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KEYNES AFTER LERNER: "THE GENERAL THEORY" WITH CONFLICT INFLATION

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Keynes (1936) wrote the General Theory to explain how a monetary economy of production can settle into an equilibrium characterized by persistent unemployment, due to the absence of endogenous market forces capable of restoring full employment. The 'General Theory' is quite abstract and theoretical, leaving open the question of the appropriate macroeconomic policy mix required to bring the economy to full employment. Moreover, while Keynes (1936) provides a demand-pull theory of inflation in the exceptional case where the economy attempts to operate above full employment – what he calls "true inflation" - , he offers no explanation for sustained inflation which can appear in the more typical situation emphasized in the General Theory, namely one characterized by persistent unemployment.

Abba P. Lerner was one of the first reviewers of 'the General Theory'. Lerner (1936) was highly favorable and constituted one of the earliest and most influential expositions of the book. His review emphasizes the central role of effective demand in determining employment levels. After that - his last published paper was published in 1982 – Lerner (1960, 1964, 1978) had a whole productive career advancing the Keynesian theory of effective demand. First, by discussing in detail the macroeconomic policy instruments required to

manage aggregate demand and steer the economy toward full employment; Second, by offering an analysis of the nature of inflationary pressures that may emerge prior to the attainment of full employment, as well as proposing appropriate policy measures to contain them.

While Keynes himself was positive about Lerner's (1944) theoretical analysis on the macroeconomic policy instruments required for the management of aggregate demand (Colander, 1984; Aspromourgos, 2014), he had no opportunity to comment on the discussion to what is now called "conflict inflation". Keynes died before the publication of Lerner (1948) where he first discusses the possibility of inflation with the economy below full employment (see also Lerner 1951a, 1951b, 1958).

The aim of the paper is to explore Lerner's developments on Keynesian macroeconomic policy and conflict inflation to reexamine the validity of the results of Keynes' "The General Theory". More specifically, we will discuss whether the framework proposed by Keynes is still enough to explain the possibility of a situation of equilibrium below full employment in the context of conflict inflation. We build on Lerner's change in the recommendation of macroeconomic policy mix, from discretionary fiscal policy in the case of deflation, to the more active monetary policy in the case of (conflict) inflation (Summa, 2024). We argue that this change can shed some light on additional limitations of the Keynes' proposed route to effective demand based on the obstacles of the nominal interest rate to fall enough to the 'neutral rate' (Garegnani, 1978-9, Milgate, 1982, Kurz, 2014, Barba, 2023).

Besides this introduction, the paper articulates into three more sections. In section two we discuss our view of the basic 'model' intrinsic in Keynes' General Theory and the causes of persistent unemployment. In section 3 we discuss Lerner's adaptation of this scheme to discuss Keynesian macroeconomic policies in the context of deflation and (conflict) inflation. In section four we argue that conflict inflation, not present in the context of the general Theory, can add more limitations on Keynes' explanation of persistent unemployment due to obstacles of the nominal interest rate to fall enough to the 'neutral rate'. First, because it increases nominal marginal efficiency of capital for a given nominal interest rate - or as we are more used today, it decreases the real interest rate for the given real marginal efficiency of capital (Serrano, Summa and Moreira, 2020). Second, it increases the 'carrying cost" of money (Barba, 2023).

We will argue that this line of reasoning finds some textual evidence on Keynes' General Theory. Also, it finds evidence on the shifts in policy proposals by Lerner. He was more in favor of fiscal policy in the 30's to 40's in a context of fear of deflation (Lerner, 1944). But since 1951 in the context of rising inflation, he has been becoming progressively more optimistic with using only discretionary monetary policy to steer the economy to full employment, and more concerned with the necessity of combining it with 'income policies' to tame conflict inflation (Lerner, 1951b, 1977, Lerner and Colander, 1982).

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