WOMAN'S COLLEGE
OF THE UNIVERSITY OF NORTH CAROLINA
GREENSBORO, NORTH CAROLINA



# HONORS PAPERS

1948/1949

Greensboro, North Carolina

1949

CONTENTS

# THE ECONOMICS OF JOHN MAYNARD KEYNES

By
Marilyn Cohn

Submitted as an Honors Paper
in the
Department of Economics

THE WOMAN'S COLLEGE OF THE UNIVERSITY OF NORTH CAROLINA

GREENSBORO, NORTH CAROLINA

1949

Prefatory note:

There are two approaches to this topic--The Economics of John Maynard Keynes. One is the direct approach, an examination of the writings of Keynes, himself. The other is the indirect approach, a survey of the literature dealing with Keynes and his economics. I have chosen the latter approach, attempting to review some of the more important writings on Keynes by contemporary economists.

# I

John Maynard Keynes, Baron of Tilton, has been one of the most controversial figures in twentieth century intellectual thought. This controversy has been of a practical as well as of a theoretical nature. It has extended from the realm of theory to that of policy and has affected "the man on the street." The reaction to Keynes may be characterized as overwhelming--some of it being overwhelmingly opposed to his ideas, and some of it overwhelmingly favorable. Characteristic of these opposed views, Drs. Swanson and Schmidt in their recent work have said:

> "The decade of the 1930's was unparalleled in two respects. It gave us the worst depression on record and it brought a world of Keynesian ideas! Which crisis led to the greatest difficulties it is not easy to say...More than one student of the decade probably would contend that we could well have dispensed with both." [1]

At the other extreme, it was said in 1946, shortly after the death of Keynes that:

> "America would be a despairing country today if we did not have faith in the ability of democracy to provide full employment and higher living standards through government action. More than to any other man, we owe this faith to John Maynard Keynes...An instinct for progress, a mastery of economic doctrines, a sweep and precision of intellect, a grasp of political problems and an extraordinary power of persuasion were needed by democracy to bridge the worlds of thought and action. In Keynes, these qualities were combined." [2]

While Keynes had been an established leader in the world of economic thought for many years, it was in 1936, after the publication of his <u>General Theory of Employment, Interest and Money</u>, [3] that some eco-

---

[1] Ernst Swanson and Emerson Schmidt, <u>Economic Stagnation or Progress</u>, New York, McGraw-Hill, 1946, p. 1.

[2] "John Maynard Keynes: 1883-1946," <u>The New Republic</u>, CXIV, April 29, 1946, 600.

[3] I shall hereafter speak of this work as the <u>General Theory</u>.

nomists began speaking of the "Keynesian Revolution" or the "New Economics of Keynes." And during the same period, other economists took up with renewed vigor the lagging banner of classical economics and made Keynes their object of bitter attack.

One might wonder, and justifiably, who was this man who has become the center of such a widespread intellectual debate? What were his ideas which have caused such divergent opinions? What was the nature of his economics that it has aroused such controversy?

It is generally accepted that the aforementioned General Theory of Keynes signalled his break with the classical school. For an understanding of this departure from the classicists, and thus gaining a better understanding of the General Theory, it would seem appropriate to examine briefly the classical theory of economics, and the processes of development of Keynes' thought within its environment. What was the evolution of Keynes' thinking?

II

John Maynard Keynes was born in 1883 of clerical background and in an academic atmosphere. His father was John Neville Keynes, a distinguished lecturer at Cambridge, and a close friend of Alfred Marshall, one of the most noted of the classical or neo-classical economists.

The young Keynes received his early education at Eton, and later at King's College, Cambridge. While at Cambridge he changed his primary interest from the study of mathematics to that of the science of economics. The study of economics, at that time, was flourishing under the moving spirits of Marshall, Sedgewick, and Edgeworth. Keynes was a devoted student and disciple of Marshall, and during most of his career he accepted the classical principles as he had been taught them by Marshall. The Cambridge version of the classical theory had for a time no more devoted adherent than was Keynes.

Thus, for an understanding of Keynes' break from his mentors, the classical tradition regarding employment must be examined.

Classical theory assumes full employment of labor and of other resources. When full employment does not actually exist, the classical theory holds that there is a tendency toward full employment. The classicists assert that when there is interference on the part of government or by private monopolists with the automatic market forces, disturbances are caused. They advocate in general a policy of laissez faire, which, they contend, promotes full employment. Having thus assured themselves of full employment, or of tendencies toward that, economic equilibrium would be maintained by the automatic market operations, and the forces of supply and demand would adjust prices and allocate resources.

Full employment as the normal condition in an exchange economy is justified by the classical theorists by reason of the assumption that supply creates its own demand. This assumption is called Say's "law of markets," after J. B. Say, an early nineteenth century French economist. Say's law reasoned that supply would correspond with demand since no one would sell a commodity without using the sales proceeds promptly for the purpose of purchasing other commodities. Since additional supply is additional demand, Say's law denies the possibility of an overproduction --not with respect to a particular commodity, but generally. Supply of one thing will constitute demand for other things.

The belief that full employment is normal "rests on the assumption that income is automatically spent at a rate which will keep all resources employed." [4] Income is either consumed, or saved; and saving is spending for producer' goods (investment). Flexible interest rates are supposed to maintain a measure of equality between saving and investing.

In actuality, however, there were depressions. These depressions were caused, according to classical theory, by failures in the system of allocation of resources, and not by a general deficiency of demand.

The classical belief that there was at all times a tendency toward full employment, and an automatic mechanism operating toward the realization of full employment when it did not actually exist, had been badly shaken during the prolonged depression of the early 'thirties. It was Keynes who gave it the final blow. Keynes undertook to demonstrate that the volume of employment was dependent upon effective demand. He contended that it would only be by coincidence that effective demand, reduced by our tendency to save and swollen by our investment, would be just enough to buy the entire output which society could produce at full employment levels.

According to Professor John Maurice Clark, "Economic theory had, since 1870, been going through a development that tended to separate it from the study of conditions such as depressions." [5] The classical school had set aside pure theory into a special compartment separate

---

4 Dudley Dillard, The Economics of John Maynard Keynes, New York, Prentice-Hall, 1948, p. 19.

5 John Maurice Clark, Alternative to Serfdom, New York, Alfred A. Knopf, 1948, p. 95.

from that in which were the factual or historical materials. They continued refining the theoretical doctrines, but many of the problems they dealt with remained as they had been left by Ricardo in 1817. To be sure, some of the classical economists departed from laissez faire to favor some piecemeal regulation of particular abuses, but this belonged in another compartment separate from that of pure theory. This was the state of affairs when the Keynesian bomb exploded in 1936. [6]

Professor Dudley Dillard states that Keynes' break with the classical school may have appeared quite sudden, but he points out that many elements of Keynes' later position can be found in his early writing and thinking. He feels that Keynes' break developed gradually; that over a long period of time Keynes came to believe that classical economics could not adequately deal with the problems of contemporary economic society. Classical economics depended upon a practical policy of laissez faire, and Keynes saw that laissez faire was declining rapidly in the years following the first world war. Since policy was of the utmost interest to him, he logically felt that if laissez faire was declining, then classical economics was no longer an adequate system of thought. He therefore developed a body of theory to replace the classical principles. [7]

According to Professor Dillard, an opposition to orthodox monetary theory is evident in Keynes' first important publication, Indian Currency and Finance (1913). In this publication he attacked a recommendation that the gold standard be adopted for India. These ideas

---

[6] Ibid., pp. 95, 96.
[7] Dillard, op. cit., pp. 294, 295.

regarding Indian currency and finance clearly foreshadow Keynes' later preference for a managed currency instead of the "automatic" gold standard.[8] According to Dr. Lawrence Klein, some present-day economists would like to make much of the fact that from the outset Keynes departed from orthodoxy, since, in this work, he made a plea for a managed currency. Dr. Klein points out, however, that Keynes' recommendation was reached on the basis of straightforward classical analysis.[9] Professor Joseph Schumpeter says that he thinks it fair to call Indian Currency and Finance the best English work on the gold exchange standard.[10]

The Economic Consequences of the Peace (1920) is significant because in this work Keynes predicted the impossibility of the Allies collecting the reparations imposed on Germany and sketched a long-view perspective of the capitalist process. In fact, Professor Schumpeter believes that the embryo of the General Theory can be found in this book.[11] At this time, however, Keynes was not worried about a lack of investment opportunities. He is famous for many predictions, but during these years he was not able to predict the economic stagnation of England because he was still classical in his analysis.[12]

During the decade of the 'twenties Keynes became extremely interested in economic policy and particularly in postwar European contro-

---

8 Ibid., pp. 298, 299.

9 Lawrence R. Klein, The Keynesian Revolution, New York, Macmillan, 1948, p. 2.

10 Joseph A. Schumpeter, "John Maynard Keynes: 1883-1946," The American Economic Review, XXXVL, September, 1946, 498.

11 Ibid., 501.

12 Klein, op. cit., p. 4.

versies. He appealed for a reduction of war debts and reparations which he considered a menace to stability everywhere; he opposed the postwar deflationary tendencies in Britain; and he opposed a return to the gold standard. Many of his suggestions went unheeded, but by 1930 most of his positions were justified. [13]

Keynes' strong bias against financial capital is revealed in his Tract on Monetary Reform (1923). Here he attributes the major ills of capitalism to monetary instability. He argues for a managed currency directed toward stabilizing the internal price level rather than a return to the gold standard which was then being advocated by most British economists and statesmen. [14]

Keynes objected to both inflation and deflation, but, according to Professor Dillard, "viewed moderate inflation as the lesser evil because 'it is worse, in an impoverished world, to provoke unemployment than to disappoint the *rentier*.'" [15] Keynes had always wanted to eliminate the *rentier* class because he considered them an inactive class in the economy.

In 1924, Winston Churchill, then Chancellor of the Exchequer, announced that the United Kingdom would return to the international gold standard at prewar parity. Shortly after this, The Economic Consequences of Mr. Churchill appeared wherein Keynes predicted dire results from the government's policy. Great Britain had not recovered from the

---

[13] Dillard, *op. cit.*, pp. 300-302.
[14] *Ibid.*, p. 303.
[15] *Ibid.*

first postwar depression and Keynes believed that Churchill's policy would result in more industrial distress, more unemployment, and strikes against industries which would attempt to cut wages. His prophecy was shortly verified. [16]

The government's policy would restore prosperity to the financial interests which supported it, but it disregarded the effects upon the industrial entrepreneurs. Keynes always championed industrial capital when its interests clashed with those of financial capital. He was not championing the working class; he was not objecting in principle to reductions in money wage and real-wage rates; but he felt that these changes could not be made without causing strikes and unemployment. These consequences, he felt, would interfere with the continuity of industrial production. [17]

Keynes' practical outlook adopted new directions during the British election of 1929. Prior to this time he had been purely a monetary reformer, but in 1929 he became interested in public works and government loans. In this campaign Lloyd George offered a public works program to remedy unemployment. According to Professor Dillard:

> "Keynes supported Lloyd George's promise that his proposed public works program would involve no rise in taxation, since the increased primary and secondary employment would augment the taxable national income while decreasing expenditures for unemployment relief in amounts sufficient to offset the additional outlays for public works." [18]

In this we see the genesis of the so-called theory of the multiplier. Professor Dillard further asserts that public works were not to be the

---

[16] Ibid., pp. 304, 305.
[17] Ibid., pp. 306-308.
[18] Ibid., p. 309.

entrance of socialism but part of the liberal program to avoid socialism.[19]

Keynes changed from an orthodox to an unorthodox economist between his Treatise on Money (1930), a monetary theory of the trade cycle, and his General Theory (1936). The transition was precipitated because of the incompatibility between the policies he advocated and the practical implications of the classical program. According to Professor Dillard:

> "...The problem in the General Theory is one of implementing a declining capitalism against the loss of the self-recuperative powers that characterized it during the nineteenth century. The uniqueness and objectives of the General Theory, both as a proposal for practical action and as an attack on the old principles of economics, can be appreciated only by understanding Keynes' shift in viewpoint."[20]

The financial crisis of 1931 seems to have been the greatest factor influencing Keynes' shift in viewpoint. He considered it the greatest economic catastrophe of the modern world. At this time the classicists urged personal thrift and reduced government spending, believing that individual saving and a balanced budget would facilitate recovery from the depression. The British government continued to stick to principles of orthodox finance.[21]

But Keynes' prognostications of the 'twenties were being fulfilled:

> "He predicted strikes and strikes had resulted; he said the gold standard was unworkable and so it had proved to be; he said industry would suffer and suffered it had. In 1931 we find Keynes mournfully picturing himself as a Cassandra whose predictions were prophetic but whose prophecies were never heeded."[22]

---

[19] Ibid., p. 310.
[20] Ibid., p. 311.
[21] Ibid., pp. 311, 312.
[22] Ibid., p. 313.

