KEYNES'S RELEVANCE TODAY

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thought Keynes's system has been relegated to a special case of wage
and price inflexibility and Keynesian policies have been increasingly
regarded as additional interferences with the 'invisible hand'. By
advocating the adjustment of the money supply as the answer to
inflation and by offering 'market' solutions to unemployment, the
economics profession has progressively abandoned logic for ideology
and set us back precisely where we started.

NOTES

1. See, for example, J. E. Roemer, Cambridge Journal of Economics, vol. 3,
no. 4, December 1979.
2. Engels makes these points in a chapter which he supplied to fill a gap in the
manuscript for vol. III (chap. 4, 'The Effect of the Turnover on the Rate of
Profit').
3. Piero Sraffa (ed.), Works and Correspondence of David Ricardo, vol. 1,
p. 5.
5. Joseph A. Schumpeter, Capitalism, Socialism and Democracy, (London,
Allen & Unwin, 1943).
6. In the USA the quantity equation is written \( MV = PQ \) where \( Q \) is real
income. This is not vapid, but untrue.
8. Professor Lord Kaldor, Origins of New Monetarism (University College
14. For an analysis of development up to 1920 see Tarling and Wilkinson,
'The movement of real wages and the development of collective bargaining
in the period 1855 to 1920' in Contributions to Political Economy,
Policies and Their Inflationary Impact', Cambridge Journal of Economics,
1977.
16. Thus the legal immunity afforded to trade unions by the 1906 Trade
Disputes Act resulted from a landslide victory of the Liberal Party
resulting directly from anti-trade union activity of the courts culminating
in the Taft Vale judgement. Moreover Labour Governments of 1945–51,
1964–70 and 1974–79 took legislative action both to restore rights
eroded by legal or statutory changes and further to improve the position of
labour.
17. Roger Tarling and Frank Wilkinson, Inflation and Unemployment – A
critique of Meade's Solution, CEPR, vol. 8, no. 1, April 1982.

6 J. M. Keynes: Society and the Economist*

JOSEF STEINDL

I THE PARADIGM

What was it that Keynes stood on its head in economics? Perhaps an
idea of it can be conveyed in simple words. The analogy between the
individual household and society as a whole which many economists as
well as laymen use in their reasoning is misleading. Conclusions drawn
from this analogy, Keynes showed, are false. Thus for the individual
household saving (spending less than one's income) leads to an
accumulation of assets. For society as a whole when people spend less
they reduce each other's income and the wealth of society is reduced.
That for the economy as a whole the relations are different, that
spending determines income and not the other way round, is not
immediately accessible to common sense which bases itself on the day
by day experience of the household. The truth of the matter is revealed
only by studying the circular relations in a society (spending = income-
spending). This shows that there are feedbacks which for the individual
household or firm are unimportant because of its small scope but which
for a large unit, such as for example the public sector, will be very
important. In economics as in other fields the scope of reasoning is
enlarged beyond the field of everyday experience and intuition and
produces results in flat contradiction with it.

The instrument for analysing the circular relations in an economy
are the national accounts. They are a double entry book-keeping for
the society, whole groups like households, business or government

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being represented by separate accounts, as are also activities like investment, consumption and so on. The systematic development of national accounting received its great impetus from Keynes and his theory. The style of theorising which made use of the concepts of national accounting became widespread only through Keynes although it was known to Quesnay and Marx. Known as macroeconomics it became crucial for the discussion of economic policy problems. It offers a convenient way between the sterility of the Walrasian general equilibrium and the limited scope of the partial analysis of Marshall, because it is couched in terms of variables which are statistically measurable and at the same time relevant for national economic policy.

A special case of circular interrelations in the economy concerns wages. Here it is the analogy between the firm and the economy as a whole which gives rise to the usual faulty reasoning: for a single firm, if it could pay a lower wage rate, the advantage were obvious and would probably lead to an expansion of output. But how different are the relations in the economy as a whole! The general level of prices is strongly influenced by costs and in a closed economy with no foreign trade costs consists mainly of wages. A general increase or decrease in wages will therefore, on simple assumptions, be passed on to prices. Thus, Keynes concludes, workers and trade unions in a closed system will not be in a position to determine the general level of real wages. This shows the lack of realism of the neoclassical view that workers could always bring about full employment if they are prepared to reduce the level of real wages sufficiently.

For Keynes the volume of employment is determined not by real wages but by demand for goods. The variability of production in the cycle is evident and the bottleneck which limits production is most of the time demand.

Let us turn to another characteristic of Keynes’s thinking. For him the only real economic constraints which limit our policy options are scarcities of real resources – of labour, skills, machines, factories, land, raw materials, exhaustible resources. If we cannot make use of them this must be due to institutions, superstition or to our own stupidity. We should be wary of the argument “There is no money for it” and always ask whether there is any real scarcity involved or not. This naturally leads to a critical attitude towards institutions, especially financial ones. Institutions, this is definitely Keynes’s view, have to be such as to make possible the full use of the available real resources.

They will not do so automatically or on the basis of very simple precepts such as proposed by Hayek (neutral money) or the monetarists. Keynes therefore had no respect for the tenets of financial orthodoxy – the gold standard, balanced budgets, sound finance – in so far as they merely hindered a rational use of available material resources.

Reference has been made above to the circulation of flows in the economy (transformation of cost into income, income into spending, spending into cost again). This stream is not kept moving by itself, it is always in danger of draining away into leakages constituted by savings. The driving force which replenishes the stream and keeps it moving is investment in plant, equipment etc. The central role of investment as the prime force of accumulation is one of the most distinctive characteristics of the Keynesian view of the economy. The strategic position of investment is due to the length of life of equipment and structures and to the uncertainty of the return. Investment thus depends on expectations which in the last resort cannot be fully justified by calculation because of basic uncertainties, so that ultimately investment is based on a kind of optimism (“animal spirits”). Investment, unstable by itself, is rendered even more unstable by the apparatus of finance which is interposed between the saver and the investor. The speculative element in investment is reinforced by the speculative character of the markets for financial instruments, claims of all kinds based on debt. Instability is therefore a basic feature of the system.¹

Every theory rests on simplification. A characteristic simplification of Keynes is the closed system. It is easy to see why: the circularity of the relations is evident only in the closed system, while in the open system it is interrupted.

