

KEYNES LECTURE IN ECONOMICS  
ON RE-READING KEYNES

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I

I AM deeply honoured by the invitation to deliver this year's British Academy Keynes Lecture.

Austin Robinson's Inaugural Keynes Lecture, delivered two years ago,<sup>1</sup> marked the publication of the first volumes in the new edition of Keynes's *Collected Writings*, which constitute the Royal Economic Society's memorial to one who had for thirty-three years been its Secretary and Editor of its *Journal*.

To anybody who wants to study Keynes there is already available a wealth of hitherto unpublished material in volumes in the new series, edited by Mrs. Elizabeth Johnson and by Dr. Donald Moggridge. In preparing this Lecture, I have received a great deal of help from Dr. Moggridge, and I have been able to use some of the material which will be published—we hope in 1977—in the form of three volumes edited by him, dealing with Keynes's activities in the Treasury during the Second World War and the nine months left of his life after the war had ended. In addition to making use also of Dr. Moggridge's published volumes in the Royal Economic Society edition—Volumes XIII and XIV entitled *The General Theory and After*—I have been helped by some of his published articles, including the article written jointly with Mrs. Susan Howson which has recently been published in *Oxford Economic Papers*.<sup>2</sup> Mrs. Howson, who has also been most helpful to me, has made available part of her book<sup>3</sup> which is to be published in 1975, and part of another book, written jointly by her and Professor Donald Winch,<sup>4</sup> to be published in 1976. I wish also to express my thanks to the Controller of Her Majesty's Stationery Office (Public Record Office and Crown Copyright material).

<sup>1</sup> 'John Maynard Keynes: Economist, Author, Statesman', Inaugural Keynes Lecture, 22 April 1971, *Proceedings of the British Academy*, vol. lviii, 1971, pp. 197–214; *Economic Journal*, London, June 1972.

<sup>2</sup> 'Keynes on Monetary Policy, 1910–1946', *Oxford Economic Papers*, July 1974.

<sup>3</sup> *Domestic Monetary Management in Britain, 1919–1938*.

<sup>4</sup> *The Economic Advisory Council, 1930–39*.

## II

I enjoy one advantage over all of the economist members of my audience. I had not read either Keynes's *A Treatise on Money* or his *General Theory of Employment, Interest and Money*, since I read them in page proof, until I began to think about this Lecture a few months ago. I felt that, as a result of approaching them with a fairly fresh mind, I would be provided with material for my Lecture. It has indeed been a fascinating experience. But the material would be more than enough as the basis of a long course of lectures. This evening I intend to concentrate on very few issues, rather than attempt to cover a wider field.

Keynes was born on 5 June 1883. At the end of 1923, at the age of 40, he finished his *Tract on Monetary Reform*.<sup>1</sup> It was, in its day, a striking work, but principally because of its literary style and its penetrating insight into practical issues. In it Keynes described as 'already a barbarous relic'<sup>2</sup> the gold standard to which we were to return two years later. On the analytical side the book was quite remarkably traditional. The analysis was based on the Quantity Theory of Money. Keynes expressed himself as a loyal follower of Marshall and Pigou. The Quantity Theory he said was 'fundamental. Its correspondence with fact is not open to question'.<sup>3</sup> He quoted a saying of Goschen's, of sixty years earlier—it could with much more justification be repeated to-day—that 'there are many persons who cannot bear the relation of the level of prices to the volume of currency affirmed without a feeling akin to irritation'.<sup>4</sup> Keynes in 1923 shared Goschen's contempt for such Philistines.

And yet a few pages further on Keynes denied the validity of the Quantity Theory, in the form in which it is normally presented, except 'in *the long run* in which we are all dead'.<sup>5</sup> A change in the quantity of money, in a period shorter than that long run, is itself the cause of a change in the ratio of the quantity of money to the price-level.

<sup>1</sup> Keynes, *A Tract on Monetary Reform*, London, 1923; Royal Economic Society edition of *The Collected Writings of John Maynard Keynes*, vol. iv, London, 1971. In the following footnotes references are made to the page numbers of the Royal Economic Society edition (and of the original edition in brackets).

<sup>2</sup> Op. cit., p. 138 (p. 172).

<sup>3</sup> Op. cit., p. 61 (p. 74).

<sup>4</sup> Op. cit., p. 61 (p. 75).

<sup>5</sup> Op. cit., p. 65 (p. 81) (the italics are Keynes's).

Six months after the *Tract* was published Keynes started work in July 1924 on a new book,<sup>1</sup> which six years later was to be published in two volumes under the title of *A Treatise on Money*.<sup>2</sup> The Quantity Theory of Money continued for a time to dominate his thinking, although the part played by investment in working capital began to assume an important role.

It was at this stage that Dennis Robertson was working on his *Banking Policy and the Price Level*. Already in November 1915, in his Preface to his book on *Industrial Fluctuation*, Robertson wrote that the war had 'compelled clear thinking on the real nature of saving and investment in the most unlikely quarters'.<sup>3</sup>

In a letter addressed to Robertson after the publication of his *General Theory*, Keynes wrote: 'I certainly date all my emancipation from the discussions between us which preceded your *Banking Policy and the Price Level*.'<sup>4</sup> As Professor Austin Robinson put it in his obituary of Keynes, *Banking Policy and the Price Level* was the first book 'to bring home to us in Cambridge . . . the essential distinction between the act of saving and the act of investment'.<sup>5</sup> In his Introduction Robertson wrote of his discussions with Keynes: 'Neither of us now know how much of the ideas contained [in Chapters V and VI] is his and how much is mine.'<sup>6</sup> Keynes, in his Preface to his *Treatise*, refers to the 'penetrating light cast by Mr. D. H. Robertson on certain fundamental matters'.<sup>7</sup>

In 1926 Keynes was hoping that his new book would be published in 1927.<sup>8</sup> It was not published until 1930.

<sup>1</sup> See Moggridge, *Collected Writings*, vol. xiii, p. 15.

<sup>2</sup> Keynes, *A Treatise on Money*, London, 1930; *Collected Writings*, vols. v and vi, 1971. In the following footnotes references are made to the page numbers of the Royal Economic Society edition (and of the original edition in brackets).

<sup>3</sup> D. H. Robertson, *A Study of Industrial Fluctuations*, London, 1915; reprinted in 1948. It had been successfully submitted in August 1914 to the Fellowship Electors of Trinity College, Cambridge.

<sup>4</sup> Keynes, *Collected Writings*, vol. xiv, p. 94. See also vol. xiii, p. 1.

<sup>5</sup> 'John Maynard Keynes, 1883-1946', *Economic Journal*, London, March 1947, p. 36.

<sup>6</sup> D. H. Robertson, *Banking Policy and the Price Level*, London, 1926, p. 5; third impression with a Note by the Author, 1932; fourth revised impression with a Preface by the Author, 1949; see also p. x of the 1949 impression. See also *Collected Writings*, vol. xiii, pp. 26-41.

<sup>7</sup> *Collected Writings*, vol. v, p. xviii (p. vii).

<sup>8</sup> See *Collected Writings*, vol. xiii, p. 43.

## III

Keynes's long struggle over a period of six years to produce a version of the *Treatise* worthy of publication was directed partly to an escape from the stranglehold of the Quantity Theory of Money in its crude form. In the end Keynes was able to write that 'the forms of the Quantity Theory . . . on which we have all been brought up . . . are but ill adapted' for the purpose of exhibiting 'the causal process by which the price-level is determined . . . They do not, any of them, have the advantage of separating out those factors through which . . . the causal process actually operates during a period of change.'<sup>1</sup>

Five pages further on Keynes wrote that the conclusions which he drew from his Fundamental Equations

are, of course, obvious and may serve to remind us that all these equations are purely formal; they are mere identities; truisms which tell us nothing in themselves. In this respect they resemble *all other versions of the Quantity Theory of Money*. Their only point is to analyse and arrange our material in what will turn out to be a useful way for tracing cause and effect, when we have vitalised them by the introduction of extraneous facts from the actual world.<sup>2</sup>

Keynes seems to have been so much under the spell of the Quantity Theory that he could write about his Fundamental Equations as though they were 'versions' of the Quantity Theory, although, up to this point in his book, the quantity of money does not figure in them in any sense.

Seven pages further on Keynes attempted a reconciliation with the Quantity Theory.<sup>3</sup> It was not successful. But in it can be seen the seed of what in the *General Theory* was to flourish under the name of the Liquidity Preference Theory. This Theory explained how the quantity of money exercises a causative influence by helping to determine the rate of interest—or more generally, as we would put it now, the state of credit and the price-levels of securities, both fixed-interest and equities.