Keynes' belief that classical theory just did not operate in its practical implication greatly influenced his transition to an anti-classical position.

In 1935, Keynes wrote an article entitled "A Self-Adjusting Economic System?". Here he maintained that the capitalist economy was not self-adjusting, this being due particularly to the special nature of the rate of interest. He said:

> "Now I range myself with the heretics. I believe their flair and their instinct move them towards the right conclusion. But I was brought up in the citadel and I recognize its power and might. A large part of the established body of economic doctrine I cannot but accept as broadly correct. I do not doubt it. For me, therefore, it is impossible to rest satisfied until I put my finger on the flaw in the part of orthodox reasoning that leads to the conclusions that for various reasons seem to me to be inacceptable. I believe that I am on my way to do so. There is, I am convinced, a fatal flaw in that part of the orthodox reasoning that deals with the theory of what determines the level of effective demand and the volume of aggregate employment; the flaw being largely due to the failure of the classical doctrine to develop a satisfactory and realistic theory of the rate of interest." [23]

The core of Keynes' analysis is indicated in this article. Dr. Klein feels, however, that this article may add to the misinterpretation of the essential innovations of the Keynesian Revolution. He refers to Keynes' claim that the inability of the classical system to determine the level of effective demand was due to an unsatisfactory interest theory. According to Dr. Klein, this does not mean that the Keynesian Revolution lies in the new interest theory--liquidity preference. He believes that this is not an essential element of the modern Keynesian system. It merely rounds out the theory and makes it complete. [24]

---

[23] J. M. Keynes, "A Self Adjusting Economic System?", The New Republic, LXXXII, February 20, 1935, 36.

[24] Klein, op. cit., pp. 42, 43.

The classicists reconcile their denial of involuntary unemployment with the fact that there have been large numbers of idle men and women who want work but cannot find it. An imperfect labor market has been created, they say, as a result of labor union action and government intervention. Wage rates are not free to fall to their competitive levels. According to the classical theory, labor is guilty of causing unemployment. Keynes objected to this classical theory as it was expressed by Professor Pigou for practical as well as theoretical reasons. From a practical point of view, Keynes believed that labor unions and welfare legislation were here to stay. He felt that Pigou's theory of unemployment was not a guide to policy under conditions as they have come to exist in modern society. But even if we could restore perfectly free competition, Keynes contended that the volume of employment is determined by effective demand and not by wage bargains between workers and employers.[25]

Keynes believed that the great fault of classical theory lay in its irrelevance to conditions in the contemporary capitalist world. Generally, Keynes' shift from classical economic thought to an anti-classical position may be attributed to a change in his ideas about economic policy. His anti-classical economic theory is derived from his practical position, which was an attack on financial capitalism and a defense of industrial capitalism. Keynes does not use the terms "financial" and "industrial" capitalism, but he does distinguish between "finance" and "industry." In the <u>General Theory</u> he distinguishes be-

---

[25] Dillard, <u>op</u>. <u>cit</u>., pp. 22-25.

tween $M^1$, or money held to satisfy the transactions and precautionary motives (industry), and $M^2$, or money held to satisfy the speculative motive (finance).[26]

According to Dr. Klein, "It was not his theory which led him to practical policies, but practical policies devised to cure honest-to-goodness economic ills which finally led him to his theory."[27]

Keynes does not question the method or the scope of classical economics. He challenges the content, the assumptions of the classical doctrine. Professor Dillard says that Keynes continued to accept much of the classical tradition. He emphasized the difference rather than the similarities between his theory and that of the classicists "in order to better drive home his main points." Professor Dillard points out that classical theory as a whole presumes laissez faire; whereas, Keynes theory as a whole is revolutionary in its repudiation of any presumption in favor of laissez faire. Consequently, Keynes strikes at the heart of classical theory.[28]

Professor Lorie Tarshis has a point of view similar to that of Professor Dillard. He believes that Keynes had considerable dependence upon classical and neoclassical tradition. He says that Keynes did not point out this dependence, but sought to emphasize his break, merely as a tactic of persuasion. Professor Tarshis mentions two particular points where classical doctrines enter in the General Theory. Keynes' "aggregate supply function" differs in minor ways but is basically similar to the supply function of neoclassical economics. Keynes deals with total production of the economy, measuring it in terms of total employ-

---

26 Ibid., pp. 296, 297.
27 Klein, op. cit., p. 31.
28 Dillard, op. cit., pp. 15, 16.

ment, rather than dealing with the output of a single commodity in terms of physical units. The second aspect is in his use of a part of the classical law of markets. He rejects Say's law, but he goes part of the way: supply may not create its own demand, but it creates the income from which a part of the demand stems.[29]

Professor Tarshis further asserts that:

> "Starting from the neoclassical position we can go much of the way towards a formulation of income theory in Keynesian terms before we have to introduce anything that explicitly contradicts other parts of the classical doctrine."[30]

Keynes' economics can be more easily understood if we review what he considered to be the nature of economics. To Keynes, economics was a "moral science." Stated another way, economics should, in the final analysis, be an explanation of actual human problems. His view was less broad than that of the historical or institutional schools, but not as narrow as those who believe the essence of economics lies in mathematico-logical analysis.[31]

Professor Allan Gruchy points out that Keynes clearly works within the Cambridge tradition. He has the same emphasis upon a hard core of pure theory, and, like others in the Cambridge school, he has a strong preference for a deductive approach. He is more aware of the historical trends in economic life than some of his orthodox predecessors, but he is not strongly attracted by historical, cultural, or sociological analysis. As did his father and Marshall, Keynes writes about levels of analysis which extend from pure theory to the more complicated and

---

[29] Lorie Tarshis, "An Exposition of Keynesian Economics," The American Economic Review, XXXVIII, May, 1948, 262.

[30] Ibid., 263.

[31] Allan Gruchy, "J. M. Keynes' Concept of Economic Science," The Southern Economic Journal, XV, January, 1949, 249.

less precise interpretations of the real economic world. Like Marshall, he seeks to erect on the essentials of pure theory an inductive superstructure which will bridge the gap between pure and applied economics.[32]

According to Professor Gruchy, Keynes did not have radically new ideas relating to the general nature of economics as a science, nor did he desert the Cambridge school for the institutional or historical schools. He says:

> "Keynes has poured a new content into the inherited molds of pure and concrete economics. He has taken Marshall's 'economic foundations' apart, rebuilt the substructure of economic science, and then erected a superstructure of economic interpretation which was only hinted at in various places in Marshall's works...Although the final result is to many economists a strange mixture of Cambridge economics and some theories similar to those found in the 'underworlds of Karl Marx, Silvio Gesell, or of Major Douglas,' Keynes himself saw nothing incongruous about his combination of orthodox and heterodox ideas. On the contrary, he appears to have regarded himself a representative of the most recent step in the further development of Cambridge economics." [33]

Marshall had planned to write a second volume to his Principles which would carry his pure theory over into concrete analysis, but this book never appeared. Consequently, his concrete studies lacked a certain unity. However, where Marshall failed, Keynes enjoyed more success. Keynes "sharpened the whole analysis relating to the superstructure of economics by providing the necessary unity for empirical studies of the economic system." [34]

Keynes, like Marshall, begins with a general description of economics. He takes this to be an "interpretation of current economic life," which is the economic society in which we live. Since this society is

---

[32] Ibid., 250,251.
[33] Ibid., 251.
[34] Ibid., 253.

basically capitalistic, Keynes' economics turns out to be an interpretation of an economy of individualistic capitalism. This position places him, according to Professor Gruchy, midway between the formalism of Lionel Robbins, and the institutionalism of heterodox economists.[35]

Keynes worked at various levels of economic analysis. At the lowest level was his pure theory of output and employment as a whole, while at the top he worked out his empirical interpretation of the current phase in the development of the capitalistic system. The latter is much less developed than the former, but this is not surprising when his background is taken into consideration. What is particularly significant about Keynes' theory of employment, as compared with Marshall's theory of the individual firm, is that it opens rather than closes the way to analysis on higher and more concrete levels.[36]

III

*The General Theory of Employment, Interest and Money*--what is it, as we have asked, that caused such widespread intellectual discussion?

The *General Theory* is an analysis of the several factors which govern employment and output levels in the modern system of free enterprise. It is not an advocacy of overall change in the present system of free enterprise or of competitive capitalistic institutions. It does not tamper with the traditional treatment of the supply function but, instead, analyzes thoroughly the function of effective demand.

---

[35] *Ibid.*, 254.
[36] *Ibid.*, 255, 256.

Keynes' thesis in the *General Theory* is that aggregate demand determines employment, and that the propensity to consume and the amount of investment at a given time in turn determine aggregate demand. This Keynes calls a "general theory" because he deals with all levels of employment.

Keynes' theory purports to explain the elements that determine employment volumes at any stated time, be it full employment, widespread unemployment, or employment at an intermediate level. This is in contrast with the classical economists who dealt with the special case of full employment.

The classical assumption of the competitive system being self-adjusting at full employment is challenged by Keynes. He calls the classical theory a "special" theory which is applicable only to one of the limiting cases of his "general" theory. Keynes believes that under the *laissez faire* system of capitalism, in the stage of development of his day and time, fluctuations in employment levels are normal. Moreover, he believes that the normal level of employment tends to be short of full employment. However, Keynes does not believe that widespread unemployment, even though it be normal or characteristic, is inevitable.

There is another meaning associated with the term "general" as used by Keynes in his *General Theory*. It is that Keynes' theory makes reference to the economic system in its entirety. In contrast, the traditional theory refers primarily to the economics of a single industry, or of an individual enterprise.