But there is also a moral behind it. In a closed system the conflicts of interest between different countries are eliminated, one nation cannot gain at the expense of another. One is therefore thrown back on devices other than sponging, robbing and stealing. The closed system represented the world as a whole.

There is no denying that Keynesian policies meet their greatest difficulty at the point where the system is open, in the balance of payments. There are two ways of confronting these difficulties: the one is to close the country more or less by suitable protectionist measures. The other is to unite all countries in a common international order which will safeguard their interests by the establishment of suitable rules.
II AMNESIA

Conventional wisdom tells us that short of a real cataclysm the technical achievements of a society cannot be lost again. Yet most economists seem to have completely forgotten what Keynes as well as the experience of several decades taught them about full employment. They talk in terms of the treasury view of 1930 (‘crowding out’), of budget deficits creating high interest rates, of increasing employment by lowering wages internationally. It is a collective cultural amnesia. Only the system of national accounts remains standing as a lasting monument of the era, difficult to destroy because it was so elaborately built over the whole world.

III THE IMPACT ON HISTORY

A technique that has been forgotten? But was it ever tried? It may be — and it has been² — argued not quite unconvincingly that the high employment experienced in the decades after the war has materialised largely without the active help of government policies consciously based on Keynesian economics; and that on the first occasion these policies were really badly needed worldwide — in 1974–75 — they were not applied.

It is true that the high level of post-war employment was partly due to fortuitous circumstances which might perhaps have produced it even had Keynes never existed, namely

(a) The re-armament in the US and Europe following the outbreak of the Korean war in 1950.
(b) The spin-off from war time and post-war military developments leading to or facilitating the introduction of new products which required large investments.
(c) The massive transfer to Europe of old technology from the US to which the Continent had practically had no access in the interwar period and during the war: this was facilitated by the Marshall plan and it led to considerable investment activity.
(d) The international economic cooperation which was the corollary of the military alliance of the West and which removed the balance of payment constraints standing in the way of expansion.

The same kind of sceptical view is also suggested by the fact that Schacht and the economic administration of Nazi Germany quite successfully applied full employment policies when the General Theory had not yet been published. Yet all this will not suffice to settle the issue.

IV KNOWLEDGE AND HISTORY

The question is whether employment techniques and theories are similar to technological knowledge. That this played a role in history can hardly be in doubt although it is a tricky task to describe it.

When we consider the relation of knowledge and material development of history we must free ourselves of primitive ideas of unilateral causation. We may get some help from the concept of feed-back and perhaps also from the view that an idea plays a role in history only when ‘the time is ripe for it’. What would this mean? Presumably it means that the idea or knowledge must combine with other events or developments in order to become relevant (‘it must fall on fertile ground’). We must also remind ourselves that the idea itself arises from a certain historical background which is fairly obvious in the case of the Keynesian ideas. Thus the idea (consciousness) exists between a flow of history which produces it and another flow of history which receives it as seed.

The economics of Keynes whether he wanted it or not in the course of time has become successively associated with one or another of the great streams of events and policies of our time.

In the first place it became associated with the finance of the war in Britain. It was in this context that the system of national accounts was developed by E. Rothbarth, J. E. Meade and R. N. Stone. Keynes and his friends intended to use this in order to overcome the inhibitions of the orthodox bankers and treasury officials against war finance by borrowing; The accounts would show them how the deficits were duly covered by a corresponding amount of saving.

The association of Keynesianism and war finance did not stop there. It was relevant to the post-war rearmament in so far as it removed the scruples of orthodox finance and instead pointed to the benefits obtained in increased employment, prosperity and industrial profits. It may be controversial how far these considerations contributed to rearmament, but it seems plausible that the military-industrial complex in the United States was somehow wedded to a Keynesian ideology.³

A different and hardly controversial association is the welfare state. This ideology arose as a reaction against the horrors of the war and a
sign of newly awakened social consciousness in the élite of a society which had been rather impervious to the suffering of the victims of the pre-war depression and which felt darkly how much this had contributed to the war. It represented also a re-assertion of the newly gained political consciousness of the workers.

In Britain it found its first expression in Sir William Beveridge’s work on social security and his ‘Full Employment in a Free Society’ as well as a series of government papers.

The welfare state in the course of time was realised in all industrial countries. It involves a large increase in the public sector and a good deal of built-in stabilisation: This means that a large part of any additional spending comes back in increased revenue and that tends to stabilise the economy.

Another ideological stream which recruited Keynes as an ally or used him as an instrument was of wider political significance. It arose from the need of western capitalism, tainted by the pre-war experience, to change its image so as to be able to face up to the competition of communist propaganda in the cold war. In fact, Keynesian economics was ideally suited for that purpose: it promised an effective reform of capitalism which freed it from some of its most ugly features. The idea that capitalism could be salvaged by Keynesian thought was eagerly embraced by social democrats and somewhat less vociferously by the conservative business community. The best witness to this was the enthusiasm for consumption which dominated the post-war business world. The bitter denunciation of Keynes by established Marxism only reflected these attitudes.

The business community accepted the Keynesian paradigm in spite of their innate dislike of some of its features (role of the state, association with welfare policies).

On the basis of these considerations we can understand the spirit of the Keynesian era: the prevailing ideology of growth and of consumption, and a tremendous optimism which becomes evident and striking once we compare it with the pessimism which took hold of the same strata of society in the 1970s. It was as if by a kind of Aladdin’s lamp Keynes had posthumously called up the ‘animal spirits’ which in his view were the prime movers of the investment process.

It appears then that the earlier quoted arguments about the irrelevance of Keynesian innovations to the post-war development are not the full story. On a balanced view they had a profound influence though this rarely took the form of government deficit spending.