And yet, another three pages on, Keynes insisted on a symbolic presentation which must to most readers of the time have appeared to have been a reaffirmation of the Quantity Theory in its simple form.<sup>4</sup>

Later on in the book Keynes was more explicit. He wrote

<sup>1</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 120 (p. 133).

<sup>2</sup> *Ibid.*, p. 125 (p. 138) (the italics are the Lecturer's).

<sup>3</sup> *Ibid.*, p. 132 (pp. 146–7).

<sup>4</sup> *Ibid.*, p. 135 (p. 150).

that under equilibrium conditions 'the quantity of money available for the Industrial Circulation *does* (if habits and methods are unchanged) rule the situation'. 'Equilibrium conditions' prevail '*when the price-level is in equilibrium with the cost of production*'.<sup>1</sup> In the section of the book from which I am now quoting, the *modus operandi* of price determination ceases to be the conventional determination by the quantity of money only when equilibrium is disturbed as a result of the rate of physical investment failing to match thriftiness. And yet much earlier in the book the Fundamental Equations indicated that the price-level under conditions of equilibrium is determined by money costs of production per unit of output.<sup>2</sup> There is a serious internal inconsistency in the *Treatise*.

The baby had been born but the umbilical cord had not yet been cut.

Keynes's insight grew immediately after he had completed the *Treatise* in September 1930. A year later, in the course of a special Preface to the German edition, he criticized the well-known concept of forced saving. It was often supposed to be the result of, and equal to, an expansion of bank credit. This 'forced' saving was regarded as supplementing 'voluntary' saving—the value of an economy's physical investment being equal to the sum of the two. This doctrine, together with the concept itself of 'forced' saving, Keynes completely rejected.<sup>3</sup> Investment creates the necessary 'voluntary' saving quite irrespective of the extent to which it is financed by the banks.

Later in 1931 and early in 1932, Keynes was making rapid progress towards a completely new formulation. *The General Theory*<sup>4</sup> was finished at the end of 1935 and published early in 1936, five years after the *Treatise*. I need only refer to Dr. Moggridge's recent account of the transition.<sup>5</sup>

Towards the end of his *General Theory*, Keynes did provide a symbolic expression, involving four elasticities of response, which he wrote 'can be regarded as a generalised statement of the Quantity Theory of Money'. He added: 'I do not myself

<sup>1</sup> *A Treatise*, vol. ii; *Collected Writings*, vol. vi, p. 4 (p. 5) (the italics are Keynes's).

<sup>2</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, pp. 122–4 (pp. 135–7).

<sup>3</sup> *Collected Writings*, vol. v, p. xxiv.

<sup>4</sup> Keynes, *The General Theory of Employment, Interest and Money*, London, 1936; *Collected Writings*, vol. vii (the pagination remains unchanged).

<sup>5</sup> Moggridge, 'From the *Treatise* to *The General Theory*: an Exercise in Chronology', *History of Political Economy* (Duke University Press), Spring 1973, vol. 5, no. 1.

attach much value to manipulations of this kind . . . I doubt if they carry us any further than ordinary discourse can.<sup>1</sup> He referred to a warning which he had given a few pages back.

It is a great fault of symbolic pseudo-mathematical methods of formalising a system of economic analysis . . . that they expressly assume strict independence between the factors involved . . . ; whereas, in ordinary discourse, . . . we can keep 'at the back of our heads' the necessary reserves and qualifications . . . Too large a proportion of recent 'mathematical' economics are merely concoctions, as imprecise as the initial assumptions they rest on, which allow the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols.

The equation which represents the so-called Quantity Theory is, of course, correct. But it is not an equation. It is an identity, like so many so-called equations in economics. An identity may be a useful means of avoiding error, but it cannot, taken by itself, prove anything about causation.

An increase in the quantity of money brought about by open-market purchases of securities by the Central Bank is calculated, by making credit easier and cheaper, to lead to an increase in physical investment, and so to a rise in the level of demand. But the so-called Quantity Theory, taken by itself, is quite incapable of determining the extent to which the rate of investment is increased and the level of demand raised—still less the extent to which the level of prices is raised, if at all.

The basic fallacy is easily explained if, for the sake of argument, I may be allowed to abstract from any *immediate* influence on the rate of investment and the level of demand. In that case, the whole of the increase in the quantity of money takes the form of an increase in the inactive deposits, the velocity of circulation of which is close to zero. The velocity of circulation which appears in the Quantity Theory is a bogus concept—it is the weighted average of the velocity of circulation of the active deposits and of almost zero—the velocity of circulation of the inactive deposits. If the whole of the increase in the quantity of money takes the form of an increase in the inactive deposits, with a velocity of circulation of almost zero, the weighted average velocity of circulation diminishes in precisely the same proportion as that by which the quantity of money increases, in the sense that the one multiplied by the other remains unchanged.<sup>2</sup>

<sup>1</sup> *General Theory*, p. 305.

<sup>2</sup> Let the quantity of active money be  $M_1$ , with a velocity of circulation,

As and when the easing of credit resulting from an increase in the quantity of money leads to a rise in the level of output, and perhaps to a rise in the level of prices, more money is demanded by the active circulation. The total quantity of money multiplied by its weighted average velocity of circulation does then increase. But it increases as an *effect*, not a *cause*, of the rise of the level of output, and perhaps of the level of prices.<sup>1</sup>

One more word about monetarist economists. They often fail to illustrate their theory by taking as an example an increase in the quantity of money resulting from open-market purchases by the Central Bank. They often confine their attention to an increasing quantity of money resulting from a public sector deficit. They consequently confuse two entirely different processes of causation. The consequences of an increase in public expenditure which is not matched by an increase in rates of taxation can be analysed on straightforward Keynesian lines without bringing into the argument the effects of raising the rate of increase of the quantity of money. With much more difficulty, the consequences of raising the rate of increase of the quantity of money can be separately analysed. Then the two sets of consequences can be aggregated.

But what many monetarist economists do is to attribute to raising the rate of increase in the quantity of money consequences which are mainly the straightforward result of increasing public expenditure.<sup>2</sup> Furthermore, they often fail to investigate the

$V_1$ , and the quantity of inactive money be  $M_2$ , with a velocity of circulation,  $V_2$ , equal to zero.

Then the weighted average velocity of circulation,  $V$ , of the total quantity of money,  $M$ , is

$$\frac{M_1 V_1 + M_2 V_2}{M_1 + M_2}.$$

But  $V_2 = 0$  and  $M_1 + M_2 = M$ .

$V$  thus boils down to  $\frac{M_1 V_1}{M}$ .

It follows that  $MV = M_1 V_1$ .

So long as a change in  $M$  takes the form entirely of a change in  $M_2$ ,  $M_1$  does not change. As  $V_1$  does not change,  $MV$  does not change.

<sup>1</sup>  $MV$  is equal to  $M_1 V_1$ , and  $V_1$  is constant.  $MV$  rises because  $M_1$  rises.

<sup>2</sup> For a critical and interesting inquiry into monetarist methods of analysis, see Victoria Chick, *The Theory of Monetary Policy*, London, 1973, pp. 126–30. Miss Chick mentions the extreme position of the Federal Reserve Bank of St. Louis, who believe that ‘Government expenditure financed by selling securities to the public will have little or no effect on total spending’. Miss Chick refers to Professor Milton Friedman’s ‘Comments on the Critics’,

intricate and highly unstable relationship between the public sector deficit and the behaviour of the quantity of money. In other words, they fail to investigate the manner, which varies enormously from one time to another, in which the public sector deficit is financed.

Finally, they usually fail completely to bring into their analysis the implications of the various limitations imposed on the banks by the Central Bank.

In taking the Quantity Theory of Money as a basis for examining the development of Keynes's thought, I do not claim that developments on other lines were not more important.

#### IV

As I have mentioned, Keynes was 40 years of age when he completed his *Tract on Monetary Reform*, the economic analysis in which was curiously conventional for a genius aged 40. He made a fresh start a year later at the age of 41. Six years later, at the age of 47, he finished the *Treatise*—a book of quite remarkable brilliance, and also a very long book, running into two volumes. It broke into entirely new ground—and broke away almost completely from the tradition to which Keynes had remained loyal at the age of 40, seven years earlier.

