**Keynes’s Radical Views on the Economic Role of the State:**

**The Centrality of Planning and Public Investment**

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**[Write Introduction]**

**Keynes on Policy: State Planning and Public Investment**

**VISIONS -- 1919**

*The Economic Consequences of the Peace* was written to warn the North American, European and British public that if the provisions of the Treaty of Versailles were enacted, the world would face the prospect of economic stagnation, financial crisis, general social and political unrest and, in some countries, possible revolution. A future world war was not out of the question. The transfer of real resources from vanquished to victor and, especially, the crippling system of financial reparations from losers to winners and loan repayments among the Allies would make the restoration of peace and prosperity impossible, Keynes argued.

But Keynes also used this occasion to make public for the first time his belief that Europe stood at the interstices between two epochs of economic history, one known and the other yet to be envisioned, never mind created. He was to make this point over and over again throughout the rest of his life. WWI accelerated the dissolution of the old order to be sure, and the Treaty threatened to make a peaceful and relatively smooth transition to a new socioeconomic structure impossible, but Keynes clearly believed that the old order was about to crumble anyway.

Keynes's main argument about the inevitable passing of the old order was that the conditions which made possible the high growth rate in Europe and North America between 1870 and WWI were inherently transitory. In the second sentence of the book Keynes states that "very few of us realize with conviction the intensely unusual, unstable, complicated, unreliable, temporary nature of the economic organization by which Western Europe has lived for the last half century" (1920, 1). He listed four foundations for the prosperity of the era. These included: a rising population; increasing economic integration (facilitated by free trade, migration and capital flows in the context of stable exchange rates and "security of property and person everywhere");[[1]](#footnote-1) and a symbiotic economic relation between the old world and the new, in which Europe sent abroad the capital and labor which helped make possible the surplus food production in the new world that in turn sustained a growing European population.

The remaining foundation was in some ways the most interesting; Keynes labeled it the "psychology of society." He believed that in the nineteenth century "Europe was so organized socially and economically as to secure the maximum accumulation of capital" (18). On the one hand, the rate of return on real capital remained attractive throughout most of the period, while (as Keynes put it in The General Theory) the entrepreneurial class "embarked on business as a way of life, not relying on a precise calculation of prospective profit" (GT, 150). On the other, the savings rate was high and financial capital was cheap, plentiful and available on a long term basis to accumulating firms. Cheap capital in turn depended on a transitory combination of economic and social conditions. One was a very unequal distribution of income and wealth. While this might have led to dysfunctional social and political tension, in fact the wealthy classes saved a high proportion of their income and were content to invest it long term in gilt-edged bonds and, later, preferred stock at low rates of interest. This facilitated the high growth rates that made life for the expanding working class at least tolerable.[[2]](#footnote-2) "It was precisely the *inequality* of the distribution of wealth which made possible those vast accumulations of fixed wealth and of capital improvements which distinguished that age from all others" (18). Keynes continued: "I seek only to point out that the principle of accumulation based on inequality was a vital part of the pre-war order of Society and of progress ... and to emphasize that this principle depended on unstable psychological conditions which it may be impossible to recreate" (21). In the postwar era a more militant and better organized working class would demand and obtain a bigger piece of the economic pie while the old rentier class, as explained below, would be devastated by the inflation of the period.

*This joint hypothesis - that the return on capital investment and thus the incentive to invest declined substantially and permanently after WWI while the propensity to save remained high became a core foundation of Keynes’s evolving policy views in the interwar period, a proposition we will return to on numerous occasions*. *From 1924 to his death, as we will see, he argued that the state would have to take primary responsibility for the lion’s share of the capital investment decision if Britain was to avoid secular stagnation and chronically high unemployment.* For example, at the end of the section of The General Theory devoted to “The Inducement to Invest,” Keynes said:

I expect to see the State, which is a position to calculate the marginal efficiency of [or expected return to] capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organising investment… (164, italics added)

Though the arguments he presented in support of this key policy conclusion evolved over time, his commitment to it never wavered.Indeed, he said that if the state controlled most large-scale investment projects, it should avoid the use of counter-cyclical fiscal and monetary policy - the policy universally believed to be quintessentially “Keynesian.” *Keynes’s support for public control of the bulk of investment as the cornerstone of policy is perhaps the best kept secret in the history of thought.*

The war of course disrupted all aspects of the pre-war economic order. It "has so shaken this system as to endanger the life of Europe altogether" (25). Several of the major impediments to the reconstitution of the old order pointed to by Keynes turned out to either be permanent or, if temporary, to do irredeemable damage to the pre-existing foundations of the system. First, the era of cheap imported food was over; further population growth, Keynes argued, would reduce living standards. Second, the system was now burdened with excessive debt of all kinds.

The war has ended with everyone owing everyone else immense sums of money. Germany owes a large sum to the Allies; the Allies owe a large sum to Great Britain; and Great Britain owes a large sum to the United States. The holders of war loans in every country are owed a large sum by the State; and the State in its turn is owed a large sum by these and other taxpayers. The whole position is in the highest degree artificial, misleading and vexatious. We shall never be able to move again, unless we can free our limbs from these paper shackles. A general bonfire is so great a necessity that unless we can make of it an orderly and good-tempered affair in which no serious injustice is done to anyone, it will, when it comes at last, grow into a conflagration that may destroy much else as well. (280)[[3]](#footnote-3)

This was not the healthy and relatively modest debt used to finance trade and economic growth in the pre-war era, but a debilitating debt which threatened financial crisis, stagnation and, ultimately, international disintegration. Much of the book is devoted to a plea by Keynes to the ruling elite to eliminate the internal debt by a one-time capital levy (or wealth tax) and the external debt through international negotiations, a plea which ultimately went unheeded.

Third, the pre-war system of international economic and financial exchange had broken down. "There are ... three separate obstacles to the revival of trade: a maladjustment between internal prices and international prices, a lack of individual credit ... to buy the raw materials needed to secure the working capital and to re-start the circle of exchange, and a disordered [international] currency system which renders credit operations hazardous or impossible quite apart from the ordinary risks of commerce" (243-44). The first and the last of these problems would continue to plague the system and occupy Keynes's attention for much of the interwar period.

Finally, Keynes feared the consequences of war-generated inflation. Prices had remained reasonably stable between the Napoleonic War and World War I (though in the period from 1896 to 1914 prices had risen substantially), they then rose dramatically over the next five years at an average rate of about 20% per year (before plunging in 1921 and 1922). Inflation was being driven by the monetizing of government deficits during and immediately after the war. "The inflationism of the currency systems of Europe has proceeded to extraordinary lengths" (II, 150). Keynes railed against the evils of inflation and the need to eliminate the policies that reproduced it. He (incorrectly) attributed to Lenin the idea that "the best way to destroy the Capitalist System was to debauch the currency" (II, 148). Inflation this virulent arbitrarily redistributes wealth (and thus violates the canons of social injustice), Keynes argued, and exacerbates uncertainty about the future to such a degree that business calculations become precarious if not futile. It turns the entrepreneur into a speculator, and destroys the foundation of the financial system. "As inflation proceeds and the real value of the currency fluctuates wildly ..., all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless; and the process of wealth-getting degenerates into a gamble and a lottery" (II, 149).

Inflation thus destroyed permanently one of the central foundations of the old order -- the "psychology of society." It drastically reduced the wealth of the rentier class, destroyed the incentives that sustained the prewar practice of holding wealth primarily in the form of long term bonds, and turned the businessman into a gambler. As Keynes would ask just a few years later: "can it be doubted that this experience must modify social psychology towards the practice of saving and investing" (IV, 67).

Keynes drew the following conclusion from all this.

The most serious problems for England have been brought to a head by the war, but are in their origins more fundamental. The forces of the nineteenth century have run their course and are exhausted. The economic motives and ideals of that generation no longer satisfy us: we must find a new way and must suffer again the malaise, and finally the pangs, of a new industrial birth (254). … England is in a state of transition, and her economic problems are serious. We may be on the eve of great changes in her social and industrial structure (253).

Thus, the old order had perished but the new order was yet to be determined, or even imagined, never mind established. Keynes's life work, as he saw it, was to help create a new economic order that would be both humane and efficient, and brought about by evolutionary change rather than through violent revolution.

**Trying to Make Sense Out of Chaos -- Inflation, Deflation and Unemployment: 1919-1923**

The economic events of the immediate post war years had done nothing to weaken the view Keynes so forcefully expressed in *The Economic Consequences of the Peace* in 1919 -- that Europe had seen the end of the institutional foundation of the old era of prosperity and now confronted the daunting challenge of constructing a new economic regime that could operate successfully in the modern environment. *The rapid inflation of the war years that so concerned him in 1919 continued through 1920 (so that wholesale prices almost tripled from 1914 through 1920 [4, 3]), only to be followed by a powerful deflation that reduced prices by almost half in the next two years.* Such wrenching price instability wreaked havoc on financial markets, creating huge speculative gains for business men and stock market gamblers as well as staggering rentier losses on the upswing followed by crushing business losses on the downswing. And deflation worsened the crushing burden of the war debt, further tightening the "paper shackles" that gripped Europe (ECOP, 280). Meanwhile, insured unemployment, which was negligible in 1918 and only 4% in 1920, rose to 17% in 1921 before sliding down to just over 10% by 1924 [WG, 5]. The fears Keynes had expressed in 1919 about the dissolution of the old order through debt and inflation were now magnified by a collapse of production and employment.

Thus, in the immediate post-war years, the British economy was, to put it mildly, violently unstable. [something on low investment in the era?] From 1919 through most of 1922 Keynes was primarily and energetically engaged in efforts to more rationally implement the peace treaties, make possible the rebuilding of the war torn economies of Europe, and eliminate the severe impediment to reconstruction and the reconstitution of a viable system of international finance and trade represented by reparations and war debts.[[4]](#footnote-4)

Starting in late 1922, however, Keynes increasingly turned his attention toward domestic events and domestic policy. Four lectures delivered to the Institute of Bankers in November and December provide insight into the status of his thinking at this difficult juncture, at a point when the economy had hit its trough. Much of the substance of these lectures (abstracting from the wealth of detailed analyses of the conditions of various European countries) would reappear in his 1923 Tract on Monetary Reform, though in 1922 he had yet to come to the firm policy conclusion expressed in that manuscript. Indeed, these lectures reflect a yet inconclusive process of struggle on Keynes's part to create an appropriate theory and an effective policy perspective capable of capturing his current insights and intuitions. Since the arguments in the *Tract* will be discussed in some detail, comments on these lectures will be brief.

Much of the discussion in these lectures about Britain's economic problems centers on the question of the expected return to the gold standard at the pre-war par of $4.86 per pound. At this time Keynes was beginning to understand, though not yet clearly, that a return to the gold standard, universally seen as the cornerstone of Britain's nineteenth century prosperity and the key to the restoration of secular prosperity, might well make it difficult, if not impossible, to secure and maintain full employment at home. Appalled by the damage done to the domestic economy by the severe price instability of the recent past, Keynes considered domestic price stability to be the *sine qua non* of a regime of persistent full employment. By now an expert on the mechanics of both the international and domestic banking systems, he believed that the monetary authorities (the Bank of England, the Treasury, and the "Big Five" private banks) had both the tools and, for the first time, the knowledge (in part gained by the necessity to "manage" the value of sterling the past few years) to enable them to control the cost and availability of credit. Deliberate control of the credit cycle in turn could be the means to permanent domestic price stability *if* that were to become the primary objective of monetary policy. But since 1920 both monetary and fiscal policy had been used not to pursue domestic price stability, but rather to pursue and achieve a savage deflation as the precondition for a return to gold at par.

With sterling still below par, monetary policy would have to exert additional deflationary pressure if it were to continue to be used in pursuit of a return to gold at par. Keynes understands that if monetary policy continues to be deflationary, it will be an impediment, to rather than a vehicle for, the restoration of full employment as well as the cause of further distributive injustice.[[5]](#footnote-5) And he seems to sense, rather than clearly see, the more general conflict between targeting the stability of external prices instead of the stability of internal prices as the prime goal of monetary policy. He is working toward, but has not yet arrived at, the firm conclusion that international objectives must become subsidiary to domestic objectives in the pursuit of economic policy.

In the lectures, Keynes argues that while the continental countries are in no condition to go back on the gold standard, at prewar par or at any fixed rate of exchange, Britain could probably do so, even at par. "There is no reason why we should not put sterling back to its pre-war parity if we wish to do so" (19-1, 61). Noting his belief that the government will eventually return to gold at par (a belief soon to be abandoned), he suggests that, if that is to be the case, "the sooner it gets there the better" (61). However, in his view a return to gold at par would be a bad mistake. Britain probably should return to gold, he intimates, but it would have been better to have done it "perhaps two years ago" (61), when the value of the pound was lower (below $3.50), and domestic prices much higher. At the present time, in the depth of the depression, prices are so low they have, he believes, destroyed entrepreneurs' incentive to expand production. Firms require an expectation of higher prices and thus of reasonable profits before they can be induced to accept the risk involved in expanding production and employment.

[T]rade will never go ahead until people are certain [prices] have touched bottom. They will never be certain that they have touched bottom until they see them going up a little; so that I am in favor of a moderate rise in prices as the only way of getting out of the present period of depression. (65)

But here is the problem with the government's policy: a return to gold at par will require perhaps an additional 7 per cent *decline* in British prices when what's needed for a revival of the domestic economy is a price *rise* of about 15 to 20 per cent.[[6]](#footnote-6) "Every hindrance in the way of that puts off the day when we shall be in [domestic] equilibrium, and when we can employ our population" (66).

The standard way to push the pound up to par would be to use monetary policy to "keep money in London for a very long period very dear -- decidedly dearer than in New York" (71). But this would injure British industry "enormously" because it would increase unemployment and excess capacity. Tighter credit reduces domestic demand by enough for long enough to force down domestic prices, thereby eventually improving the trade balance, which raises the value of sterling. Thus, Keynes has become conscious of the existence of a severe contradiction between the monetary policy needed for the restoration of domestic equilibrium on the one hand, and the return to gold at par on the other.

Keynes had already become convinced of an institutional aspect of the modern capitalist economy that would color all his inter-war thinking: *forced wage deflation was not an effective remedy for above-equilibrium real wages*.[[7]](#footnote-7) He agrees with the conservatives that workers, especially unskilled workers, had achieved an above-equilibrium real wage as a result of the war and of post war events; he estimates that the real hourly wage has risen about 20 per cent from its pre-war level in spite of the depression (66). However: "The business of forcing down certain levels of wages ... into equilibrium is almost hopeless, or it will take a long time" (66). A few months later he would write: "I argue, therefore, in the first place, that our existing industrial system is singularly ill-adapted to a policy of deliberate deflation ... " (116). The specific point at issue is that with labor unions much more economically powerful than in the nineteenth century, it would require high unemployment lasting many years to beat real wages down.