V NOT A RETIRING SCHOLAR

The novel and unorthodox ideas of Keynes were laid down systematically in his General Theory of Employment, Interest and Money (1936) which together with two earlier books, A Tract on Monetary Reform (1923) and A Treatise on Money (1930) formed the bulk of his theoretical output. Preceding this, however, over a long time beginning in 1919, there was a vast amount of work of a more practical nature dealing with problems of economic policy which arose from the events of the time. It has to be realised that a large part of Keynes’s working time and interest was taken up not by the university in Cambridge but by an active engagement in the formulation of economic policy, either in an official capacity, mainly during and after the two world wars, or as an independent writer, lecturer and expert, mainly between the two wars. There was no lack of challenging problems: The condition of Europe after the war, the special problems of post-war Britain – the high burden of war time debts and the need for structural adjustments, mass unemployment which never ceased to be a problem until the second world war, the return to the gold standard at an over-valued rate for the pound sterling (1925), which could be maintained only at a heavy cost in high interest rates and unemployment and was finally given up in 1931 in favour of a floating pound, and in the further course the shift of British policy from free trade to protectionism.

It is surprising that the work of Keynes on these policy questions, apparently guided by a very strong intuition and acute observation, anticipated to a very large extent the results he reached much later and by tortuous routes in his academic work on a theoretical plane.

In fact he advocated public works as a remedy for unemployment consistently and strongly from 1924 onwards. To finance the public works he proposed that the money should be taken out of the sinking fund. There he immediately came into conflict with Treasury views. In view of the crushing burden of the public debt the Treasury was trying to accumulate a surplus year by year in order to repay some of the debt. They were not willing to let Keynes raid their fund.

The works Keynes had in mind concerned transport, communications, electricity transmission, docks and ports and housing. He wanted to include in these schemes also private investment financed by treasury loans or guarantees and subject to technical advice and guidance by a semi-public authority.
Keynes also considered as a source of finance the rechannelling of the considerable funds which year by year were flowing into foreign investment. Of the funds raised on the capital market five times as much was going into foreign investment than into home investment. He argued that the effect of these foreign investments on export and thus on employment in Britain was small whereas an investment of the same sums in Britain would to a very large part increase output and employment there. Keynes was not very explicit about the methods to be employed; he did not clearly advocate a control of capital movements. Needless to say he was touching one of the most neuralgic points of the City. His arguments suggest that he hoped to make the home investments so much more profitable that the foreign investment would be 'crowded out'.

In carrying on his campaign for an active employment policy Keynes felt again and again the need to defend himself on a very general philosophical ground against the accusation of heresy: 'I bring in the State; I abandon laissez-faire, not enthusiastically, not from contempt of that good old doctrine, but because, whether we like it or not, the conditions for its success have disappeared.' He pleaded that private initiative was lacking in the execution of the big projects he had in mind and which would yield from 5 to 9 per cent (he was obviously thinking of the risks involved).

In his lecture 'The End of Laissez-Faire' he pointed to saving and investment as activities which could not be left to the free play of the market but which necessitated the intervention of the State.

Another recurring theme is the contrast between enterprise and thrift: 'It should be obvious that mere abstinence is not enough by itself to build cities or drain fens. . . . It is enterprise which builds and improves the world's possessions'. In social terms the contrasting pair may be translated into: Industry versus the rentier. It is obvious where Keynes's sympathies lay and how acutely he felt the oppressive consequence of a crushing and prolonged debt on an economy and a country. One of the main elements in his proposed post-war settlement was the cancellation of all war debts. Later in a discussion of the financial situation of France, a country which carried the heavy burden of an excessively large rentier class, he recommended price inflation as a way out of the impasse.

And, of course, cheap money policy was a natural concomitant of Keynesian concern for investment and government borrowing. This leads to one of the greatest issues in the inter-war economic policy debates: The return to the gold standard. Keynes, almost alone, passionately opposed it. It corresponded to the interest and the opinion of the City of London that the return should take place at the pre-war rate to the dollar, an issue in which the prestige of the City was at stake. Keynes argued that at this rate the pound would be over-valued by about 10 per cent; a deflation of the wage and price level would be necessary to maintain an equilibrium of payments at this level, with unpleasant economic and social consequences: the existing unemployment would be increased. In fact, on a plain reading of the subsequent events the fears were fully justified. Britain had to keep the rate of interest high in order to prevent an ever pressing outflow of money to New York and this as well as the heavy damage to exports, especially in the critical case of coal, led to great unemployment and to the general strike in 1926. Keynes's opposition against the gold standard was, however, not confined to the particular rate: He had from the beginning developed a policy preference for devaluation as against deflation. He wanted priority to be given to internal policy concerns and not to the establishment of fixed currency relations. The gold standard, he said, bound the City to Wall Street both with respect to interest rates and to price developments.

Faintly visible behind this debate is a fundamental issue which divided and distinguished Keynes from his compatriots and contemporaries. It is the theme of a lesson which he tried to teach them untiringly, beginning with the famous chapters on Europe in the Economic Consequences of the Peace. He said that the world was not the same after this war and that it would never again be the same. He did not share the nostalgic sentimentality of the British middle class who imagined that it was possible to return to the pre-war Britain where they had been so happy. A special part of this illusion was that the City of London would reconquer and maintain its former place in the world. Keynes destroyed this illusion in a cutting passage of merciless logic.

In the last resort when Churchill called in outside experts to state their case, Keynes remained completely isolated.

The most mature statement of employment policies from that time is contained in the pamphlet Can Lloyd George Do It? written jointly with Hubert Henderson. The Treasury view that public works would merely crowd out private investment was countered by a reductio in absurdo: since large private investment projects are not different from public investment why should they not also crowd out other investment? The Treasury view thus seemed to imply that employment could never be increased at all. In reality there were three sources of finance
for the public investment: the saving in payments to the former unemployed; the reduction in foreign lending (this argument apparently here applied to the export surplus); and ‘the savings which now run to waste through lack of adequate credit’.