Five years later, at the age of 52, Keynes finished the *General Theory*, which, although belonging to the same school of thought as his *Treatise*, was based on a very different line of analysis, and was concerned to some considerable extent with different problems. At the same time the analysis of the *General Theory*, quite unlike that of the *Treatise*,<sup>1</sup> was fully consistent with Keynes's popular writings, of which *Can Lloyd George Do It?*,<sup>2</sup> written jointly with Hubert Henderson in 1929, is a good example.

I wonder how many precedents there are for a man at the age of 41 breaking away from the tradition in which not only had he been brought up but had just written an important book,

*Journal of Political Economy*, Chicago, vol. 80, no. 5, September–October 1972 (see p. 922).

Miss Chick's summary of the extreme monetarist views is: 'It is the monetary change, not the government expenditure, which is the important influence on the economy. Hence money, not fiscal policy, matters.'

<sup>1</sup> For a distinctly different view of the relationship to the *Treatise* of Keynes's advice on British policy see Donald Moggridge and Susan Howson, 'Keynes on Monetary Policy', *Oxford Economic Papers*, July 1974, p. 236.

<sup>2</sup> Keynes and H. D. Henderson, *Can Lloyd George Do It?*, London, 1929; *Collected Writings*, vol. ix, pp. 86–125.

and in the course of only eleven years producing a world-shattering book.

During these eleven years Keynes had many other pre-occupations—partly the usual ones of being First Bursar of his college, of lecturing to, and supervising, undergraduates, of editing the *Economic Journal*, being chairman of an insurance company, and much else, but in addition of being a very active member of the Economic Advisory Council, set up early in 1930, and of the Macmillan Committee, which sat from November 1929 until June 1931.

Keynes was not a man who easily got worried or lacked confidence in himself. But without allowing his spirits, which were normally buoyant, to be affected, he was at no stage satisfied with his accomplishment.

On the evening on which he finished the *Treatise*, he wrote to his mother. 'Artistically it is a failure—I have changed my mind too often for it to be a proper unity.'<sup>1</sup>

Five months before he completely finished the *General Theory*, Keynes wrote to me: 'I am in the stage of not liking my book very much.'<sup>2</sup> Joan Robinson recalls that in reply to a note from her: 'I hope you are not suffering from author's melancholy', Keynes replied: 'Author's melancholy did set in at the end. I feel I have not been worthy of my great task.'

Eight months after he had finished the *General Theory*, Keynes wrote to Sir Ralph Hawtrey:

I may mention that I am thinking of producing in the course of the next year or so what might be called *footnotes* to my previous book. . . Of course, in fact, the whole book needs re-writing and re-casting.<sup>3</sup>

It is fashionable nowadays to write carping comments about the *General Theory*, expressing doubts about both its originality and its importance. I often wonder to what extent these critics are aware of the quite astonishing state of economics before the publication of the *Treatise on Money*. In a preface to a book published two years ago, called *A Tiger by the Tail*,<sup>4</sup> consisting largely of extracts from the writings and lectures of Professor Hayek, Mr. Arthur Seldon, the editor, states that 'it is not clear that [Keynes's] work will survive longer than that of some of his contemporaries'. He rightly points out that 'some economists never accepted the Keynesian system'. The only ones whom he

<sup>1</sup> *Collected Writings*, vol. xiii, p. 176.

<sup>2</sup> *Collected Writings*, vol. xiii, p. 634.

<sup>3</sup> *Collected Writings*, vol. xiv, p. 47 (the italics are Keynes's).

<sup>4</sup> F. A. Hayek, *A Tiger by the Tail*, London, 1972.

mentions, in addition to Professor Hayek himself, are Pigou, Dennis Robertson, and W. H. Hutt. Apparently Mr. Seldon has never heard of Pigou's renunciation of his criticisms of the *General Theory*.

Pigou's renunciation took the form of two lectures delivered in November 1949 to a large audience of Cambridge dons and undergraduates. Referring to 'the kernel of Keynes' contribution', as set out on page 246 of the *General Theory*, Pigou said:

Whatever imperfection there may be in his working out the fundamental conception embodied there, the conception itself is an extremely fruitful germinal idea. In my original review article on the *General Theory*<sup>1</sup> I failed to grasp its significance and did not assign to Keynes the credit due for it. Nobody before him, so far as I know, had brought all the relevant factors, real and monetary at once, together in a single scheme, through which their interplay could be coherently investigated.<sup>2</sup>

It was a moving occasion. Another moving occasion, at which I was also present, was when Lord Robbins, in a speech in the House of Lords delivered in July 1966, said:

In the inter-war period when mass unemployment actually prevailed, I was on the wrong side: I opposed measures of reflation which I now think might have eased the situation.<sup>3</sup>

In July 1966 the number of unemployed was 265,000—a percentage of 1.1 (today it is 625,000—2.75 per cent). Lord Robbins was, of course, careful to make it clear that he was not advocating measures of reflation at that time—a view with which I was in agreement.

Lord Robbins has developed the theme at greater length in his *Autobiography*.<sup>4</sup> He writes: 'I shall always regard this aspect of my dispute with Keynes as the greatest mistake of my professional career.'

## V

I turn now to Keynes's treatment of the behaviour of money wages. It will serve to illustrate the attitude towards the Quantity Theory of Money of the Keynes of the *General Theory* if I begin by outlining the attitude of many Keynesians to the extremely serious problem presented today by inflation. According to the monetarist school of thought, the remedy is

<sup>1</sup> Pigou, *Economica*, vol. iii, No. 10, London, May 1936, pp. 115–32.

<sup>2</sup> Pigou, *Keynes's 'General Theory': A Retrospective View*, London, 1950, p. 65.

<sup>3</sup> House of Lords, *Official Report*, 28 July 1966, col. 953.

<sup>4</sup> *Autobiography of an Economist*, London, 1971, pp. 152–5.

to prevent the supply of money from increasing faster than the rate of increase of the national product added to such modest rate of rise of the price-level as appears acceptable. We are assured that, after a period of some years, the economy will settle down in a happy state of tranquil growth, with the price-level rising at a modest rate.

Part of the Keynesian comment about such a policy is that a decline in the ratio of the supply of money to the value of output would mean rising rates of interest, and a progressive failure of the supply of credit to meet the needs of industry, falling prices on the Stock Exchange, and bankruptcies at an increasing rate. Unemployment would grow progressively, and would reach a level which was politically unacceptable, before it had any appreciable influence, if any at all, on the outcome of wage bargaining.

Already in his *Treatise on Money*, Keynes had drawn the fundamental distinction between cost inflation and the kind of inflation which shows itself in profits being abnormally high. The distinction is brought out sharply in his Fundamental Equations.<sup>1</sup> Underlying a rising price-level are two elements. The first is a rising rate of efficiency-earnings—the rate of money earnings per unit of output. This Keynes called *income inflation*. The second element Keynes called *profit inflation*. It is the result of the level of demand being such as to push prices above earnings per unit of output, resulting in profits being abnormal.

In so far as the abnormal profits are earned in the production of consumption-goods, they are earned at the expense of real wages. Incidentally, here we can trace the seed of what was, over twenty years later, to become the post-Keynesian theory of the distribution of income. In so far as the abnormal profits are earned in the production of capital goods, real wages are not directly affected. But such profits encourage an increase in the rate of investment—the output of capital goods—and this results in abnormal profits being earned in the production of consumption-goods as well.

As I have already indicated, Keynes had not, when he completed the *Treatise*, broken entirely loose from the trammels of the Quantity Theory of Money. But here we have a theory of determination of the price-level in which the Quantity Theory plays no explicit part. Implicitly it appears through monetary influences on the output of capital-goods. In this particular part of the *Treatise*, monetary influences appear in

<sup>1</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 140 (p. 155).

the form of the market rate of interest. Following Wicksell, the great Swedish economist,<sup>1</sup> Keynes described as the natural rate of interest that rate of interest which would result in such an output of capital goods—such a rate of investment—as would entail no profit inflation. But inflation could still take the form of income inflation, as a result of money wages rising faster than productivity.