Skidelsky points to the key lessons Keynes had already drawn from wage behavior in the past two years. Evidence from this period strongly influenced his belief that the Classical proposition that flexible money wages can be relied on to restore full employment if the economy falls into recession of depression was mistaken, a belief at the core of chapters 2 and 19 of The General Theory*.*

*Money wages had fallen by a third during the slump -- the last example in British economic history of downward flexibility. Yet they had not fallen enough to restore equilibrium and for the rest of the 1920s remained rigid, despite further deflationary pressure.* ... Keynes and the financial establishment drew different lessons from this experience. Keynes concluded that the deflation of 1920-1 had brought Britain to the 'verge of revolution', and that, as a working assumption, wage rates should now be regarded as too rigid in the short period to adjust to the 'ebb and flow of international gold credit'. ... We have in these lectures an early clue as to what Keynes was to be saying in the years ahead. Wages were 'stickier' than prices. This observation was not novel. More novel was the conclusion that, as a practical matter, the price level and exchange rate should be adjusted to the going wage rate, rather than the other way round. (II, 134, italics added)

In stressing this point about wages, Keynes merely hints at (though he does not clearly theorize) a contradiction between a return to the gold standard at *any* fixed rate and sustained full employment at home. For, as he only mentions here but forcefully stresses in the *Tract*, the mechanism by which the exchange rate stays fixed under shifting relative prices and productivities at home and abroad, is through fluctuating interest rates that force domestic wages and prices to change appropriately by altering domestic demand. If domestic wages are no longer very flexible with respect to demand, as he argues, if inflation is unjust and corrosive of thrift and deflation is economically disastrous, then the domestic and international requirements for monetary policy may *frequently* be in contradiction.

For these reasons, and because workers and the Labour Party were now more electorally influential than before the war, the political party that espouses and implements a policy of return to gold at par will have to pay a severe price for so doing. The general point is this: the severity of the disequilibria of the past four years had convinced Keynes that, though many of the old verities remain true 'in the long run', the process of moving between long run equilibria *under modern conditions* could be long and enormously costly. That is, the contradictions of the short-run matter, a point not acknowledged by supporters of the return to gold at par, most of whom spent the entire inter-war period arguing that the only long-run solution to Britain's unemployment was to deflate her way back to her pre-war domination of export markets. They disdained short-run policies designed to directly raise domestic demand and lower unemployment, claiming that they only made the process of adjustment to the long-run solutions longer and costlier. In reviewing these issues one year later in the *Tract* he will make his oft-cited and oft-misunderstood observation that, in troubled times, policy must focus on short-run problems or the policy makers may fail to survive to see the long run. This is not the 'old days'; Britain had entered and new and difficult economic milieu.

But this *long run* is a misleading guide to current affairs. *In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again. (II, 65, emphasis in original)[[8]](#footnote-8) [

Keynes is not clear yet, as he will be one year later, on precisely how this policy contradiction should be resolved, or indeed on precisely how general the conflict is. He appreciates the fact that flexible rates help eliminate trade imbalances much more quickly, effectively and painlessly than fixed or "pegged" rates. And he points out that maintenance of the existing system of exchange rate flexibility would eliminate the worrisome attribute of fixed rate systems that domestic prices (and therefore production and employment) must be forced down whenever there is downward pressure on sterling. But he does not yet pursue this line of reasoning to its logical policy conclusion.

Under present conditions, as soon as we import too much or export too little, the exchanges move against us; and when the exchanges move very rapidly the price of every article is changed -- the price of imports and exports is changed almost forthwith. ... If, on the other hand, you have a pegged exchange, then if you are purchasing more than you can afford, there is a tendency for gold to flow out in payment of the adverse balance. The effect of the outflow of gold is to make money dearer by slow stages which are familiar to people. That reacts on trade. It makes trade curtail itself rather, and gradually, by a very slow causal process, forces home prices down ... But it is a very long and slow process. ... That is one of the very deep reasons why in unstable conditions you almost invariably do have an unpegged exchange. (75)

But flexible rates have their own problem, one that Keynes, as an inveterate foreign exchange market gambler, knew all too well. With no assured center of gravity predetermined by policy, unregulated or fully flexible exchange rates easily became the object of speculation which can transform moderate exchange rate cycles into periods of substantial instability. Thus, flexible rates were, to a degree that depended on the stability of the general economic environment, inherently unstable.[[9]](#footnote-9) If "the exchange rates are not stabilized by policy they will never come to an equilibrium by themselves." (57)

Though early parts of the lectures suggest that Keynes himself is committed to a return to gold (at less than par), by their conclusion he no longer seems so sure of his position. He will make up his mind in 1923.

The unpegged exchange is so sensitive that it is valuable for certain purposes; yet one has to admit that the pegged exchange is so slow in its operation that it is dangerous for country to adopt until it is sure that the basic conditions are fairly sound: then, as a correction to the seasonal movement [in pressures on the exchange rate], it is essential. This is an argument which is rather the opposite of what I have been saying in these lectures, but it is of sufficient interest and importance, and has enough relevance on the other side of the case for it to be right that I should mention it in conclusion. (76)

Though confused about which path to follow here, Keynes was quite clear about the stakes involved in making the right set of choices in the post-war reconstitution of European and world economic institutions and policies. In January 1923, in the introduction to the last segment of an influential series of articles on European reconstruction published in the *Manchester Guardian*, he made the following observation, cited by Skidelsky.

In our present confusion of aims, is there enough clear-sighted public spirit left to preserve the balance and complicated organisation by which we live? Communism is discredited by events; socialism, in its old-fashioned interpretation, no longer interests the world; capitalism has lost its self-confidence. Unless men are united by a common aim or moved by objective principles, each one's hand will be against the rest and the unregulated pursuit of individual advantage may soon destroy the whole. (in Skidelsky II, 121).

Skidelsky notes that at this point, "Keynesianism is already a gleam in his eye -- not as an economic theory, but as the vision of an enlightened Middle Way" (II, 122).

By May of 1923 there were clear signs of the revival of production and employment (and a rise in the value of sterling and the price of industrial shares) from their 1922 lows; the worst of the slump appeared to be over. But sterling dropped significantly from May to July, and, in response, the Bank of England raised the Bank rate from 3 to 4 per cent. Keynes was outraged. In an article in the Liberal Party journal *The Nation and Athenaeum* (he had become chairman of the board of directors of the journal in March), he snarled at the "secret process of deflation" being carried on by the Bank, one "surely to be regretted with trade as discouraged and unemployment as high as they are now" (19-1, 97).[[10]](#footnote-10) The contradiction between domestic and international priorities in the use of monetary policy was now becoming ever clearer to him, and he had made up his mind about the direction in which the contradiction should be resolved.

The raising of the Bank rate to 4 per cent is one of the most misguided movements of that indicator which have ever occurred. Trade is discouraged and declining; prices are falling slightly; employment is very bad; and the political situation is such as to damp down enterprise and hold back everyone from entering into new business. ... There is *no necessary* reason why disturbances on the Continent need cause a million or two of Englishmen to stand idle. ... Our job is to do our best to free ourselves from the psychological reactions of foreign politics ... and resolutely to keep our own business going as best we can. ... What is the explanation? ... There is not much doubt that the explanation is to be found in the fall of the dollar exchange (not at all unusual at this time of year)... That is to say, the Bank of England thinks it more important to raise the dollar exchange a few points than to encourage flagging [domestic] trade. (100-01, emphasis in original)[[11]](#footnote-11)

Keynes then argues that there is a clash between the goals of the monetary authorities and the stated objective of the Prime Minister. It is the policy of the Bank "*to bring about a curtailment of credit, and to arrest a rising tendency or to produce a falling tendency in sterling [i.e., domestic] prices"* (103, emphasis in original). But the Prime Minister, the "day before Bank rate was raised", had committed himself to price stability (103). Responding to criticism of his powerful attack on the Bank, Keynes stressed the unrecognized contradiction in the conventional wisdom about policy. Everyone who mattered favored return to gold and therefore supported Bank policies designed to maintain the value of sterling, but most commentators also favored domestic price stability.

It used to be our policy to restore the gold standard. It has become our policy to keep prices stable. We have taken on the new doctrine, without, as yet, discarding the old, and when they are incompatible we are torn between the two. (106)

Of course, Keynes could have been here describing his own confusion in his lectures to the Institute of Bankers at the end of 1922. But his confusion has by now been definitively resolved. Rejecting the conventional wisdom maintained by all three major political parties and almost all 'responsible' public opinion, he went on public record in opposition to a return to the gold standard at any fixed rate. He called instead for monetary policy to end its "secret policy of deflation" in defense of sterling and to pursue domestic price stability as its primary objective, letting the pound adjust as needed. In August, in a letter to *The Times* about the return to gold, he put his position as follows.

For my part I believe that confidence in the price level is the biggest and most practical help which the official world can give to the business world; and that the lack of this confidence is a considerable cause, and probably the only remedial one, of present unemployment. If the Prime Minister were able to announce that he had consulted with the Governor of the Bank of England and that the two of them were determined to do all in their power to promote and preserve confidence in the existing value of sterling prices *(letting the dollar exchange go hang, if necessary*), great good would result. (112, emphasis added)

The final stage in Keynes' public conversion from support of the gold standard to a belief in the use of monetary policy to control the domestic price level (instead of controlling the exchange rate) would come with the publication of his *Tract on Monetary Reform* in December. In the *Tract* he presents all the key ideas on monetary policy he had discussed for the past year or so in a neat and orderly manner, marshals evidence in their support, and presents his policy conclusions in a clear and compelling form.

**A Tract on Monetary Reform -- 1923**

Keynes believed that the collapse of production and employment in Britain in 1921-22 had been caused in large part by the great instability of prices.[[12]](#footnote-12) By training and experience a monetary economist, and still years away from his 1930s focus on aggregate demand as the prime determinant of output and employment, he developed a theory in which rising and falling prices, facilitated or made possible by increases and decreases in the supply and demand for credit, were responsible for the drastic insta­bility observed in the real sector of the economy. In some ways his theoretical perspective was traditional or conservative -- even classical -- since his analysis seemed to imply that if the aggregate price level could only be kept relatively stable, the real sector, left to itself, could be counted on to create relatively full employment and good output growth. But in other ways, his thinking in 1923 as he wrote*A Tract on Monetary Reform* was theoretically as well as politically radical.

The *Tract* re­presents an important step in Keynes's development as the champion of British "middle-way" state economic planning, for its main policy conclusion was that Britain should move into a new regime of flexible exchange rates and a monetary and credit policy in which the state would consciously control the domestic price level rather than the external or dollar-sterling price. It thus presents an early and preliminary version of what was to become his standard policy prescription -- state-management of the domestic economy unencumbered by binding constraints originating in the international sector.

**I. Theory**

Many important theoretical ideas and concepts we associate with the mature Keynes play an important role in the *Tract*. They include the central role given to uncertainty, expectations, conventions, business "psychology" as a key influence on production and investment, *the "regime of money contract"* (33), and financial fragility in the deter­mina­tion of the pattern of movement of the economy. Skidelsky argues that the "most distinctive feature in Keynes's account is his stress on expectations" (II, 55) Keynes emphasiz­es the first two of these points in his brief Preface to the book. The traditional capitalist practice of letting uncoordinated private individuals and institutions chose the national pattern of saving and investment, he argues, will, under modern conditions, lead to instability and high unemployment unless the future can be made more predictable and, therefore, expectations made more stable, through deliberate state control of the domestic price level. Stabilization of the aggregate price level is the key to reducing uncertainty and preventing expectations from becoming dysfunctional. Though his theory of the importance of aggregate demand and the determinants of aggregate demand was not yet developed, Keynes made the argument that excessive price instability reduced economy-wide spending, raised unemployment and mal-distributed income. Capitalist individualism

cannot work properly if the money, which [individual savers and businessmen] assume as a stable measuring rod, is undependable. Unemployment, the precarious life of the worker, the disappointment of expectation, the sudden loss of savings, the excessive windfalls to individuals, the speculator, the profiteer -- all proceed, in large measure, from the instability of the standard of value. ... [R]isk, and the reward of risk-bearing, [?] is one of the heaviest, and the perhaps the most avoidable, burden on production. This element of risk is greatly aggravated by the instability of the standard of value. (4, xiv)

In a piece published in *The Nation* in August he had made the same point this way.

Modern individualistic society, organised on lines of capitalist industry, cannot support a violently fluctuating standard of value, whether the movement is upward or downward. Its arrangements presume and absolutely require a reasonably stable standard. Unless we can give it such a standard, this society will be stricken with a mortal disease and will not survive. (117)[[13]](#footnote-13)

The first chapter deals with the economic and social consequences of price instability. The term 'social' is important because Keynes is thinking here, as in *The Economic Consequences of the Peace*, in terms of the broad sweep of events taking place in the twentieth century and the social, cultural, institutional and political preconditions for the efficient functioning of domestic and global capitalism. He restates of his 1919 themes, that unstable price movements since 1914 have virtually destroyed the preconditions for the successful reproduction of the pre-war system used to finance capital investment.

The fluctuations in the value of money since 1914 have been on a scale so great as to constitute, with all that they involve, one of the most significant events in the economic history of the modern world. The fluctuation of the standard ... has not only been of unprecedented violence, but has been visited on a society of which the economic organisation is more dependent than that of any earlier epoch on the assumption that the standard of value would be moderately stable. (4, 1-2)

Changes of this magnitude "are producing now the vastest social consequences" (4, 1).

His first point, stressed earlier in The Economic Consequences of the Peace, is that over the 19th century there evolved a separation of "the management of property from its ownership" with fixed income securities -- "mortgages, bonds, debentures, and preference shares" -- becoming increasingly important (4, 5). In this historically contingent form of capitalism, the high savings of the affluent rentier class were provided to the entrepreneurs of the day at low cost and without substantial managerial interference, to be converted almost automatically into capital accumulation both because the return on capital was high and because, as noted, in this prosperous environment businessmen invested not on the basis of a careful calculation of expected profits, but almost as "a way of life" (GT, 150). The system was very successful, according to Keynes, but *such a rentier-based "regime of money contract" could not have persisted without the unusual price stability that occurred between the Napoleonic War and the start of the war.*[[14]](#footnote-14)

For a hundred years the system worked, throughout Europe, with an extraordinary success and facilitated the growth of wealth on an unprecedented scale. ... The morals, the politics, the literature, and the religion of the age joined in a grand conspiracy for the promotion of saving. ... But amidst the general enjoyment of ease and progress, the extent to which the system depended on the stability of the money to which the investing classes had committed their fortunes was generally overlooked. (6)

Anticipating his mid-1930s stress on "conventional" expectation formation, Keynes notes that belief in the permanent stability of the value of money was not rooted in any careful study of the broad sweep of history, for such a study would have show recurrent outbursts of instability that took place around a long-run trend of moderately rising prices. There existed, rather, merely a "*conventional belief* in the stability and safety of a money contract..." (7, italics added). "Custom and favourable experience had acquired for such investments an unimpeachable reputation for security" (12). [Footnote: Keynes insertion of “conventional beliefs,” “customs,” and expectations based on extrapolation from the relevant past into macro-economic theory were early steps in what would turn out to be a methodological revolution that culminated in the publication of The General Theory.] Thus, the enormous inflation of prices during the war and for two years thereafter mortally injured the old system connecting rentiers and business men - or saving and the demand for capital investment, first, by destroying the European rentier class itself, and second, by making conventional belief in price stability untenable. A system based on long-term, nominal debt contracts was simply incompatible with substantial price instability.