Professor Raymond Saulnier believes that the psychological "law" that individuals tend to consume progressively smaller proportions of their income as that income becomes greater is the clue to, or perhaps the basis of the <u>General Theory</u>. It is reasoned that, as employment and income are on the increase, there must follow an increase in new investment to absorb the new savings. Otherwise, there will be a deficiency of returns to entrepreneurs, resulting in a lack of inducement to continue to offer increasing employment. [37]

Spending habits are determined by the community's propensity to consume. The inducement to invest, which must be strong enough to attract capital, or resources not otherwise spent on current consumption industries, depends on the marginal efficiency of capital and the relevant rates of interest. The <u>General Theory</u> concerns itself with demonstrating how there can be less than full employment with a given propensity to consume and a given rate of new investment.

Keynes does not think that the advocates of the belief in the automatic self-adjustment processes in the economy are on firm ground. He denies that there are forces operating which tend to adjust automatically the spending habits of the community (the propensity to consume) with the investment activities (the inducement to invest) causing full employment necessarily to follow. Furthermore, he believes that as a community becomes more wealthy, and as its stock of capital goods is increased, the "adjustment" becomes more difficult. Keynes reasons that as the amount of capital goods becomes greater it becomes increasingly difficult to find attractive fields of new investment.

---

37 Raymond J. Saulnier, <u>Contemporary Monetary Theory</u>, New York, Columbia University Press, 1938, pp. 308-310.

We are returned, therefore, to the factors that govern the propensity to consume and the inducement to invest. There is an important distinction between consumption and investment. It is this distinction that is fundamental to Keynes' analysis. In simplest terms, Keynes' theory is that employment depends fundamentally on the amount of investment. Professor Gruchy sums up the General Theory by saying that "given the psychology of the public, the level of output and employment as a whole depends on the amount of investment." [38] It is on investment that Keynes places emphasis when he says that employment in investment activities helps to maintain demand for the output of existing facilities. As investment fluctuates, so will employment fluctuate. A high level of investment will result in a corresponding high level of employment. Fluctuations in the level of investment may be caused by the uncertainties in the existing knowledge of the future. It is future expectations that guide the potential investor in making his decision.

A logical starting point in the development of Keynes' theory is the principle of effective demand, since unemployment results from a deficiency in total demand.

Fundamental to the principle of effective demand is the principle that as the real income of the community increases, consumption will also increase, but by less than the increase in income. Effective demand is manifested in the spending or investing of income. Consequently, when there is less spent than earned there is a gap, and there must be an increase in investment equal to that gap to create sufficient demand to sustain the employment level.

---

38 Gruchy, op. cit., p. 256.

The term "demand" as used by Keynes refers to the aggregate demand of the entire economic system. Also, Keynes uses the amount of labor to measure output as a whole. The aggregate demand "price" for the output of any given amount of employment is the total sum of money expected from the sale of the output produced when that amount of labor is employed.

The "aggregate demand function" is a schedule of the proceeds expected from the sale of the output resulting from varying amounts of labor. As the amount of labor, or employment, increases or decreases, the aggregate demand price increases or decreases.

The "aggregate supply function" is a schedule of the minimum amounts of proceeds required to induce varying quantities of employment.

Thus, the actual amount of employment is determined to be at the point where the aggregate demand function intersects the aggregate supply function. The point of effective demand is marked by this intersection. It is at this point that entrepreneurs are capable of realizing their greatest profits. However, there is no basis for an assumption that this point will also yield full employment. Full employment could prevail at a time when aggregate supply and demand functions are in harmony, but should it so prevail, it is only by reason of the coincident fact that the gap between income and consumption had been filled by investment.

Keynes believes that these two schedules, demand and supply, intersect typically at a point in the scale where there is less than full employment. It logically follows to Keynes that to change this equilibrium when there is less than full employment, some external influence is required.

The ultimate purpose of Keynes' theory is to seek the causes of employment and unemployment, and to explain the factors that determine their respective volumes. He uses many terms in his General Theory, and those which seem to be most strategic are the propensity to consume (consumption schedule), the marginal efficiency of capital (investment demand schedule), and the rate of interest. In explaining unemployment, Keynes directs his attention to those factors that are subject to change or to regulation, the effect of which is to raise the level of employment. Significantly, these factors are closely related to the aforementioned consumption and investment schedules and to the rate of interest.

The aggregate demand function is defined as the relation of "any given level of employment to the 'proceeds' which that level of employment is expected to realize." [39] The propensity to consume determines that part of the "proceeds" relevant to the aggregate demand function which comes from expenditures on consumption goods. The other part is made up of expenditures on investment goods.

The propensity to consume is a functional relationship between aggregate income and consumption. Consumption demand depends on the size of income and the share of it that is spent on consumption goods. The schedule showing the various amounts of consumption corresponding to different levels of income is called the "schedule of the propensity to consume." Keynes assumes that the propensity to consume is rela-

---

39 Saulnier, op. cit., pp. 326, 327.

tively stable in the short run. This assumption is essential to his theory. A high propensity to consume is favorable to employment; whereas, a low propensity to consume means that investment must be relatively greater to maintain a high level of employment.

According to Keynes, if employment, and therefore income, tend to increase "...not all the additional employment will be required to satisfy the needs of additional consumption." 40 Thus:

> "...Employment can only increase _pari passu_ with an increase in investment; unless, indeed, there is a change in the propensity to consume. For since customers will spend less than the increase in aggregate supply price when employment is increased, the increased employment will prove unprofitable unless there is an increase in investment to fill the gap." 41

Effective demand for investment comprises the other element of the aggregate demand function. This component is more complex and unstable than is consumption demand. In our society, if all goods that are produced are consumer goods, that is, goods consumed as they are produced, nothing is added to the wealth of society. However, those things produced that are over and above the quantities of goods currently consumed, are an accretion to the wealth of society. Investment implies that additional wealth. Such investment may take the form of inventories, or stock-piles of consumer goods; but more often, or more typically, investments are regarded as those expenditures by business men for factories, or capital goods.

---

40 John Maynard Keynes, _The General Theory of Employment, Interest and Money_, New York, Harcourt, Brace, 1936, p. 97.
41 _Ibid._, p. 98.

Anticipated profits arising from anticipated additional demand from increased facilities is the factor inducing investment in more factories. Since anticipated profits are based on future demands for the goods, and since the estimates of the future conditions vary from time to time, it is normal that the volume of investment be subject to wide fluctuations.

Usually, most of the funds used by business men to finance new construction are borrowed. The amount which a business will borrow for such purpose, or the amount which would be invested in such enterprise, is as high as the point where the cost of the borrowed funds does not exceed the expected return from the investment. The inducement to put money into new facilities is, therefore, determined by the estimate of the profitability of the investment in relation to the prevailing rate of interest. This expected profitability of new investment is called the "marginal efficiency of capital."

In the case of a going concern, a business already established and performing profitably up to the full extent of its capacity, the "marginal efficiency of capital" would be the incremental profit over the incremental cost. To the individual business man, it would be the ultimate amount of additional profit remaining to him after he had paid the cost of borrowing the money with which to add a machine in his factory, purchase a truck, remodel his store front, or increase his inventory. A business man would continue to expand his capacity to do business so long as his expected profit at the end of a period is greater than the cost of expansion, or the excess of the rate of return over the rate of interest.

According to Professor Dillard:

> "Keynes uses the term marginal efficiency of capital rather than expected rate of profit or some other conventional term like the marginal productivity of capital because he wished to emphasize the dynamic setting in which the present and the future are linked by the expectations of the investors." [42]

Potential investors may be far-sighted, or they may be near-sighted, or they may be totally blinded as to the future course of events.

> "In this dynamic setting the investor is extremely cautious about investments that will realize their value, if at all, only over many years to come. The longer the period involved, the greater the chance that unforseen events will intervene to disappoint today's investor. The role of capital assets as a link by which wealth-holders bridge the gap between the present and the future is one of the fundamental ideas underlying Keynes' entire analysis." [43]

The marginal efficiency of capital tends to be unstable in the short run and to decline in the long run. We may follow this reasoning more easily when we examine the other determinant of the volume of investment, namely, the rate of interest.

Two factors determine the rate of interest: the state of liquidity preference and the quantity of money. As to liquidity preference, this is the desire of people to hold some of their assets in the form of cash, readily available for whatever purposes would be compelling or preferable at a future date. The quantity of money is the total amount of funds in the form of paper currency, coins, and bank deposits outstanding in the hands of the general public.

---

42 Dillard, op, cit., p. 40.
43 Ibid., p. 41.

People who hold quantities of cash on hand (or in the bank) are motivated by three reasons: the transactions motive, the precautionary motive, and the speculative motive. The first motive is ordinary; it refers to money for current needs, for working capital, for transactions such as current bills, wages, and incidental expenses. The second, the precautionary motive, is often as necessary for the prudent conduct of a business as is the first. It refers to money kept on hand for unforseen emergencies. It is a reserve for contingencies kept in a liquid state. For both of these motives, the demand is relatively stable. The third of these motives, the speculative motive, is of greatest importance in its relation to the rate of interest. Uncertainty regarding the future rate of interest is the reason why people hold money for the speculative motive. If people think the interest rate will go up, they have an incentive to hold their money until this takes place. The lower the interest rate goes, the more people will hold their wealth in the form of money.

The demand for money held by reason of the speculative motive is subject to wide fluctuations. Liquidity preference becomes stronger or weaker as the potential investor's attitude regarding the future changes. When liquidity preference becomes stronger, the interest rate rises, and when it becomes weaker, the interest rate accordingly falls. But since the future is so uncertain, the level of the interest rate is dependent upon highly psychological factors.

The interest rate fluctuates according to the supply of and demand for money. If the supply of money is held stable, then the interest rate will fluctuate according to the demand for money. But since the banking system and monetary authorities have some control of the quantity of money, they could pursue a policy of flexible money supply in an effort to control the rate of interest.

Both the rate of interest and the marginal efficiency of capital involve psychological attitudes toward the future, making investment less stable than consumption. Because of this the volume of employment is mainly determined by the volume of investment.

It is these fluctuations in the marginal efficiency of capital along with the rate of interest that are the fundamental causes of the movement of the business cycle.

In the expansion stage of the cycle investors (business men) have optimistic expectations which cause a marginal increase in investment. This in turn leads to a marginal increase in employment, and results in a marginal increase in aggregate income. During this period the rate of return on investment is greater than the rate of interest. However, there is a propensity to consume that is stable. Failure to spend increments of income on consumption leads to a proportional marginal decrease in the rate of return, and a marginal decrease in expectations. At this time, there may be a marginal increase in liquidity preference, thus leading to a marginal increase in the rate of interest. The rate of return on investment goes down and the rate of interest goes up.

The period of recession is characterized by a marginal decrease in investment, which in turn leads to a marginal decrease in employment and aggregate income, which might be followed by collapse and depression.

That which accelerates recovery is that which causes a marginal increase in investment and consumption at an earlier date than would be the case if the ordinary process of inducement to invest were to follow its course. Government spending to increase investment and consumption will accelerate recovery.

Keynes' <u>General Theory</u> contains many theoretical concepts like the propensity to consume and the inducement to invest. But these terms are only the beginning. Their full meaning emerges in the use to which Keynes puts them. The concept of the propensity to consume is used to show the need for a high rate of consumer expenditure. It indicates a need for a more equal distribution of income and wealth which might possibly be answered by a steeply progressive income tax, or more social services on the part of the government. From the concept of the marginal propensity to consume, Keynes derives the investment multiplier. The multiplier shows us that if private investment is lagging, investment on the part of the government, public works for example, will increase the national income not only by the amount the government spends but by some multiple of it. Another implication of Keynes' theory is the importance of controlling the quantity of money. Keynes felt that a strong monetary authority could control the rate of interest and thus stimulate investment and employment.