This tormented expression of the fact that there are potential savings which are not tapped for lack of investment illustrates the terrific struggle for adequate expression of an insight grasped intuitively. In the same pamphlet there are also vague statements of the multiplier effect (p. 106). There is also reference to the structural maladjustment which was then complicating the problem of unemployment. The change in structure required a shift of manpower from declining to growing industries. But the necessary condition for such a shift from the declining industries, argued the authors of the pamphlet, is that ‘jobs have first been created elsewhere, and employers are crying out for men’ (p. 90). In another paper there is a foretaste of the Keynesian theory of a general shift in wages: ‘... if wages are cut all round, the purchasing power of the community as a whole is reduced by the same amount as the reduction of costs’; a change in wage cost extending to all industries and all countries leaves everybody where he was before.

When the recession came Keynes abandoned his free trade principles in favour of protectionism. To most people this seemed a volte face; but it might be said that he was only developing a principle which he had asserted before when he expressed his preference for devaluation against deflation: the priority of the internal equilibrium and employment of a country in its relation to the outside world. We shall meet this theme again in the discussions on the international currency order.

The preceding selection of points and arguments from the writings on economic policy may serve as an introduction to a more general observation.

The genesis of the General Theory offers a good illustration for the view that important innovations in economic theory are distilled from intuitive solutions of the economic policy problems of the day. The revolutionary content of the General Theory was pre-established in the economic policy writings which arose from the deep and passionate engagement of Keynes in the issues of his day.

Moreover the writings on economic policy show a very continuous and consistent line of development up to 1936 with an impressive constancy of certain themes and principles. By contrast, the development on the theoretical plane was erratic, with wild jumps and turn rounds by 180 degrees. Keynes had very little respect let alone awe in front of the great bankers, the City men, the civil servants and politicians or the paraphernalia of their trade. He felt a master in this milieu. But when he entered the maze of academic thinking he was burdened by traditions from which he gained his freedom only after a long struggle. He wrestled with the quantity theory through two books and did not completely extirpate it even in the third. He based his Treatise on Money on the assumption of constant total output, an assumption which was underlying most of the faulty reasoning of the ‘classical’ theory and which blocked the way to the General Theory.

The contrast between the two worlds is shown also in the style. The style of Keynes is at its best not in his theoretical work but when he writes on economic policy. His power to reduce an analysis to its essentials, to give concrete shape to abstract considerations so that you feel you can touch and hold them is superb. He gives his best when he tries to speak to the general public.

VI THEN AND NOW: ANALOGIES AND PARALLELS

Can the economic issues which were the subject of heated debates in the 1920s be of any interest to us today? The distance which separates us from this time is thrown into light if we consider that radio broadcasting was introduced in 1921, that the first flight over the Atlantic by Lindbergh took place in 1927; television, computers and robots were subjects of science fiction and atomic power the term in an equation in a new fangled physicist’s theory which nobody could understand. But the issues which Keynes and his opponents debated have a surprising and terrifying resemblance to similar issues today.

We have again to do with mass unemployment today, although the victims are now better cared for than they formerly were. And it is again the dominant wisdom that it is due to excessive wages that they cannot be employed.

Then and now the arguments against effective action include ‘crowding out’ and the burden of the public debt. This burden, interestingly enough, is today much lower than at the time of Keynes: in the UK the interest payments were 24 per cent of central government expenditure in 1920 and rose to 40 per cent in the late 1920s.

After the Second World War, up to a few years ago, they were less than 14 per cent. The change was in the same direction in other countries.

It is quite true that this burden is bound to increase. The reason is not
so much increased borrowing of governments as high interest rates. And here there is a very strong parallel between Britain in the twenties and Britain, as well as Europe, today. Lord Kaldor considers the two periods as the first and second reign of the monetarist dogma (using the term in a rather wide sense). In both cases vital interests were sacrificed on the altar of an exotic deity: the interest rate was kept high in order to prevent the outflow of funds. In the first period, though, the policy was decided inside the country, while in the second case it was imposed on Europe from outside, and very difficult to avoid in the circumstances.

Another parallel strikes the eye if we think of Keynes’s attitude to capital exports. He had complained that the financial apparatus was predominantly geared to the needs of other countries and not of home investment. Today the foreign investment of Britain is by far less important than it was; the great foreign lending of the British banks is offset by borrowing abroad. But the complaint remains that the banks are neglecting the interests of home industry. In addition its international involvement makes the system extremely unstable. Incidentally, it would be highly amusing if we had a comment from Keynes on the functioning of the joint stock system today, with the take-over movement as its central feature.

Notwithstanding all the analogies, there is one difference which distinguishes our time: inflation. While for that reason one argument against expansion – that it would lead to rising prices and wages – is more credible now that it was in the deflationary inter-war years (it was used nonetheless even then) we must not blind ourselves against the immense harm that deflation did in those years. By reducing the value of real estate and other tangible assets as well as cash flows, it increased the number of foreclosures and insolvencies.

Today, it is true, the high interest policy together with decreasing inflation rates tends to produce a similarly depressing effect on the value of real assets.

Turning now to the wider aspect of social attitudes: Can we not find analogies today to the nostalgia which Keynes found in the British middle class who were longing to go back to pre-war times? In a nostalgia, that is, for the pre-welfare state? It would seem to be equally utopian, but it can explain the strength of neo-conservatism in US and Britain. Perhaps there is at least a small bit of topicality in the remarks which Keynes made about the capitalists of the time after the First World War: ‘They allow themselves to be ruined and altogether undone by their own instruments, governments of their own making, and a Press of which they are the proprietors’. 

And the inability of politicians, conservative as well as social democratic, to grasp the least bit of Keynes’s ideas or to share his distaste for the stupid waste of humanity and ruin of his country? Alas, the analogies abound.

VII THE OPEN ENDS OF THE GENERAL THEORY

The General Theory is not always a paragon of clarity, unequivocal and unambiguous, nor does it represent a very complete and consistent system. As Keynes said ‘. . . the whole book needs re-writing and re-casting’. The gaps in the argument of the General Theory stand out in relief very distinctly when we compare it with the work of M. Kalecki which otherwise offers a close parallel to it.