The monetary events which have accompanied and have followed the war have taken from [rentiers] about one-half their real value in England, seven-tenths in France, eleven-twelfths in Italy, and virtually the whole in Germany and the succession states of Austria-Hungary and Russia. .... Nor can it be doubted that this experience must modify social psychology towards the practice of saving and investing. (12, 16)

The theory Keynes presents to explain why and how price instability causes production and employment to fluctuate builds on arguments in The Economic Consequences of the Peace and prefigures ideas published in 1930 in A Treatise on Money. In essence it is this: "It has long been recognized, by the business world and economists alike, that a period of rising prices acts as a stimulus to enterprise and is beneficial to business men" -- and vice-versa (17). Since output prices tend to respond more quickly to changes in final demand than input prices (including wages), rising prices bring what Keynes calls "windfall profits" to the business man. Rising prices help the him in two ways: (1) they reduce the burden of his existing debt (and since, in Keynes's view, nominal interest rates rarely catch up to the pace of inflation, they lower the cost of new credit as well); and (2) since production and marketing take time, inflation raises his selling price relative to the prices paid for inputs. Given Keynes's assumption of endogenous expectation formation, a process of rising prices (or inflation) normally induces expectations of future price increases and thus of expected future windfall profits -- "The continuous enjoyment of such profits engenders an expectation of their renewal" (18). As in all Keynes's theories, expectations codetermine reality. "If the market expects prices to rise still further, it is natural that stocks of commodities should be held speculatively for the rise, and for a time the mere expectation of a rise is sufficient, by inducing speculative purchases, to produce one" (18).

Expectations of higher future profits of course cause business men to expand production, employment, and the purchase of commodity inputs: "the intensity of production is largely governed by the anticipated real profit of the entrepreneur" (32). Such expectations also induce business men to increase their reliance on credit in order to expand production more quickly. The Keynesian "financial fragility hypothesis" popularized by Minsky is in evidence here: the economy is driven in part because "The practice of borrowing from banks is extended beyond what is normal" (18). This expansion can overshoot the 'equilibrium' or 'normal' production level in part because for some time the inflation-adjusted or real rate of interest at which loans are extended to entrepreneurs may stay below the normal or equilibrium level. "In a period of rapidly rising prices, the money rate of interest seldom adjusts itself adequately or fast enough to prevent the real rate from becoming abnormal" (20). Thus, if business men expect a continuing price rise, "it may pay them to increase their borrowings and to swell production beyond the point where the real return is just sufficient to compensate society as a whole for the effort made" (32). In the deflationary period, as in a Keynes-Minsky downturn, everything works in reverse. The burden of debt is increased, not only for business borrowings, but "in these days of huge national debts ... the burden of taxation becomes intolerable on the productive classes of the community" (30). And since falling demand hits output price before cost, it brings 'windfall' losses and expectations of lower profit rates. Just as in chapter 19 of *The General Theory*, when people expect prices to fall, everyone is better off waiting before buying commodities of any kind. Thus, the demand for commodities falls, pulling prices down. The expectation of falling prices is sufficient to bring the price level down:

[a]n expectation about the course of prices tends, if it is widely held, to be cumulative in its results up to a certain point. ... Thus a comparatively weak initial impetus may be adequate to produce a considerable fluctuation. (34)

What Keynes is doing here is painting a theoretical picture of a cycle around some given level of output and employment just as he will do again, in greater detail, in A Treatise on Money. It is unclear whether or not this is to be understood to be full-employment ‘equilibrium "The claim was being made for a greater understanding and control of short-run or cyclical phenomena. The relationship between the 'short run' and the 'long run' (or indeed what these comments meant) was left unexplored" (Skidelsky, II, 153-4). From comments made both before and shortly after the *Tract*, one would assume that the price level would first have to be moved to the appropriate level (whether monetary policy unaided could accomplish this is not made clear here), before this theory of counter-cyclical monetary policy could be applied. At any rate, *there are decidedly anti-classical insights here, perhaps the most important of which is that movements -- or even expected movements -- in the general or aggregate price level will significantly affect the level of output and employment*. Moreover, there is the clear implication that in modern conditions the market system left to itself may be incapable of preventing destabilizing large scale price movements. Therefore, for the first time the capitalist state must take direct responsibility for the maintenance of domestic price stability.

*There is also the suggestion that the influence of uncertainty (here called risk) on economic instability through the medium of expectations is becoming stronger as economic relations grow more complex and the* time *between the decision to undertake production and the receipt of revenues from production lengthens.* The causes of this problem arise, Keynes says,

to a certain extent out of the character of the social organisation described above, but [are] aggravated by the technical methods of present-day productive processes. With the development of international trade, involving great distances between the place of original production and the place of final consumption, and with the increased complication of the technical processes of manufacturing, the amount of *risk* which attaches to the undertaking of production and the length of time through which this risk must be carried are much greater than they would be in a comparatively small self-contained community. (32)

Keynes believed that this problem of uncertainty was both increasingly dangerous and very difficult to resolve. "The provision of adequate facilities for the carrying of this risk at a moderate cost is one of the greatest of the problems of modern economic life, and one of those which so far have been least satisfactorily solved" (33). His main insight here is that as the average time involved in the process of production lengthens, production becomes increasingly and inherently speculative (a problem that will eventually be dominated in his thinking by a focus on the inherently speculative nature of the process of capital investment). Unexpected changes in relative prices are one part of the problem, but the anti-classical issue of the dangers caused by unexpected changes in the average price level is perhaps more dangerous yet.[[15]](#footnote-15)

This argument is similar in spirit to one made by Karl Marx.

It is clear, however, that with the development of labour productivity and hence of production on a large scale [in capitalism], (1) markets expand and become further removed from the point of production, (2) credit must consequently be prolonged, and (3) as a result, the speculative element must come more and more to dominate transactions. Large-scale production for distant markets casts the entire product into the arms of commerce; but it is impossible for the nation’s capital to double, so that commerce would purchase the entire national product with its own capital before selling it again. Credit is thus indispensable here, a credit that grows in volume with the increasing value of production and grows in duration with the increasing distance of markets. A reciprocal effect takes place here. The development of the production process expands credit, while credit in turn leads to an expansion of industrial and commercial operations. (Capital Volume 3, (Translated by David Fernbach) New York: Random House (Vintage Books Edition) 1981, p. 612. Emphasis added.)

The language used here clearly indicates that Keynes is already focused on the crucial theoretical differences between the *barter economy* analyzed in classical theory (in which changes in the stock of money or the aggregate price level cannot affect the real sector) and the modern *monetized economy or "regime of money contract***"** (in which goods trade for money, not other goods; production and sales take time; and contracts, especially financial contracts, fixed in money terms are ubiquitous) -- a distinction referred to in drafts of The General Theory as between a *"real wage or co-operative economy" and a "money-wage or entrepreneur economy"* (29, 77-8).

A considerable part of the risk arises out of fluctuations in the *relative* value of a commodity compared with that of commodities in general during the interval which must elapse between the commencement of production and the time of consumption. ... But there is also a considerable risk directly arising out of instability in the value of money. During the lengthy process of production the business world is incurring outgoings in terms of *money* -- paying out in money for wages and other expenses of production -- in the expectation of recouping this outlay by disposing of the product for *money* at a later date. That is to say, the business world as a whole must always be in a position where it stands to gain by a rise of price and to lose by a fall of price. Whether he likes it or not, the technique of production under a regime of money contract forces the business world [sic] to carry a big speculative position; and if it is reluctant to carry this position, the productive process must be slackened. (33, emphasis in original)[[16]](#footnote-16)

Keynes seems to be suggesting in this chapter not only that production and employment have become increasingly elastic with respect to absolute price instability, but that increasing *uncertainty about future price movements are adversely affecting the incentive to save as well as the propensity to accumulate capital*. That is, not only has the amplitude and length of the production-employment cycle been affected by institutional change and price instability, the trend around which this cycle takes place may have been impacted as well.[[17]](#footnote-17)

Finally, Keynes argues that the inflation-deflation cycle of the past decade has had profound social and political as well as economic consequences. His main concern is that price instability of this magnitude violates social justice as he defines it by arbitrarily and substantially redistributing income and wealth among and within the three great classes of society: rentiers, businessmen and workers. On average, rentiers were devastated by the inflation, while business men and workers were enriched. "Throughout the continent the pre-war savings on the middle class, so far as they were invested in bonds, mortgages, or bank deposits, have been largely or entirely wiped out" (16). Yet during the inflation phase business men reaped large, if speculative and undeserved gains, and many sectors of labor, in Great Britain and the US, were able to use the greater bargaining power they achieved during the war "to take advantage of the situation not only to obtain money wages equivalent to what they had before, but to secure a real improvement [and] to combine this with a diminution in their hours of work..." (26). But since no important aspect of this substantial redistribution reflected changes in the economic contributions to society of the classes, its "most striking consequence is its **injustice**", especially to middle class savers (29). Deflation, on the other hand,

means impoverishment to labour and to enterprise by leading entrepreneurs to restrict production, in their endeavour to avoid loss to themselves; and is therefore disastrous to employment. ... Of the two perhaps deflation is ... the worse, because it is worse, in an impoverished world, to provoke unemployment than to disappoint the rentier. (35-6)

Keynes thus finds this cycle of redistribution through inflation-deflation to be not only morally repugnant, but economically and politically dangerous because it destroys belief in the efficiency and fairness of economic institutions, a precondition for social stability. In particular, it changes the image of the business man from creative entrepreneur to speculator and "profiteer", destroys the incentive to save in the inflation phase, and causes depression and financial distress in the deflation stage. And, it erodes popular support for and allegiance to the existing system of class status and privilege. In *The Economic Consequences of the Peace* he wrote:

The sight of this arbitrary rearrangement of riches strikes not only at security, but at confidence in the equity of the existing distribution of wealth. Those to whom the system brings windfalls, beyond their deserts and even beyond their expectations or desires, become 'profiteers', who are the object of the hatred of the bourgeoisie, whom the inflation has impoverished, not less than the proletariat. (II, 149)

By 1923 high unemployment and the recession had only deepened his sense of foreboding.

**II. Policy**

Keynes's policy conclusion is simple, but radical. Either the state must be given unprecedented responsibility for maintaining a relatively stable domestic aggregate price index, or the determination of national savings and the conditions under which savings are made available for capital accumulation can no longer be left to individuals and the market. As has been observed, he now believes that the monetary authorities should be empowered to seek domestic price stability as their primary objective, an objective they can in fact achieve through 'scientific' management of the cost and availability of credit.[[18]](#footnote-18)

It is one of the objects of this book to urge that the best way to cure this mortal disease of individualism is to provide that there shall never exist any confident expectation either that prices generally are going to fall or that they are going to rise; and also that there shall be no serious risk that a movement, if it does occur, will be a big one. (35)

What moral for our present purpose should we draw from this? Chiefly, I think, that it is not safe or fair to combine the social organisation developed during the nineteenth century (and still retained) with a laisser-faire [sic] policy towards the value of money. ... If we are to continue to draw the voluntary savings of the community into `investments', we must make it a prime object of deliberate State policy that the standard value, in terms of which they are expressed, should be kept stable... (16)

The last two chapters of the book discuss policy considerations in detail. The first of the two policy-oriented chapters is organized around the central issues in the debate over the return to gold. The specter of a possible return to gold at par (as proposed by the Cunliffe Committee in 1918) reinforces the chapter's emphasis on the dangers of deflation, for it would entail an appreciation of the pound on the order of 10% or more, and therefore require a deflation of some similar order of magnitude just to maintain the trade balance in it's current, unsatisfactory position. Yet a domestic business revival, as explained earlier in the book, would require a rise in prices of perhaps even greater magnitude. In November 1922 he had written:

I am in favour of a moderate rise in prices as the only way of getting out of the present period of depression. ... the more I study the statistics the more convinced I am that we shall not be in equilibrium until wholesale prices have risen from 15 to 20 per cent. (19-1, 65-6)

A return to gold at par would thus rule out a return to full employment for quite some time.

Keynes had already argued (in December of 1922) that nominal wages could not be easily reduced. This is a point he would stress as the decade evolved. "The business of forcing down certain levels of wages ... into equilibrium is almost hopeless, or it will take a long time" (19-1, 66). Since real wages were too high to facilitate export growth, he reasoned, prices would have to go up. Keynes does not repeat such arguments here, but reiterates instead the "simple arguments against deflation" made earlier in the book (118). Deflation "redistributes wealth in a manner injurious, at the same time, to business and to social stability", arbitrarily transferring wealth from "the active classes" to the passive rentiers, while simultaneously reducing production and employment (118). "Modern business, being carried on largely with borrowed money, must necessarily be brought to a standstill by such a process" (119). Moreover, the huge increase in government debt generated by the war would make deflation fiscally untenable: "For the burden it would throw on the taxpayer would be insupportable" (119).

Keynes then addresses the pressing policy issue: the pros and cons of targeting *internal versus external* price stability as the primary object of policy. In Keynes's view, a system of flexible exchange rates in an environment of stable domestic prices would be vastly superior to a fixed rate system that requires flexible domestic prices. He will consistently support, throughout his career, the general proposition that the state should *directly* target domestic goals in its economic policy, treating international sector objectives as instrumental and subsidiary to domestic ones. As explained, Keynes believed that domestic price instability causes social and distributive injustice, and unemployment. He had already begun to make the case, which he would make with even greater vigor in the near future, that the modern British economy, burdened with War debt, cannot tolerate deflation and that *workers will not agree to lower their nominal wages unless forced to by something akin to civil war*. But the gold standard requires domestic price flexibility -- here deflation -- to work properly.

We are familiar with the causal chain along which the pre-war method reached its result. If gold flowed out of the country's central reserves, this modified discount policy and the creation of credit, thus affecting the demand for, and hence the price of, the class of goods most sensitive to the ease of credit, and gradually, through the price of these goods, spreading its influence to the prices of goods generally, including those which enter into international trade until at the new level of price foreign goods begin to look dear at home and domestic goods cheap abroad, and the adverse balance was redressed. (129)

Thus, there are two serious and related problems involved in a return to gold. First, the British economy no longer has the requisite *flexibility of prices or mobility of resources* to tolerate it. For one thing, debt burdens have increased enormously since 1914. For another, workers are much better organized and therefore better positioned to resist the downward pressure on wages generated by unemployment. "The organisation of certain classes of labour -- railwayment, miners, dockers, and others -- for the purpose of securing wage increases is better than it was" (4, 26) and the war increased workers expectations and militancy Thus,

The period of depression has exacted its penalty from the working classes more in the form of unemployment than by a lowering of real wages, and State assistance to the unemployed has greatly moderated even this penalty. (28)

Second, monetary authorities will not be able to control the domestic price level unless they are free to set interest rates and to control the supply of credit with precisely this objective in mind. Keynes believed that credit conditions ultimately determine the domestic price level which, in turn, as we have seen, determines production and employment. "The internal price level is mainly determined by the amount of credit created by the banks..." (141). His logic here is this: cyclical swings in demand move prices, but both direct and derived demand are strongly influenced by the cost and availability of credit.[[19]](#footnote-19) If Britain returned to the gold standard, the monetary authorities would have to let external factors dictate credit policy. On the other hand, if the domestic price level could be stabilized through monetary policy, then exchange rate flexibility will be able to adequately regulate the trade balance. Thus, in the debate between the adoption of flexible exchange rates and deliberate state control of internal prices, and a return to the gold standard, Keynes comes down strongly on the side of radical change.

[T]here does seem to be in almost every case a presumption in favor of the stability of prices, if it can be achieved. Stability of exchange is in the nature of a convenience which adds to the efficiency and prosperity of those engaged in foreign trade. Stability of prices, on the other hand, is profoundly important for the avoidance of the various evils described in chapter 1. Contracts and business expectation, which presume a stable exchange, must be fewer, even in a trading country such as England, than those which presume a stable level of internal prices. (126)[[20]](#footnote-20)

Keynes does not want a completely unregulated foreign exchange market. Here, as in his lectures at the end of 1922, he stresses the problem that will be generated by an exchange rate with no center of gravity. As before, he argues that trade in food and raw materials imparts a distinct seasonal character to movements in the trade balance and, therefore, to pressures on sterling. In the complete absence of Bank intervention, speculators, uncertain as to the magnitude or duration of any particular cycle phase, will magnify these seasonal movements, causing substantial instability in the value of the pound. To resolve this problem, he calls for the Bank of England to make a forward market in sterling, and use this market to institute a kind of 'crawling peg'.

