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Are We Really All Keynesians Now?

Some Dangerous Theoretical Illusions

TRIBAL WARfare is not the most attractive feature of contemporary economics, but it is much the most exciting. A BBC2 "Controversy" programme on inflation in September last year had much to recommend it as a sporting occasion. But the vigour of debate occasionally makes it less careful and precise; distinguished economists become misled by their own slogans and tend to assert glibly what they know should be argued cautiously. One particular vice is the habit of attaching a brand-name to a school of thought, not with the intention of designating a common theme, but with that of heightening rhetorical impact. It is right to be suspicious of this tendency because it conveys a possibly spurious impression of unanimity, of a confederation of intellects, which can persuade non-participants in the debate by sheer force of numbers. But there can be a still more serious reason for distrust. When the confederation becomes known by a special name there is a danger that the name can give a distorted idea of the quality of its intellectual weaponry. The danger is greatest when the name used is that of a much revered warrior, now dead, who achieved a number of famous victories in his lifetime.

In economics, the revered warrior in all confrontations is still John Maynard Keynes. A quote from Keynes, no matter how slight and trivial, appears to silence opposition. It has the same force as an appendix of mathematical reasoning or a half-dozen learned articles. It can be a powerful blow in debate and, indeed, it can sometimes serve as a substitute for thought. It is important, therefore, to examine carefully the credentials of any group which calls itself "Keynesian." At present the Keynesian label has been attached to a body of economists in England, principally from Cambridge University, who have certain special views on the problem of inflation control.[1]

In choosing this label they have—or believe they have—a great advantage. It is a commonplace that Keynes was worried above all by the depression of the 1930s and the attendant un-

This article continues our discussion of fundamental problems in contemporary economic theory. See also in ENCOUNTER *E. J. Mishan, "The New Inflation" (May 1974), H. V. Hodson, "Re-reading Keynes's General Theory" (February 1973) and Harry G. Johnson, "Revolution & Counter-Revolution in Economics" (April 1971). Tim Congdon was educated at St John's College and Nuffield College, Oxford. He is an economic journalist on "The Times Business News."*

[1] The best-known Keynesians in this country are Sir Roy Harrod, Lord Kahn and Joan Robinson. Lord Kahn and Mrs Robinson have stayed at Cambridge, but Sir Roy Harrod has taught at Oxford for most of his academic career. Although Cambridge is the centre of Keynesianism many economists in universities throughout England would profess themselves as Keynesians; and it is, perhaps, slightly misleading to locate it too precisely in geographical terms.

Throughout the article Keynesianism will mean the body of beliefs of this group of economists and Keynesians will be these economists. A distinction will, therefore, be drawn between Keynesian economics and Keynes' economics.

A similar distinction is to be found in A. Leijonhufvud's *On Keynesian Economics and the Economics of Keynes* (1968), although Leijonhufvud is concerned with the whole body of Keynes' economics whereas I am only interested in his work on inflation.

employment, and that his work on inflation was insubstantial and can be neglected. The Keynesians therefore have freedom to propound their own views as those of Keynes—and it amounts to a licence to counterfeit his intellectual coinage.

IN FACT, IT IS NOT TRUE that Keynes was uninterested in inflation. He lived through the most rapid inflation of the 20th century: that between 1914 and 1920, which ravaged the British financial system and devastated the currencies of most European countries. His writings on inflation are extensive. It is possible, then, to examine the consistency of modern Keynesian views on inflation with Keynes's own position. It emerges that several leading strands in Keynesian thought cannot be said to have their origins in Keynes's work. The claim that there is a close correspondence between the two is based on a myth—a myth which has been carefully nurtured by a number of English economists who collaborated with Keynes in the 1930s, but who have outlived him and have propagated an influential, but spurious, oral tradition.

Tribes, even tribes of economists, need myths. They are a form of emotional nourishment, a sort of spiritual subsistence level. It is important that this particular myth be exploded.