Keynes' belief that the problem of employment is not as great in a poor community as in a rich community also has many implications. According to Keynes, a poor community will spend a large proportion of income on consumption so only a small amount need be filled by investment. Also a poor community will not have accumulated a great stock of capital goods so there will be great demand for investment. A wealthy community, however, must have many investment outlets if there is to be full employment. If a wealthy community does not have investment outlets, it will have to restrict its output.

Keynes asserted that:

> "...The richer the community the wider will tend to be the gap between its actual and its potential production; and therefore the more obvious and outrageous the defects of the economic system." [44]

Since Keynes, this belief has been advanced by the mature economy theorists.

IV

"The success of the General Theory was instantaneous, and, as we know, sustained." [45] These words appeared ten years after Keynes' great work came upon the scene. They were said by Professor Schumpeter, an American economist of substantial fame, who is not a "follower" of the Keynesian doctrine, but who recognizes some of the greatness of Keynes.

Keynes' vast influence was not only in economic theory, which includes theoretical concepts and the tools of analysis. His greatness extended to the field of practical policy. That Keynes should make himself felt in the fields of policy is not at all surprising since he had so profound an interest in the problems of his day, and in the practical solutions that policymakers were seeking. Nevertheless, Keynes' influence on policy was precipitated by his influence on theory, and it

44 Keynes, General Theory, p. 31.
45 Schumpeter, op. cit., 515.

is commonly believed that his greatness was not in the precise policies he advocated, but in his basic analysis of the forces responsible for the level of unemployment.

A measure of both the greatness and the influence of Keynes may be found in the fact that there have been thousands of writings resulting from his original work, contributions not only by economists, but by social scientists in other fields. Every implication of his thought, the nuances of his phraseology, all these have been explored by those who followed Keynes' General Theory in 1936. Recent and current authors have, with but few exceptions, adopted the new concepts and the tools of analysis formulated by Keynes whenever these authors deal with monetary matters, with the business cycle, or with general theory. This new language has extended from theory to the hard realities of practical policy. "In this sense," Professor Alvin Hansen points out, "friend and foe alike have become Keynesians." [46]

Recent years have witnessed a veritable flood of writing on economic analyses of national income, of consumption, of investment, and of government spending. For much of these works, the authors are indebted to the General Theory. Professor Seymour Harris claims that "it would be a mistake to assume that Keynes has been victorious on every issue or to the same degree in all countries," but he feels that everywhere Keynes made significant contributions. [47]

---

46 Seymour Harris, editor, The New Economics, Keynes Influence on Theory and Public Policy, New York, Alfred A. Knopf, 1947, p. 197.
47 Ibid., pp. 19, 20.

Professor Harris says that almost all will agree that Keynes' propensity to consume was an outstanding contribution, and that this theory has already played a large part in twentieth century economics. Professor Metzler shows that Keynes' theory of cycles rests largely on his theory of the propensity to consume because failure to spend increments of income on consumption ultimately brings the decline in business activity, and the failure of consumption to decline as much as output accounts for the rise in business activity. [48]

Of but slightly less importance was Keynes' contribution by his analysis of "expectations." Professor Harris feels that weaknesses may be noted in Keynes' theory of expectations in the present development of its analysis. In 1936, however, when Keynes originally provided the integration of expectations with his theory of money and marginal efficiency, a notable advance had been made. [49]

A third contribution which Harris deems to be Keynes' most significant gift to economics was his emphasis on under-employment equilibrium. Keynes showed the necessity of studying economies operating at less than full employment levels. He pointed out the difficulties, short of government intervention, of removing the obstacles to full employment. [50]

Professors Harris and Dillard both lavish their praise on Keynes for the extent of his influence, and each in his own words is impressed by the rapidity with which Keynes' new thought took hold. Professor Harris says that "It is doubtful whether any other economist ever had

---

48 Ibid., pp. 26, 27.
49 Ibid., p. 28.
50 Ibid., pp. 29.

so large an influence, particularly in so short a time." [51] According to Professor Dillard:

> "The General Theory of Employment, Interest and Money has had more influence upon the thinking of professional economists and public policy makers than any other book in the whole history of economic thought in a comparable number of years... Many economists who were at first highly critical of Keynes have deserted their old position for the Keynesian camp. In book after book, leading economists acknowledge a heavy debt to the stimulating thought of Lord Keynes." [52]

Professor Clark believes that "for conventional economics the effect of the Keynesian proposition is startling." [53] He points out that where once we had learned that productivity was the great economic good, now we are told that it can breed trouble in the form of unemployment. And this, Professor Clark believes, is socially more serious than the temporary deprivation of some of the latest advances. Where once we believed that producing more capital goods meant producing less consumption goods, now we are told that producing more capital goods leads to more consumption goods. Before Keynes, we felt that thrift was the high road to prosperity. Now, we are told a country must spend, if necessary go into debt, to recover from a depression.

Professor Clark feels that the Keynesian formula has introduced new ideas and changed the emphasis on old ones, two important examples of these being deficit spending and policy toward private income. [54]

It is perhaps too soon after the depression of the 1930's to get the full measure of Keynes' influence over policies as determined in

---

51 Ibid., p. 12.
52 Dillard, op. cit., p. 1.
53 Clark, op. cit., p. 106.
54 Ibid., pp. 105-108.

high places. History yet to be written will record the extent to which Keynes influenced, or possibly even dominated, the decisions that were made, not only in England but in the United States, to stem the high tides of unemployment and their concomitant economic distress.

Deficit spending, the shelves of public works projects, and benefits at the grass roots were of Keynes' patent. Working models of these patents were generated directly by Keynes whenever and wherever he was in direct contact with men in authority, and less directly by those who believed as he did that there needed to be a new "revolution" in economic thinking. Our own New Deal was to a substantial extent in harmony with the Keynesian philosophy; it was Keynesian theory transplanted to American action.

Many people feel that Keynes contributed greatly to the economic policies of the New Deal. In fact, it has often been said that Keynes, during a visit with President Roosevelt, inspired the spending policies of the early New Deal. Professor Harris points out that in the acceptance of deficit financing and loan expenditures, the government was putting the theories of Keynes into practice. Many of the policies followed by the government made the American economy look like a testing laboratory of Keynesian ideas. Examples of these were the setting up of the National Recovery Administration, the Agricultural Adjustment Administration, the various relief programs followed, and the Social Security Act. These programs seemed to be attempts to transfer purchasing power from non-spender to spender. The tax legislation of 1935 also seemed to be designed to raise the average propensity to consume.

Through the Thomas amendments and the revaluation of gold, the government was preparing the way for monetary expansion and declining rates of interest.

But, Professor Harris asserts that Keynes did not fully approve of early New Dealism. He was not pleased with many of the measures they employed. Professor Harris thinks that it is difficult to find clear proof of Keynes' direct influence on American fiscal policy. [55] He says:

> "A survey of economic policies, particularly in the early years of the New Deal, reveals so much confusion, so many inconsistencies, and so many serious errors, that Keynes would undoubtedly not want to take too much credit for what was done. That the President or his early advisers (e.g. Moley, Berle, Baruch, Morgenthau, Tugwell), had been indoctrinated with Keynesian economics (the 1930 variety of course) is most doubtful...Yet the general pattern, especially as New Dealism evolved, checked well with Keynes' strategy and tactics...And though the President never quite understood Keynes, many of his later advisers...became supporters of the new economics. Keynes' theories and programs undoubtedly had a substantial effect, even if it is difficult to trace. By 1933, the supporters of the new policies and even the man in the street though unaware of the sources, were using arguments that Keynes had made commonplace." [56]

Keynes' influence in economic policy was widespread. He contributed to the solution of the problems of reparations, exchange rates, international equilibrium, central banking policy, inflation, deflation, and employment. "By removing underbrush, building foundations, and illuminating the signposts, Keynes prepared the road to full employment and stability." [57]

Professor Dillard points out more specific examples of the growing acceptance of Keynes' philosophy of government intervention, public

---

55 Harris, op. cit., pp.15-18.
56 Ibid., p. 18.
57 Ibid., p. 13.

investment, and other forms of economic policy. In addition to the New Deal policies, he mentions the special economic message of President Truman to Congress at the close of the second world war; the English, Canadian, and Australian "White Papers" on unemployment policy; the Murray Full Employment Bill of 1945 and the Employment Act of 1946; the newer thinking in the field of fiscal policy; the International Monetary Fund; and the International Bank for Reconstruction and Development.[58]

A Keynesian School formed itself after the entrance of the General Theory. This school is generally made up of those economists who are usually referred to as "pro-Keynesian," economists who have carried on the theories of Keynes and further developed them. Many of Keynes' original theories have been changed, qualified, and expanded to such a degree that Keynes himself might not have been in full agreement with them.

The Keynesian School and the Keynesian doctrines did have their beginnings in the General Theory, however. They have been molded and qualified, in the writings of Robertson, Hicks, Lange, Smithies, Lerner, Hansen and many others.

John Maynard Keynes, more than likely, will go down in history as being one of the great economists of all times. Certainly he has been the outstanding figure in the world of economic thought in the first half of the twentieth century. Even those who staunchly disagree with Keynes have not been able to ignore him. Keynes believed that economic

---

58 Dillard, op. cit., p. 2.

theory of his day was inadequate, and, consequently, set out to formulate more adequate theories. This he did alone. Keynes was an individualist; he sailed into uncharted waters. He refused to allow economists to retreat to ivory towers, to ignore the problems of the time. Truly, he awakened the world of economic thought.

No one, not even his most ardent followers, believe that all of Keynes' theories were perfect. Faults and errors have been found in his economics, but that is to be expected. Only history can make the final judgment of Keynes and his economics, but let us examine some of the criticism of his work and attempt to evaluate its present standing in modern economics.