[T]he Bank of England [should] take over the duty of regulating the price of gold, just as it already regulates the rate of discount. 'Regulate', but not 'peg'. The Bank of England should have a buying and a selling price for gold, just as it did before the war, and this price should remain unchanged for considerable periods, just as bank rate does. But it would not be fixed or 'pegged' once and for all, any more than bank rate is fixed. ... A willingness on the part of the Bank both to buy and sell gold at rates fixed for the time being would keep the dollar-sterling exchange rate steady within corresponding limits, so that the exchange rate would not move with every breath of wind but only when the Bank had come to a considered judgment that a change was required for the sake of the stability of sterling prices. (150-1)

The concept of a moving or crawling peg resolves the contradiction that prevented Keynes from firmly making up his mind about which way to move in the choice between a fixed and a flexible rate system in his lectures to the Institute of Bankers a year earlier. By solving the problem of speculation stimulated by seasonal trade patterns, Keynes is now free to argue that a rejection of fixed rates has no serious downside consequences.

Keynes reminds the reader that the gold standard has in fact been inoperative since the start of the war. England had been living with a "managed currency" for a decade: "The bank rate is now employed, however incompletely and experimentally, to regulate the expansion and deflation of credit in the interests of business stability and the steadiness of prices" (137). The war had drastically reduced Britain's gold reserves; to protect them the government had placed an embargo on the export of gold (that was scheduled to expire at the end of 1925). Thus, "the gold standard is already a barbarous relic.[[21]](#footnote-21) ... A regulated nonmetallic standard has slipped in unnoticed. *It exists*" (138, emphasis in original). Ever the smooth polemicist, Keynes has signaled his audience that his seemingly radical proposal is not as radical and unprecedented as it might seem at first glance. (This is not the last time he will 'sugar-coat' his plea for radical policy change: see, for example, chapter 24 of The General Theory.)

Keynes concludes chapter 4 with the argument that **no** post-war gold standard, however constructed, will operate through gold flows linked mechanistically to changes in the flow of credit and money and, from these, to changes in prices. Both policy alternatives in this debate will require deliberate and discretionary monetary policy. A new gold standard will be managed through the guidance of the central banks of the US and the UK acting, presumably, in cooperation. Gold will exist in such a system "only as a constitutional monarch" (138). But, in an argument prefiguring his discomfort at the Bretton Woods negotiations, he tells the reader that it is the Americans who will call the tune, and the British who will be forced to dance accordingly. And, just as at Bretton Woods, Keynes is not happy at the prospect of American dominance.

With the distribution of the world's gold, the reinstatement of the gold standard means, inevitably, that we surrender the regulation of our price level and the handling of our credit cycle to the Federal Reserve Board of the United States. (139)

Keynes then sums up his position in this great debate, decisively rejecting a return to the ante-bellum status-quo. This was a rebellious position because virtually all politically powerful forces - in government, in economics and in business and finance - vigorously supported a return to gold at the pre-war value of the pound. Organized labor was the only other important agent in his corner.

Therefore, since I regard the stability of prices, credit, and employment as of paramount importance, and since I feel no confidence that an old-fashioned gold standard will even give us the modicum of stability that it used to give, I reject the policy of restoring the gold standard on pre-war lines. At the same time, I doubt the wisdom of attempting a 'managed' gold standard with the United States ... because it would make us too dependent on the policy and on the wishes of the Federal Reserve Board. (140)[[22]](#footnote-22)

The fifth and last chapter of the book presents a somewhat technical argument about the relation between the actions of the Bank of England, the Treasury, and the "Big Five" private banks, on the one hand, and movements in interest rates and the supply of credit on the other.[[23]](#footnote-23) Its details need not concern us. Keynes's main goal is to show that the monetary authorities already possess the power to control credit conditions and thus, in his view, the domestic price level. No new legislation is needed. "Therefore it is broadly true to say that the level of prices, and hence the level of the exchanges, depends in the last resort on the policy of the Bank of England and of the Treasury ..." (145).[[24]](#footnote-24) Moreover, he notes, the system he proposes is, more or less, what is in fact already taking place.

It will be observed that in practice we have already gone a long way towards the ideal of directing bank rate and credit policy by reference to the internal price level and other symptoms of under- or over-expansion of internal credit, rather than by reference to the pre-war criteria of the ... level of the dollar exchange. (146)

Therefore, Keynes stresses, his plan can be effected merely by turning what has been seen as a temporary expedient into a permanent and intentional policy. It requires only "a development of our existing arrangements on more deliberate and self-conscious lines" (147) and a commitment by the monetary authorities to "adopt the stability of sterling prices as their *primary* objective -- though this would not prevent their aiming at exchange stability also as a secondary objective by cooperating with the Federal Reserve Board in a common policy" (147, emphasis in original).

The existence of secondary objectives and of limitations on economists' understanding of the precise relation between changes in policy instruments and movements in credit, and between movements in credit and subsequent changes in prices, meant that the monetary authorities would have to act with judgment and exercise *discretion*. *No simple policy rule could possibly be adequate for this complex task, a position he supported throughout the long course of his policy evolution.*

Actual price movements must of course provide the most important datum; but the state of employment, the volume of production, the effective demand for credit as felt by the banks, the rate of interest on investments of various types, the volume of new issues, the flow of cash into circulation, the statistics on foreign trade and the level of the exchanges must all be taken into account. The main point is that the *objective* of the authorities, pursued by such means as are at their command, should be the stability of prices. (149)

This position on the question of rules versus discretion in policy was one he would maintain throughout his life.

In a speech summarizing the key points made in the *Tract* at the time of its publication, Keynes stressed the seriousness of the consequences which would follow from rejection of his advice and a continuation of the economic policies appropriate to the pre-war regime. *It reflects a consistent theme in his attempts to sway elite public opinion to his approach to policy: my reforms will not look so radical, he argues, if you compare them with the alternative.[[25]](#footnote-25)*

But I should like to warn the gentlemen of the City and of High Finance that if they do not listen in time to the voice of reason their days may be numbered. I speak to this great City as Jonah spoke to Nineveh that great city. I prophesy that unless they embrace Wisdom in good time, the system upon which they live will work so very ill that they will be overwhelmed by irresistible things which they hate much more that the mild and limited remedies offered them now. (19-1, 162)

Skidelsky ends his discussion of the *Tract* with the following observation

Beneath both the technical and the ironic drapery of the *Tract* were a series of connected propositions which were to inspire Keynes's economic work for the rest of his life. Economic health was too important to be left *to laissez-faire*. Economic management, which had already started, must become part of the modern science of government, not the tool of vested interests. The war had vastly increased the dangers of social upheaval. To preserve the core of an individualist society from revolutionary danger some of the outerworks had to be sacrificed. (II, 160, emphasis in original)

*There is considerable disagreement on precisely what constituted this "core of an individualist society" that Keynes was determined to protect*. We return to this crucial question of interpretation below, arguing that it was not "capitalism" as an *economic system* that he was fighting to preserve, but as a "way of life" that could be reproduced under a wide variety of economic arrangements.

**Public Investment and State Planning 1924: The 'Real' Keynesian Revolution Begins**

Spring 1924 found Keynes in a fairly upbeat mood. Unemployment, though still too high to be acceptable, was in decline; price deflation had ceased; and Keynes had come to believe that rather than returning to the gold standard in the near future as he previously expected, the government was likely to maintain a flexible exchange rate regime, at least for a while. "We are not on a gold standard basis; and are not likely to be in the very near future" (192). Best of all, the monetary authorities, for reasons of their own, seemed to be operating in a manner broadly consistent with Keynes's advice, at least temporarily targeting domestic price stability rather than trying to raise the value of sterling. "The policy of deflation has been abandoned, and we therefore have an extraordinary opportunity of trying an experiment of the new policy without any harm" (192).

Keynes's mood is well reflected in a speech given in March in response to criticism of the *Tract*. It had been argued that Keynes had exaggerated the influence of financial factors in generating Britain's unemployment, and neglected the effects of structural factors, especially the decline in traditional exports, as well as the influence of improved social welfare programs in reducing pressure on the unemployed to take a job. *Indeed the accusation the Keynes neglected the problem of structural unemployment has been made so often that it is almost universally believed that he was guilty as charged.* But Keynes here immediately acknowledged that these factors were indeed operative, and added one more -- stronger unions had forced real wages above their market clearing value. What is required, he said, was an evaluation of the relative importance of all these forces. The facts, as he interprets them, are as follows.

The unemployment figures which, a little time back, were of the order of 12 per cent have now fallen, I think, to 7 or 8 per cent, and may easily fall in the near future towards 5 per cent ... The worst of the slump, in my opinion, is nearly over. (183)

The financial factors he was concerned with in the *Tract*, he argues, are primarily responsible for the unemployment in excess of 5 per cent: "when we reach 5 per cent it may be correct to argue that the other causes ... are largely responsible" (183).[[26]](#footnote-26) That is, if his advice on monetary policy were to be accepted and implemented, the next phase of policy should be to use other tools, *presumably microeconomic in nature, to try to eliminate structural unemployment.*

When we have got unemployment down to 4 or 5 per cent, then there are other causes which have also to be tackled by other methods, but, if you have the financial factor responsible for the difference (say) between 5 and 12 per cent, then it is an enormous cause of immense poverty, immense suffering, and it is a matter which is well worth bending our energies to get rid of. (184)

Since monetary policy had apparently been targeted toward domestic price stability in recent months with good result, he was more convinced than ever that his belief in the power of managed credit was justified, and he looked forward to continued experimentation along these lines.

A number of influential critics of the *Tract* had argued that the substitution of discretionary monetary policy for the more or less automatic policy rules associated with the gold standard was utopian because it presumed more knowledge and skill on the part of the monetary authorities than they possessed.[[27]](#footnote-27) Again Keynes disagreed; it was a shortfall of will, not of talent, that was the problem.

I do not think there is the slightest reason for supposing that the talent of the country available for work of that kind is in any way short of what it ought to be. I think that the intellectual ability which has controlled the policy of the Bank of England over the past few years has been extraordinary. New ideas have grown up lately as to what the aim of their policy ought to be. That is one thing, but the success with which they have in the past carried out the daily technique of quite as difficult a problem namely, the maintenance of the gold standard in conditions where gold is not the primary medium of circulation, is quite enough encouragement. (188)

Keynes concluded this speech on quite an optimistic note. If things continued to go well, then at some point in the not too distant future, the stance of monetary policy would have to be switched from loose to tight. "I was in favour of dear money before the break of the boom in 1920" he reminds his listeners, "and got into a good deal of trouble for wanting a 7 per cent Bank rate at what was called an inappropriate date" (192). If the monetary authorities continue to act in accordance with the policies laid out in the *Tract*:

I believe that not many months will elapse before I shall be in favour of dear money again. ... If, therefore, by the date at which one could hope that some of these ideas are beginning to fructify, the slump is thoroughly over and the boom beginning, we shall make our first experiment in the form of putting on dear money at a very early date compared with previous occasions and avoiding the impending boom of 1925 or 1926. (193).

Keynes's optimism at this time raises an important and puzzling question of interpretation. Just two months later he will, for the first time, adopt the position that even if monetary policy along the lines he has been suggesting is implemented, *it will not prove adequate to restore full employment unless assisted by a program of large-scale public and/or publicly-assisted investment projects.* What caused Keynes to change his mind about the efficacy of monetary policy at this time? What explains his unprecedented emphasis on the necessity for *public* capital accumulation? We return to this question after carefully examining what Keynes said about the need for public investment in May and June of 1924.

On May 24th Keynes published an article titled "Does Unemployment Need a Drastic Remedy?" in The Nation and Athenaeum, the Liberal Party journal. This article both restates Keynes's argument that the conditions required for the efficient operation of a regime based on laissez-faire and the gold standard no longer exist, and introduces what is for Keynes a major new *fiscal policy* initiative. The piece was stimulated by policy proposals made by Lloyd George. The Liberal Party had made reduction of unemployment the focus of their Fall 1923 election campaign (won by the Labour Party, who took power under Prime Minister Ramsay MacDonald in January 1924). George had used the pages of *The Nation* in April to argue that the country needed not only sensible, non-deflationary monetary policy to return to full employment, but the fiscal stimulus of large public investment expenditure as well. A debate on George's proposal in the pages of *The Nation* ensued, with Keynes having the final word.

We examine this article in detail as well as Keynes's contributions to the debate which it triggered because ***they contain Keynes's initial presentation and defense of the radical policy position he fought for, in one form or another, until his death in 1946 - public control of the lion's share of large capital investments should be by far the most important policy goal****.* Though the theoretical defense of the policy position adopted here would not be fully in place until the early 1930s, and though Keynes's emphasis would shift from time to time over the next several years between a short-term and long-term interpretation of the public investment program, the broad outline of his policy perspective is clearly and permanently established in this 1924 debate. According to Skidelsky:

The years 1924 and 1925 were more obviously watershed years than 1923. ... Events and the processes of his own thought radicalised him, so that he emerged the self-conscious champion of a new economic and political order.

The break with the past was sudden. New ideas came flooding in, and demanded expression. From 1924 Keynes knew what he wanted to do and, in very broad terms, why. (II, 173)

Keynes opens the piece by briefly surveying the state of the economy; the unemployment data he presents are not much different than those presented in his upbeat speech two months earlier. He estimates current male unemployment at about 8 per cent, compared to 12 per cent in early 1923 and 14 per cent in early 1922. Much of the male unemployment is structural.

If the figures be analysed we find a great concentration of unemployment in the shipbuilding and engineering industries (i.e., nearly four times the percentage elsewhere). Outside these industries, unemployment amongst adult males does not now exceed much more than 4 per cent of the employable population.

But Keynes's mood seems different: the economy seems to him to be 'stuck' in a temporary equilibrium with unemployment still too high. (In retrospect at least it is clear that the economy *was* 'stuck' at this time: the unemployment rate, at 10.9 per cent in the first half of 1924, had reached would prove to be its inter-war period low. "Keynes's starting point was that unemployment had not fallen to the level of 4 or 5 per cent he had predicted in December" (Skidelsky II, 184). He sees no sign of an imminent boom now.

Business is weighed down by timidity. It lacks conviction that anything good will continue for long. It watches anxiously for the signs of retrogression; and as soon as the army wavers, individuals bolt. No one is ready to plant seeds which only a long summer can bring to fruit. (221)

Mitchell and Dean report that the unemployment rate for all unions (largely though not exclusively male) was 15.2%, 11.3% and 8.1% respectively in 1922, 1923 and 1924. The Engineering, Metal and Shipbuilding Unions reported unemployment rates of 27%, 20.6% and 13.8% in those years. Since the All Unions numbers include these high unemployment industries, Keynes's numbers may not have been too far off the mark. The unemployment rate for insured nonagricultural workers was 10.9% in 1924 (p 67).

Keynes criticizes those who believe that unemployment above a sustainable minimum will be eliminated simply by avoiding "gross errors of policy" (219). *He estimates that full employment, or a "sustainable minimum" unemployment rates is about 3 percent![[28]](#footnote-28)* The end of deflationary monetary policy did contribute substantially to the revival of business from its depression low, he argues, but, at least under current conditions, not much more help can be gained through monetary policy alone. This is clearly a new position for Keynes; even an optimal monetary policy will not be enough to restore domestic equilibrium.