IT MAY HELP THE ARGUMENT ALONG if a summary of the Keynesian position is provided. I hope that this summary does justice to Keynesian thought, despite the obvious and unavoidable danger that, by highlighting its central elements, its variety and subtlety will not be sufficiently acknowledged.

The inflationary process is seen as basically a question of "cost-push." There are a number of forces which are said to raise costs of production throughout the economy. Prices are then raised in response to preserve profit mark-ups.

This cost-push process has to be contrasted with "excess demand" explanations of inflation, in which the causes are said to be too much demand for labour (which, *then*, raises wages and costs) and goods (which enables firms to raise prices without fearing loss of business).

The initial impulse behind the cost-push process comes from the trade unions. The Keynesians are somewhat ambivalent in their attitude to the union movement, because it is regarded as both the cause of a self-defeating jostling between different groups for a higher share of the national cake (which they deplore) and the agent of income redistribution in favour of the lower classes (which they applaud). An insistence on the villainy of the trade unions is, however, common to all the Keynesians in some form or other.

At the one extreme there is Lord Balogh who is outspoken and unhesitating in his condemnation. Others are more reserved. Dr Roger Opie, in his contribution to a new book on ***Keynes: Aspects of the Man and his Work*** (based on the first Keynes seminar held at the University of Kent in 1972), attributes their behaviour to the economic context in which they operate. It is, he says,

> the experience of *past* high employment which has given unions the taste of power; and the combination of organised labour and oligopolised industry which has given them the opportunity to exercise it without limit.[2]

Professor Joan Robinson recognises the conflict between the public aims of the labour movement as a whole and the private, self-interested objectives of the individual union. Although the vicious inflationary spiral caused by wage bargaining "does no good to the workers", nevertheless "it remains the duty of each Trade Union individually to look after the interests of its own members individually."[3]

Accompanying this hostility, open or disguised, to the trade unions, is a set of beliefs about the operation of the labour market. Wages are set, not by demand and supply, but by bargaining. Workers do not move from industry to industry and from firm to firm in response to the incentives of better pay and prospects. The labour market is characterised by rigidities and imperfections, and wage-determination takes place in an environment of "countervailing power," without respect for fairness or for social justice.

The imperfections in the labour market are matched by imperfections in the production and supply of goods. Opie's reference to "oligopolised industry" is typical. Occasionally even the retailers have to take their share of the blame. As Sir Roy Harrod puts it, the distributors are "sometimes up to a little mischief."

In short, "the core" of cost-push inflation is the conflict between "managers, trade unionists, and the non-unionised" as they "all struggle endlessly to increase or at least preserve their share of the national product." The timing and

[2] Roger Opie, "The Political Consequences of Lord Keynes", in D. E. Moggridge (ed.), *Keynes: Aspects of the Man and his Work* (Macmillan Press, 1974), p. 87.

[3] Joan Robinson, *Economic Philosophy* (1962), p. 131.

John Maynard Keynes on Inflation (1920)

1. THE OLD ARGUMENTS in favour of dear money no longer hold in their entirety because a high bank rate has no *immediate* effect on the exchanges either by influencing the volume of bills offered for discount in London or by influencing the flow of gold.

2. It is also true that a moderate increase of bank rate may have very little salutary effect indeed and may merely make government borrowing dearer without deterring other borrowers. This will be especially the case if there is a wide discrepancy between what may be described as the official rate for money and its real value. Increases in the official rate, unless they have brought the official rate approximately to the real rate, may be without much influence.

3. As bankers can in the present circumstances always obtain a sufficient basis for credit expansion by liquidating their holdings of Treasury Bills and thus increasing their balances at the Bank of England, there are only two possible means of checking credit inflation, namely by dear money or by a policy of discrimination.

