability to present strong counterarguments.
9. Explain what is meant by neo-Keynesianism and how it differs from Keynesianism. (In your answer, be sure to explain who was A. C. Pigou.)
10. Explain whether or not neo-Keynesianism differs from Keynesianism with respect to the conclusion that a free economy cannot have full employment.
11. Explain why the neo-Keynesians are led to conclude that reductions in wage rates and prices can have only a relatively modest impact on the increase in employment and output.
12. Explain why Pigou's doctrine is even weaker than the Keynesians themselves recognize.
13. In the 14th Edition of their book, Samuelson and Nordhaus state: "The basic difference between classical and Keynesian approaches can be found in differing views about the behavior of aggregate *supply*. Keynesian economists believe that prices and wages adjust slowly, so any equilibrating forces may take many years or even decades to operate. The classical approach holds that prices and wages are flexible, so the economy moves to its long-run equilibrium very quickly. . . . While the classical economists were preaching that persistent unemployment was impossible, economists of the 1930s could hardly ignore the vast army of unemployed workers . . . . Keynes emphasized that because wages and prices are inflexible, there is no economic mechanism to restore full employment and ensure that the economy produces its potential. . . . In the Keynesian model, aggregate supply slopes upward, implying that output will increase with higher aggregate demand as long as there are unused resources." (pp. 46467; similar views are expressed in the 15th Edition, on pp. 602603.) (a) Describe Samuelson's departure both from Keynesianism and traditional neo-Keynesianism in his explanation of the cause of unemployment, i.e., in terms of whether unemployment is caused by wage-rate rigidities or by the alleged inelasticity of the aggregate demand curve. (b) Explain whether or not it

is true to say, as Samuelson does, that "The classical approach holds that prices and wages are flexible, so the economy moves to its long-run equilibrium very quickly." Did the classical economists maintain that wages and prices are flexible in the face of minimum-wage and prounion legislation and similar government interference? (c) Explain whether or not it is true to say, as Samuelson does, that the classical economists preached "that persistent unemployment was impossible." Did they maintain this proposition in reference to conditions in which government interference prevented the necessary adjustment of wage rates and prices or only to conditions in which wage rates and prices were free of government interference? (d) Is Samuelson accurate in claiming that "Keynes emphasized that because wages and prices are inflexible, there is no economic mechanism to restore full employment and ensure that the economy produces its potential." Or was Keynes position that there is no way for a free economy, which *has* flexible wages and prices, to achieve full employment? (e) In what way does Samuelson's position represent an unadmitted capitulation to the claims of classical economists?

14. Explain what is meant by the Keynesian doctrine of the unemployment equilibrium?

15. Compare and contrast the Keynesian aggregate demand curve with the consumptionist aggregate curve.

16. (a) Explain whether the basis of the Keynesian aggregate demand curve is the claim of many union leaders that wage rate reductions result in proportionate reductions in consumer spending. (b) Explain why it does not follow that wage rate reductions, while reducing the spending of the individual wage earner, reduce total spending on the part of wage earners. (c) Explain why the fall of wage rates to their equilibrium level is in fact almost certain to be accompanied by a rise in total payroll spending and in productive expenditure as a whole.

17. Explain what is meant by the Keynesian "IS" curve.

18. Explain the relationship between the IS curve and the Keynesian aggregate demand curve.

19. State the Keynesian argument for an unemployment equilibrium in terms of the alleged effect of full employment on the rate of profit.

20. Explain whether the Keynesian argument for an unemployment equilibrium depends on the assumption that the minimum acceptable rate of return for lending and investing is specifically 2 percent.

21. Explain what is meant by each of the following: (a) the production function, (b) the saving function, (c) the equilibria of investment and saving, (d) the marginal efficiency of capital schedule.

22. Explain the derivation of the IS curve from the functions and schedules described in answer to the preceding question.

23. Explain why in terms of the relationship Keynesianism alleges between the "marginal efficiency of capital" and the volume of investment in physical terms, reductions in wage rates and prices result in proportional reductions in total spending.

24. Describe the unemployment equilibrium in terms of the alleged relationship between the portion of their incomes that people attempt to save at the point of full employment and the amount of profitable investment that can take place.

25. Explain the three grounds for the MEC doctrine.

26. Explain what is meant by "fiscal policy."

27. Explain how fiscal policy, in the form of chronic government budget deficits, is supposed to be the solution for the unemployment equilibrium, according to Keynesianism. In your answer, be sure to explain the effect budget deficits are supposed to have on the marginal efficiency of capital at the point of full employment.
28. Present an environmentalist analogy to the Keynesian doctrine of the unemployment equilibrium and fiscal policy as the solution for it.
29. Explain the criticisms of each of the three grounds for the MEC doctrine. Be sure to describe the logical fallacy committed by the Keynesians in each instance.
30. Explain why the Keynesian claim that a fall in wage rates and prices cannot achieve full employment, because at full employment the rate of return on capital would be too low, is a claim that the rate of return in the recovery from a depression is lower than it is in the depression.
31. "A major reversal of economic reality on the part of the Keynesian analysis is its belief that in a depression saving and net investment are at their maximum possible limits, and the problem is that full employment requires that they be carried still further. The actual fact is, however, that far from being at their maximum limits, saving and net investment are extremely low or even *negative* in a depression." Discuss. (In your answer, be sure to explain why saving and investment are negative in a depression.)
32. Explain why the marginal-efficiency-of-capital doctrine constitutes a *reversal* of the actual relationship between net investment and the rate of profit in the context of a business cycle, i.e., why more net investment accompanying the return to full employment would result in a *rise* in the rate of profit, not a fall.
33. Describe the contradiction between the marginal-efficiency-of-capital doctrine and the multiplier.
34. Explain why a fall in wage rates is the requirement for the restoration of net investment and profitability along with full employment.
35. Explain the effect on business profits if wage rate reductions were accompanied by reduced total wage payments, and the saving of funds were used to buy plant and equipment.
36. Explain what is meant by the paradox-of-thrift doctrine.
37. Explain why the paradox-of-thrift doctrine rests entirely on the central notion of the Keynesian analysis that there is room in the economic system for only a strictly limited amount of profitable investment.
38. Explain why there is no such thing as saving being a mathematical function of income. (In your answer be sure to explain the relationship of saving to the increase in the quantity of money and what would happen to saving if the quantity of money stopped increasing.)
39. Explain what is meant by "liquidity preference."
40. Present the arguments advanced by the Keynesians for expecting a 2 percent minimum to the rate of return at which people are willing to lend or invest and what is supposed to happen to the size of cash holdings once the rate of return gets that low. (a) Explain why, in answer to the Keynesian arguments in its favor, 2 percent does not in fact constitute a necessary floor to the rate of return. (b) Explain why, in a free economy the rate of profit and interest would almost certainly be far above 2 percent. (Be sure to answer in terms of the rates of net consumption and net investment.) (c) Explain why if

the rate of return somehow did get so low that people attempted to hoard, that very fact would operate to raise the rate of return.