By introducing income inflation as a possibility consistent with the absence of profit inflation, Keynes improved on Wicksell. Keynes has been accused of either failing adequately to acknowledge his debt to Swedish economists or of failing to profit from their pioneer work. Professor Gunnar Myrdal, in his rightly famous book on *Monetary Equilibrium*, published in German in 1933,<sup>2</sup> wrote:

The English school of theorists has only slowly arrived at Wicksell's statement of the problem . . . J. M. Keynes' new brilliant, though not always clear, work, *A Treatise on Money*, is completely permeated by Wicksell's influence. Nevertheless Keynes' work, too, suffers somewhat from the attractive Anglo-Saxon kind of unnecessary originality, which has its roots in certain systematic gaps in the knowledge of the German language on the part of the majority of English economists.<sup>3</sup>

Keynes did, in fact, admit, in the *Treatise*—in referring to books by von Mises, Professor Hans Neisser, and Professor Hayek—that he would have made more references to them if his knowledge of German had not been so poor. 'In German I can only clearly understand what I know already!'<sup>4</sup>

Wicksell was available to Keynes only in German. Keynes certainly derived the phrase 'natural rate of interest' from Wicksell. And he regarded Wicksell's book as sufficiently important for me to translate. Sir Roy Harrod's view is that 'the process of thought by which Keynes reached his conclusions was independent, and not derived from the study of Wicksell'.<sup>5</sup>

<sup>1</sup> Wicksell, *Geldzins und Güterpreise*, Jena, 1898; English translation, *Interest and Prices*, London, 1936.

<sup>2</sup> A shorter version of Professor Myrdal's book was originally published in Swedish in *Ekonomisk Tidskrift* in 1931. Three introductory chapters were added in the German version, from the first of which the passage quoted in the text is taken. The German version was published in 1933 as part of *Beiträge zur Geldtheorie*, edited by Professor Hayek. An English translation of the German version was published in 1939.

<sup>3</sup> Myrdal, *Monetary Equilibrium*, London, 1939, pp. 8–9.

<sup>4</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 178, n. 2 (p. 199, n. 2). Keynes mentioned also that these authors' works had come into his hands only as the pages in question were being passed through the press.

<sup>5</sup> Harrod, *The Life of John Maynard Keynes*, London, 1951, p. 409.

The truth seems to lie closer to the implications of Professor Gunnar Myrdal's phrase 'systematic gaps in the knowledge of the German language' than to that of his phrase 'completely permeated'.

On this issue we have Keynes's own testimony, in an article published in 1937, in replying to an article by Professor Bertil Ohlin. Keynes wrote that Sir Ralph Hawtrey and Dennis Robertson had 'strayed from the fold' of classical economics sooner than he had. He regarded Sir Ralph Hawtrey 'as his grandparent and Dennis Robertson as his parent in the paths of errancy', and he had 'been greatly influenced by them'. Keynes might have adopted 'Wicksell as his great great-grandparent, if he had known his works in more detail at an earlier stage in his own thought and also if he did not have the feeling that Wicksell was *trying* to be "classical"'.<sup>1</sup>

Professor Myrdal, in his recent book of essays, called *Against the Stream*, does actually praise Wicksell because he 'was always eager to root his new ideas in thoughts which, after laborious study, he had found expressed somewhere in the great literature, in part from the beginning of the nineteenth century'.<sup>2</sup> This view, taken by Professor Myrdal, confirms Keynes's complaint that Wicksell was *trying* to be classical.

In fact, Professor Myrdal's own book, *Monetary Equilibrium*, is strongly based on classical thought as the following quotation indicates: 'The "natural" or, as Wicksell sometimes says the "real", rate of interest is defined as the marginal increase in "physical productivity" of the services of land and labour when they are saved.'<sup>3</sup>

That is by the way. I was saying that Keynes improved on Wicksell by demonstrating the compatibility of income inflation, due to money wages rising faster than productivity, with the market rate of interest being equal to the natural rate; and so he demonstrated the compatibility of income inflation with profit inflation: whereas Wicksell defined the natural rate as the rate of interest which would result in stability of the price-level.

<sup>1</sup> *Economic Journal*, London, June 1937, p. 242, footnote; *Collected Writings*, vol. xiv, p. 202, n. 2 (the italics are Keynes's).

The fact that later on, in his *General Theory* (pp. 242-3), Keynes abandoned the use of Wicksell's term 'natural rate of interest' is irrelevant to the issue of the degree of Wicksell's influence on Keynes.

<sup>2</sup> Myrdal, *Against the Stream*, New York, 1972, p. 59.

<sup>3</sup> Myrdal, *Monetary Equilibrium*, p. 49. This passage had appeared in the original Swedish article, published in 1931.

Curiously enough, Wicksell's view that a constant price-level was a condition of monetary equilibrium was immediately questioned, in 1899, by Davidson, another Swedish economist.<sup>1</sup> Davidson maintained that if technical productivity was growing the price-level must fall under conditions of monetary equilibrium. Davidson's exposition is hard to follow, as Professor Myrdal pointed out. The obvious solution—the one presented by Keynes—was simultaneously found by Professor Myrdal in 1931.<sup>2</sup> Davidson was right if money wages are sticky and if competition is fairly perfect and prices flexible.

It is unfortunate that Keynes failed in his *General Theory* to refer to Professor Myrdal's book. But although it was published in German in 1933, the English translation was not published until 1939.<sup>3</sup>

Keynes's concept of income inflation, published 44 years ago, fits in with much modern thinking about the causes of inflation. Although Keynes abandoned the actual phrase in his *General Theory*, he strengthened the logical basis of the concept. One of the important contributions of the *General Theory* is what Sir John Hicks, in his recent book on *The Crisis in Keynesian Economics*, calls the *wage-theorem*. Keynes had already in his *Treatise* enunciated the doctrine, which emerged logically from his discovery of income inflation.<sup>4</sup> The money-wage is the fulcrum on which rests the whole structure of everything expressed in terms of money—all prices, incomes of every kind, and all money-values. A higher level of money-wages means that everything expressed in terms of money is higher in the same proportion. The one important exception is the quantity of money. If it is held constant, a higher money-wage means that in real value—in terms of its purchasing power over labour and goods—the quantity of money is reduced. The only important influence on the real state of the economy of a higher

<sup>1</sup> Davidson's review of Wicksell's *Geldzins und Güterpreise* in *Ekonomisk Tidskrift*, 1899.

<sup>2</sup> Myrdal, *Monetary Equilibrium*, p. 139. This passage had appeared in the original Swedish article, published in 1931.

<sup>3</sup> Keynes's copy is to be found in the Marshall Library—the Library of the Cambridge Faculty of Economics and Politics. It is clear from his pencilled markings that Keynes read it carefully. He was especially interested in Professor Myrdal's references to Wicksell. The following passage is heavily scored: 'It is nowadays generally recognised that the quite complicated quantitative relation between the amount of means of payment and the "price level" is by no means such that it can be said that the amount of means of payment *determines* the price-level, rather than the other way round' (p. 14). (The italics are Professor Myrdal's.)

<sup>4</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 150 (p. 167).

money-wage takes the form of the higher rates of interest, and the general tightening of credit, which result from a reduction in the real value of the quantity of money.

In addition, all incomes and debts fixed contractually in terms of money are smaller in real value as a result of the money-wage being higher. I am, of course, abstracting from effects on exports and imports.

The basis of the fundamental role of the money-wage in determining all prices, money-incomes, and money-values is that money-wages not only form part of costs of production but, because they are to a large extent spent, they form part of total purchasing power expressed in terms of money. The higher costs resulting from a higher level of money-wages are met by the resultant addition to demand in terms of money; while in real terms demand is unaltered.

Keynes's analysis of the behaviour of money-wages is unsystematic and unsatisfactory. His failure adequately to consider how wages would, or might, behave under conditions of fairly full employment is attributable to the high level of unemployment with which he was faced and to his belief that, apart from war, unemployment would never fall to a really low level. His main concern was not with rising wages but with certain aspects of falling wages. First of all, he stressed the extreme reluctance of money-wages to fall even under the pressure of severe unemployment. Sir John Hicks points out that in 1933 in this country, 'the wage-index had fallen no more than 5 per cent below its level in the mid-twenties'.<sup>1</sup> In the early 1930s the number of unemployed rose above 2 million—above a percentage of 20—and in 1932 was about 2,800,000—a percentage of 28. During the last stages of completion by Keynes of his *General Theory*, in 1934 and 1935, unemployment was falling but it remained over 1,200,000.

The difficulty of securing a fall of wages had been the basis of the argument used by Keynes in *The Economic Consequences of Mr. Churchill*. Even if severe unemployment in the unsheltered industries did result in some fall of wages, 'wages will not fall in the sheltered industries, merely because there is unemployment in the unsheltered industries. Therefore, you will have to see to it that there is unemployment in the unsheltered industries also.'<sup>2</sup>

<sup>1</sup> Hicks, *The Crisis in Keynesian Economics*, Oxford, 1974, p. 67.