4. DISCRIMINATION *is not likely to be effective because it is precisely unexceptionable proposals from bankers' customers that it is necessary to stop, that is to say, proposals for expansion by prosperous well-conducted businesses, whose order books are full and who therefore feel disposed to increase their works. Discrimination against speculation and obviously dubious enterprises will not be nearly enough. Nor can a policy of discrimination be effective unless it is reinforced by the imposition of all the other war-time bureaucratic controls over new issues, foreign investments and the remittance of money abroad. In short, discrimination, in order to be effective, presumes a very high degree of socialisation of our whole industrial structure, so far as it concerns the supply of capital. It is doubtful if either Whitehall or Lombard Street is equipped at the present time to direct such socialisation of capital to industry wisely or efficiently. If this view is accepted, the only alternative is to select borrowers by their willingness to pay a high rate.*

5. *If matters are left as they are, inflation will certainly proceed with its existing impetus until a much higher price level has been established with all the social unrest and other inconvenient consequences which that will bring with it.*

6. *With the rate for money in New York from 2 to 3% in excess of the London rate, London is much the cheapest market to borrow. The danger of our exchanges now lies not in the risk of London lending to untrustworthy borrowers, but to her lending money she has not got to borrowers of unexceptionable character at a rate far below the real value of new capital.*

7. *It is therefore a policy of despair to proceed as at present even if it be true that dear money may check trade.*

8. *Dear money will do good by checking bankers' loans, diminishing foreign loans and, not least, by bringing the mind of the business world to a better realisation of the true position.*

9. *As a result of rising prices profits in trade are now so high that money may have to be made very dear before the necessary results are achieved. This fact has to be faced and a rate of even 10% must be contemplated.*

10. SUCH A VERY HIGH RATE *might produce a crisis, though this crisis might, unlike its predecessors, be only financial and not commercial. That is to say, it would not in the present flourishing condition of trade proceed so far as to cause any serious amount of unemployment. It might prevent our staple industries from having twice as many orders as they can fulfil; but there is a very wide margin of safety before they would be reduced to working below their capacity.*

11. *At present real capital goods and labour are so fully employed that almost all new credit puts prices up, or puts the exchanges down, by leading the borrower either to compete with other purchasers for home products, or to buy something more from abroad.*

12. *It would also be fatal to attempt to finance the Housing scheme on an inflationist basis. In present circumstances increased building can only take place by diverting labour and materials from other employers. It is foolish to suppose that a great housing scheme can be superimposed on the present industrial solution. Money for housing cannot be created but must be taken from other purposes, which brings us back again to the dilemma of dear money or a far-reaching socialisation of the supply of capital.*

13. *As regards the exchanges it is above all necessary that money in London should be a little dearer than in New York.*

14. *The rate for money should therefore be put up to 7% and then again soon after to 8%. The results of this action would have to be watched. But as a personal opinion I should not be surprised if 10% would be required to achieve the necessary results.*

15. FINALLY VERY GRAVE ISSUES are at stake. A continuance of inflationism and high prices will not only depress the exchanges but by their effect on prices will strike at the whole basis of contract, of security, and of the capitalist system generally. The new state of affairs created by persistent inflation will only be tolerable under socialistic control and that is where the present policy, if persisted in, will necessarily lead us, before probably we are really ripe for such a development.*

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* *P.R.O. T.117/1384. Keynes's Notes of Interview with Chancellor (February 15, 1920).*

size of the demands placed on the economy do not have a primarily economic explanation. The principal influences are, instead, social and psychological; and they operate continuously. The outcome of the distributional struggle is not determined by productivity, but by power. The crucial determinant is the strike threat.

What, then, is the answer to cost-push inflation? It is direct intervention by the government in the form of prices and incomes policies. The Keynesians are united in this, and they would appear to have convinced a majority of the academic economics profession. There are few clearer statements of support than that from Sir Roy Harrod in *Keynes: Aspects of the Man and his Work*. He writes:

> I am myself a definite advocate of what we call an "incomes policy." I believe there must be direct interference.

A prices and incomes policy serves many functions. It is, first and foremost, a weapon to fight inflation. But it is more than that. By enabling a central authority to monitor price movements it supersedes—or, at least, overrides—the monopoly bargaining power of large firms and the trade unions. It can, therefore, contribute to attempts to distribute economic rewards more fairly. It is a means of attaining social justice.[4]

What of the uses of monetary correctives? These are scorned.