No one has a firmer belief than I in the relation between unemployment and monetary policy, and when, two years ago, the figures were nearly double what they are now, this disastrous situation was, I am sure, largely attributable to a misguided inflation and prolonged by a misguided deflation. ... Perhaps this cause is not yet eliminated entirely, -- but a monetary policy which aimed at reducing the unemployed by (say) a further 100,000 [about one percentage point], would run dangerously near another inflation. (219-20)

In his March speech Keynes suggested rather confidently that sensible monetary policy could be used to bring the unemployment rate down to 4 or 5 per cent; here he implies that it would be "dangerous" to shoot for much less than about 7 per cent using monetary policy alone. He does not tell the reader why he has changed the target, though he does say that an attempt to lower the unemployment rate by more than about one percentage point "would run dangerously near another inflation." But he does state, for the first time, that monetary policy, even if it is unconstrained by a need to defend the gold standard and is managed sensibly, must be combined with some non-financial stimulus to get the job done (220).[[29]](#footnote-29) .

He repeats here his unequivocal rejection of the use of forced wage deflation as a mechanism to lower unemployment.[[30]](#footnote-30) And he states clearly one of his most important beliefs about the appropriate method to reduce structural employment -- a problem which, contrary to received wisdom, Keynes always understood and took seriously. Considering both the political and economic aspects of the problem, Keynes maintained a consistent belief that structural unemployment could only be eliminated by *a combination of macroeconomic and microeconomic policies -* *by industrial and labor market policy (and later managed trade) on the one hand, and more aggressive monetary and fiscal policy stimulation on the other*.

Part of [the unemployment] is due to the immobility of labour as between industries; part to the fault of trade unions; and part to a disparity of wages between what are called the sheltered and the unsheltered [or traded goods] industries. But we cannot cure these ills by the pressure of starvation, or by breaking the power for evil, and perhaps for good also, of the trade unions, or by reducing wages in the sheltered industries to the level of the unsheltered From these thoughts the mind must be averted, for from such directions help will not come. Rather, we must seek to submerge the rocks in a rising sea, -- not forcing labour out of what is depressed, but attracting it into what is prosperous; not crushing the blind strength of organised labour, but relieving its fears, not abating wages where they are high, but raising them where they are low.(221)

So the way to get to full employment was not through a direct attack on unions and wages in the depressed export industries as called for by the conventional wisdom, but by inducing these workers to move "into what is prosperous": a carrot was needed, not a stick.[[31]](#footnote-31) *Keynes's empathetic treatment of the labor movement, which is consistent with his treatment of labor in The General Theory, is one he maintained through the rest of his life*. But at the moment, with the economy stuck in neutral, the incentive for businesses to provide more jobs, for workers in general and for those particular workers facing structural unemployment in the depressed industries, was missing.[[32]](#footnote-32)

An innovative idea was required, and Keynes, of course, would prove to be the master of theoretical innovation. The idea he presents can be reasonably interpreted as a very crude precursor of the concept later to be known as the "*multiplier*." We "must look for succour to the principle that *prosperity is cumulative*. We have stuck in a rut. We need an impulse, a jolt, an acceleration" (220, emphasis in original). This article represents Keynes's initial attempt to link large-scale public investment with some form of the multiplier concept, and join fiscal and monetary policy in pursuit of sustained full employment. For this reason, it should be understood to be the starting point of the 'real' Keynesian revolution in the theory of macro policy.

It is probably fair to say that Keynes was not always consistent through the remainder of the decade in his interpretation of whether this idea that prosperity required "an impulse, a jolt, an acceleration" was properly thought of as merely a short-run idea -- 'kick-start' the engine and watch it go, or, as in most of his work, whether it applied as well to the longer-run. The body of his work makes clear that Keynes wanted a fundamental, long-term change in the impetus to large-scale capital investment through new institutions and policies that gave the public sector control over the contours of the capital accumulation process. However, this interpretation of his policy was clouded from time to time in response to the nature of his audience and the need to package his ideas in a politically palatable form. In this seminal article, however, Keynes clearly gives it a *secular* interpretation, arguing that previous eras of long-term prosperity in Britain had some largely exogenous engine of capital accumulation which helped start and sustain the growth process. His implicit theoretical assumption is that eras of prosperity in capitalism require some great secular wave of transformative infrastructural and/or technological investment, carried on year after year largely without regard to short-run fluctuations in profitability and capable of creating a ripple effect of induced capital accumulation across important sectors of the economy. The idea that Britain had entered a long period in which the secular forces that underpinned the capital accumulation process are too weak to generate full employment is a theme also emphasized in *The General Theory*.[[33]](#footnote-33)

British prosperity in the nineteenth century owed very much to the railway boom in its first half, beginning at home and extending abroad, and to the immense building activity of its latter half. ... The boom in motors and in building combined, no doubt, with many favourable attendant circumstances, has carried the United States to an unprecedented standard of living. (221)

Keynes argues that private firms operating solely through ordinary market incentives cannot, in the modern era, initiate the long-term, large-scale capital projects required to accelerate growth. *It is thus left to the public sector to step in and help create an engine of long-term capital accumulation that can pull the economy out of its distress and keep it buoyant over the longer run.*

Is there not a chance that we can best achieve [prosperity] by recreating the mood and conditions in which great works of construction, requiring large capital outlays, can again be set on foot? Current savings are already available on a sufficient scale -- savings which from a lack of outlet at home, are now drifting abroad to destinations from which we as a society shall gain the least advantage. Private enterprise unaided cannot stop this flow. The policy of preventing public utilities from yielding more than a modest profit has gone so far that it is no longer worth the while of private enterprise to run risk in a field where the gain is limited and the loss unlimited. We are in danger, therefore, of interfering with private initiative, yet substituting nothing for it. The advances under the Trade Facilities Act, begun for a temporary emergency and on a small scale, point the way, perhaps to a new method of administering an important part of the saving of the public. The next developments of politico-economic evolution may be found in co-operation between private initiative and the public exchequer. The true socialism of the future will emerge, I think, from endless experiments directed towards discovering the respective appropriate spheres of the individual and the social, and the terms of fruitful alliance between these sister instincts. (222)[[34]](#footnote-34)

His concern about British savings "drifting abroad" with little advantage to the domestic economy was not new, nor would it prove to be merely temporary.[[35]](#footnote-35) Indeed, it will receive increased emphasis in Keynes's work over the next few years.

It is worth noting that the ideas Keynes espoused here constituted heresy on a grand scale. It was not the line about "true socialism" that was heretical, for Keynes and many other radical Liberals thought of themselves as liberal socialists (to be distinguished from what they considered to be the ill-informed and perhaps dangerous "State Socialists" of the Labour Party), and they often referred to themselves as such. Rather, it is the fact that Keynes here adds to his previous acts of sacrilege -- rejection of the gold standard and support for discretionary regulation of the credit system in pursuit of domestic objectives -- his belief that capitalism may be incapable of generating adequate growth even under optimal monetary policy so that the State must take upon itself *direct* control of a substantial part of the capital accumulation process (in addition to its exercise of indirect influence through control of the cost and availability of credit). To complete his list of sins against orthodox belief he will, in the course of debate in *The Nation*, advocate *permanent controls over the movement of financial capital out of Britain*.

Keynes's concrete proposal was for the Treasury to initiate and finance "expenditures up to (say) £100,000,000 a year" -- or *about 2.6 per cent of 1924 GDP* -- "on the construction of capital works at home, enlisting in various ways the aid of private genius, temperament, and skill" (222).

Keynes does not hazard a guess in this article as to the number of jobs that might be created by public investment of £100,000,000 a year, but he did suggest, in an article published in July 1925, that such a sum "is enough to make good the wastage of nearly 500,000 men in unemployment" (19, 427). The implicit assumption that each worker creates net output of £200 is quite close to the figure of £220 used most often in the more careful calculations of the job creating power of public investment made by Keynes and the Liberal Party starting in 1929, when the multiplier concept and its role in the theory of aggregate demand first became more consciously incorporated into his analysis.

Since insured unemployment was about 1.2 million in 1924, a reduction of one-half million (amongst the insured unemployed) would have cut the unemployment rate from 10.3 to about 6 per cent. Using the figure of 1.4 million total unemployed, the same calculation implies a reduction from 7.9 to 5.1 per cent of the total workforce. (Garside, 5) This was clearly designed to be neither a modest nor a short-term program.

It is important to realize that though the use of "public works" to help temporarily employ some of those without jobs had long been advocated by various political commentators in inter-war Britain, no program of this magnitude -- certainly no longer-term program -- had ever been proposed by someone of Keynes's gravitas.[[36]](#footnote-36) The funds for the program were to be diverted from current contributions to the government's "sinking fund." Rather than continue to use the substantial tax revenues generated by the fund to retire War debt, Keynes wanted to use it instead to finance public investment. Since every pound spent on public investment resulted in one additional pound of debt outstanding, the investment was, in effect, debt financed. In this way, Keynes explained in a metaphor he often used, the government could replace "unproductive debt with productive debt" (222).

What kinds of projects should the government fund? Consistent with his general position on such questions, Keynes insisted that expert advice must be sought on this crucial issue.

It is for the technicians of building, engineering, and transport to tell us in what direction the most fruitful new improvements are awaiting us. (222)

Keynes does mention three projects that "are already known to everyone in a general way." Each of these projects could involve huge investment expenditures over a long time period. Note that he conceives of this program as lasting at least a decade.

a national scheme for the mass production of houses which would supplement the normal activities of the building industry and make up *in five or ten years* the deficiency with which the latter has proved unable to deal. The adaptation of road-building to the needs of motor transport ... The development of economical means for the transmission of electrical power in this country. Unaided private enterprise is not capable of dealing with any of these projects, even when their technical soundness is beyond doubt. (222-23, emphasis added)

Keynes concludes this article by stressing three key points: (1) a *combination* of sensible monetary policy and a program of state-guided investment is needed to achieve full employment; (2) public investment on this scale will help divert the flow of British financial capital away from largely unproductive foreign investment to domestic investment; and (3) carefully selected large-scale public investments can be used in a kind of industrial policy to reduce structural unemployment.

I look, then, for the ultimate cure of unemployment, and for the stimulus which shall initiate a cumulative prosperity, to monetary reform -- which will remove fear -- and to the diversion of national savings from relatively barren foreign investment into state-encouraged constructive enterprises at home -- which will inspire confidence. That part of our recent unemployment, which is not attributable to an ill-controlled credit cycle, has been largely due to a slump in our constructional industries. By conducting the national wealth into capital developments at home, we may restore the balance of our economy. Let us experiment with boldness on such lines, -- even though some of the schemes may turn out to be failures, which is very likely.[[37]](#footnote-37) (223)

Keynes fleshed out these ideas in response to attacks by his critics. Since we argue that this intervention by Keynes turned out to be the first shot fired in the 'real' Keynesian revolution, it is worth exploring the elaborations of his position presented in these pieces.

An editor of *The Times* expressed doubt about using the sinking fund for the purpose of funding public investment. Keynes explained his position as follows. Payments to War debt holders put between 50 and 100 million pounds in their hands every year, money that was recycled into financial markets. But in the currently sluggish state of the economy, domestic private enterprise and government at all levels together cannot provide sufficient demand to absorb both these funds and the flow of new domestic savings:

Rent Restriction Acts, the control of profits and charges of public utility undertakings, and the fear of further developments in the same direction have deprived private enterprise of sufficient incentive to embark on new schemes of construction involving great expenditures. If the steam locomotive were to be discovered today I much doubt if unaided private enterprise would build railways in England. (224)

Therefore, much of this money ends up flowing abroad, where it does "little to directly stimulate British industry and can only operate by depreciating the exchange rate" (224). What is needed, then, is a large-scale program of state investment and state-guided private investment to create a greater demand for these funds.[[38]](#footnote-38) Note how he stresses here, as he will always stress, that the projects he has in mind are not make-work, but are economically efficient and productive.

…we must make new initiatives to stimulate capital investment at home.

I am strongly opposed to encouraging non-economic projects, by subsidies or otherwise. But, for good or evil, in present-day conditions *laissez-faire* can no longer be relied on to furnish economic projects with the capital they need. ... Yet it is not true that nothing wants doing at home. (224)

His main defense of his views appears in a second *Nation* article in June 1924 called "A Drastic Remedy for Unemployment: Reply to Critics." In this defense he puts more stress than in the original article on: (1) the problem of excess saving -- the balance between saving and investment has moved closer to the center of his thinking and will eventually become a central concept in his new macro theory; (2) the problem of free capital mobility, which, under current conditions leads primarily to what he calls "the flight of foreign capital"[[39]](#footnote-39); and (3) the 'rigidity' or lack of 'flexibility' of the modern, post-war British economic system.

Reminding the reader that since the sinking fund throws up to 100 million pounds a year in excess of new saving on the capital market, Keynes points out that it is essential that thought be given to "the supply of alternative investments" that might absorb such a sum. "At first, Local [government] Loans, home, municipal, and industrial debentures partly filled the bill. But with the advent of deflation, the Geddes Axe, and industrial depression, the supply [of new securities] has dried up" (226).[[40]](#footnote-40) In other words, at the present time savings exceeds domestic investment.

Meanwhile, the rate of interest on foreign bonds floated in London has fallen about one per cent below the rate for similar bonds in New York. As a result,

We are lending too cheaply resources we can ill spare. Our traditional attitude toward foreign investment demands reconsideration,; -- it is high time to give it a bad name and call it 'the flight of capital'. (227)

Keynes would shortly expound at length on the various problems caused by the flight of capital: here he focuses on its link to unemployment. His main concern is that outward capital flows in excess of net exports (inclusive of returns on previously invested capital) will exert downward pressure on the pound which must continue until exports rise by enough to restore payments balance. But Keynes argued that since the war world demand for British exports had become relatively price inelastic, so that the required depreciation was potentially quite large. This created serious problems in his view, because the post war British economy did not have the elasticity or fluidity or easy mobility of either capital or labor that would be required for the real economy to smoothly and quickly adjust to such severe exchange rate changes. It did not resemble the flexible economy constructed in Classical theory. The 'short-run' adjustment to the new equilibrium value of sterling thus would be extremely painful -- perhaps socially and politically explosive -- and could last a long time.

[T]here may be violent resistances to the process of adjustment. The fall of the exchange tends to raise the 'cost of living', and the 'sheltered' industries may struggle to avoid the reduction of real wages which this entails. Our economic structure is far from elastic, and much time may elapse and indirect loss result from the strains set up and the breakages incurred. Meanwhile, resources may lie idle and labour be out of employment. (228)

Skidelsky points out that by making the argument that devaluation could not lower British unemployment because the rise in the cost of living it brought on would meet with major resistance from labor in the sheltered industries, Keynes was in effect saying that the British economy was too 'rigid' to tolerate *either* substantial upward or downward movement in the value of sterling. Recall that Keynes had earlier insisted that a rising value of sterling would trigger labor unrest in the unsheltered industries.

His new argument amounted to the proposition that such was the rigidity of the British industrial system that, even with the exchange rate free to float downwards, British unemployment -- concentrated in the export trades -- could be alleviated only by public works. (II, 187)

This emphasis on labor market rigidity, especially downward rigidity, would continue to characterize Keynes's thinking for the next two decades.[[41]](#footnote-41)

The degree of resource flexibility required for either *laissez-faire* or the gold standard to operate effectively may have been present in the old regime, Keynes acknowledged, but it is not present in the new one.