V

The early reviews of the General Theory were critical ones; particularly that of Professor A. C. Pigou, who was the target of many of Keynes' criticisms. According to Professor Pigou, "Einstein actually did for Physics what Mr. Keynes believes himself to have done for Economics." [59]

In his review of the General Theory, Professor Pigou touched upon almost every topic which later attracted the attention of critics. He believed that Keynes was inconsistent in his treatment of liquidity preference. He attacked Keynes' attempt to associate the interest rate mainly with the demand for money to satisfy liquidity preference. On this point Professor Harris believes that Pigou touched one of Keynes'

---

59 Harris, op. cit., p. 29.

vulnerable spots. Pigou was prepared to accept Keynes' theory of the multiplier, but felt that Keynes failed to account for the limitations imposed by the requirements of additional money and rising rates of interest. Pigou was not so pessimistic as Keynes on the savings-investment issue and on the wages issue he did not interpret Keynes' position as a complete break with the classicists.[60]

Professor Clark points out that in his Theory of Employment (1933), Pigou believed that labor could always increase employment by reducing its wage demands. Keynes felt that Pigou had given an accurate presentation of the classical theory, but he also felt that this theory was faulty. Keynes believed that reducing wages in depression would not maintain employment under ordinary conditions. He favored stabilizing money wage rates in depression. Professor Clark adds that in a later book Employment and Equilibrium (1941), Pigou "comes closer to Keynes' method of treatment."[61]

Professor Dillard points out that in Lapses from Full Employment (1945), Pigou says that he favors attacking unemployment by manipulating demand rather than by manipulating wages. Professor Dillard believes that this is certainly a departure from the classical position and a major triumph for Keynes.[62]

Pigou has modified his position since the General Theory and yielded much to the Keynesian position, but he continues to write in defense of

---

60 Ibid., p. 30.
61 Paul Homan and Fritz Machlup, editors, Financing American Prosperity: a Symposium of Economists, New York, Twentieth Century Fund, 1945, pp. 99, 100.
62 Dillard, op. cit., p. 24.

classicism. He admits that there are many subtleties of the classical theory which the classicists did not envisage, but for practical purposes he believes their conclusions were correct.[63]

Professor Knight in his early review of the General Theory found little with which he could agree. Professor Schumpeter also on the whole was critical, but he is certainly more favorable to Keynes now than he was in 1936. Professor Harris believes it fair to say that the 1936 reviewers, both favorable and unfavorable, are now more impressed by the book than they were in 1936.[64]

Professor J. R. Hicks' early critique of the General Theory was a sympathetic one. Professor Hicks points out that on the whole the technique of the General Theory was more conservative than that of the Treatise. It was Marshall's technique, but it was applied to problems never tackled by Marshall. Marshall and his contemporaries had, according to Professor Hicks, taken over the conclusions of the Ricardians but had never tested these conclusions by means of their own technique. Keynes did this testing and found the Ricardian conclusions badly wanting. Professor Hicks agreed with Keynes that the time had come when it was necessary to change some of the elements in the outlook inherited from the classics.[65]

According to Professor Hicks the most striking doctrine in the General Theory is that which proclaims the necessary equality of savings and investment. This he says looks like a recantation on the part of

---

63 Harris, op. cit., p. 31.
64 Ibid., pp. 32, 33.
65 J. R. Hicks, "Mr. Keynes' Theory of Unemployment," The Economic Journal, XLVI, June, 1936, 253.

the Keynes of the Treatise, but careful inspection shows that is not. Professor Hicks believes that it is merely a change in definition, but one that marks an important change in point of view. He points out that in the Treatise, money theories were explained in terms of deviations from the norm and the deviation between saving and investment was one of them. But in the General Theory there is no norm so it is useless to discuss deviations from it. The new definitions of savings and investment are a reflection of this new point of view and they are defined with reference to the changing economy itself. According to Professor Hicks:

> "They are equal because--and this takes us near the heart of Mr. Keynes' method--even in a changing economy, supplies and demands are equal. They are equal so long as we define supply as that amount of a commodity which sellers are willing to offer at a particular date in the market conditions of that date; unsold stocks being unsold because sellers prefer selling them later to selling them at a lower price now. These stocks being reckoned as part of future supply, not current supply, it follows that current supply and current demand must be equal--just because every transaction has two sides." 66

Professors Robinson, Hansen, Samuelson and many others, however, have been critical of Keynes' terminology which made savings equal to investment. Professor Hansen, who has since become an ardent Keynesian, was very critical in an early review of the General Theory. According to Professor Hansen, Keynes' terminology was confusing and many difficulties and obscurities arise from his failure to give exact definitions and to employ them consistently. He refers to Keynes' definition that savings and investment are always equal. They are obviously equal in terms of the real phenomena, but in terms of the

---

66 Ibid.,241.

receipt and disposition of money funds, Professor Hansen says that the terminology makes it difficult to handle satisfactorily the important concepts of hoarding and dishoarding, credit creation and debt cancellation. [67]

Keynes himself made an interesting remark in the first restatement of his position after the publication of the General Theory. Regarding the criticism of his language, he said:

> "I am more attached to the comparatively simple fundamental ideas which underlie my theory than to the particular forms in which I have embodied them...If the simple basic ideas can become familiar and acceptable, time and experience and the collaboration of a number of minds will discover the best way of expressing them." [68]

Professor Viner's early review, though critical, was in many respects favorable. He said:

> "The indebtedness of economists to Mr. Keynes has been greatly increased by this latest addition to the series of brilliant, original, and provocative books, whose contribution to our enlightenment will prove, I am sure, to have been greater in the long than in the short run." [69]

Discussion of Keynes did not stop after the early reviews of his General Theory. Criticisms are still being written, and in the twelve years that have followed the publication of the General Theory many issues have arisen involving Keynes and the impressions he has given. Economic journals and other magazines have been full of articles concerning these debatable questions.

---

67 A. H. Hansen, "Mr. Keynes on Underemployment Equilibrium," The Journal of Political Economy, XLIV., October, 1936, 675, 676.
68 J. M. Keynes, "The General Theory of Employment," The Quarterly Journal of Economics, LI, February, 1937, 211, 212.
69 Harris, op. cit., p. 34.

One issue which has caused some discussion involves whether on not it is fair to describe Keynes as a "depression" economist. Professor Schumpeter believes that one would be correct in calling Keynes' economics the economics of depression. According to Professor Harris, this description is not an adequate one. He believes that a more appropriate description would be to characterize Keynes as an anti-cyclical economist or as an anti-deflation and anti-inflation economist. [70]

Professor Harris points out that in 1939 Keynes proposed heroic measures to preclude wartime inflation. In his pamphlet <u>How To Pay For the War</u> (1940), he gave birth to the concept of the inflationary gap and proposed measures to deal with it. The accusation that Keynesians glibly propose a full employment economy without taking into account its inflationary potentials is untrue, at least insofar as Keynes himself is concerned, for, according to Professor Harris, Keynes was far from blind to the inflationary dangers of full employment. [71]

Another issue that has been widely discussed concerns whether or not Keynes was a socialist. Many Americans hold the belief that Keynes was a socialist and that the reform measures of Keynesian economics are leading to socialism. Professor Dillard asserts that Keynes definitely was not a socialist and that this viewpoint is wholly unjustified. He feels that Keynes follows in the tradition of the great British economists since Adam Smith, all of whom were liberals with the possible exception of Malthus. Keynes differs from his liberal predecessors in

---

70 <u>Ibid</u>., p. 22.
71 <u>Ibid</u>., pp. 23, 24.

the extent of intervention which has program entails. Keynes repudiated <u>laissez faire</u>, but cherished the spirit of individualism. [72]

Of government participation in economic life, Keynes said:

> "I defend it...both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative." [73]

"In spite of the high degree of government intervention involved in Keynes' program," Professor Dillard believes that Keynes "remained fundamentally an individualist in his economic and social philosophy." [74]

Keynes disliked the notion of the class struggle from either the conservative or the labor point of view. He disliked the class consciousness of labor, but equally disliked capitalists who believed "that the coming political struggle is best described as Capitalism <u>versus</u> Socialism, and, thinking in these terms, mean to die in the last ditch for Capitalism." [75] If there were going to be a class struggle, however, Keynes said that it would find him on the side of the educated bourgeoisie. In politics he was always a self-styled liberal and a member of the British Liberal Party. [76]

According to Dillard, Keynes usually ignored the socialist argument that social ownership of the means of production was essential, but there are indications that he was strongly opposed to collectivism. Some of these were his lack of regard for the work of Marx, his opposi-

---

72 Dillard, <u>op. cit.</u>, p. 318.
73 Keynes, <u>General Theory</u>, p. 380.
74 Dillard, <u>op. cit.</u>, p. 324.
75 <u>Ibid.</u>, p. 319.
76 <u>Ibid.</u>, pp. 318, 319.

tion to socialization of the instruments of production, and his attitude toward Soviet Russia. [77]

The Keynesian approach sees the state as a balancing force which would only supplement the behavior of individual capitalists. Socialism, on the other hand, sees the state as the sole owner which would entirely replace the individual capitalist. Keynes believed that his program could be executed within the existing social order. His goal was an alternative to socialism in the sense of government ownership of the means of production. Keynes criticized the financial and speculative aspects of capitalism. He wanted to eliminate these faults, not the private ownership of the means of production.

According to Professor Harris:

> "...Keynes was essentially a defender of capitalism. Only the stupidity of those whom he supports can account for any other interpretation. Keynes indeed offers government a larger degree of control over the economic process and a larger degree of operation than the old-fashioned economist; but his motive is to save capitalism, not destroy it." [78]

A third issue that has been widely debated regards the stagnation thesis and Keynes' relation to it. According to Professor Howard Ellis, Keynes launched the stagnation thesis under the caption of "equilibrium with less than full employment." This theme was elaborated on in the United States by Professor Hansen. Professor Ellis says this thesis:

> "has persuaded most of its numerous followers of the eventual demise of private enterprise, though its chief authors do not go farther than to suggest that a large part of investment will for the forseeable future have to be carried on by the state." [79]

---

77 *Ibid.*, p. 322.
78 Harris, *op. cit.*, p. 5.
79 Homan and Machlup, *op. cit.*, pp. 129, 130.

He points out that both Keynes and Hansen felt that a supposed excess of saving in relation to the profitable use of capital was the immediate cause of unemployment. They spoke of the technological, psychological, and institutional obstacles to investment. Keynes used the first two arguments, and Hansen has elaborated on the institutional obstacles such as monopoly influence and the disappearance of the frontier.

In examining these three obstacles to investment, Professor Ellis says that although we cannot foretell the future, the present scene in the field of technology is bright with promise, but new inventions may cause technological unemployment and may create business risks. Taking all sides into consideration, he says that the case of technological progress is speculative and it would be difficult to assert whether it would aid or impede the flow of investments under private enterprise.

Professor Ellis believes that the psychological obstacles to investment are serious, but they can be attacked through eliminating some of the institutional obstacles. In regard to the institutional obstacles, Professor Ellis feels that the stagnation school is moving on ground that is unfamiliar to other and less "modern" economists.[80]

In the papers read at the convention of the American Economic Association in 1947, two interpretations of Keynes' influence on the stagnation thesis were given by Professors Williams and Tarshis. Professor Williams said:

---

80 Ibid., pp. 129-131.

"It was not a coincidence, or a misinterpretation of Keynes, that the first great development of the theory by his disciples was the stagnation thesis." [81]

Professor Williams feels that there is no better statement of the stagnation thesis than that given by Keynes, when he said:

"The richer the community, the wider will tend to be the gap between its actual and its potential production; and therefore the more obvious and outrageous the defects of the economic system...Not only is the marginal propensity to consume weaker in a wealthy community, but, owing to its accumulation of capital being already larger, the opportunities for further investment are less attractive." [82]

Professor Williams says that it is suggested that we should distinguish between Keynes' "personal opinions" and his "theory," but he believes that the stagnation thesis is essential to the theory. He adds that "as we move away from the circumstances that the thesis envisaged, the power of the theory in economic policy decreases." [83]

Professor Tarshis, on the other hand, says:

"It is commonly believed that Keynesian economics should be identified with the 'mature economy thesis'...This is nonsense. Not all who accept these insidious, as they are now regarded, views are Keynesians. And likewise it is not necessary for all those who are optimistic about our long term prospects, who wish to encourage private investment, and who abhor government intervention, to oppose the central themes of Keynes' doctrine, though obviously many of them will do so." [84]

Professor Clark believes that "the most serious conclusion" that can be drawn from Keynes' central formula is that an economic system cannot maintain any given level of employment unless it will invest

---

81 John H. Williams, "An Appraisal of Keynesian Economics," The American Economic Review, XXXVIII, May, 1948, 275.
82 Ibid., 275, 276.
83 Ibid., 276.
84 Tarshis, op. cit., 272.

as much as its members will choose to save. A very rich country which has a large supply of capital and is not in the process of rapid growth (as the United States was during the nineteenth century) would, according to the theory, have difficulty keeping investment at the same pace as saving. A rich country with great productive power may have a harder time making use of its power than a poorer and less productive country. Consequently, Professor Clark believes the Keynesian formula furnished a basis for the "mature economy" theory.[85] However, he says:

> "This does not prove that the United States is in a condition in which it is condemned chronically to fall short of its productive powers and to suffer unemployment; but it raises the question...One conclusion that seems hard to question, and is widely accepted by thoughtful business men as well as economists, is that as a country gets richer, this brings inherent tendencies to greater instability."[86]

The problem of secular stagnation is evident in Professor Hansen's review of the General Theory in 1936. He points out that outlets for investment in durable goods have been affected by the approaching stabilization of population and by the end of the frontier, adding, however, that rural electrification and housing projects may turn out to be important investment outlets. He says:

> "In view of the prevailing (and probably increasing) cost rigidities, and in view of the possibility of a slowing down in capital-consuming technological innovations, the problem of structural, or secular unemployment (altogether apart from the cyclical unemployment of ordinary industrial fluctuations) is almost certain to present itself for solution in the decades before us."[87]

Hansen believed that remedying this situation was all-important, whether or not Keynes' theoretical analysis of underemployment equilibrium was correct.