> I do not think it is any good saying that banks can stop inflation—saying, let them reduce the money supply. How can the poor banks reduce the money supply? What actually happens is that wage-earners get a demand granted which must raise costs.[5]

If monetary methods were adopted they would cause unemployment and this is thought to be unacceptable. It would be the negation of Keynesianism if unemployment were the best method of fighting rising prices.

THERE IS NO DOUBT THAT the Keynesian position is internally consistent. If one believes that "greed" and "envy" are the causes of inflation, one is likely to be sceptical of the use of such indirect methods of control as changes in taxation and interest rates. It is much easier to legislate against greed and envy directly—by laying down statutory limitations on their effects. It is also consistent with a particular perception of reality. If monopoly is pervasive, if markets are stunted by imperfections and rigidities, it is futile to apply those remedies which work on the assumption that the economic world is competitive and responsive to supply-and-demand pressures.

But the Keynesian position is not, as we shall see, consistent with that of Keynes. It has no foundation in his written work and is not, indeed, compatible with fundamental aspects of his economic philosophy.

But surely, it might be said, the Keynesians must be basing their case on some element of Keynes's thinking. Is there any kinship between their arguments and his?

In fact, there is an assumption common to their way of thinking and the most important part of Keynes's work. It is a technical assumption, slipped into the interstices of the theoretical structure; and, for that reason, one whose significance is easily overlooked. It is the assumption throughout *The General Theory of Employment, Interest and Money* (1936) that the analysis can be conducted in terms of "wage-units."

Keynes was not concerned in his investigation of unemployment with the relationship between capital inputs and output. The vital relationships were those between employment, output, and demand. The function of the wage-unit assumption was that it enabled his analysis to focus on these relationships—"provided we assume that a given volume of effective demand has a particular distribution of this demand between different products uniquely associated with it. . . ." The wage-unit was defined as the sum of money paid to each "labour-unit" or, in effect, each worker.[6] This was a very useful assumption. Keynes could proceed to the determination of output and employment, without needing a prior theory of the determination of the money wage and without troubling himself over micro-economic minutiae. It might seem to follow that Keynes considered money wages to be given exogenously—perhaps as a result of bargaining.

The subtle effect of the wage-unit assumption on later thinking is exposed in an important new book on *The Crisis in Keynesian Economics* by Sir John Hicks. The validity of analysis conducted in wage-units turns on what Sir John

[4] Sir Roy Harrod, "Keynes's Theory and its Applications", in D. E. Moggridge (ed.), *Keynes. . .*, pp. 9–10; and Opie, p.86. There have been suggestions that there is such a thing as a "just price" and that "social considerations" should enter into price determination. See A. Jones, *The New Inflation* (1973), particularly chapters 5 and 6.

[5] Sir Roy Harrod in D. E. Moggridge (ed.), *Keynes. . .*, p. 9.

[6] J. M. Keynes, *The General Theory of Employment, Interest and Money* (1936), pp. 41–43. See, particularly, the footnote on pp. 42–43.

calls "the wage theorem"—that "when there is a general (proportional) rise in money wages . . . the normal effect is that all prices rise in the same proportion."[7]

Given the wage theorem it is immaterial what the particular money wage is. The relationships between liquidity preference, the investment function, and the rest, which are the hub of Keynes' economics, are unaffected. Consequently, it is a convenient and innocuous simplification to assume a fixed money wage. Consequently, the relationship between aggregate demand and the money wage can be neglected.

This chain of thought—or, rather, this compound of faulty thought-habits and pseudo-empirical hunches—is the source of all the trouble. Keynes made the wage-unit assumption because it facilitated his *theoretical* task. He could grapple more quickly with the issues of demand and employment, once the awkward (but, to him, supererogatory) problem of money wage determination was put to one side. But this does not mean that he thought money wages were determined exogenously *in the real world.*

Unfortunately, the Keynesians have come to think just that. It is almost comical to picture Sir Roy Harrod indulging in an elaborate exegetical hunt to find some justification for all this.