The book does not contain any distribution theory and distribution is rarely mentioned in it. In consequence the propensity to save is defined so as to refer to the income of the nation as a whole, in other words to a kind of average behaviour. The importance which the distribution of income has for the propensity to save is completely left in the dark although it is perfectly sure that Keynes was only too well aware of it. Aggregation is definitely carried too far here. The distinction between retained profits of business and saving of rentiers and other people outside enterprises is obscured although it is relevant for Keynesian arguments.

The importance which this omission has for the later exegesis of the General Theory will soon become obvious. In this connection it is also noteworthy that monopoly in all its forms is largely absent from the scene except for the trade unions. In the discussion of money and real wages perfect competition is explicitly assumed. As an implication of this Keynes was still carrying with him a part of the ballast of the ‘classical’ tradition the bulk of which he had successfully discarded: he believed that an increase in demand must necessarily lead to increased prices of manufacturing goods with the implication of inevitable fall in real wages in the upswing of the cycle. It was later shown by J. G. Dunlop and L. Tarshis that a negative correlation between real wages and the cycle did not exist.

A second and perhaps the most important point concerns the method and the meaning of the General Theory. Is it a general equilibrium theory which describes the relations within a system which would keep it at rest provided it were not disturbed from outside, or is it a process analysis which shows step by step how a system starting from given initial conditions develops from one day to the next? The
of interest he meant the long term rate, and his alternative to investment in bonds (consols) was only money. The short term assets had then to be considered as money unless he disregarded their existence in the context altogether. The last interpretation is the more plausible one; since Keynes introduced the money supply as an exogenous variable he could not plausibly include short term assets in it.

Kaldor has drawn attention to the fact that the quantity of money is always exogenous in Keynes's exposition of the theory of interest and he sees in this a survival of the quantity theory of money. In so far as the quantity of money (ultimately also of base money), and not only its velocity, responds to the amount of transactions, increasing in boom and declining in recession, it is endogenous in character. This side of the picture is never seen in Keynes, because he implicitly always deals with open market operations in his exposition of interest theory.

Conspicuous by its absence from the General Theory is a theory of the trade cycle. Bits and pieces relevant to the subject are strewn all over the place but they do not amount to a theory. It would be unfair to blame Keynes for this omission; but one cannot help contemplating how much more committed to dynamics the book would have looked had he gone further in this direction. There are two further subjects which are under-represented in the book although Keynes had plenty to say about them in his practical policy writings: the open economy and long-term development. Both are so extensive and so complicated that Keynes had every justification to leave them out. They are mentioned here only because it has become fashionable to dwell on them, especially on the failure of Keynes to extend his theory to the long run. The tacit implication of this criticism is that he ought to have gone into general equilibrium theory. It was to his credit that he did not.

VIII THE COUNTER-ATTACK

The dismantling of the General Theory started as soon as it was published if not before, and with the prominent participation of some of Keynes's friends and colleagues. The method was to prove that the new theory did not differ as much as Keynes claimed from the conventional ('classical') equilibrium theory, that it was only a special case of it, or applicable only under narrowly restricted circumstances.

The attackers naturally profited from the weaknesses pointed out above. Thus Harrod\textsuperscript{28} blatantly asserted that the marginal efficiency of
capital was nothing else but the marginal productivity known to neoclassical theory, and in this way assimilated the General Theory to the neoclassical distribution theory. He could do this only because Keynes had been so vague and uncommitted with regard to distribution theory. The identification was a travesty. Marginal productivity relates specifically to factor substitution. Marginal efficiency, by contrast, relates primarily to an expansion of output capacity; it depends on the state of demand and on the exploitation of new technical know how. The broader meaning of Keynes's concept results from the fact that it refers to an economy in which there is no full use of resources and in which the dynamic possibilities of new technical methods come into play. These influences are embodied in the concept of expectations.  

The review of Harrod as well as that of Hicks which was destined to become very influential, uses, however, a more fundamental way of attack by addressing itself to the very meaning of the General Theory.

The method is to misunderstand and misinterpret the General Theory as an equilibrium theory, a procedure which as we have seen has been facilitated by Keynes himself. By this trick all the distinctive and revolutionary features of Keynesian theory vanish and dissolve into thin air. What sense is there in a system of mutually dependent variables to argue that investment determines saving and not the other way round? The concept of effective demand as an active agent loses its meaning for the same reason. It is true that Keynes did talk of a long-term equilibrium with a 'relative stability'.

What he described there – and it is worth re-reading – is a tendency to long-term unemployment characteristic of our system, and he added that it must not be taken as a necessity but should be changed.

The specific line taken by Hicks in his interpretation is directed towards money and interest. His main concern is to insist that an increased inducement to invest or an increase in the propensity to consume would raise the rate of interest via an increased demand for money on account of the transactions motive. How could Keynes, he asks, maintain that the rate of interest would not rise in these circumstances (when more money would be needed for the increased volume of business transactions)? The answer is probably that Keynes assumed the long term rate of interest to respond only very slowly to a change in the conditions of the money market (which corresponds to experience). But however that may be, the conclusions drawn by Hicks are quite amazing. He does not deny the essential Keynesian position that the rate of interest is a monetary phenomenon depending on institutions only and determined by banking policy. Yet he maintains that by demonstrating that the rate of interest must rise in the circumstances described above he has approximated the Keynesian system to that of the 'classics'. But for the 'classics' the rate of interest is determined by material scarcity, of capital or of saving, not by institutions or policy. Yet for Hicks the Keynesian system is now, after his 'corrections' concerning the rate of interest, different from the traditional classical system only under special circumstances: It is a 'slump economics' (op. cit., p. 158) or also: 'the general theory of employment is the economics of depression' (p. 155).