<sup>2</sup> *The Economic Consequences of Mr. Churchill*, London, 1925, p. 13; *Collected Writings*, vol. ix, p. 215.

Keynes had to contest the very widely held view that, quite apart from favourable effects of exports, if only wages fell more heavily, unemployment would be reduced. He argued emphatically that lower wages simply meant lower purchasing power, and that so far from unemployment being reduced it would be increased if a fall of wages resulted in an expectation of further falls of wages and prices.

Furthermore, a really heavy cut in wages, resulting in a heavy fall of prices, would seriously endanger the financial position of companies which were partly financed by loans and debentures. As a result, the financial position of banks would be threatened. Although their assets would rise in real value to the same extent as the deposits held with them, some of their borrowers would become bankrupt. The solidarity of the whole financial system would be threatened.<sup>1</sup>

Keynes was mainly concerned, in the *General Theory*, with the failure of economists and others to appreciate the reluctance of money-wages to fall and to realize that even if they did fall, unemployment would not be diminished, except in industries subject to competition with overseas suppliers.

However, he did write something about the relationship between the behaviour of money-wages and the level of demand, as reflected in the level of employment. He expressed such a relationship in what would today be regarded as the wrong form. He referred to a rise of the level of money-wages in response to a rise of demand and employment, whereas today we would refer to the relationship between the rate of increase of money-wages and the level of employment. This is just one aspect of the fact that Keynes's concepts were designed for an economy in a state of depression. Similarly, he would discuss the influence of a change in the actual quantity of money as opposed to a change in its rate of growth.

Among the forces responsible for the behaviour of money-wages, Keynes mentioned 'the power of trade unions',<sup>2</sup> the greater readiness of entrepreneurs to give way to pressure 'when they are doing better business'<sup>3</sup> and 'the psychology of the workers and the policies of employers and trade unions'.<sup>4</sup> However, there is no analysis of the problem. The only reasoned statement

<sup>1</sup> See 'The Economic Consequences to the Banks of the Collapse of Money Values' (August 1931), *Collected Writings*, vol. ix, pp. 150-8.

<sup>2</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 152 (p. 170).

<sup>3</sup> *General Theory*, p. 301.

<sup>4</sup> *Ibid.*

which I have been able to find either in the *Treatise* or in the *General Theory* is the following in the *General Theory*:

. . . this accords with our experience of human nature. For although the struggle for money-wages is . . . essentially a struggle to maintain a high *relative* wage, this struggle is likely, as employment increases, to be intensified in each individual case because the bargaining position of the worker is improved.<sup>1</sup>

So we find that, as long ago as 1936, Keynes regarded what is now called the 'leap-frogging effect'—or the wage-wage spiral as opposed to the wage-price spiral—as the main cause of rising wages. This is the view which many of us have held for some years.

Keynes added that 'these motives will operate within limits', and that the level of money-wages in practice fluctuated very little. His belief was dominated not only by contemporary experience, with heavy unemployment, but also by the 'fair measure of stability of prices' between 1820 and 1914, which he attributed to 'a balance of forces in an age when individual groups of employers were strong'.<sup>2</sup>

As to full employment, Keynes wrote that 'when a further increase in the quantity of effective demand produces no further increase in output . . . we have reached a condition which might be appropriately designated as one of true inflation'.<sup>3</sup> But he had written earlier, 'full, or even approximately full, employment is of rare and short-lived occurrence'.<sup>4</sup>

There are passages in the *General Theory* which seem to suggest that there is one quite definite level of demand, resulting in a level of employment which can be described as a 'state of full employment'. As Sir John Hicks, in his recent book, remarks, when the Keynes theory is set out in the

text-book manner . . . it is bound to give the impression that there are just two 'states' of the economy: a 'state of unemployment' in which money wages are constant, and a 'state of full employment' in which pressure of demand causes wages to rise.<sup>5</sup>

Some of the gross over-simplifications of Keynes's analysis of which the textbooks are shamefully guilty are attributable to Keynes's burning desire to be understood. To clarify his presentation, he was apt to give a misleading impression of believing

<sup>1</sup> *Ibid.*, p. 253.

<sup>2</sup> *Ibid.*, p. 308.

<sup>3</sup> *Ibid.*, p. 303.

<sup>4</sup> *Ibid.*, p. 250.

<sup>5</sup> Hicks, *op. cit.*, p. 60.

in a number of simple relationships. Many of his readers have failed to realize that the simplifying assumptions made for the sake of clarity are not to be taken literally.

But actually, in the relationship between the behaviour of money-wages and the level of employment, no such excuse is admissible. Keynes stated clearly in a number of passages that, to quote one of them, 'the wage-unit may tend to rise before full employment has been reached'.<sup>1</sup> On the previous page he has recognized that, in general, the demand for some services and commodities will reach a level beyond which their supply is, for the time being, perfectly inelastic, whilst in other directions there is still substantial surplus of resources without employment.<sup>2</sup>

Keynes's belief that the level of money-wages is fairly stable accounts for his views about a policy of trying to achieve a stable price-level. Before he had completed the *Treatise*, he took part in a discussion of a paper on 'Money and Index Numbers' presented by Sir Ralph Hawtrey to the Royal Statistical Society. Of Sir Ralph Hawtrey he said that 'there are few writers on [monetary] subjects with whom I personally feel in more fundamental sympathy and agreement. The paradox is that in spite of that, I nearly always disagree in detail with what he says'.<sup>3</sup> On the choice between aiming at a stable price-level and aiming at a stable wage-level, Keynes said:

I believe you have less social friction if wages on the whole tend to go up with progress than if they keep steady. I think that earners are more satisfied if, when they become more efficient, they benefit in the shape of higher wages than if they benefit by lower prices.<sup>4</sup>

This view was stated in the *Treatise*,<sup>5</sup> and later reaffirmed in the *General Theory*.<sup>6</sup>

Thirty-five years have passed since it was possible in all seriousness to discuss the possibility of a falling price-level as a result of a constant *average* level of money-wages (requiring that in some sectors wages fall to compensate for rises in other sectors). It is in that setting that Keynes's work on the subject has to be appreciated.

<sup>1</sup> *General Theory*, p. 301.

<sup>2</sup> *Ibid.*, p. 300.

<sup>3</sup> *Journal of the Royal Statistical Society*, Part I, 1930; *Collected Writings*, vol. xiii, p. 127.

<sup>4</sup> *Collected Writings*, vol. xiii, p. 129.

<sup>5</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 152 (pp. 169–70).

<sup>6</sup> *General Theory*, p. 271.

## VI

It seems odd that, in the passages which I have quoted, Keynes seemed to regard the behaviour of the level of money-wages as though it was open to a choice of policy. That was not his view at all. Already in the *Treatise* he wrote:

It is more important to have a system which avoids as far as possible, the necessity for *induced* changes [in the behaviour of money-wages] than it is to stabilise the price-level according to any precise principle, *provided always that the rate of change in the price-level is kept within narrow limits.*<sup>1</sup>

Of course, it always was Keynes's view that, to quote from *The Economic Consequences of Mr. Churchill*, a policy of trying to reduce wages and prices 'by intensifying unemployment without limit . . . is a policy . . . from which any humane or judicious person must shrink'.<sup>2</sup>

In the middle of the Second World War, an article in the *Economic Journal* by Professor Hayek, on 'A Commodity Reserve Currency', gave Keynes an opportunity, at a time when in the Treasury he was deeply involved in post-war problems, to air his views in public in the today more relevant context of coping with an upward surge of money-wages as opposed to reluctance of money-wages to fall. In a Rejoinder to Professor Hayek's article, Keynes mentioned 'attempts to confine the natural tendency of wages to rise beyond the limits set by the volume of money', which rely on 'the weapon of deliberately creating unemployment. This weapon the world, after a good try, has decided to discard.' Keynes referred to the view that

a capitalist country is doomed to failure because it will be found impossible in conditions of full employment to prevent a progressive increase of wages. According to this view severe slumps and recurrent periods of unemployment have been hitherto the only effective means of holding efficiency wages within a reasonably stable range. Whether this is so or not remains to be seen. The more conscious we are of this problem, the likelier we are to surmount it.<sup>3</sup>

So Keynes foresaw that there would be a problem. He did not foresee that nothing would be done about the problem until it had got out of hand. He did not foresee the order of magnitude of the problem. The terrifying size of the problem

<sup>1</sup> *A Treatise*, vol. i; *Collected Writings*, vol. v, p. 153 (p. 170) (the italics are the Lecturer's).