---

85 Clark, op. cit., pp. 100, 101.
86 Ibid., p. 101.
87 Hansen, "Keynes on Unemployment Equilibrium," 681.

Drs. Swanson and Schmidt recently edited a book entitled Economic Stagnation or Progress which purports to introduce the public to the thinking of the critics of the Keynes-Hansen school. They point out that the first wide reading of the General Theory coincided with the 1936 to 1939 crisis. It was then, they assert, that, "spurred on by those first generalizations of Lord Keynes' effort," the new dogma was born. "A philosophy of the mature economy and deficit spending, based on the Keynesian theory of oversaving was evolved and given status by a theory designed in the light of rationalization." [88]

Acceptance of the "new philosophy," they say, was overwhelming, coming from economists, popular writers, legislators, and many of the laymen who had sponsored similar doctrines under more euphonistic names. But the fact that most economists never endorsed it went unnoticed. Dissent from the doctrine was slow, but, according to Drs. Swanson and Schmidt, a large number of economists have now gathered in refutation of it. [89]

They say that the traditional economic liberal believes that "even in the absence of new technological improvements, there are virtually unlimited investment opportunities that would become profitable should the rate of interest decline." The mature economy theorist disagrees with this. They (Swanson and Schmidt) say the reason for this divergence lies in a curious loophole in the thinking of the stagnationists:

> "To them virtually all economic forces as conditioned by technical, institutional, and psychological factors, operate

---

88 Swanson and Schmidt, op. cit., p. 2.
89 Ibid., pp. 2, 3.

> concurrently and immediately, without any tendency to induce lags in the relations between saving, spending and earning. Thus, the moment incomes go into hoards (an aspect of liquidity preference in operation) the decline in investment follows." [90]

Drs. Swanson and Schmidt assert that this simultaneity of forces is unreal. Decisions to invest are really conditioned by forces operating over time and are not generally dependent upon immediate decisions to consume or not to consume. This assumption of simultaneity leads the stagnationists to believe that there is a dearth of investment. They are forced to take such a short-run viewpoint--almost momentary, in fact--that they cannot comprehend all the forces leading to investment decision or changes in the demand for capital. They either do this or they take such a long-run viewpoint that they have a strictly timeless investment function.

According to Drs. Swanson and Schmidt, investment falls to a minimum in a society where uncertainties of return on investment are great, but, on the other hand, in a free-market society, where price-cost relationships are definitely determinable because of price flexibility, investment opportunities are tremendous. [91]

Drs. Swanson and Schmidt point out that there is a fundamental disagreement between the economic liberals and the secular stagnationists. They say that the economic liberals look to the price system and the free market, when properly implemented, to coordinate and organize the many firms employing resources, machines and labor. Changes in the quantity and quality of things produced are effected, as the need arises,

---

90 Ibid., p. 25.
91 Ibid., pp. 25, 26.

through market increases or decreases in prices (costs). The Keynesians, they say, turn to a centralized authority, which would largely dispense with the price system and would organize production chiefly through central planning and supervision. They argue that the Keynesians would make adjustments by authoritarian changes of resources, machines and labor, assisted by a monetary-fiscal policy designed to replace the free-market. [92]

From an appraisal of the school of secular stagnation, Drs. Swanson and Schmidt reach six conclusions, that:

(1) "The quest for security embodied in the Keynes-Hansen philosophy may, more than any other cause, bring lasting unemployment." [93]

(2) "The seeking of security has been made the football of political expediency. Fundamental principles are avoided and it appears that every effort is bent to prevent the creation of a workable private enterprise economy." [94]

(3) "A program for full employment through centralized authority cannot be justified by an appeal to the concept of relatively declining consumption expenditures." [95]

(4) "Investment by private enterprise does not depend alone on the amount of consumption and therefore upon 'the under-writing of consumption' through continuous deficit spending." [96]

(5) "Economic progress still requires saving and that undercon-sumption as a primary cause of depression is an illusion." [97]

(6) "Economic progress still depends upon the advance of specialization and upon 'a climate favorable to risk-taking' in the making of new investments." [98]

In a recent article Professor Lyle C. Fitch says that current books exemplify the divergence of contemporary thought concerning the basic

---

92 *Ibid.*, p. 158.
93 *Ibid.*, p. 159.
94 *Ibid.*, p. 160.
95 *Ibid.*, p. 162.
96 *Ibid.*, p. 170.
97 *Ibid.*, p. 167.
98 *Ibid.*, p. 172.

causes of mass unemployment and the means of preventing it. He points out that Professor H. Gordon Hayes' Spending, Saving and Employment and Economic Stagnation or Progress by Drs. Swanson and Schmidt make a good study in contrasts because of their attitude toward Keynes. The former is in the Keynesian mode whereas, the latter is essentially an anti-Keynesian polemic. Professor Fitch believes that studying books of this sort together can prove more fruitful than analyses of the individual books. 99

The mature economy thesis received a strong attack in 1945 with the publication of The Bogie of Economic Maturity by the Machinery and Allied Products Institute, under the direction of George Terborgh, research director of the Institute. This book is a thorough critique of the belief that economic maturity is primarily responsible for capitalist depression and stagnation. Terborgh attempts to show that the mature economy doctrine will not stand the test of historical and statistical evidence. Terborgh seems to feel that the capitalist mechanism is not perfect and that the American economy is growing older, but that the latter is not the basic cause of the former.

Professor Hansen answers Terborgh's attack in an appendix of his book Economic Policy and Full Employment. He says:

> "The notion seems to run through Terborgh's book...that the 'mature economy' thesis holds that economic stagnation is unavoidable. In fact, the bulk of my writing has been devoted to an analysis of economic policies that would give us an expanding economy and full employment. The question really is: would a policy of mid-nineteenth century laissez faire give us that

---

99 Lyle C. Fitch, "Comments on Keynesian Economics," Political Science Quarterly, LXII, September, 1947, 418.

> degree of expansion and full employment which we experienced in that century?...Are the Automatic forces making for investment outlets as strong in our world today as in the century preceding World War I?" 100

Professor Hansen points out that it has always been recognized that the development of new territory and new resources, population growth, and inventions are the leading factors underlying new investment opportunities. These factors, he says, were existent in the nineteenth century, giving rise to optimistic expectations regarding investment. Professor Hansen terms undeveloped resources and population growth _extensive_ expansionist factors and inventions an _intensive_ expansionist factor. He says that it is generally agreed that the extensive factors play a relatively smaller role today, but the critics argue that we should not worry because the intensive factors are still present, and they can do the job. Regarding this, Professor Hansen says it may be true, but the probabilities are the other way. 101

Professor Hansen refers to Terborgh's admission that a decline in population growth does reduce investment outlets, but he says that Terborgh's argument that "a more slowly growing population, with a larger proportion of people over sixty-five, tends to save less" does not solve the problem, for Terborgh has forgotten that in addition to a high proportion of old people (spenders) there is a low proportion of children (upon which parents are compelled to spend). Thus, Professor Hansen says the savings function is not likely to be different

---

100 Alvin H. Hansen, _Economic Policy and Full Employment_, New York, McGraw-Hill, 1947, p. 298.
101 _Ibid._, p. 299.

in a stationary population than in a growing one. In the transition to a stationary population, which we are now experiencing, the proportion of children is rapidly declining, while we have not yet reached the point where the proportion of aged is very large, so we have been passing through a phase where the age distribution tends to raise the savings functiong. This has intensified the savings-investment problem.[102]

Professor Hansen then adds that:

> "Terborgh finally not only admits that the decline in population growth does tend to reduce investment opportunities but also that institutional reforms including social security and progressive taxation may in part offset this unfavorable factor by raising the propensity to consume."[103]

Professor Hansen says that this agrees with his own analysis and he welcomes Terborgh's support of a compensatory fiscal program but regrets that he was not equally in favor of an expansionist development program. He says it is of interest to note that Terborgh agrees with the two programs of his plan which are modern programs, the compensatory fiscal policy and social security and progressive taxation, while he opposes the developmental program which had its beginnings with Alexander Hamilton, Gallatin and his system of public roads and canals, and the government support to the building of railroads.[104]

One of the more recent criticisms of Keynes comes from Mr. Jacques Rueff, a Frenchman, who has been connected with the banking world in that country. Mr. Rueff's criticism refers to what he considers faulty

---

102 Ibid., p. 304.
103 Ibid., p. 305.
104 Ibid.

analysis in the General Theory, itself, as well as to implications which this analysis may have.

According to Mr. Rueff:

> "The Keynesian philosophy is unquestionably the basis of a world policy today; and if the spectre of 'under-employment' appears in the world tomorrow, as is probably, it will be the universal recourse of peoples and governments. If it is true, it will be the salvation of the world; if it is false, it may lead to catastrophe by turning the world to ineffective remedies which may make the evil much worse." [105]

Mr. Rueff believes that there is a serious error in the Keynesian analysis. He says that if workers offer an increment of labor on the market, and if they do not intend to divert to consumption expenditure or investment the whole of the increment of income which an increment of labor makes possible, it is because they intend to increase their cash holdings by an amount equal to the increment of income which they do not spend. In proportion as they offer labor without demanding consumers' goods or investment goods, they are demanders of money. If this conclusion is admitted, Mr. Rueff believes that it upsets the whole Keynesian construction. [106] He says:

> "...I maintain that the demand for additional cash holdings is equivalent in its economic effects to demand for consumption or investment goods and, consequently, that it is able to provide a market for the labor forces offered on the same conditions as the demand for such goods." [107]

In an attempt to prove this, Mr. Rueff makes a detailed study of the effect of the demand for money. He says that it may seem out of

---

105 Jacques Rueff, "The Fallacies of Lord Keynes' General Theory," The Quarterly Journal of Economics, LXI, May, 1947, 344.
106 Ibid., 346, 347.
107 Ibid., 347.

proportion, for the increase of individual cash holdings could never amount to more than a limited sum, but he believes that it is directly related to the center of the Keynesian argument.[108]

In his analysis he first discusses a regime in which he assumes the money to be entirely metallic and then he considers the general case. If a worker through an increase in employment enjoys an increase in his cash holdings, other conditions remaining unchanged, his increase in cash holdings will cause a consequent decrease in the cash holdings of other members of society below the level of the holdings they desire to maintain. In order to restore their cash holdings to the level desired, the latter have to offer without demanding and this will bring about a fall in the whole system of prices. But the price of gold remains stable. This will cause a transfer of productive resources from the products whose prices fell to the production of gold. The bank of issue buys all the gold offered and not demanded and consequently supplies, by monetizing the increased production of metal, the additional cash holdings desired. Thus, the labor forces are diverted from the production of consumer or investment goods to the production of metal destined for monetization.