It is a puzzle why Keynes did not defend himself against the interpreters who no sooner than his theory was born endeavoured to replace it by a changeling of the most doubtful character. In fact, he thanked Harrod for his review. But those who at that time underwent the conversion from 'classics' to Keynes can still remember what a strenuous intellectual adventure it was. It must be realised that Keynes was surrounded by complete incomprehension of a public stunned by the novelty of his ideas. It may be that Harrod wanted to be helpful by dressing up the bovey man in impeccable academic clothes, and that Keynes took it in this way. What neither of them realised at that time was that the distortions of the first hour would grow into a ruling system called neoclassical synthesis. This theory dominated the universities in the decades in which full employment ruled in the outside world. It said that in the long run a laissez-faire system would re-establish and maintain full employment and that the deviations from it were temporary and unimportant. Members of this school tended to split personalities, putting on in turn the Keynesian hat when they advised the Administration on economic policy of the day, and the neoclassical hat when they wrote on highbrow economic theory.

A particular subspecies of the neoclassical synthesists was wont to argue that since full employment was safeguarded in any case by the Keynesian demand management, it was fully legitimate to apply neoclassical reasoning to the present world.

In this way the thought of Keynes was gradually undermined so that the take-over of the university departments by a combination of pure neoclassicists and monetarists could proceed fairly quickly. The appropriate moment for this was dictated by events outside the universities: The calling off of Keynesian policies by the leading powers.
IX HAVE KEYNESIAN POLICIES FAILED?

Before the 1970s what impressed the observer of the post-war scene was how much fuller employment was maintained than Keynes had ever expected.

When Sir William Beveridge had put the full employment target at 3 per cent Keynes wrote to him: ‘No harm in aiming at 3 per cent unemployment but I shall be surprised if we succeed.’

The post-war unemployment rate in Britain, and in most European countries as well, was of the order of 2 per cent or less until the 1970s. In the US the figure was rather larger. The high levels of employment were realised with – what seems to us now – relatively moderate rates of inflation (of the order of 3 per cent in the 1950s and 4 per cent in the late 1960s). It has to be borne in mind, though, that this favourable result was facilitated by an improvement of the industrial countries' terms of trade in relation to the third world.

For quite a long time, therefore, the maintenance of high levels of employment succeeded much better than Keynes himself had expected.

To understand the crisis of the 1970s fully we have to realise, that even before the overt difficulties of that time certain unfavourable factors were active behind the façade of prosperity.

One of them was the fact that in some countries Keynesian policies had never been wholeheartedly adopted. The US had only a fleeting relation to full employment. Congress could be reconciled to it only when it was bound up with the military-industrial complex. The adherence to full employment policy therefore weakened in 1969.

Germany had been forced into full employment in the early fifties from outside, by an export boom. In the later sixties she pursued a restrictive monetary policy which contributed decisively to the weakening of private business investment since that time.

Great Britain departed from the cheap money policy of the early post-war years in 1951; monetary controls played a larger role since then. Full employment policy in Britain was qualified by the recurrence of balance of payments crisis (sometimes provoked by the refusal to devalue when it was necessary – in 1964) which were partly due to a structural weakness of the foreign balance and partly due to a tendency of wage levels to run ahead of those of her competitors. While in the earlier period (up to the middle sixties) the economy was overstrained owing to large defence spending, it later lost its impetus because private investment flagged.

But the weakening of investment may not have been exclusively a result of the policies pursued, it may also have come from certain structural changes in the capitalist system. The concentration of business proceeded and this tended to increase the fear of excess capacity and a cautious attitude to investment. A symptom of the weakening interest in real investment was the take-over movement, a growing interest in financial manipulation as opposed to production. The weakening of private investment was the direct cause of the growing budget deficits, a development which reached its climax after the recession of 1974–75.

If Keynesian policies are said to have failed in the 1970s this can only mean that continuing full employment has proved impossible because it has led to insuperable difficulties. Most prominent among these difficulties is the tendency for 'efficiency wages' (as Keynes termed wages per unit of output) to drift upwards and thus to cause inflation. This has always been stressed by the close followers of Keynes, Joan Robinson, Lord Kahn and Lord Kaldor. Keynes himself foresaw the difficulty, and stated that this was a political question. This is indeed confirmed by the observation that restraint on wage levels operates in a climate of social consensus (Sweden, Austria, Germany, Switzerland) whereas wage inflation is uncontrollable in a climate of social confrontation (Italy, Great Britain, France before De Gaulle and after 1968). It appears that inflation is the expression of a latent conflict about income distribution which is carried on continuously, with everybody passing on the bill which nobody wants to pay. It may also be more than a coincidence that wage inflation characteristically dominates in countries with unstable government: Great Britain has only once in the post-war period had a government (Macmillan) which lasted longer than five years. The 'see-saw' is bound to act as a de-stabiliser on economic calculations. Italy with a permanently unstable government is another example.

The wider socio-political aspects of full employment policy no doubt would deserve close study. The long period of full employment and prosperity has wrought considerable social changes; sometimes these changes have come, in typical Marxian fashion, in conflict with existing rigid structures, and social and political tensions have resulted. An outbreak of such tensions occurred in 1968 with the student movement and militant workers' unrest, simultaneous in a number of countries, in France verging for a moment on social revolution. The wage explosion 1968–70 followed in the wake of these signs of social impatience. By way of a feedback process (wage–price–wage spiral) a wage explosion
confined to one year increased also the inflation rates of the following years. The effects of the wage explosion might still have been managed if it had not been for subsequent events: the transition to fluctuating exchanges removed an important restraint on wages, and the divergence of inflation rates in different countries was thereby increased. To this was further added the haussse in commodity prices in 1973 and the oil shock at the end of that year.

After the recession in 1974–75 had started it soon became obvious that the US and Germany had given up full employment policies. This was a political choice. These countries had not done all they could to explore alternative ways, such as an incomes policy based on social consensus instead of confrontation. Moreover, by letting the dollar drift downwards, US inflation was powerfully stimulated. Nor is it clear that inflation would have been worse than it actually was if the US had pursued a policy of expansion to absorb the excess of labour supply. This would have avoided the loss in productivity growth which drove up the wage cost per unit of output, and which resulted from stunted growth of GDP and low capacity utilisation.