<sup>2</sup> *The Economic Consequences of Mr. Churchill*, p. 17; *Collected Writings*, vol. ix, p. 218.

<sup>3</sup> Keynes, *Economic Journal*, June-September 1943, pp. 185 and 187.

today is attributable in this country partly to the failure of all Governments before July 1961 to be fully conscious of the existence of the problem, still less of its potential order of magnitude.

A note by Frank Graham, the Princeton Professor, on the Keynes versus Hayek controversy appeared in a later number of the *Economic Journal*. He referred to correspondence which had passed a year earlier between him and Keynes.<sup>1</sup> In a letter to Graham, Keynes asked:

How much otherwise avoidable unemployment do you propose to bring about in order to keep the Trade Unions in order? Do you think it will be politically possible when they understand what you are up to? My own preliminary view is that other, more reasonable, less punitive means must be found.<sup>2</sup>

Keynes was also corresponding on the same subject with Benjamin Graham, the famous advocate of an international composite commodity buffer stock.<sup>3</sup> Keynes explained his view that:

If money-wages rise faster than efficiency, this aggravates the difficulty of maintaining full employment . . . and is one of the main obstacles which a full employment policy has to overcome.

. . . The more aware we were of the risk, the more likely we should be to find a way round other than totalitarianism. But I recognised the reality of the risk.<sup>4</sup>

The discussions with Professor Hayek, and Frank and Benjamin Graham, arose because Keynes objected to Professor Hayek's Commodity Reserve Currency on the grounds that it did not provide for exchange-rate adjustments. Keynes's attitude is reflected in the proposals for international monetary reform—both his own proposal of an International Clearing Union (based on 'bancor') and the proposal for the International Monetary Fund which came into effect.

In recommending the proposals for an International Monetary Fund to the House of Lords in May 1943, Keynes said that the experience of the years before the war had led most people, 'though some late in the day', to certain firm conclusions:

Three are highly relevant. We are determined that, in future, the

<sup>1</sup> Graham, *Economic Journal*, December 1944, p. 428. The correspondence was about the drafting of Frank Graham's Note on the Keynes versus Hayek controversy. Keynes was acting as Editor of the *Economic Journal*.

<sup>2</sup> Letter of 31 December 1943 (not yet published).

<sup>3</sup> Benjamin Graham had also submitted an article on the subject of Keynes's controversy with Hayek. It was not published.

<sup>4</sup> Letter also of 31 December 1943 (not yet published).

external value of sterling shall conform to its internal value, as set by our own domestic policies, and not the other way round. Secondly, we intend to keep control of our domestic rate of interest. Thirdly, whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instruments of bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors.

. . . I hope your Lordships will trust me not to have turned my back on all I have fought for. To establish these three principles which I have just stated has been my main task for the last twenty years.<sup>1</sup>

A year earlier, recommending his own proposal to the House of Lords, Keynes had said:

We do indeed commit ourselves to the assumption that the Governing Board of the Union will act reasonably in the general interest . . . That is the least we can do . . . But if, in the event, our trust should prove to be misplaced and our hopes mistaken, we can, nevertheless, escape from all obligations and recover our full freedom with a year's notice.<sup>2</sup>

These words fall sadly on our ears. Keynes's vision of the post-war world has turned out to have been seriously defective in a number of important respects.<sup>3</sup>

First of all, Keynes failed to foresee the immensity of the demands on the productive resources of all advanced industrial countries, over an indefinite future, as opposed to a few years of post-war replenishment and reconstruction, so that the problem is not how to secure a reasonably high level of employment but how to avoid an unduly high pressure of demand on productive resources.

Secondly, Keynes failed to foresee that, for the first twenty

<sup>1</sup> *Official Report*, House of Lords, 23 May 1944; *The New Economics*, edited by Seymour Harris, New York, 1948, p. 374; to be published in 1977 in one of the volumes of *Collected Writings*.

<sup>2</sup> *Official Report*, House of Lords, 18 May 1943; Seymour Harris, *op. cit.*, p. 364; to be published in 1977 in one of the volumes of *Collected Writings*.

<sup>3</sup> On the other hand, Keynes did display prophetic instincts in his post-humorous article on 'The Balance of Payments of the United States', *Economic Journal*, June 1946. He did, however, get the time-scale wrong when he wrote: 'The chances of the dollar becoming dangerously scarce in the course of the next five to ten years are not very high.'

It is less obvious that Keynes was justified in his remarkable belief in the efficacy of 'deep undercurrents at work, natural forces, one can call them, or even the invisible hand, which are operating towards equilibrium'. Keynes, a sick man, was displaying a natural irritation over 'modernist stuff, gone wrong and turned sour and silly'.

years of its existence, the IMF would operate on the principle that exchange-rates were almost, though not entirely, sacrosanct—the fault of Central Banks and Governments as well as of the authorities of the Fund.

Thirdly, Keynes failed to foresee that, of all the advanced industrial countries, Britain would systematically exhibit the highest excess of the rate of increase of wage-earnings over the rate of growth of productivity; and that, more generally, the ranking order of this excess among industrial countries would remain systematically fairly stable over decades. It is one thing to operate a system of changeable exchange-rates when the changes are sometimes in one direction, sometimes in the other; it is quite another thing when they are always in the same direction.

Fourthly, Keynes failed to foresee that, twenty-nine years after the end of the war, the percentage rate of increase of money-costs of production in a number of industrial countries would have reached double figures.

Keynes was essentially a man of moderation. He would have had difficulty in accepting as a possibility the degree of stupidity in advanced countries indicated in such figures.

Keynes's unawareness of the magnitude of the problem with which industrial countries generally, and ours in particular, were to be faced is echoed in various documents written towards the end of the war. Keynes, preoccupied with various talks with the Americans, could devote little time to the drafting of the Coalition Government's White Paper on *Employment Policy*. But there is no evidence that he wanted more emphasis to be given to the problem of curbing the upward tendency of wages, to which one perfunctory page is devoted.<sup>1</sup>

Beveridge quoted from an article published anonymously in *The Times* a warning by Professor Joan Robinson. 'In peacetime the vicious spiral of wages and prices might become chronic.'<sup>2</sup> He took the problem somewhat more seriously than the Government and devoted to it two and a half pages, in the course of which he wrote:

The primary responsibility of preventing a full employment policy from coming to grief in a vicious spiral of wages and prices will rest on those who conduct the bargaining on behalf of labour. The more

<sup>1</sup> *Employment Policy*, Cmd. 6527, May 1944, pp. 18 and 19.

<sup>2</sup> 'Planning Full Employment', *The Times*, London, 23 January 1943 (the second of two articles: the first was published on the previous day); *Collected Economic Papers*, vol. i, London, p. 85. Joan Robinson's articles received Keynes's approval after they had been published.

explicitly that responsibility is stated, the greater can be the confidence that it will be accepted . . . Wages ought to be determined by reason, not by the methods of strike and lock-out. Ordeal by battle has for centuries been rejected as a means of settling legal disputes between citizens.<sup>1</sup>

Even Hubert Henderson, who, working in the Treasury, allowed no opportunity to slip for teasing Keynes and was sceptical of full-employment policy, made no reference to the problem of rising wages in his two Notes on the subject which have been published.<sup>2</sup> The second one dealt with Keynes's observations on the Report of the Steering Committee which led to the White Paper, published two months later. Its opening words are striking:

Lord Keynes adopts towards the report the tone of an authoritative exponent of Scientific Truth dealing with the fumbling efforts of the half-educated. He recognises a praiseworthy groping towards the light, but deploras an undue timidity attributable to muddled thinking and the tenacity of error. He implies that his own point of view, which would prescribe more boldly, and claim much more, is not that of an eminent individual or of a particular school of thought, but of 'theoretical economic analysis', and that it is really not open to challenge by anybody who understands what he is talking about.

. . . Despite the current trend of fashion, the implication that all reputable economists would accept these doctrines is a grotesque exaggeration, unless indeed their acceptance is taken, as perhaps it is by Lord Keynes, to be the criterion and hallmark of a reputable economist. In my opinion these doctrines are unhistorical, unimaginative, and unscientific.<sup>3</sup>

(This was the Hubert Henderson who fifteen years earlier had collaborated with Keynes in writing *Can Lloyd George Do It?*, which ended as follows:

The future holds in store for us far more wealth and economic freedom and possibilities of personal life than the past has ever offered.