The old principle of *laissez-faire* was to ignore these strains and to assume that capital and labour were fluid; it also assumed that, if investors choose to send their money abroad at 5 per cent, this must mean that there is nothing at home worth doing at 5 per cent. Fifty years ago this may have been a closer approximation to the truth than it is now. With the existing rigidity of the trade-union organisation of labour, with the undue preferences which the City organisation of new issues and the Trustee Acts afford to overseas investment, and with the caution which for many reasons, some good and some bad, now oppresses the undertaking of new capital investment at home, it does not work. (228)[[42]](#footnote-42)

It is therefore crucial that Britain drastically reduce the proportions of the currently sizeable proportion of its savings that flow to foreign rather than domestic uses. In August he would estimate that in 1923 "we invested abroad about two-thirds of what passed through the investment markets, and probably between half and a third of total savings" (284). What is needed is a two-pronged attack on the problem. One component of the solution, which is not stressed here, is negative: keep savings at home through permanent controls on the outward flow of capital. In two months he would tell readers of *The Nation* that "The Treasury should use its power of license to ... strictly ration overseas borrowers" (282). *His support for permanent capital controls was itself permanent; he never changed his mind on this point*.[[43]](#footnote-43)

The second prong is positive: stimulate the domestic demand for money capital through a major program of large-scale government investment. There is a wealth of large-scale investment projects that are economically efficient and socially productive to undertake: "Surely [critics] cannot maintain that England is a finished job, and that there is nothing worth doing on a 5 per cent basis" (228). But private capitalists cannot undertake them because while the downside risk of loss is limited only by the size of the financial commitment, the potential gains today are -- in contrast to the nineteenth century -- exceedingly modest, about what could be earned by investing in a safe security.[[44]](#footnote-44) In the original article he explained that the "policy of preventing public utilities from yielding more than a modest private profit has gone so far that it is no longer worth the while of private enterprise to run a risk in a field where the gain is limited with the loss unlimited. We are in danger, therefore, of interfering with private initiative, yet substituting nothing for it." (222) In this defense he calls attention to the result of this situation.

There is no sphere where private initiative is so lacking -- for quite intelligible reasons -- as in the conception and execution of very costly projects which may be expected to yield from 5 to 6 per cent. (229)

Is it worth the while, or within the power, of anyone to organise a new project costing £20,000,000 with the expectation of a return of 5 per cent? These persons 'exercising foresight' about new, costly, moderately remunerative projects do not exist. If there was no Manchester Ship Canal, does [anyone] suppose that a syndicate of private persons would spring up today to construct it? (230)

Where then is the domestic investment demand to come from? In summing up his position for his critics Keynes gives a clear reading on his general views at this time on the proper economic role of the state in the new post-war economic regime. We quote Keynes at length.

In considering how to [raise the rate of capital accumulation], we are brought to my heresy -- if it is a heresy. I bring in the State; I abandon *laissez-fair*, -- not enthusiastically, not from contempt of that good old doctrine, but because, whether we like it or not, the conditions for its success have disappeared. It was a double doctrine, -- it entrusted the public weal to private enterprise *unchecked* and *unaided*. Private enterprise is no longer unchecked, -- it is checked and threatened in many ways. There is no going back on this.[[45]](#footnote-45) The forces which press us may be blind, but they exist and are strong…. [T]he next developments of politico-economic evolution will emerge from new experiments directed towards determining the appropriate spheres of individual and government action. And to proceed to particulars, I suggest that the state encouragement of new capital undertakings, by employing the best technical advice to lay the foundations of great schemes, and by lending the credit and the guarantee of the Treasury to finance them more boldly than hitherto, is becoming an inevitable policy. (228-29, emphasis in original)

This is a radical economic and *political* view, and will be perceived as such by those private interests (including, of course, the City), who fear the political as much as the economic consequences of transferring such unprecedented power from economic elites and institutions to the State. They will oppose Keynes’ policy proposals throughout the rest of the inter-war period. W.R. Garside explained that the main reason why Keynes’s proposals for publicly controlled capital accumulation raised such fierce opposition were: first, they encouraged “repeated demands for yet further increases in public expenditures” and second, by violating the principles of “sound finance” they opened the door to “state socialism” or “managed capitalism” and the destruction of “private property rights” (1985, 551-52). The full quotation from which these phrases were taken is as follows:

There is no doubt, however, that to the majority of contemporary politicians, civil servants, city financiers and industrialists, a policy of deliberately unbalancing the budget in the hope of expanding employment was a fearful prospect, not least in its potential for encouraging repeated demands for yet further increases in public expenditures. ...

The other barrier to the adoption of a more positive public works policy was the fear of state intervention. The rules of 'sound finance' were, as one writer pointed out, a defense not only against economic catastrophe but *also against state socialism*. Indeed, in calling for a more drastic remedy for unemployment via loan-financed public works, Keynes remarked in May 1924 that 'the next development of politico-economic evolution will emerge from new experiments directed towards determining the appropriate spheres of individual and of government action'. And behind the Treasury's notorious rejection of increased government expenditure for such purposes lay the powerful conviction that it would undermine the democratic structure of local government and *threaten private property rights*. What worried contemporary politicians (not least within the Labour Party) about the development programmes of Lloyd George and Oswald Mosley was their implicit assumption of a powerful executive, their rejection of the inherent efficacy of market forces in favour of some form of 'managed capitalism', and a suggested timetable of action which smacked of bureaucratic dictatorship. (Garside, 1985, 551-52, italics added)

Skidelsky tells us that "What Keynes called his 'heresy' was not well received [even] by his personal and political friends" (II, 186).[[46]](#footnote-46)

Keynes returned to the theme of the need for state initiation of large scale public capital projects while testifying before the government Committee on National Debt and Taxation in early October 1924. A committee member asked him about his call for £100 million a year of publicly initiated and financed capital investment. He responded as follows:

Owing to the control of profits and rates, and so forth, which is now popular, an investment in a public utility is very unlikely to yield the investor any unusual gains; he will never be allowed to obtain more than a certain rate of interest. On the other hand, he is not secured against losses. The result is that the inducement to the investment of money in large public utility enterprises is very much less than it was, for example, during the period of the railway boom, when our railways were built. ... I am, therefore, very doubtful whether, in present conditions, the railway system of England could be built by unaided private enterprise. I believe that considerations of this sort stand in the way at this moment of the development of our ports, of our transport system, and of our power system, and that the policy of leaving these to unaided private enterprise is a thing which is no longer practicable. As to the forms in which the state can help, I think there ought to be a great variety... (322)

Keynes argued that "a number of experiments might be made as to the best channel for doing this" (322). The Chairman of the Committee then commented that the Treasury was already providing loan guarantees for private investment (under the Trade Facilities Act). Keynes picks up the argument.

We are drifting in that direction; it is already being done. I should like to do it more consciously and on a larger scale. ... we are liable to suffer because we are now in an interregnum period in which in half of our ideas we have a sort of semi-socialism and in another half of our ideas we still depend on unaided private enterprise. Public utility enterprise is the sort of thing which particularly suffers in a situation of that kind. This is closely connected with this drift of money to the colonies. In the colonies they have gone faster; they are not in that *interregnum;* the state assists all kinds of things which are not assisted here. ... I cannot think that there is so small a need for investment in public enterprise as is actually going on. (322, emphasis in original).[[47]](#footnote-47)

A statement Keynes made to the Committee on Industry and Trade in July 1925 (after the election victory of the Conservatives in late October 1924 and following Churchill's announcement of the return to gold at par in April 1925) might serve as a brief summary of his position. He links his call for public investment to what he saw as the *permanent* erosion of Britain's traditional export markets and places enormous stress on the structural imbalance in labor markets that it created. Public investment, he argues could save some jobs in the depressed industries and, simultaneously, increase the demand for labor outside these industries that could employ some proportion of export-industry workers whose old jobs cannot be saved.

[O]wing to changes in the external world ... probably our export trades will be permanently on a lower scale in relation to population than they were in pre-war days. And I think we should do well to have a transference of labour to some extent from the export trades to non-export trades, and balance our reduction of exports by investing less capital abroad and more capital at home. ... So that my long-period policy would be the gradual transference of labour from export industries and a large programme of capital expenditures at home, which would absorb the savings which had previously found an outlet abroad.

...

If we had any of the great schemes that have been proposed for capital development at home, that would certainly stimulate the employment of labour in the coal industry and in the iron and steel industry because they would require the products of those industries.

...

[I]f there is an intake for labour the business of transfer is not an insuperable difficulty. What I think is so extraordinarily difficult is to absorb labour out of industries when the other industries are not wanting any labour. You must first of all create a condition of demand for labour in other industries. (409-10)

Why did Keynes make this permanent radical left-turn in mid-1924, just after his optimistic statements in the spring? There are a number of possible explanations. First, and perhaps most important, he had begun to doubt that the hoped-for boom would arrive or be strong enough to push the unemployment rate down to 4 or 5 per cent. Skidelsky notes that the economic upturn stopped, and the economy "stabilized" in 1923 (II, 131). "As unemployment, despite the trade revival, remained obstinately stuck at 10 per cent of the insured workforce, his mind turned to 'drastic remedies." (184) Moggridge observes that the "settlement of Europe and a monetary policy aimed at price stability would not in themselves do the trick (420).

Second, Keynes may have begun to fear that macro policy was unlikely to be used to reduce unemployment further. There certainly was no hope for expansionary fiscal policy: the government's budget had moved into surplus and the War debt was in the process of being paid down. And the new Labour government was, if anything, more orthodox than the Conservatives on budgetary matters.

To many [government officials], high spending was bad as budget deficits. 'It is no part of my job as Chancellor of the Exchequer', stated Snowden in 1924, "to put before the House of Commons proposals for the expenditure of public money. The function of the Chancellor of the Exchequer, as I understand it, is to resist all demands for expenditure made by his colleagues and, when he can no longer resist, to limit the concession to the barest minimum of acceptance. (in Aldcroft, 1986, 105)[[48]](#footnote-48)

Keynes's thoughts about the likelihood of expansionary monetary policy are not quite as easy to interpret. On the one hand, both Labour and the Conservatives had pledged to follow out the recommendations of the Cunliffe Committee and return to gold at par at some, yet unspecified, future date. And the embargo on gold was to expire at the end of 1925. Such thinking pointed toward monetary-policy induced deflation.

Indeed, many commentators have argued that Keynes's support for large-scale public investment was always *conditional*, meant only to apply during periods in which the domestic use of monetary policy was prohibited by the necessity of the Bank of England to defend the pound. The problem with this interpretation, at least as applied to 1924, as Peter Clarke has pointed out, is that Keynes commented on several occasions in this period that he did not believe the return to gold at par was either inevitable or imminent.[[49]](#footnote-49) Moreover, since at this time many observers including Keynes expected U.S. prices to rise faster than prices in Britain, even a return to gold at par did not necessarily mean deflationary monetary policy.

A sensible conclusion here is that Keynes probably did not expect monetary policy to become substantially more expansionary at this time, and even if it did, the main result was likely to be increased foreign loans rather than lower domestic unemployment.

Third, the Lloyd George arm of the Liberal Party with which Keynes was now associated had declared the reduction of unemployment to be their number one economic policy priority and an ambitious program of public investment to be the means to achieve this goal. Given the likelihood that the economy was 'stuck' at high unemployment and unlikely to receive substantial macropolicy relief on that score, Keynes may have had a purely political motive to argue in support of George's proposal. But, even if political expediency might provide an explanation of why Keynes's thinking initially moved in the direction of public investment at this time, it cannot possibly explain the tenacity with which he defended his position in the face of opposition even from his friends, nor the fact that he maintained his belief in the centrality of public investment until his death.

There is an alternative approach to this issue: we could simply take Keynes at his word and accept the arguments he presented in the debate in *The Nation*. The economy was mired in a high unemployment 'equilibrium', and much of that unemployment was structural, located in the traditional export industries. Export-led growth through policy-induced wage deflation was impossible, indeed the attempt to follow this road was potentially catastrophic. A vigorous easing of credit conditions was not in the cards, but, more important, Keynes was concerned that even if low British interest rates succeeded in pushing the value of sterling down, there would be labor unrest in the sheltered industries as workers resisted a large fall in their living standards. His persistent argument that capital outflows fail to lower unemployment in the short to medium-run is based on this thesis. There were new and permanent 'rigidities' in the British economy that meant that the traditional long-term policy analysis was no longer an effective guide to practical action.

Moreover, Keynes was beginning to see that, as he would argue in 1925, that *"our export trades will be permanently on a lower scale in relation to population that they were in pre-war days" (19-409).* Contrary to almost all respectable opinion, the requisite sources of growth might well have to be primarily domestic, not international, in character. But the private sector seemed to have lost its capacity to self-generate strong *secular* growth, even if credit conditions were easy. As he stated over and over again, the private sector was no longer capable of generating those long-term, growth-creating, epoch-making 'engines' of capital accumulation associated with previous boom eras. So if it took a domestic engine of accumulation to achieve and reproduce full employment, it would have to originate in the state or public sector. One key advantage of a program of large-scale public investment (compared to monetary policy) was that it could be in part *directed via industrial policy* toward the structurally unemployed in, for example, the construction, engineering, mining and steel industries as well as focused on the districts in which these unemployed workers lived.

Moving beyond Keynes's specific arguments in this debate, we might consider the following interpretation of the direction of his thinking. The combination of the loss of traditional export dominance, the increased rigidity in the economic structure, and the loss of private-sector engines of accumulation meant that the economy could no longer be moved from a high-unemployment 'equilibrium' to sustained full employment merely through sensible monetary policy, as he had at first believed. Enlightened monetary policy might well be adequate to keep the economy fluctuating near full employment once full employment had been achieved (a belief he would come to reject in the 1930s), but it was not powerful enough unaided to shift the system from one equilibrium position to another if these positions were quite far apart to begin with. Old truisms about how to get to full employment might still be true in the 'long run', but the short-run was no longer short in real or calendar time, and severe economic and political damage could take place within its confines. To shift the economic trajectory substantially, sensible monetary policy must be used to accommodate with the engine of public capital accumulation. The reasons Keynes himself gave (or at least implied) as to why he had come to believe in 1924 that public investment was a necessary part of a full-employment policy seems reasonably convincing.[[50]](#footnote-50)

**The Return to Gold and the General Strike: 1925-26**

The government announced the return to gold at pre-war par on April 28, 1925. Naturally, Keynes believed this policy to be profoundly ill conceived. Convinced that some variant of the gold standard was now unavoidable, he spent a great deal of energy trying to convince the government to alter its stated intention of maintaining the value of sterling at $4.86, a rate he believed to be too high to permit full employment at home. Though he spoke and wrote widely about the problems of the gold standard, his most famous intervention was "The Economic Consequences of Mr. Churchill", a pamphlet based on three articles that appeared in the *Evening Standard* newspaper in July 1925.[[51]](#footnote-51) The pamphlet contains a number of arguments that are of interest to us.