But while the preoccupation with inflation was understandable in the US where owing to less social security private saving is more widely important than in Europe, giving up full employment in Europe represented a more surprising change of policy. Some countries such as France were holding out for an expansionist policy in 1975, and they were ultimately forced to give it up only because of Germany’s restrictive policies. Thus the ultimate victory of the restrictionist policy almost everywhere resulted not from independent decisions of the different countries, but was to a large extent brought about by the pressure which the creditor countries with their low inflation rates brought to bear on the rest of the industrial world.

This leads to a subject which has to be treated separately in detail. It concerns the worsening in international economic relations which started in the late 1960s. That the foreign balance was the neuralgic point in his policies Keynes knew only too well and in his later years he was entirely occupied with this complex of questions.

X THE DEFEAT

The war changed the position of Keynes: from an outside critic he became a member of the establishment, holding a highly responsible office in the Treasury. He was concerned with war finance on which he had written an analysis which became the basis for a new understanding of this subject. In particular he introduced the concept of the inflationary gap, the difference between the amount of effective demand and the available supply, as a measure of the degree of inflation.

The policy of cheap money pursued during this war was due to his influence and in consequence it became known as a 3 per cent war as opposed to the 5 per cent war 25 years earlier. The easy money policy and the large treasury borrowing was made possible by the strict controls of the British war economy which created a dam for the large excess of incomes over available civilian supplies, channelling it off into saving: beside exchange control there were the physical controls at home – raw material controls and extensive rationing of consumer goods. Curiously enough, rationing did not meet with the approval of Keynes. It competed with his own ‘deferred payment’ scheme of taxes to be repaid after the war. This scheme was applied in practice only to a very limited extent, and rationing which corresponded more nearly to the strategy proposed by Kalecki, became the effective instrument for dealing with the inflationary gap. In this question Keynes was less advanced than the war time civil service which, driven by necessity, came to understand very well the administrative and socio-politic advantages of the strategy of rationing ('fair shares').

The main concern of Keynes was, however, external finance. This involved, in particular, the negotiations with the United States which, from the Mutual Aid Agreement over Bretton Woods to the Financial Agreement were carried out by him.

In the Keynesian work of these war years two different but interwoven themes were present: One was ensuring the survival of Britain by procuring finance for its pressing needs day by day. The other was to lay the plans for a new international order of currencies, applying Keynesian thinking on a world scale. The two were, unfortunately, not unrelated. Britain, completely drained of reserves by 1940 and having sacrificed two-thirds of her exports, was dependent on supplies offered by the United States as ‘Lend and Lease’ which was granted on the understanding that Britain would ‘pursue a policy, in cooperation with the United States, for world recovery and prosperity'.

American ideas on what this policy was to be were coloured by the free trade ideology of the State Department and its leader Cordell Hull. This corresponded to the interests of a creditor country of great industrial efficiency. A special bugbear was discrimination, one of its forms being non-convertibility of currencies. A ban on discrimination
was the chief content of the 'consideration' demanded of Britain. After being first mentioned in the Atlantic Charter it became Article VII of the Mutual Aid Agreement. This was directed against Britain's Imperial Preference and it also would have rendered impossible any bilateral practices. Convertibility was insisted on in the Bretton Woods Agreement with a period of grace of 5 years which was reduced to two years in the Financial Agreement of 1945 (the conditions for the post-war loan).

Now to the Keynesian vision of an international order. It started from a specific problem, the prospective difficulties of post-war Britain, but it had a much more general significance.

Keynes had already in 1933 thought of an international currency order which would secure abundant liquidity and therefore obviate the aggressive scramble for gold or equivalent reserves which destabilised and depressed the level of world trade and which forced weaker countries into a deflationary policy of unemployment. In the early stage of the war Keynes considered two alternative ways of avoiding a recurrence of the conditions of the interwar period: Britain, with American assistance, could employ Keynesian remedies for unemployment and trade depression on a world scale. This involved also measures for stabilising commodity prices by means of Buffer Stocks, proposed in a Memorandum for the War Cabinet on the International Regulation of Primary Products. Proposals for the finance of the Buffer Stocks were also contained in the plan for the Clearing Union. (These plans were gradually lost sight of in view of the pressure of currency problems and also owing to Keynes's illness. Or else, Britain, thrown back on her own devices, would have to make use of the bilateral techniques developed in Germany by Schacht. Pursuing the first alternative Keynes set to work from 1941 on to develop his famous plan for an International Clearing Union. Its idea was to base the international monetary order not on gold but on a central fund into which each country (in accordance with a quota settled for each country) would pay in its own currency and from which it would obtain the right to draw within certain limits whatever currencies it needed to balance its foreign accounts. In this way the fund would act as a clearing house for the countries of the world, it would settle surpluses and deficits in their balance of payments by a general reckoning up.

The most important aims pursued by the plan for a Clearing Union were the following:

(a) Adequate reserves were to be created and an equitable and reasonable distribution of these reserves was to be guaranteed.

(b) Arrangements were to be made to counteract the existing bias against the debtor countries and in favour of the creditor countries, which favoured depression. Not only persistent debtor countries but also equal persistent creditor countries were to be forced to contribute their part to the adjustment whenever a disequilibrium arose. In this way the bias in favour of depression characteristic of the present system was to be avoided.

(c) It was to be recognised that adjustment of exchange rates were necessary and reasonable in certain circumstances. Therefore rigidity of exchange rates was not proposed, but the opposite extreme, fluctuating exchanges, was also excluded.

The aim was not only to start the countries off on expanding trade, but also to prevent disequilibria from arising, or to correct them if they arose, and to maintain a continuing expansionist climate. The plan was criticised for not going far enough by Kalecki and Schumacher. But no doubt the plan offered a chance for the revival of world trade after the war.

At this point, however, the harsh realities of the other preoccupation of Keynes came into play. The United States had drawn up a rival plan, the White-Plan, which was strongly based on gold, did not provide adequate reserves and did not correct the bias in favour of the creditor.