Thus, Mr. Rueff feels that it is impossible to accept Keynes' conclusion that, in the case assumed, insufficient demand for consumer or investment goods constitutes an obstacle to the increase of employment. If labor is offering an increment of employment, and if they only wish to increase their cash holdings by increasing their income, then the

---

108 <u>Ibid</u>.

labor forces will find themselves directed toward producing the additional cash holdings desired. Mr. Rueff feels that by omitting this, Keynes' theory cannot be a general theory and still less a true theory.

Mr. Rueff admits that this reasoning holds only in societies where there are workable mines of gold, but says that the absence of accessible deposits only modifies the form of the regulatory apparatus. The fall of prices, if not checked by absorbing the under-employed into industries producing gold, tends to divert them to the production of goods which could be marketed abroad.[109]

Next Mr. Rueff discusses the general case of a society using inconvertible money or money which can be obtained both by the monetization of metal and the discount of commercial paper. This analysis is similar to the preceding one. Some individuals increase their cash holdings and others have less than they desire. The latter must offer without demanding. This increment of offers may react either upon wealth in the strict sense leading to a fall in prices or upon credit instruments leading to an increase in money rates. Like the metallic regime, the non-utilization of certain incomes does not give rise to a lack of markets. Wealth of the same value as that not demanded is spontaneously diverted from the market to the bank of issue. And there it is used for the manufacture of the increments of cash holdings demanded by the owners of the additional incomes which were not consumed and not invested. Thus, Mr. Rueff believes that as long as the

---

109 Ibid., 348-350.

increase in cash holding continues, the increments of production will find a market. [110]

Mr. Rueff concludes that in all cases the demand for liquidity implies a demand for wealth of equal value. This wealth can be metal or credits, themselves representatives of goods stored or sold on credit. The demand for liquidity, like every demand, merely sets forces in motion which tend to stimulate in the productive apparatus the adaptation capable of satisfying it. Therefore, he feels that Keynes is wrong in saying that to demand money is to demand nothing, for liquidity preference offers, like any other demand, an outlet for the labor forces offered on the market. [111]

Mr. Rueff believes that the Keynesian theory rests on an erroneous idea because of Keynes' thought in the monetary sphere. He admits that if at the moment when the increase of employment takes place, it is not directed into a channel which permits it to furnish the increments of income, the situation may be that explained by the Keynesians. But he says that Keynes considers this a position of under-employment equilibrium; whereas, he regards it as a temporary state which would be modified by the forces arising from the mechanism of regulation. If these forces were rendered ineffective, then Keynes' theory would be an explanation of reality, but this would mean that the theory which Keynes calls "general" would be valid only for special cases of economies which are insensitive to the movements of prices and interest rates. [112]

---

110 *Ibid.*, 351-353.
111 *Ibid.*, 354.
112 *Ibid.*, 359.

On the whole, Mr. Rueff believes that general application of Keynes' policy will give rise to economic disorders, will re-establish a regime of general planning analogous to war time and will be based on the suppression of all individual liberty. The results of an application of Keynesian remedies, being based on a false theory, will, according to Mr. Rueff, be very different from those which they were designed to produce.[113]

Professor Benjamin Anderson also regards Keynes as a "dangerously unsound thinker," and feels that Keynes' influence in the Administration and upon most economists in the employ of the government has been incredibly great. Professor Anderson particularly believes that Keynes' attack on the doctrine that supply creates its own demand should be analyzed. He asserts that Keynes ignores the essential point in the doctrine he attacks, saying that nowhere in the General Theory does Keynes take account of the law of equilibrium among industries, which has always been recognized as an essential part of the doctrine that supply creates its own demand. Furthermore, he feels that Keynes ignored the rich work done by such writers as J. B. Clark and the Austrian School, who elaborated the laws of proportionality and equilibrium.

Professor Anderson criticizes Keynes' preference to look at things in block, saying that he does not consider the intricacies of the interrelations of markets, prices and different kinds of production. He points out that throughout his analysis, Keynes works with aggregates--

---

113 Ibid., 367.

the aggregate supply function, the aggregate demand function, et cetera. But nowhere, according to Professor Anderson, does he discuss the interrelationships of the elements in these aggregates. There is no recognition that elements in the aggregate supply function give rise to demand for other elements in the aggregate supply. [114]

Keynes' most vigorous assault upon classical views was in respect to the interest rate as the equilibrating factor. According to Professor Anderson, Keynes presents "an extraordinarily superficial argument" when he rejects the prevailing ideas with respect to interest and savings. He says that Keynes assumes an <u>uncaused</u> rise in the rate of interest and has little difficulty disposing of this. Professor Anderson asserts that economic phenomena do not occur without <u>causes</u>. [115]

Professor John Williams believes that the paradox of the <u>General Theory</u> and one of its chief weaknesses is that while its central thesis is long run, its formal analysis is short run. And in this sense it is a special rather than a general theory. Professor Williams also feels that the <u>General Theory</u> is more static than the classical theory it was intended to supplant. In addition to this, Professor Williams points out that various writers (Schumpeter, Hicks, Lange, Leontief, Tobin, Modigliani) have shown that some of the more novel features of Keynes' interest and wage theory rest on special assumptions and are less damaging to classical theory than he supposed. [116]

Keynes' great contribution, according to Professor Williams, was in focusing attention upon income and in challenging on monetary grounds

---

114 Homan and Machlup, <u>op</u>. <u>cit</u>., pp. 63-65.
115 <u>Ibid</u>., pp. 66, 67.
116 Williams, <u>op</u>. <u>cit</u>., 279.

the assumption of a full employment level of income automatically sustained. Professor Williams feels that the most important question to ask regarding Keynes is not how much his theory differs in formal logic from classical theory, but how much it differs from business cycle theory. We should ask ourselves, he says, whether Keynes has done economics a service or a disservice in attempting to push the analysis of economic fluctuations back into an abstract framework of equilibrium theory. [117]

According to Professor Harris, no thoughtful reader of Keynes could deny his great concern over rising prices with expanding output, but many readers will interpret his economics as too exclusively concerned with general measures for maintaining demand, and not adequately interested in structural maladjustments, price rigidities, and monopolies. He feels, however, that a careful reader will discover many instances where Keynes discusses wage and price rigidities, problems of rationalization, et cetera. Professor Harris admits that Keynes and perhaps his followers have been too disposed to neglect problems of allocation of economic resources, increased productivity and the like, but he says that these problems had received attention elsewhere and theirs was the task to disinter the general measures which largely had been buried with Malthus more than a century ago. [118]

## VI

One of the best recent analyses of Keynes is that by Professor David McCord Wright, who attempts to make a thorough evaluation of Keynesian economics today. Professor Wright points out that economic

---

117 Ibid., 279, 280.
118 Harris, op. cit., pp. 21, 22.

theory, like the Supreme Court of the United States, often reflects the state of public opinion which in turn is related to fluctuations of economic activity. Consequently, he says that increasing prosperity has brought about a growing reaction against Keynesian teaching, which Professor Wright feels will go considerably further before it is reversed.[119]

Professor Wright believes that the tendency, especially in the popular press, to divide economists into two classes, "Keynesian" and "anti-Keynesian" has been bad for economics and has undermined the prestige of this science. The implication that there is an unabridgable gulf between these two groups he believes to be both inaccurate and unfortunate. It is inaccurate because almost every American economist uses some elements of the Keynesian schema; it is unfortunate because it leads to loose generalization.[120]

Professor Wright also points out that since the Keynesian doctrine is usually treated by both opponents and adherents against a background of so-called "classical" thought, it has given the impression that before the _General Theory_ there was a single homogeneous body of doctrine regarding the relationship of employment, interest, and money and that the _General Theory_ represents a marked divergence from that doctrine. According to Professor Wright, both of these impressions are inaccurate and their joint effect seriously warps the perspective on the problem.[121]

---

119 David McCord Wright, "The Future of Keynesian Economics," _The American Economic Review_, XXXV, June, 1945, 284.
120 _Ibid._, 285.
121 _Ibid._, 287.

Professor Wright feels that Keynes' concept of the marginal efficiency of capital and his bull and bear analysis have roused little opposition and are generally accepted. The failure of the propensity to consume in the short run to more inversely with the rate of interest is so well established empirically as to be incontrovertible. The behavior of the longer-run propensity to consume is more problematical and at times appears to rise spontaneously so as to overtake output. The Keynesian views most often challenged, however, are, according to Professor Wright, the special theory of the fall of profits, the "purely" monetary interest theory, and the attitude toward price and wage reduction. [122]

Professor Wright believes that Keynes' psychological law that, in the short period, consumption rises as income rises, but not as much, is nearly as well established empirically as the broader statement that consumption does not vary inversely with the rate of interest. He feels, however, that this theory has been much more controversial. This doctrine, according to Professor Wright, would be accepted more readily by conservatively inclined writers if they realized that it is not an exclusive business cycle theory, or theory of the collapse of marginal efficiency of capital. Professor Wright says that it is not necessary, in order to follow the Keynesian analysis, to feel that the failure of consumption to rise as output rises is the sole cause of collapse or even the most important cause. What one does have to believe is that current investment opportunities vary, that they are not boundless, and

---

122 *Ibid.*, 291.

in a "given" situation that they can be exhausted. Failure of consumption to rise is just one of many forces which may cause trouble. [123]

Professor Wright feels that in the area of price and wage reduction, there is much less real conflict between Keynes and other economists than is usually thought. The difference is more one of opinion than of analysis. Fundamentally, Keynes is attacking the attitude which blames unemployment on the insistence by labor upon too high a real or money wage level. [124]

Professor Wright concludes that Keynesian theory is not so much a contradiction or modification of Marshallian theory, as a supplemental development. Keynes' monetary theory applies to conditions of less than full employment. Marshall's theory remains correct, as far as Keynes' theory is concerned, in a world where there is full employment and great demand for capital. [125]

Despite the large area of agreement, there are many economists to whom Keynesian economics remains distasteful. Professor Wright believes that the weaknesses of the Keynesian school can be compared to the weaknesses of the classical school in a simple formula:

> "The 'classical' writers tended to pay too little attention to obstacles to effective demand; the Keynesians tend to slur over obstacles to supply." [126]

One reason submitted by Professor Wright for some of the present disagreement lies in the fact that economists are not immune to humanity's weakness for false generalization. He points out that some pre-Keynesian

---

123 Ibid., 291, 292.
124 Ibid., 295, 296.
125 Ibid., 298.
126 Ibid., 299.

writers were guilty of making special cases universal laws. Keynes brought to light the falsity of their generalizations by working out special cases of his own. He had scarcely done this before some of his disciples tended to turn some of his special cases into false generalities. [127]

Professor Wright believes that the present attack on the essential Keynesian scheme can be explained not so much in specific weaknesses as in the uncomfortable nature of the theory itself in the light of traditional American legal and political theory. He says:

> "One can follow the main outlines of Keynes' doctrine and still believe in capitalism, but one cannot follow Keynes' doctrine and believe that capitalism will always and 'automatically' cure itself of disturbance and unemployment. There lies the rub." [128]

The Keynesian solutions, both for the cycle and for stagnation, imply effort, thought, policy and discretion. Professor Wright emphasizes that in a changing world one policy cannot always be valid. As the business situation changes, policy toward it should change. This change in policy would be directed toward preserving security in a competitive democratic capitalism. But, Professor Wright feels that it will never satisfy those individuals who yearn for the automatic self-regulating system which the nineteenth century laissez faire economists thought they had found. [129]

Professor Wright admits that there is much room for development and improvement in the future of Keynesian economics. He points out

---

127 Ibid., 303.
128 Ibid., 304.
129 Ibid., 305.

the need for continued sequence analysis, for less facile manipulation of large aggregates and more particular research, for less tautology and more investigation, for a more explicit recognition of our hidden biases, for more condideration of the obstacles to supply as well as failure of demand, and, if we wish to retain the present system, for a greater understanding of the essential institutional requirements of capitalism.