> I have searched through his writings very carefully, not long ago . . . for the purpose of discovering anything he had to say about what we call "cost-push inflation". . . . I could find only one short passage in Keynes, just a couple of sentences, where he said, "Of course the wage-earners might demand more than corresponding to their rise in productivity, might demand more and get more.' . . . You can find those words if you search; I ought to give you chapter and verse, but I have not put down the page reference; they are there all right. . . .[8]

The fact is that Keynes never considered the possibility of "what we call 'cost-push inflation'." The "one short passage" may or may not be a figment of Sir Roy's imagination. The many thousands of words written by Keynes on inflation as an excess demand phenomenon are palpable and, to anyone who "searches through his writings very carefully", rather obtrusive.

There is, however, a certain agreement between the Keynesians' and Keynes's views on social fairness. His writings at times resemble a roll-call of the class structure of a late industrial society, with references to profiteers and rentiers and unions scattered throughout the pages. The passages on income distribution in *How to Pay for the War* describe the upward swirl of the wage-price spiral particularly well. Here, indeed, it might be said, is the endless social struggle for a higher proportion of the national income.[9]

BUT IT IS DIFFICULT TO INFER Keynes's attitude to the labour movement from his writings. He was certainly alerted to its potential impact on the organisation of the markets in factor services. In one of his public speeches he described trade unionists as

> once the oppressed, now the tyrants, whose selfish and sectional pretensions need to be bravely opposed.[10]

But the harshness of the observation is unusual, and it may be an isolated piece of bravura intended more for public relations purposes than as an expression in inner conviction. In *The General Theory* (and elsewhere) the unions are a fact of life; they are not the subject of a favourable or adverse judgment.

But, if there are some reasons for attributing Keynesian views to Keynes's intellectual legacy, there are many more reasons for denying any connection between the two.

BEFORE MOVING ON to an examination of Keynes's theory of inflation, it is essential to challenge a widespread misapprehension: that Keynes knew nothing about and was uninterested in the price mechanism or, more generally, in what we would now call micro-economics. This is simply untrue.[11]

[7] Sir John Hicks, *The Crisis in Keynesian Economics* (Blackwell, 1974), pp. 59–60.

[8] Sir Roy Harrod in Moggridge (ed.), *Keynes. . .*, p. 9. Other examples: "It would be most inappropriate for me to stand up here and tell you what Keynes would have thought. Goodness knows he would have thought of something much cleverer than I can think of" (pp. 8–9); and: "I do not think we can tackle it without direct interference. . . . They do seem to be doing this rather more effectively in America now than here—having tribunals, boards, call them what you will, responsible for fixing maximum price increases. I am sure we have got to come to that, and, as our Chairman very kindly hinted, I had a letter in *The Times* on this very subject yesterday."

[9] J. M. Keynes, *How to Pay for the War* (1940), of which pp. 61–70 are reprinted in R. J. Ball and Peter Doyle, *Inflation* (1969), pp. 21–27.

[10] J. M. Keynes, "Liberalism and Labour" (1926), reprinted in *Essays in Persuasion* (1931), p. 341.

[11] There is an extremely tart and amusing footnote on pp. 70–71 of D. E. Moggridge (ed.), *Keynes: Aspects of the Man and his Work* on this theme, which I strongly recommend to the connoisseur. It is at Joan Robinson's expense. She had supported the notion that "Maynard had never spent the 20 minutes necessary to understand the theory of value", sublimely unaware that as a matter of fact (as is clear from one of the notes to her publisher) he had acted as referee to her very book on the subject.