There is no reason why we should not feel ourselves free to be bold, to be open, to experiment, to take action, to try the possibilities of things. And over against us, standing in the path, there is nothing but a few old gentlemen tightly buttoned-up in their frock coats, who only need to be treated with a little friendly disrespect and bowled over like ninepins.

<sup>1</sup> *Full Employment in a Free Society*, London, 1944, pp. 198-201.

<sup>2</sup> *The Inter-War Years and Other Papers*, edited by Henry Clay, London, 1955, pp. 220-35 and 316-25.

<sup>3</sup> *Ibid.*, pp. 316-17. More light will be thrown on the relations between Keynes and Henderson in the Treasury in the volumes of *Collected Writings* to be published in 1977. See Harrod's *Life*, p. 530.

Quite likely they will enjoy it themselves, when once they have got over the shock.)<sup>1</sup>

Keynes had, in *The Economic Consequences of the Peace*, expressed his horror of inflation. There we find the famous statement that 'Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency'. Keynes added that 'Lenin was certainly right'.<sup>2</sup> In the first chapter of his *Tract on Monetary Reform*, published in 1923, he analysed the great injuries inflicted both by heavy inflation and by heavy deflation, and expressed himself on balance in favour of stability of the price-level.<sup>3</sup> 'Inflation is unjust and Deflation inexpedient', he wrote. 'Of the two perhaps Deflation is, if we rule out exaggerated inflations such as that of Germany, the worse.'<sup>4</sup>

Keynes obviously regarded the upward and downward movements of the price-level both between 1914 and 1922 and during and after the Napoleonic wars as altogether exceptional. He believed himself to be living in a country in which, as in other advanced industrial countries, the price-level was quite remarkably stable. In the *Treatise* Keynes referred to 'the sensational rise of prices' in Britain between 1550 and 1650.<sup>5</sup> The price-level rose by 200 per cent between 1500 and 1650. The average annual rate at which it rose was 0.75 per cent. That is the degree of inflation which Keynes regarded as abnormal. Even more exceptional was the fall of prices in 1930 to which Keynes referred as he was completing the *Treatise*.<sup>6</sup>

In his booklet *How to Pay for the War*,<sup>7</sup> he advocated:

1. Heavy taxation, partly in the form of post-war credits.
2. A capital levy after the war.
3. Universal family allowances in cash.
4. A constant price-level, secured by subsidies of a limited range of essentials, considerably narrower than the list covered by the official cost-of-living index.
5. Agreement on the part of trade unions, if this price-level

<sup>1</sup> *Can Lloyd George Do It?*, London, 1929, pp. 43-4; *Collected Writings*, vol. ix, p. 125.

<sup>2</sup> Keynes, *The Economic Consequences of the Peace*, London, 1919, p. 220; *Collected Writings*, vol. ii, pp. 148-9.

<sup>3</sup> *Collected Writings*, vol. iv, p. 16 (p. 17).

<sup>4</sup> *Collected Writings*, vol. iv, p. 36 (p. 40).

<sup>5</sup> *A Treatise*, vol. ii; *Collected Writings*, vol. vi, p. 137 (p. 154).

<sup>6</sup> *Ibid.*, p. 338 (p. 377).

<sup>7</sup> Originally published in the form of two articles in *The Times*, London, 14 and 15 November 1939; in an enlarged form *How to Pay for the War*, London, February, 1940; *Collected Writings*, vol. ix, pp. 367-439.

did not rise, not to press for an increase of wages, which, if granted, would be greatly to the disadvantage of the working class, reliance being placed on the common sense and public spirit of trade unionists at a time of war.

It was the official cost-of-living index, not the narrower one advocated by Keynes, which it was attempted to stabilize. As to a post-war capital levy, obviously neither Winston Churchill nor his Chancellors of the Exchequer, Kingsley Wood and John Anderson, either wished or were entitled to indicate that if a Labour Government came into power after the war, it could be relied upon to impose a capital levy.

Actually Keynes changed his mind. As a member of the National Debt Enquiry Committee which met in the first half of 1945, he opposed Professor James Meade's proposal of a post-war capital levy, referring to it as 'capital levity'. The scheme of post-war credits came into operation on a far less extensive scale than that advocated by Keynes in his booklet. Indeed, Professor Richard Sayers writes:

[The] sums were in the end so much smaller than Mr. Keynes had originally envisaged that it is hardly fair to describe Sir Kingsley Wood's innovation as an implementation of the Keynes plan.<sup>1</sup>

Family allowances were discussed, but in the end a plan began to be prepared in 1943 for implementation immediately after the end of the war (it reached the Statute Book in June 1945 and payments began in August 1946).<sup>2</sup>

Keynes began to work in the Treasury in June 1940, first of all as a member of a Consultative Council appointed by the Chancellor of the new Coalition Government, Kingsley Wood. A little later Keynes was given a room in the Treasury.<sup>3</sup>

In a paper presented in September 1940,<sup>4</sup> Keynes estimated that if his budgetary proposals, amounting to about £400 million extra taxation in the coming fiscal year, were rejected, retail prices would rise initially by at least a further 15 per cent, followed by a vicious price-wage spiral. In the outcome the Chancellor aimed at £250 million.

Since the beginning of the war up to July 1940, when Keynes began to operate effectively in the Treasury, the index of

<sup>1</sup> R. S. Sayers, *Financial Policy, 1939-45 (Official History of the Second World War)*, London, 1956, p. 84.

<sup>2</sup> *Ibid.*, p. 98.

<sup>3</sup> See Sayers, *op. cit.*, p. 45; Harrod's *Life*, pp. 497-8.

<sup>4</sup> Referred to by Professor Sayers, *op. cit.*, pp. 70-4. The paper will be included in one of the volumes of *Collected Writings* to be published in 1977.

weekly wage-rates rose by 13.3 per cent, and the cost of living by 20.6 per cent. During the whole period of the war, the wage-rate index rose by 49.2 per cent and the cost of living by 31.6 per cent, a remarkable achievement, part of the credit for which is due, not only to Keynes, but also to those civil servants, many of them economists, who gladly followed his lead. From the time when Keynes began to operate effectively in the Treasury, the wage-rate index rose by 32.1 per cent and the cost of living by 9.5 per cent.<sup>1</sup>

Mr. Leonard Nicholson, who was concerned with these figures during the war, pointed out<sup>2</sup> that the official cost-of-living index was based on the working-class family budget of 1914. Tobacco had a weight of only 0.8 per cent, and beer (and, of course, all forms of alcohol), and entertainment were excluded altogether. Goods of which the prices were subsidized in the war were over-weighted and goods which were subject to indirect taxation were very inadequately represented. Mr. Nicholson calculated his own indices both for wage-earners and for all consumers. Between 1939 and 1944, the wage-earners' index rose by 47 per cent and the consumers' index by 50½ per cent. Between 1939 and 1940 the index for wage-earners rose by 17 per cent and between 1940 and 1944 by 25 per cent.

But it was entirely consistent with the proposal put forward by Keynes in *How to Pay for the War* to aim at stability of an index based on the budget of a poor family, with a standard of living of the average working-class family in 1914.<sup>3</sup> There were plenty of opportunities in the Second War, as in the First, for those who could afford it to spend money on heavily taxed luxury goods which escaped the operation of price control. But the object was to keep down the cost of living of those who could not afford luxuries.

During the war the official cost-of-living index rose at an average annual rate of about 6 per cent (and Mr. Nicholson's over the period 1939 to 1944 at an annual rate of about 8½ per cent). From the time when Keynes began to work in the Treasury until the end of the war, the official cost-of-living index rose

<sup>1</sup> *British Labour Statistics: Historical Abstract 1886-1968*, Tables 13, 40, and 89.

<sup>2</sup> 'Employment and National Income during the War', *Bulletin of the Oxford Institute of Statistics*, Oxford, 13 October 1945, pp. 236-7; *Studies in War Economics*, Oxford, 1947.

<sup>3</sup> In the outcome, stabilization covered a somewhat wider range. See Sayers, *op. cit.*, p. 66.

at an average annual rate of about  $1\frac{3}{4}$  per cent (and Mr. Nicholson's over the period 1940 to 1944 at an annual rate of about  $5\frac{3}{4}$  per cent). I leave the figures to speak for themselves.

The proceedings of the first Keynes Seminar, held at Keynes College of the University of Kent two years ago, edited by Dr. Donald Moggridge, have just been published under the title *Keynes: Aspects of the Man and his Work*. On the front of the dust cover is reproduced a cartoon by Low, which appeared in the *Evening Standard* on 8 March 1940. It shows a prostrate Keynes completely blocking the road. In his hand Keynes holds a notice-board on which is written 'Road Closed: J. M. Keynes at Work'. A party of runners, described as 'Wages and Prices', find themselves completely balked.