Professor Wright agrees that there should be more development along these lines but he emphasizes that if we turn away from the fundamental system and neglect its warnings regarding effective demand, it will be a major scientific disaster and one which will reduce the chances for a survival of capitalism.[130]

Professor Clark believes that there are a number of surprising similarities in the work of Keynes and Ricardo. This belief has also been expressed by Professor Schumpeter and Dr. Arthur Smithies. Both formulated brilliant deductive theories, growing out of contemporary events, conditions and issues. Both structures were left incomplete, with short-comings of organization and terminology. Both men would probably have revised their work had they lived. Both left a school of disciples, some of whom became more orthodox than the master, resulting in a one-sided emphasis in policy. Because of this last fact, Keynes turned Ricardo upside-down, but Professor Clark asserts that we cannot afford to do the same to Keynes. He suggests a synthesis of Keynesian and other elements, saying that this synthesis is urgently needed if modern policies are to have the best theoretical underpinning.[131]

---

[130] Ibid., 306, 307.
[131] Clark, op. cit., pp. 91, 92.

According to Professor Clark, in analyzing Keynesian economics, it is important to distinguish the problems he opened up from the particular solutions he suggested. He believes that Keynes' solutions might be altered or even discarded and his work would still be revolutionary in the opening up of problems and the admission that <u>some</u> solution is possible other than the one that had previously been accepted. Professor Clark says:

> "He broke a taboo of more than a century's standing and lifted the tabooed area of inquiry out of the 'intellectual underworld' to a place commanding the best efforts of the best minds in the field." [132]

He credits Keynes with establishing the hypothesis that production can be limited by a deficiency of total demand and that depression and underemployment can be due to something other than producing the wrong things at the wrong prices. He made respectable the hypothesis that chronic underemployment can exist as a result of market forces and not merely as a disorder which they are always automatically acting to eliminate. Keynes shifted the focus of theoretical economic inquiry from prices and the allocation of resources to the problem of the total flow of spending, production, and employment. In doing this Keynes succeeded where previous heretics had failed. According to Professor Clark, the combination of simplicity, flexibility, significance and scope of the <u>General Theory</u> is an authentic attribute of genius. [133]

The Keynesian body of thought offers hope of abolishing mass unemployment without revolution, by influencing the volume of spending

---

132 <u>Ibid.</u>, pp. 92, 93.
133 <u>Ibid.</u>, p. 93.

through things the state can do within the market mechanism. It does not say that the free market mechanism should be replaced, but that it should be helped so that it will work without stalling. [134]

Powerful as it is, Professor Clark points out that the Keynesian formula has limitations. Keynes was primarily interested in establishing the possibility of chronic underemployment as a natural result of economic forces so his formula is one of equilibrium that can be reached either with full employment or less than full employment. This leaves out any definite explanation of cyclical fluctuations. Keynes reduced these to incidental implications in the textual comment rather than in the formula. The formula is vague as to the amount of income which people choose to save and as to movements of wages and prices with changes in income. Professor Clark believes that the chief vagueness concerns the determinants of investment. He feels that these limitations leave much for subsequent students to do, but that they hardly detract, if at all, from the revolutionary impact of the main idea. And this, according to Professor Clark, is "the possibility of limitation of production by demand, short of productive capacity." [135]

Professor Schumpeter feels that the quality of Keynes' work suffered from the quantity. His secondary work shows the traces of haste and in some of his important work, the traces of interruptions that injured its growth. His work was not allowed to ripen and never received the last finishing touch. According to Schumpeter, "Who fails

---

134 Ibid., p. 94.
135 Ibid., p. 105.

to realize this...will never do justice to Keynes' powers." [136] Professor Schumpeter believes, however, that to some extent Keynes' success is due to the fact that "even in his boldest rushes he never left his flanks quite unguarded--as unwary critics of either his policies or his theories are apt to discover to their cost." [137]

According to Professor Gruchy, there was in Keynes' mind a much greater unity or coherence than is evident in his many scattered writings. His visons of a unified thought system unfortunately were put on paper in a fragmentary form. [138]

According to Professor Clark, the simplest formula regarding the present state of Keynesian and classical economics is that "Keynesian laws apply until we get full employment and orthodox laws after that." [139] But he feels that there is no machine-made way of deciding which kind of law holds. He suggests that each problem should be examined in the light of the possibilities suggested by both theories. Any solution will probably be found to go beyond the simple formulas of either theory. According to Professor Clark:

> "The Keynesian formula is a striking antithesis to orthodoxy where just such a striking antithesis was needed to break through the crust of outworn ideas. It remains for the next generation to fashion a synthesis, both in theory and in policy." [140]

Many economists agree with this and many of them feel as does Dr. Smithies, who has been and still is a strong follower of the Keynesian

---

136 Schumpeter, op. cit., 503.
137 Ibid., 516.
138 Gruchy, op. cit., 257.
139 Clark, op. cit., p. 108.
140 Ibid., pp. 109, 110.

doctrine, that Keynes' theory must be regarded as the beginning rather than the end. Dr. Smithies calls upon us to construct a really "general" theory, in which Keynes' theory would be a special case. [141]

That Keynes, himself, was a great man is generally recognized. In the wide scope of his interests, in his eloquence and persuasiveness, in his almost complete command over economic forum, and in the impression he made upon our quasi-capitalistic system, he has not had an equal. Professor Schumpeter believes that "whatever happens to the doctrine, the memory of the man will live," [142] and this impression is usually accepted among thoughtful economists today.

Had Keynes accomplished nothing else, he definitely has done economics a service in the thought and discussion he has stimulated. But Keynes did do more than that; there is no doubt that some of his theories are here to stay. Keynesian economics is still young and only the future can fully evaluate it. Adequate evaluation, however, calls for further study and analysis in both the problems with which Keynes dealt and those which he neglected to analyze. Consequently, it would seem advisable for the future course of economic thought if the words of such men as Professors Clark and Wright and Dr. Smithies were kept in mind; it would seem advisable for present-day economists to regard Keynesian economics as the beginning and not the end and for them to seek a synthesis of Keynesian and other theory.

---

141 Harris, op. cit., p. 569.
142 Schumpeter, op. cit., 518.

# BIBLIOGRAPHY


A. Books

Clark, John Maurice, Alternative to Serfdom, New York, Alfred A. Knopf, 1948.

Dillard, Dudley, The Economics of John Maynard Keynes, New York Prentice-Hall, 1948.

Hansen, Alvin H., Economic Policy and Full Employment, New York, McGraw-Hill, 1947.

Hansen, Alvin H., Full Recovery or Stagnation? New York, W. W. Norton, 1938.

Harris, Seymour E., editor, The New Economics: Keynes' Influence on Theory and Public Policy, New York, Alfred A. Knopf. 1947.

Homan, Paul and Machlup, Fritz, editors, Financing American Prosperity: A Symposium of Economists, New York, The Twentieth Century Fund, 1945.

Keynes, J. M., The General Theory of Employment, Interest and Money, New York, Harcourt, Brace, 1936.

Klein, Lawrence R., The Keynesian Revolution, New York, Macmillan, 1948.

Roll, Erich, A History of Economic Thought, New York, Prentice-Hall, 1942.

Saulnier, Raymond J., Contemporary Monetary Theory, New York, Columbia University Press, 1938.

Simons, Henry C., Economic Policy for a Free Society, Chicago, The University of Chicago Press, 1948.

Swanson, Ernst W. and Schmidt, Emerson P., Economic Stagnation or Progress, New York, McGraw-Hill, 1946.

Terborgh, George, The Bogie of Economic Maturity: A Summary, Chicago, Machinery and Allied Products Institute, 1946.

B. Periodicals

Ayres, C. E., "The Impact of the Great Depression on Economic Thinking," The American Economic Review, XXXVI, May, 1946, 112-125.

Davenport, John, "Baron Keynes of Tilton," Fortune, XXIX, May, 1944, 147, 240-258.

Fitch, Lyle C., "Comments on Keynesian Economics," Political Science Quarterly, LXII, September, 1947, 418-427.

Gruchy, Allan, "J. M. Keynes' Concept of Economic Science," The Southern Economic Journal, XV, January, 1949, 249-266.

Hansen, Alvin H., "Mr. Keynes on Underemployment Equilibrium," The Journal of Political Economy, XLIV, October, 1936, 667-686.

Hicks, J. R., "Mr. Keynes' Theory of Employment," The Economic Journal, XLVI, June, 1936, 238-253.

Hoover, Calvin B., "Keynes and the Economic System," The Journal of Political Economy, LVI, October, 1938, 392-402.

"John Maynard Keynes," The New Statesman and Nation, XXXI, April 27, 1946, 295.

"John Maynard Keynes: 1883-1946," The New Republic, CXIV, April 29, 1946, 599-600.

Keynes, J. M., "A Self Adjusting Economic System?" The New Republic, LXXXII, February 20, 1935, 35-37.

Keynes, J. M., "The General Theory of Employment," The Quarterly Journal of Economics, LI, February, 1937, 209-223.

Lusher, David W., "The Structure of Interest Rates and the Keynesian Theory of Interest," The Journal of Political Economy, L, April, 1942, 272-279.

Robertson, D. H., "Some Notes on Mr. Keynes' General Theory of Employment," The Quarterly Journal of Economics, LI, November, 1936, 168-191.

Robinson, E. A. G., "John Maynard Keynes, 1883-1946," The Economic Journal, LVII, March, 1947, 1-68.

Roos, Charles F., "The Demand For Investment Goods," The American Economic Review, XXXVIII, Maym 1948, 311-320.

Rueff, Jacques, "The Fallacies of Lord Keynes' General Theory," The Quarterly Journal of Economics, LXI, May, 1947, 343-367.

Schumpeter, Joseph A., "John Maynard Keynes: 1883-1946," The American Economic Review, XXXVI, September, 1946, 495-518.

Smithies, Arthur, "The Multiplier," The American Economic Review, XXXVIII, May, 1948, 299-305.

Tarshis, Lorie, "An Exposition of Keynesian Economics," The American Economic Review, XXXVIII, May, 1948, 261-272.

Williams, John H., "An Appraisal of Keynesian Economics," The American Economic Review, XXXVIII, May, 1948, 273-290.

Wright, David McCord, "The Future of Keynesian Economics," The American Economic Review, XXXV, June, 1945, 284-307.

Approved by

Albert S. Keister

Director

Examining Committee

Walter C. Neale

Richard Bardolph