Two points need to be established initially. First, though the pamphlet is really about the proper value of sterling to adopt, Keynes clearly has not renounced the principled opposition to the return to gold he has expounded for the past two years, and he continued to speak against it after the pamphlet was published. "The arguments" here, he says, "are not arguments against the gold standard as such. This is a separate discussion which I shall not touch here." (9, 212) Second, he has not altered his belief in the necessity of a program of large-scale public investment projects to help solve the problems of structural as well as general domestic unemployment. Indeed, he is concerned that the return to gold will eliminate the chance to implement this needed program. After stressing the fact that the rising value of sterling did not create, but only aggravated, the unemployment problem -- "we were not free from trouble a year ago" -- Keynes argues as follows:

It was also probable that certain of our export industries were over-stocked both with plant and with labour, and that some transference of capital and men into home industries was desirable and, in the long run, even inevitable.[[52]](#footnote-52) Thus we already had an awkward problem; and one of the arguments against raising the international value of sterling was the fact that it greatly aggravated, instead of mitigating, an existing disparity between internal and external values, and that, by committing us to a period of deflation, it necessarily postponed active measures of capital expansion at home, such as might facilitate the transference of labour into the home trades. (9, 210-11).

In a similar vein, in testimony before a government committee studying this issue given just before the publication of this pamphlet, Keynes repeated the conclusion of "Does Unemployment Need a Drastic Remedy?" British exports would never be restored to their pre-war preeminence.

So that my long-period policy would be the gradual transference of labour from export industries and a large programme of capital expenditures at home, which would absorb the savings which had previously found an outlet abroad. ... Provided we could have capital programmes at home and easy money conditions at home, I believe it would be easy to make a beginning at absorbing that labour in home industries. ... If we had any of the great schemes that have been proposed for capital development at home that would certainly stimulate the employment of labour in the coal industry and in the iron and steel industry because they would require the products of these industries. (19, 409-10)[[53]](#footnote-53)

Given the positive development that had taken place in the global economy, Keynes thinks the main problem with a $4.86 pound is that creates a mismatch with "relative price here and abroad" (207) that would take a general wage reduction of some 10 to 12 per cent to eliminate. If a universal and simultaneous reduction of all money incomes could be attained, everyone's real and relative income statue would be approximately maintained.[[54]](#footnote-54) "If *everyone* was accepting a similar reduction at the same time, the cost of living would fall, so that the lower money wage would represent nearly the same real wage as before" (211, emphasis in original). But here's the nub of the problem, one he would stress many times, including in chapters 2 and 19 of *The General Theory*: an unregulated capitalist economy has no institutions that could possibly arrange such a fair and equitable adjustment process. "But, in fact, there is no machinery for effecting a simultaneous reduction" (211). Thus, the only way available under the gold standard and *laissez faire* to lower costs by 10 per cent in the export industries is by initiating a lengthy, costly, unjust and potentially disastrous *dynamic disequilibrium process* in the hope that it will ultimately achieve this objective.

Keynes's main objective in this pamphlet is to critically evaluate these disequilibrium dynamics so as to make them transparent and, therefore, abhorrent to the public. His analysis of the processes by which the effects of an over-valued pound and the tight money needed to support it become "diffused" throughout the economy achieves a level of theoretical sophistication not yet evident in the *Tract*. *In anticipation of a methodological innovation stressed in The General Theory, especially in chapters 2 and 19 on wage deflation, in which dynamic disequilibrium processes unfolding over calendar time replace the instantaneous comparative statics used in most policy analysis*, Keynes is now much clearer about precisely why a policy of deliberate deflation to lower wages and, therefore, to lower costs is both economically and socially objectionable.

He makes three main points about deflationary disequilibrium dynamics. First, the mobility of labor across industries and regions is severely limited by: strong unions (which interfere with the 'freedom' of the those unemployed in one sector to bid down wages, especially wages outside that sector), the existence of the 'dole', the inability of workers to secure adequate housing outside the area in which they currently live; and the absence of high-growth sector capable of absorbing the unemployed as well as new entrants to the labor market. Therefore, to achieve the wage reduction needed to maintain the pound at pre-war par would require deep and widespread unemployment. Second, the necessary process of deflation will distribute reductions in nominal and real incomes in a manner that violates norms of social justice and economic efficiency. Therefore, if a deflationary policy is adopted by the state, the state must, in the name of social justice, simultaneously institute an equitable *incomes policy*. Third, the 'short-run' disequilibrium process inherent in defense of the pound at par will involve major costs that are likely to result in economic and political class warfare. Keynes's believes the workers will be justified in their resistance to these policies.

The gold standard has no automatic or just method to achieve a new equilibrium at par, Keynes says. It only exists in "the imaginary academic world, peopled by City editors, members of the Cunliffe and Currency Committees ... where the necessary adjustments follow 'automatically' from a 'sound' policy by the Bank of England" (214-15). The actual adjustment process is initiated by a rise in sterling which triggers a "depression in the export industries." This depression and the requisite tightening of credit are supposed to "*diffuse* themselves evenly and fairly rapidly throughout the whole community. But the professors of this theory do not tell us in plain language how the diffusion takes place" (214). Keynes suggests that an explanation in the following plain language would make the process clear.

To begin with, there will be a great depression in the export industries. This, in itself, will be helpful, since it will produce an atmosphere favourable to the reduction of wages. The cost of living will fall somewhat. This will be helpful too, because it will give you a good argument in favour of reducing wages. Nevertheless, the cost of living will not fall sufficiently and, consequently, the export industries will not be able to reduce their prices sufficiently, until wages have fallen in the sheltered industries. Now, wages will not fall in the sheltered industries, merely because there is unemployment in the unsheltered industries. Therefore, you will have to see to it that there is unemployment in the unsheltered industries also. The way to do this is by credit restriction. By means of the restriction of credit by the Bank of England, you can deliberately intensify unemployment to any required degree, until wages *do* fall. ...

We ought to warn you ... that it will not be safe politically to admit that you are intensifying unemployment deliberately in order to reduce wages. Thus you will have to ascribe what is happening to every conceivable cause except the true one. (214-15)

Keynes is doing something quite innovative here in laying out the between-equilibrium time-consuming processes involved in the operation of the gold standard.

The key point is that unemployment of substantial size and duration must be deliberately created by the monetary authorities in order for these processes to function properly when sterling is substantially over valued. "Deflation does not reduce wages 'automatically'. It reduces them by causing unemployment" (220).[[55]](#footnote-55)

This point is reinforced by the emphasis that he placed on the important distinction between *sheltered* and *unsheltered industries* in much of his writing around this time.[[56]](#footnote-56) The "great question now before the country is by what process of adjustment the sheltered prices can be brought down to the level of the unsheltered prices" (19, 385). The rise in the pound itself will create unemployment in the export industries and in those industries that must compete with imports (whose prices are lowered by the appreciation of sterling). But these industries, on average, buy most of their inputs from industries that are sheltered from the direct effects of trade (and therefore under no pressure to lower their prices), and workers in unsheltered industries buy most of their consumption goods from sheltered industries as well. Thus, trade-sector costs will not be reduced by near as much as their prices have been cut. Therefore, it becomes essential that the authorities deliberately create unemployment and excess capacity in the sheltered industries as well, in order to force down their prices, which will then be transmitted as lower costs to the unsheltered industries.[[57]](#footnote-57)

This disequilibrium adjustment process is best understood as a kind of "*war*", Keynes tells us, in which the strong can protect themselves while the weak are beaten down. In anticipation of core arguments in chapters 2 and 19 of The General Theory, he argues that the multi-stage adjustment process creates:

a struggle with each separate group in turn, with no prospect that the final result will be fair, and no guarantee that the stronger groups will not gain at the expense of the weaker. The working classes cannot be expected to understand better than Cabinet Ministers what is happening. Those [in the unsheltered industries] who are attacked first are faced with a depression in their standard of life, because the cost of living will not fall until all the others have been successfully attacked too; and, therefore, they are justified in defending themselves. Nor can the classes, which are first subjected to a reduction of money wages, be guaranteed that this will be compensated later by a corresponding fall in the cost of living, and will not accrue to the benefit of some other class. Therefore, they are bound to resist so long as they can; and it must be war, until those who are economically weakest are beaten to the ground. (211)[[58]](#footnote-58)

In yet another argument that anticipates The General Theory, Keynes notes that this process violates the precepts of social justice, and the changes it brings to relative incomes bear no necessary relation to economic efficiency even in the longer run. For this reason, Keynes believes workers are right to resist such an unfair process: "I sympathise with the working classes in resisting a general reduction of real wages. I am sure that no material reduction is possible in the near future without engaging on a social struggle of which no one could foretell the outcome" (19, 444). And when the struggle broke out in earnest in the General Strike of 1926, Keynes did express sympathy with the coal miners when other members of his class smelled revolution in the air and wanted to see the strikers crushed by the power of the state.

Keynes makes his analysis more concrete by applying it to the coal industry. The rise in sterling has lowered output price substantially. But most of the cost of production lies in wages, not in reduced-cost imports, and the workers’ cost of living hasn't declined since most of their purchases are sheltered goods and services. Domestic coal demand is depressed because iron and steel are depressed. There is excess capacity and the need to permanently lower the number of workers in the industry, but with new mines opening outside rather than within traditional mining areas the new jobs are going not to unemployed miners, but to new entrants to the mining labor force. What is needed here is a boom in domestic industry to absorb this permanent excess. Keynes is on the record as to how to achieve that -- easy money and public investment, the precise opposite of the current policy, and his audience is well aware of this.

The mine owners have proposed that their profits be restored at the new low prices by a reduction in wages, irrespective of a reduction in the cost of living -- that is to say, by a lowering in the standard of life of the miners. They are to make this sacrifice to meet circumstances for which they are in no way responsible and over which they have no control. It is a grave criticism of our way of managing our economic affairs, that this should seem to anyone to be a reasonable proposal ... (222)

Two policy implications follow. First, the only fair and efficient way to transfer the excess supply of miners out of the industry is to be able to offer them good jobs elsewhere in the economy: *expansionary macro policy is a prerequisite to solving the structural unemployment problem.* But the credit contraction policies of the Treasury make this impossible.

But the remedy can only come from the absorption out of this industry into others. The necessary condition of this, however, is that other industries be booming. It is this sort of way -- by keeping down the expansion of other industries -- that credit restriction reacts on coal. (222)

Second, the problem is greatly exacerbated by the limitations placed on the mobility of labor between different occupations and industries in the modern economy. Of particular concern here is the lack of such mobility out of the depressed export industries into the sheltered industries. If unemployed unsheltered labor cannot or will not offer themselves at reduced wages to firms in the sheltered sectors, then the price of sheltered goods will not decline until depression spreads to these industries. The combination of limited mobility and the absence of new labor demand in other industries puts the coal miners in a terrible bind.

If miners were free to transfer themselves to other industries, if a collier out of work or underpaid could offer himself as a baker, a bricklayer, or a railway porter at a lower wage than is now current in these industries, it would be another matter. But notoriously they are not so free. *Like the victims of economic transition in past times, the miners are to be offered the choice of starvation of submission, the fruits of their submission to accrue to the benefit of other classes*. But in view of the disappearance of an effective mobility of labour and of a competitive wage level between industries, I am not sure that they are not worse placed in some ways than their grandfathers. (223, italics added)

Keynes discussed the problem of labor immobility problem at greater length in testimony to a government committee in early July. This analysis sheds a great deal of light on his thinking about disequilibrium processes, and on the institutional underpinnings of his thinking. The key assumption of supporters of the return to gold at par is "that labour is free to move from industry to industry and place to place, and that an unemployed man can get himself occupation by offering to work for a lower wage that the standard wage in one of the prosperous industries."

That theory has no relation to the facts at all, however.[[59]](#footnote-59) It is impossible of course for a collier to offer himself as a baker below the standard wages of bakers, that cannot in fact happen, partly because of the power of the trade unions in preventing the cutting of rates by competition of unemployed labour from other industries, partly because the dole has reduced the extreme pressure to find employment elsewhere, and partly because labour for two reasons is very much less mobile between places and industries. The reason it is less mobile between places is due partly to the condition of housing. A man has a house in the place where he has been employed, and it is a rash and dangerous thing for him to give up that house to go and seek employment in another part of the country where very likely he will not be able to get a house. (396)

Keynes's final point refers to labor's immobility between industries. It underpins his firm belief that structural unemployment will not be eliminated in the absence of substantial growth in the economy as a whole: there has to be a major macroeconomic component to the attack on structural unemployment. When there is strong growth in most industries, the problem of excess labor in one industry can be resolved largely by eliminating new hires for some -- perhaps even an extended -- period of time. New entrants to the labor force (which were substantial in these years) could then find employment in the growth industries, while retirements and quits will do the downsizing in the declining sectors. In an expanding economy the economic and political environment need not be poisoned by the class conflict inherent in mass firings and long-term unemployment, which is one reason for adopting policies capable of generating sustained full employment.

Keynes believes that an historical quirk has prevented a wide-spread understanding of this crucial point.

During a considerable part of the nineteenth century we were increasing at a rapid rate: everything was on a general crescendo, just as in the United States now... That meant that when a given industry was too large and another too small you did not force a man out of the industry that had too much labour into the other, but you just stopped taking new men in for a certain period of time, and with the rapid general progress going on, the slack would be taken up not so much by driving men out of the industry as by simply stopping the intake for a bit. Then it was very much easier to bring your industry into equilibrium by just not taking on new hands -- which you can do when the whole economic machine is stepping forward at a great pace -- then by actually discharging men. ... [S]acking men ... is much more difficult both practically and humanly than stopping new men coming into the industry. (396)

T he orthodox view of the gold standard, he argues, was a product of the nineteenth century, when its strategy of letting internal prices and the location of industry and jobs adjust to keep the exchange rate fixed "did not work badly in the conditions of that age." "But of course they never tried in that age a forcible disturbance of 10 per cent." Even then, when secular growth was robust, "the change in the value of our money relatively to the value of other people's in any given period never approached that." (397) Herein lies the grave error of the government. They adopted a policy that requires a greater degree of internal flexibility of prices and of resources than anything attempted in the nineteenth century, and they did so under stagnant economic conditions and when labor, for reasons that Keynes has carefully enumerated, had become substantially less mobile than in the previous century. This argument is an excellent example of an important truth: economic theories that inform policy must be institutionally contingent and historically specific.[[60]](#footnote-60) Keynes's conclusion on the merits of the attack on the miners could not be clearer. Note that he describes the policy as one undertaken by the ruling elite against the working class for their own enrichment.

On grounds of social justice no case can be made out for reducing the wages of the miners. They are the victims of the economic juggernaut. They represent in the flesh the 'fundamental adjustments' engineered by the Treasury and the Bank of England to satisfy the impatience of the City fathers to bridge the 'moderate gap' between $4.40 and $4.86. (223)

If it is unjust to force the miners to submit to mass unemployment in order to force their wages down in defense of the return to gold at par, then the whole policy is unjust because most workers will eventually be placed in a similar position. So long as the gold standard requires domestic deflation to sustain itself**,** *it is an unjust policy of class warfare waged by the "City" and its allies against the working class***.** "Indeed another five years of this policy might bring us to the edge of revolution, if revolution is ever possible in this country." (19, 445) "The gold standard", Keynes argues, "with its dependence on pure chance, its faith in 'automatic adjustments', and its general regardlessness of social detail, is an essential emblem and idol of those who sit in the top tier of the machine" (224). Even the disparity of its effects within the working class is repugnant. "For the method of economic pressure, since it bears most hardly on the weaker [unsheltered] industries where wages are already relatively low, tends to increase the existing disparities between the wages of different industrial groups" (224-25).