After negotiations in September–October 1943 a Joint Statement of the United States and Britain was published in April 1944 which leaned essentially on the US proposals. It constituted the defeat of Keynes's aims. In Britain it was passionately opposed by Hubert Henderson, Joan Robinson and Thomas Balogh. The Joint Statement was the basis for the Bretton Woods conference in July 1944 and the Savannah conference 1945 from which the International Monetary Fund and the World Bank emerged.

Bretton Woods involved nothing essentially new. The ruling system became a gold–dollar exchange instead of a gold–sterling exchange. As predicted by Henderson, Balogh and Joan Robinson the system was not in a position to stand up to the post-war strain which resulted from the contrast between the demand of an impoverished Europe and the output capacity of the US and led to a large excess demand for dollars. This danger had been soft-pedalled by Keynes who had made himself the defender of his own undoing. When Britain, in an attempt to carry out the obligation contracted against the loan of 1945, introduced convertibility in 1947, the Bretton Woods system effectively broke down, because this move failed instantaneously. In the further course of events, the international payments system was kept
going only owing to massive American loans and investments and chiefly to Marshall aid which constituted in a way a realisation or substitute for Keynesian plans for the recovery of the world.  

It seems that Keynes was beaten by historical necessity, in so far as he happened to represent a waning power (although this was not essential for the principles he stood for). This interpretation is not generally shared. Lord Kahn thinks that the British position was stronger than it seemed and that a great part of the concessions might have been avoided. Keynes had been a very sick man which affected his stamina and his whole outlook. (He died four weeks after return from the Savannah conference).

The defeat of Keynes is still felt today. From Bretton Woods and Savannah a wide arch is spanned to our own time. The countries of Europe, trusting in the existence of a working international order, have been induced to open themselves up with regard to trade and payments. But, it is obvious by now, a workable international order does not exist. Countries find themselves helplessly thrown about by arbitrary movements of capital and exchange rates. They are, as Keynes had warned on the eve of the return to gold, bound to Wall Street in their interest rate policy. A house of cards – the Euromarket – has been built up, which is exempt from any kind of national or international control. It is the ultimate triumph of laissez-faire in the matter of finance. Where is the lender of the last resort to which, on an international level, banks will be able to turn if this structure starts crumbling?

The decisive defeat of Keynesian policies did not come in the domestic sphere of wage policy, it occurred in the international field. Indeed, the two digit inflation in industrial countries which is widely regarded as the rock on which Keynesian policy had been ultimately stranded was itself merely the consequence of uncontrolled laissez-faire in the international commodity markets. This regime was pleasant enough for the industrial countries in so far as it turned the terms of trade in their favour in the 1950s and 1960s. But the low commodity prices led to neglect of investment in the plantations and mines, so that the output could not cope with the sudden increase in demand in the world boom of the early seventies.

The point of Keynes's Buffer Stock Scheme had been precisely to avoid this: by maintaining adequate and stable prices it was to secure a steady development of supplies.

In a different way also the case of oil demonstrates the consequence of laissez-faire: the excessively low prices of the pre-OPEC times made the industrial world wasteful of oil and drove it into an extreme dependence on oil producers who then took revenge on their former exploiters. Here too, international agreements between producers and consumers might have avoided the extreme changes of the terms of trade. Moreover, the Clearing Union would from the start have prevented frustration of development countries by giving them adequate credits for investment. This should have reduced the latent tension between North and South and therefore the likelihood of 'ganging up' on either side.

The 'invisible hand' has certainly not left traces of any kind of rational ordering: instead the visible heavy hand of creditor countries has imposed their policies on others.

If Keynes was defeated, it was not on the plane of logic: it was on the plane of power. Was he then, was the Clearing Union and the Buffer Stock Scheme, utopian? Yes, and it looks even more so today. Yet it is said that utopians are the greater realists. We are today faced with the same questions which confronted Keynes in the years 1939–41 in his thinking on international relations. We have practically not got any further in the meantime. If we want to start anew, we have to start where Keynes left off.

NOTES

2. R. Matthews, 'Why Britain Has Had Full Employment Since the War', Economic Journal, vol. 78, September 1968, pp. 555–69, and the discussion in Economic Journal, March 1970. He says there were no budget deficits and there was buoyant private investment, but he admits that at least the absence of 'perversions' of the government could be attributed to an advance in know-how due to Keynes. Matthews completely neglects that the vastly increased government spending was partly financed by increased profit taxes which cut into company savings and therefore acted much like a budget deficit.
4. 'Does Unemployment Need a Drastic Remedy?', The Nation, May 1924.
8. The Economic Consequences of the Peace, Coll. W., vol. II.
14. 'This has been noted by others including J. A. Schumpeter according to whom generally... vision of facts and meanings precedes analytic work...'. *History of Economic Analysis*, (New York: 1954) p. 1171, which he illustrates by the example of Keynes of whom he says: 'The whole period between 1919 and 1936 was then spent in attempts, first unsuccessful, then increasingly successful at implementing the particular vision of the economic process of our time that was fixed in Keynes's mind by 1919 at the latest' (p. 42).
15. D. Winch, op. cit., p. 105. In proportion to GNP these interest payments were 5.4 per cent in 1920 and 7 per cent in 1930, compared with 4 per cent after the Second World War.
21. This becomes evident in *How to Pay for the War* (1939).
34. *How to Pay for the War, Coll. W.*, vol. ix.
42. 'New Plans for International Trade', *Institute of Statistics Oxford; Bulletin*, vol. 5, supplement no. 5, August 1943. It was claimed there, *inter alia*, that without exchange controls to limit international capital movements the functioning of the plan would not be guaranteed.
45. In the sense of a system of fixed exchange rates the Bretton Woods system did of course last until the US stopped converting dollars into gold at the end of 1971. The contention of Lord Balogh is that this system functioned only thanks to factors essentially extraneous to it, namely the Marshall Plan, the US direct foreign investments, the civil and military assistance to allies and finally the military expenditure abroad which together created abundant reserves throughout the period. In the end this abundance of dollars became too great a blessing so that the readiness of the world's central banks to hold them became doubtful, and this meant the end of the gold-dollar system.