His awareness of the virtues (within limits) of the price mechanism saved him from the common assumption among the Keynesians that official interference to restrain rises in the absolute price level—or, more explicitly, prices and incomes' policies—has no damaging repercussions on the configuration of relative prices. Equally, he was sceptical of the effectiveness of price controls, a scepticism formed by knowledge of conditions in the inflation-ridden European economies of the early 1920s. In *The Economic Consequences of the Peace* (1919), he wrote:

> The preservation of a spurious value of the currency, by the force of law expressed in the regulation of prices, contains in itself, however, the seeds of final economic decay, and soon dries up the sources of ultimate supply.

A page later he added:

> The effect on foreign trade of price-regulation and profiteer-hunting as cures for inflation is even worse.[12]

An even more contemporary ring attaches to his derision of the "bread subsidies" which were common at the time.

Similarly, he did not consider wage control to be feasible. There are recurrent passages in Keynes—particularly when Britain returned to the gold standard (in 1925)—where the need to bring down the level of wages is stressed (if the exchange rate had to be unnecessarily raised). But it was precisely the impracticality of efforts to depress the general wage level which was the problem (and, therefore, made adjustments of the exchange rate expedient). In 1931, just before Britain left the gold standard, he wrote that the reduction of all money wages in the economy

> if it were to be adequate would involve so drastic a reduction of wages and such appallingly difficult, probably insoluble, problems, both of social justice and practical method, that it would be crazy not to try [the alternative of import restrictions].[13]

Of course, the Keynesians could argue that today the community has become habituated to directives from the centre. The improvement in communications has made it that much easier to

[11] E. Johnson and D. E. Moggridge (eds), *The Collected Writings of John Maynard Keynes:* vol. 2, *The Economic Consequences of the Peace* (London, 1971), pp. 151–2.

[12] J. M. Keynes, *Essays in Persuasion* (1931), p. 284. The alternative of import restrictions is the one preferred in the context of the passage quoted—but Keynes was, of course, in favour of a devaluation if it was politically possible.

administer and to police a prices and incomes policy. It might be contended that in these altered circumstances Keynes would revise his views, acknowledging some merits in legally imposed limitations on wage and price rises.

It is, I believe, impossible to argue with this. It might well be true. But surely no one can give a definitive answer one way or the other. What is clear is that there is nothing in Keynes' writings which explicitly envisages and endorses a prices and incomes policy, and there is much in their mood and tenor which is contemptuous of its makeshift predecessors in the 1920s.

WHAT, THEN, OF Keynes' views of the inflationary process?

The first is that Keynes regarded inflation as an excess demand phenomenon. There is very little, if anything, in his writings to suggest that he regarded it as something else.

The most lucid and consecutive discussion to be found in his work is in chapter 21 of *The General Theory* on "The Theory of Prices" (and, more especially, between pages 295 and 303). Paradoxically, however, it is rather hard to use this section for our purposes. The difficulty is that Keynes thought the proposition that inflation was due to excess demand so self-evident that he did not bother to argue it. The discussion consists of permutations of assumptions, all of which derive from a theoretical position of extreme orthodoxy. *No alternative to excess-demand inflation is contemplated, let alone explored.*

The form of the discussion is to put forward, as a pivot for further argument, the principle that

> So long as there is unemployment, *employment* will change in the same proportion as the quantity of money; and when there is full employment, *prices* will change in the same proportion as the quantity of money.[14]

The validity of this principle is shown to depend on five assumptions.

Only one of the five assumptions is concerned with the institutional context of wage bargaining. It is the tendency for the wage-unit—or, in effect, money wages—to rise before full employment has been reached.

