feeling that Wicksell was trying to be "classical". [32, 1937].

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'. [52, 1972]. 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." [53, 1931].

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.

The fact that later on, in his General Theory, 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. [33, 1936]

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.
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. [5, 1974]. Keynes had already in his *Treatise* enunciated the doctrine, which emerged logically from his discovery of income inflation [34, 1930]. 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 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.

Keyne'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'. [6, 1930]. 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.' [35, 1925].
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. Al-
though 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. [36, 1931].

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, un-
employment 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', [37, 1930], the greater readiness of entrepreneurs to give way to pressure 'when they are doing better business' and 'the psychology of the workers and the policies of employers and trade unions'. [38, 1936]. However, there is no analysis of the problem. The only reasoned statement 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. [39, 1936].

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'. [40, 1936].
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'. But he had written earlier, 'full, or even approximately full, employment is of rare and short-lived occurrence'. [41, 1936].

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. [7, 1974]

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 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'. 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. [42, 1936].

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. [43, 1930].

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'. [44, 1925].

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. [48, 1943].

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 today 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. 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.

Keynes was also corresponding in 1943 on the same subject with Benjamin Graham, the famous advocate of an international composite buffer stock. 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 totalitarianism. But I recognized the reality of the risk.

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, [64, 1944]. 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.

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'. 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 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. [2, 1944].

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'. [45, 1919]. 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. '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'. [46, 1923].

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. 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. [47, 1930]

During the Second World War the official cost of living index rose at an average annual rate of about 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. It was quite largely due to co-operation between the Government and the T.U.C.

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. [63, 1947].

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.' [50, 1945].

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.

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 full employment. But I am not sure how much light the kind of analytical method you apply can throw on this essentially political problem. [61, 1971].

It is clear to me that these references to the problem of rapidly rising wages as being political point to incomes policy. But Keynes had absolutely no idea of the terrifying orders of magnitude which recent years have displayed.
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