There is nothing in the *General Theory*—rather the contrary—which anticipates Keynes's growing awareness that if unemployment ceased to be a serious problem, it would be replaced by the problem of pressure to raise money-wages faster than productivity. But while the *General Theory* was going through the press, it continued to be discussed with Keynes by his disciples, particularly by Professor Joan Robinson, who included an essay on the subject in a book published in 1937, which Keynes read in draft and approved in its final form.<sup>1</sup>

In a comment on the Australian Full Employment White Paper, Keynes wrote in June 1945: 'One is also, simply because one knows no solution, inclined to turn a blind eye to the wages problem in a full employment economy.'<sup>2</sup>

At this point I go back for a moment to Keynes's letter to Benjamin Graham of December 1943. Keynes wrote:

The task of keeping efficiency-wages reasonably stable (I am sure they will creep up steadily in spite of our best efforts) is a *political* rather than an economic problem.<sup>3</sup>

In the course of his Inaugural Keynes Lecture delivered three years ago, Austin Robinson quoted the following passage from a letter written by Keynes in 1944, as editor of the *Economic Journal*, to an author who had submitted an over-formalistic analysis of the problem of inflation:

I do not doubt that a serious problem will arise as to how wages are to be restrained when we have a combination of collective bargaining and

<sup>1</sup> Joan Robinson, 'Full Employment', *Essays in the Theory of Employment*, London, 1937, pp. 3–39; republished in *Collected Economic Papers*, vol. iv, Oxford, 1973, pp. 176–98—see also the *Introduction* to Part II, pp. 174–5.

<sup>2</sup> Donald Moggridge and Susan Howson, *op. cit.*, p. 244, n. 1.

<sup>3</sup> Letter of 31 December 1943. (The italics are the Lecturer's.)

full employment. But I am not sure how much light the kind of analytical method you apply can throw on this *essentially political* problem.<sup>1</sup>

It is a *political* problem that could be solved in the war when the efforts of the people of this country were devoted to one common end. Its solution, it is true, depended on the operation of wartime controls, including price controls and labour controls, but also compulsory arbitration, together with rationing and subsidies. But, regarded as a political problem, need we really be defeatist about it today?

Sir John Hicks, in his recent book, writes about Keynes 'that it is hard to see that in his book he has *any* theory about the causation of changes in money wages'.<sup>2</sup> The existence of any such theory seems to me logically impossible.

The rate of increase of wages at any moment of time is largely a matter of historical accident and the influence of recent history on the states of mind of the various parties concerned. The rate at which the wage-level rises is what it is largely because that is the rate at which it has been rising in the recent past and is expected to continue to go on rising. In the seeking of a remedy, the first objective is to break the momentum which has got built up. Faced squarely and fairly, it is not such a very difficult problem at a time, like the present, when the prices of imported raw materials, oil and foodstuffs, and of those semi-manufactured and manufactured goods, the prices of which enter into the cost of living, are rising at very low rates. All that is necessary is to guarantee the real wage, subject to the condition that, with a few exceptional cases, the real wage is not allowed to rise, and to change the brackets of income subject to various rates of tax, so that constant real wages mean constant take-home pay.

In saying that the rate of increase of wages at any moment of time is largely a historical accident, I am abstracting from three important considerations.

First of all, I am implicitly discussing a closed system. In industries exposed to competition with overseas suppliers, the attitudes in wage-negotiations of the representatives both of the employers and of the wage-earners are bound to some extent to be influenced by the level and behaviour of money-

<sup>1</sup> Austin Robinson, 'John Maynard Keynes: Economist, Author, Statesman', Inaugural Keynes Lecture, 22 April 1971, British Academy, *Proceedings of the British Academy*, vol. lvii, 1971; *Economic Journal*, London, June 1972 (the italics are the Lecturer's).

<sup>2</sup> Hicks, *op. cit.*, p. 61 (the italics are the author's).

costs of production of their overseas competitors. And in a fairly open economy this influence will be transferred through the process of leap-frogging, and the application of the principle of comparability, to sheltered industries. It should be recalled that our really severe wage-inflation of the last four years was anticipated in the Netherlands and in France, and to some extent is to be regarded as an infection introduced from Western Europe.

Secondly, I am abstracting from such constraints as may be imposed by the behaviour of the supply of money, operating through the state of credit, and its possible effect in causing unemployment to increase to such a high level that it influences trade union attitudes and the attitudes of militant unofficial leaders. The height of the level of unemployment needed to exercise such an influence I believe to be politically unacceptable (and unacceptable to humane people).

Thirdly, I am abstracting from the possibility of shortages of labour, so widespread as to an important degree to result in competitive bidding up of wages by employers in their attempts to add to their labour force and to prevent its depletion.

At this point I should explain my own beliefs, which I think are shared by a number of other economists. I can briefly summarize my attitude by differentiating between three ranges of levels of demand and unemployment.

First, there are the levels of unemployment which prevailed before the war and in the context in which Keynes wrote his *General Theory*. I regard that range of unemployment as politically quite unacceptable, and therefore to be ruled out.

Secondly, there is the range of much lower levels of unemployment, such as have prevailed over various periods since the war.

Thirdly, there is the range of levels of demand so high that, notwithstanding quite appreciable numbers of unemployed, there can be said to be widespread shortages of labour, sufficiently extensive and acute to exercise an independent influence on the behaviour of wages.

The trouble is that, as Keynes made clear, and as Sir John Hicks puts it in his recent book: 'Particular labour scarcities are bound to be revealed, in a process of expansion, while there is still, in total, considerable unemployment.'<sup>1</sup> Even today, with unemployment of 625,000, a percentage of 2.75, serious labour bottlenecks are, here and there, adding up to something quite appreciable, holding back production. The trouble is

<sup>1</sup> Hicks, *op. cit.*, pp. 62-3.

partly that, since 1941, we have been so obsessed with the importance of taking work to the workers that our arrangements for moving workers to the work are hopelessly inadequate. One of the great obstacles is allowing complete autonomy to local authorities over the manner in which they draw up their waiting lists for dwellings, which on the whole are based on the principle of 'first come, first served', and pay little or no regard to the economic interests of the country.

Keynes, in a passage which I have already quoted,<sup>1</sup> was more concerned with the limitation imposed by such bottlenecks on the response of output to a rise of demand than with any influence on the behaviour of wages. That, I believe, remains the correct view at present-day levels of unemployment. The seriousness of the bottlenecks in retarding the structural changes, needed to improve the balance of payments and the contribution of the engineering industries to productive investment, is far greater today than their seriousness in aggravating the upward movement of wages over the country as a whole. Such aggravation becomes serious only at lower levels of unemployment. Furthermore, these bottlenecks are made more serious in impeding structural change than they are when little structural change is called for.

The question what Keynes would be advocating today is, of course, a nonsense question. Were he alive today—apart from the fact that he would be 91 years old—his own ideas would have developed enormously; under his influence the ideas of others would have developed on different lines; and the economic situation of the country, and of the world, would be different.

Keynes often used to remark to me that he enjoyed the advantage of waking up every morning like a new-born babe, entirely uncommitted to what he had thought or advocated previously. This is why he has so often been charged with inconsistency. The fact is that he did not resist a change of attitude, whether it was due to a change in the situation, or to the development of his own thinking, partly under the influence of other economists.

Keynes was in the habit of saying that if anything was certain, it was that the future would not resemble the past. He concluded his posthumous article with the words:

No one can be certain of anything in this age of flux and change . . . [If our] plans palpably fail, then, of course, we and everyone else will try something different.

<sup>1</sup> *General Theory*, p. 300.

. . . We shall do well not to fear the future too much . . . We shall run more risk of jeopardising the future if we are influenced by indefinite fears based on trying to look ahead further than any one can see.

I agree with Sir Roy Harrod, who, addressing the Keynes Seminar to which I have referred, said, referring to our present-day problem of inflation:

What do we do? What is the remedy? It would be most inappropriate for me to stand up here and tell you what Keynes would have thought. Goodness knows he would have thought of something much cleverer than I can think of.<sup>1</sup>

<sup>1</sup> *Keynes: Aspects of the Man and his Work. The First Keynes Seminar held at the University of Kent at Canterbury, 1972*, edited by Donald Moggridge, London, 1974, p. 8.