Let me quote the relevant passage in full:

> In actual experience the wage-unit does not change continuously in terms of money in response to every small change in effective demand; but discontinuously. These points of discontinuity are determined by the psychology of the workers and by the policies of employers and trade unions.[15]

In other words, the significance of the union movement is recognised. *But the exercise of bargaining power depends on prior changes in "effective demand."*

This was plainly thought to be the normal run of events. These "discontinuities" represented "semi-inflations" which "have, moreover, a good deal of historical importance." It is not surprising that Keynes saw unions as susceptible to the same economic pressures as firms or individuals. In his lifetime, the membership of the union movement was substantially reduced on two distinct occasions—between 1921 and 1924 and between 1929 and 1932. In both instances the cause was the downturn in demand. To summarise, Keynes believed there to be an interplay between institutions and economic forces; but he did not believe, as do the Keynesians, that institutions dictate to or overwhelm these forces.[16]

A FURTHER point is that Keynes thought inflation to be closely connected with monetary conditions. Indeed, his definition of inflation was stated in terms of the money supply. He did not dither with the two competing modern definitions—of "rising prices" and "aggregate demand in excess of aggregate supply." Instead:

> From 1914 to 1920 all countries experienced an expansion in the supply of money relative to the supply of things to purchase, that is to say *Inflation.*

The emphasis on money is, of course, consonant with the dominant themes of Keynes's depression economics. In the more simplistic explanations of Keynes's theory there is often undue concentration on the need for public works to raise spending. But this neglects the cause of inadequate private investment, which was too much liquidity preference or, roughly speaking, the behaviour of the demand for money.[17]

When savings take the form of liquid holdings (*e.g.* money) rather than illiquid holdings (*e.g.* plant and machinery), the demand for goods declines and there is unemployment. The tradi-

[14] Keynes, *The General Theory of Employment, Interest and Money* (1936), p. 296.

[15] Keynes, *The General Theory*, pp. 301–302.

[16] The frailty of institutions in the face of economic imperatives is one of the themes of an interesting new book: G. A. Dorfman, *Wage Politics in Britain*, Charles Knight (1974). See, particularly, chapter 2 on the inter-War period.

[17] Keynes, *Essays in Persuasion* (1931), p. 81. There is a fascinating discussion of the notion of liquidity preference, and its connection with investment flexibility, in the second part of Sir John Hicks, *The Crisis in Keynesian Economics.*

tional answer was to lower the rate of return on liquid holdings—until savers shifted back into illiquid.

But Keynes saw that there were psychological and institutional barriers to a downward reduction in the rate of interest—from which it followed that monetary policy, intended to engineer changes in interest rates, could not by itself cause a recovery of demand. Hence, there was a need for "a somewhat comprehensive socialisation of investment."

However, if the impotence of monetary policy in a depression is one of the principal conclusions of Keynes's economics, there is no foundation for the widespread Keynesian attitude that "money does not matter." Keynes's writings are replete with references to the banking system and financial assets. It would be remarkable if he thought them irrelevant to problems of economic policy in normal circumstances. (The 1930s, of course, were not normal circumstances. But it should be remembered that three out of the eight historical illustrations in chapter 30 of *A Treatise on Money* were analyses of inflations. Keynes did think about the longer time span.)[18]

In Keynes, the monetary variable under discussion was always "the rate of interest" (*i.e.* the price of money) rather than "the money supply" (*i.e.* its quantity). This has subsequently been a fertile and persistent source of disagreement between the Keynesians and others. The Keynesians say that no support is to be found in *The General Theory* or elsewhere for the mechanistic rules advocated by, for example, Milton Friedman of the Chicago school, in which the monetary variable emphasised is the quantity of money.

The Keynesian position is, in fact, a misrepresentation. Keynes was in no position to talk with confidence of the money supply, because he lived in an age before full statistics were available. The rate of interest, on the other hand, was something known and observable.

There are points in *A Treatise on Money* (1930) where Keynes was plainly searching for an indication of the money supply. There were mismatches between changes in such indicators as he found and money national income changes, which, interestingly enough, he attributed to "lags" between "profit" and "income inflations."

[18] E. Johnson and D. E. Moggridge (eds), *The Collected Writings of John Maynard Keynes:* vol. 6, *A Treatise on Money: The Applied Theory of Money* (1971), pp. 132–186.

An additional factor is that Keynes, who was active in City finance and speculation, looked at monetary policy as City men do. Bankers, who have to arrange loans from day to day, think of the demand for credit as fickle and volatile, while economists, who look at broad monetary aggregates and long-run time series, regard it as continuous and stable. Bankers see interest rates, which give signals of credit availability, as the determining variable while economists tend to regard the money supply as all-important and are inclined to underplay the significance of transient price incentives. Keynes usually thought in interest-rate terms. But this does not mean that he distrusted the effectiveness of monetary policy as a method of changing credit availability.

The clearest statement of his position is again to be found in *A Treatise on Money*. The authorities have, he said, no control over individual prices (like those of cars or meat) in the economic system. Nor do they have *"direct"* control over the money supply because the central bank must act as lender of last resort. But they do determine one price, "the rate of discount", or the rate of interest; and it is this which gives them leverage on the system as a whole.[19]

A final, and perhaps decisive, point is that, when Britain was confronted with nasty outbreaks of inflation during his lifetime, Keynes supported policies of a traditional, demand-restrictive nature. It has been too readily assumed that the years from 1914 to 1945 were of prolonged and unremitting depression, characterised by falling or stable prices, and that Keynes was, therefore, never called upon to offer advice on the control of inflation. This is quite wrong.

In early 1920, Britain was in the midst of an inflationary boom of proportions which have never been paralleled before or since (although conditions in 1973 and 1974 have, in some respects, been rather similar). In both 1918 and 1919 money wages soared by nearly 30% a year and even by February 1920 there seemed no sign of an early release from the grip of the price explosion which had inevitably followed.

The Chancellor of the Exchequer, Austen Chamberlain, asked for an interview with Keynes to obtain his opinion on the right course of action. Chamberlain later summarised his impression of the interview as:

> K. would go for a financial crisis (doesn't believe it would lead to unemployment). Would go to whatever rate is necessary—perhaps 10%—and would keep it at that for three years.[20]

Shortly afterwards Keynes prepared a 15-point memorandum in which he amplified his advice. Perhaps the most startling feature is the similarity between the economic issues of early 1920 and those of late 1974, and only a little less startling is Keynes's set of recommendations to deal with the problems.

Is THIS DOCUMENT an aberration? Would Keynes have retracted it with the benefit of hindsight and of the breakthroughs in economic thought he pioneered in the 1930s? In 1942 he was shown his 1920 memorandum. He was not in the least repentant. Far from thinking his position too iconoclastic, he acknowledged that other economists at the time had thought exactly the same and that they had been equally right.

> As usual the economists were found to be unanimous and the common charge to the contrary without foundation!
>
> I feel myself that I should give today exactly the same advice that I gave then, namely a swift and sharp dose of dear money, sufficient to break the market, and quick enough to prevent at least some of the disastrous consequences that would then ensue. In fact, the remedies of the economists were taken, but too timidly.[21]

THERE IS NO NEED to go any further. The argument could be reinforced by an analysis of Keynes's views of war finance, but there is already enough evidence to buttress my main contentions.

There is nothing in Keynes' writings, philosophy, or work which coincides with the present-day Keynesians' viewpoints on inflation policy. They favour direct government interference to keep prices down. Keynes scorned price regulation as ineffective and harmful. They consider inflation to be a cost-push phenomenon. He never envisaged it as anything but a phenomenon of excess demand. They dismiss monetary policy. He thought the one sure answer to inflationary excesses was "a swift and severe dose of dear money."

Are we really all "Keynesians" now?

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[19] Keynes himself put "direct" in italics (p. 189), presumably because he thought that a rise in the price of money would cause people to economise on its use and, therefore, the authorities could indirectly control the money supply. The belief that a central bank should not hold down the money supply directly, because it has the lender-of-last-resort function, is a very typical banker's attitude. Incidentally, it is one reason why Friedmanite economists and central bankers often do not see eye to eye.

[20] Susan Howson, "'A Dear Money Man'?: Keynes on Monetary Policy, 1920", in *The Economic Journal* (June 1973), p. 458.

[21] Susan Howson, *The Economic Journal*, p. 461.