What then should be done? The only sensible choice would be to dramatically switch policies: "it is impossible to recommend any truly satisfactory course except its reversal" (224). Since this is not in the cards, the next best solution would be the implementation of an *incomes policy*. The government should explain to the labor movement that a reduction of all money wages of some 10 per cent is needed (under current international prices and exchange rates) and to ask their cooperation in attaining this reduction in a fair and equitable manner, one that will not substantially change real or relative incomes. But, as noted, Keynes believed that unregulated capitalism had "no machinery for effecting a simultaneous reduction" (211). "If there were any machinery by which you could reduce all wages simultaneously the objections to the policy that I have been outlining would not be very serious." (19, 393) Therefore, *if* a deflation was to be deliberately caused by state policy, the state was obligated to create new administrative "machinery" to see that it was done efficiently and equitably.

This may be the earliest record of Keynes's insistence that any policy involving significant deflation must, in the name of social justice and economic efficiency, be accompanied by the implementation of what he elsewhere calls a "Great National Treaty." The design and implementation of such an incomes policy remained his preferred solution to the problems of social justice and class antagonism inevitably associated with any policy of deflation. It was best not to deflate at all, but if the government was committed to a deflationary policy, it had to be accompanied by a 'national treaty'. Keynes suggests that Prime Minister Baldwin make the following proposal to labor:

Can we not agree, therefore, to have a uniform initial reduction of money wages throughout the whole range of employment, including government and municipal workers, of (say) 5 per cent, which reduction shall not hold good unless after an interval it has been compensated by a fall in the cost of living? (228)

Labor would respond, Keynes suggests, by asking Baldwin about what was to happen to the incomes of other classes -- about "what he intended to do about money payments other than wages -- rents, profits, and interest" (228). Keynes notes that rentier incomes are the hardest issue to deal with because "it is of the essence of any policy to lower prices that it benefits the receivers of interest at the expense of the rest of the community; this consequence of deflation is deeply embedded in our system of money contracts" (229). The only equitable solution then is to use the tax system to ensure that non-wage money income fell in proportion to wages.

On the whole, I do not see how labour's objective can be met except by the rough-and-ready expediency of levying an additional income tax of 1s in the £ [or 10 per cent] on all income other than from employments, which should continue until real wages had recovered to their previous level. (229)

Keynes understands that the design and implementation of an incomes policy such as he proposes, which he is sure is "sound in principle," might be difficult to accomplish within a relevant time frame. Should this prove to be the case, should the only vehicle that would make deflation economically sound and morally acceptable be rejected on grounds on practicality, then the only acceptable option would be to end tight credit and defense of the pound at par and "stake everything" on the hope that US prices will rise by enough to make British exports reasonably competitive.

**VISIONS: 1925-26: Keynes Further Develops His Theory of the Proper Role of the State in Contemporary Capitalism**

*Three Important Essays in Persuasion*

Secularly high unemployment and the elimination of monetary policy as a domestic policy instrument entailed in the return to gold at par forced Keynes to concentrate his attention more intensely on the improving his ideas about why and how Britain should create a new and more powerful economic role for the state. He extended and elaborated his radical vision of political economy in a series of articles published in 1925 and 1926 dealing with broad questions of economics and politics. Three of these are especially important: "The End of Laissez-Faire," "Am I A Liberal," and "Liberalism and Labour."[[61]](#footnote-61) While he continued to refine the details of the policies and programs needed to implement his vision over the next two decades, the broad outlines of his thinking about the new order represented in these essays never underwent substantial revision. The ideas presented here "served him well right down to 1946" (Moggridge, 454). Indeed, when the onset of the world slump in the 1930s added an enormous sense of urgency to Keynes's political and economic struggles for a new order, he re-issued the pieces under review here in 1931 in *Essays in Persuasion*. Thus, they remain essential for understanding the true nature of Keynes's attempted revolution in economic thinking and for evaluating the counter-revolution represented by what Joan Robinson called "Bastard Keynesianism" -- the dominant theory and policy paradigm of the first three decades of the post WWII era.

"The End of Laissez-Faire" was first delivered as the prestigious Sidney Ball Lecture at Oxford in November 1924, not long after the debate over "Does Unemployment Need a Drastic Remedy?." It was published as a pamphlet in mid 1926. It contains some of Keynes's most important beliefs about the transition from the old order to the new. The general subject is the total inadequacy of "individualism and *laissez-faire*" as a "disposition towards public policy" in the postwar era (9, 272). In this context *laissez-faire* stands for severe limitations on government domestic economic intervention, support for free trade (which he did support throughout the 1920s) and for free capital flows in the international sector (which he opposed). While acknowledging, as he always did, the efficacy of *laissez-faire* as a crude guide to both domestic and international economic policy in the nineteenth century, Keynes unleashed a diatribe against the use of this theory of government policy under the conditions of modern capitalism. *The purpose of his attack is to try to demonstrate that those who have rejected his call for managed credit and a large program of public investment in pursuit of full employment have largely based their resistance on a theoretically and empirically insupportable economic theory.*

The essay opens with a fascinating section devoted to a critical analysis of the evolution of the doctrine of *laissez-faire*. It is of interest in and of itself, and because of the insightful comments Keynes makes on economic methodology. These comments, though often neglected in discussions of Keynes's rejection of *laissez-faire*, are in fact the heart and soul of his attack on orthodox theory in this essay.[[62]](#footnote-62)

Keynes attributes the rise to dominance of laissez-faire 'free-market' economic theory to the emergence of a complex set of developments in politics, philosophy and the economy in the 18th and 19th centuries. Among these were the undeniable incompetence of the state, and the economic success of private initiative. He notes "the corruption and incompetence of eighteenth century government, many legacies of which survived into the nineteenth. ... Almost everything which the State did in the eighteenth century in excess of its minimum functions was, or seemed, injurious or unsuccessful." Thus it appeared that "material progress between 1750 and 1850 came from individual initiative, and owed almost nothing to the directive influence of organised society as a whole" (275). The increasing influence of Darwin then reinforced belief in *laissez-faire*. "The economists were teaching that wealth, commerce, and machinery were the children of competition -- that free competition built London. But the Darwinians could go one better than that -- free competition had built man" (276). These historical developments help explain why "we feel such a strong bias in favour of *laissez-faire,*" and why there had been such strong resistance to Keynes's recent policy proposals in support of "state action to regulate the value of money, [and] the course of investment ..." (277).

Economists of authority, starting with John Stuart Mill and including Alfred Marshall, have rejected all simplified or simplistic variants of the *laissez-faire* doctrine, Keynes argues, but their views have "not prevailed against the general opinion that an individualistic *laissez-faire* is what [economists] ought to teach and what in fact they do teach" (282). *A key reason for this unfortunate situation lies in the misuse or misunderstanding of the methodology appropriate to economics.* It is appropriate, Keynes said, for economists to begin or enter their analysis with an assumption set that is too simple to adequately reflect the economy they wish to study, or to incorporate the key "fact" about it. Rather, they choose the one which "is the simplest, not [the one that] is the nearest to the facts" (282). In particular, they begin with a model of the economy in which ruthless or perfect or Darwinian competition in pursuit of "unlimited private money-making as an incentive to maximum effort" is leads *by design* to maximum economic efficiency. The problem is that they neglect the crucial second step in the use of this method of abstraction in which assumptions are added or substituted that are more realistic reflections of the most important institutions and facts in the economy.[[63]](#footnote-63)

Keynes begins with the crucial theory of competition because it a centerpiece of conservative thinking and, he argues, *the theory of competition that is the sine qua non of laissez-faire theory is fatally flawed*. The concept of competition used in conservative theory assumes that:

there must be no mercy or protection for those who embark their capital or their labour in the wrong direction. It is a method of bringing the most successful profit-makers to the top by a ruthless struggle for survival, which selects the most efficient by the bankruptcy of the less efficient. *It does not count the cost of the struggle*, but only looks to the benefits of the final result, which are assumed to be permanent." (282-83, emphasis added).

Keynes thus points to a severe flaw in the basic method of orthodox analysis, *one that applies as well today as it did in the 1920s.* Though orthodox theory requires the assumption of *an ongoing process* of "ruthless" competition, it incorporates only one dimension of the competitive struggle -- the *benevolent state* of its final equilibrium position. It ignores competition as a perpetual *process that has destructive as well as constructive dimensions.* "It does not count the cost of the struggle" itself. Its static equilibrium method cannot possibly consider the costs and inefficiencies of competition's disequilibrium dynamics. Keynes here implicitly allies himself with Karl Marx, who believed that competition had both positive and negative moments. It provided the degree of coherence that free-markets at times exhibit, but also the destructive or crisis-generating tendencies observed in the historical record. Joseph Schumpeter is also well-known for his view that competition generates both creative and destructive behavior; a view captured in his famous argument the competition generates "gales of creative destruction."[[64]](#footnote-64)

Moreover, Keynes continues, the wonderful orthodox conclusions about *laissez-faire* are based on "an incomplete hypothesis introduced, presumably for the sake of simplicity ... [that] depends on a variety of unreal assumptions ..." (284). The realism of assumptions matters. He begins by arguing that orthodoxy requires two general assumptions: (1) that "the processes of production and consumption are in no way organic"; and (2) "that there exist a sufficient foreknowledge of conditions and requirements, and that there are adequate opportunities of obtaining this foreknowledge." The first assumption refers to the organic-atomistic debate stressed in the *Treatise on Probability* and continued by interpreters of Keynes even today. The second, of course, refers to the axiomatic elimination of fundamental or "Keynesian" uncertainty from orthodox theory. Of course, by the time he published *The General Theory*, fundamental uncertainty and the assumption that aggregate demand is the primary determinant of output and employment had become the two cornerstones of his macro theory.

Keynes then lists six specific, important, and realistic conditions which had to be omitted from the assumption set in order to arrive at the orthodox economic and policy conclusions. This crucial omission rendered the derived hypotheses from the theory useless, he argued. Good economists, he says, reserve to a later stage of their argument the inclusion of following important realistic assumption needed to generate a usable theory - but they must eventually include them or their theory will not provide useful guidance to policy makers.

(1) when the efficient units of production are large relative to the units of consumption, (2) when overhead costs or joint costs are present, (3) when internal economies tend to the aggregation of production, (4) when the time required for adjustments is long, (5) when ignorance prevails over knowledge, and (6) when monopolies and combination interfere with equality in bargaining -- they reserve, that is to say, for a later stage of their analysis the actual facts. (284-85)

If the assumption set is expanded to include these important "actual facts," orthodox *laissez-faire* conclusions cannot possibly be sustained.[[65]](#footnote-65)

But this is not the whole problem. We must now add to the analysis the costs of the destructive dimensions of the competitive *process - of its disequilibrium dynamics*. We must "bring into the calculation the cost and character of the competitive struggle itself, and the tendency for wealth to be distributed where it is not appreciated" (285). We cannot leave out of our cost-benefit calculations, he insists, the "sufferings" of those defeated in the struggle "who are starved out", or the loss of the productive resources destroyed in the process, or the maldistribution of income and wealth that results (the "overfeeding" of the winners), or the "evil look of anxiety" on the faces of the losers or the "struggling greediness" of the winners (285).[[66]](#footnote-66)

*Thus, there is simply no convincing case that can be made in support of laissez-faire using realistic assumptions relevant to conditions in the twentieth rather than the eighteenth or nineteenth century.* When the institutions and practices of an economic system change, theories of that system must adapt to incorporate these changes; for economic theory to be a useful guide to policy, it must be institutionally specific and historically contingent.

It is worth noting in passing here, that Robert Skidelsky, who wrote an excellent three-volume biography of Keynes and his contributions to economic theory and policy, concluded that *The End of Laissez-Faire* "fails to develop any sustained critique of [laissez-faire]. This is the hole in the heart of the essay." He accuses Keynes of "lumping together" a few bits of criticism, some philosophical and some "merely practical," that, in total, do not amount to much. Among these trivial bits are, according to Skidelsky: the question of time and knowledge - that is, of fundamental or radical uncertainty - a cornerstone of The General Theory; the apparently "purely moral" question of the "cost of the competitive struggle," - so much for Schumpeter and Marx; and, a crucial issues for Keynes in this period - economies of scale and scope and the monopoly and oligopoly market power they make possible.

As a result we are left in the dark about whether the laissez-faire project cannot, as a matter of fact, be realised in given circumstances, whether it cannot be realised in any conceivable or probable set of circumstances, or whether it would be wrong to try to realise it, even if it could be. (II, 225).

One can only express amazement that the man who is perhaps Keynes's greatest biographer could be so wrong about so important an issue.[[67]](#footnote-67) Indeed, the entire evaluation of this essay by Skidelsky is shockingly off the mark. Modern general equilibrium theorists (such as Arrow, Debreu and Hahn) have carefully enumerated the conditions that *must hold* to sustain a *laissez-faire* conclusion. Keynes's essay correctly argues that a number of the most important of these conditions are unrealistic or counter-factual; they do not hold. The fact that Skidelsky is a historian and not an economist (which probably, on balance, contributed to the high quality of his Keynes biography) may explain why he fails to understand that the methodological criticisms leveled at received theory in this essay are in fact devastating to it. We might also consider that at the time this biography was written, Skidelsky referred to himself as a monetarist.

To explain the tenacious hold *laissez-faire* maintained in modern Britain nevertheless, Keynes believes, one must look to three non-economic factors. First, he believes that the arguments made against orthodoxy by Marxists and Labour Party State Socialists [who support public ownership of all means of production and Soviet-style quantitative planning] have been as wanting as the case offered in its support. Second, the experience of state control of the economy during World War I was mixed, so that both interventionists and conservatives can marshal evidence in support for their views from the war-time economy. And third, *laissez-faire* has been and continues to be the preferred philosophy of political economy of the British ruling elite. *Keynes here joins Marx (probably unwittingly) in arguing that the ruling ideas in every epoch are the ideas of the ruling class*. Individualism and *laissez-faire* "could not ... have secured their lasting hold over the conduct of public affairs, if it had not been for their conformity with the needs and wishes of the business world of the day" (286). This argument is reminiscent of a point made in chapter 3 of *The General Theory* in explaining how Ricardian economics "conquered England as completely as the Holy Inquisition conquered Spain": that it "afforded a measure of justification to the free activities of the individual capitalist, attracted to it the support of the dominant social force behind authority" (GT, 32-33).

Keynes summarized his general perspective on *laissez-faire* as follows.

It is not true that individuals possess a prescriptive `natural liberty' in their economic activities. There is *no* `compact' conferring perpetual rights on those who Have or those who Acquire. The world is *not* so governed from above that private and social interest always coincide. It is *not* so managed here below that in practice they coincide. It is not a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally is enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does *not* show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately. (9, 287-88, emphasis in original)

Since there can no longer be any presupposition that *laissez-faire* is an appropriate guide to economic policy or that the minimalist state is economically efficient, the central task of the moment is

to determine what the State ought to take upon itself to direct by the public wisdom, and what it ought to leave to individual exertion. ... Perhaps the chief task of economists at this hour is to distinguish afresh the *Agenda* of government from the *Non-Agenda*; and the companion task of politics is to devise forms of government within a democracy which shall be capable of accomplishing the *Agenda*. (9, 288)

Keynes first addresses the latter question: what are the appropriate institutional forms in a democracy for the creation and implementation of an unprecedented degree of government economic influence and control in a capitalist system? His answer here is consistent with all his later writings. He believes that the institutions that will design and implement the details of economic planning must be free of all political or democratic interference in their day-to-day or week-to-week operations -- these are the exclusive province of experts and technicians. But the general objectives and relative priorities of planning are to be under democratic political control, the sole province of the elected authorities. "*Semi-autonomy within the state*" - the public corporations - is the key concept here.

I believe that in many cases the ideal size for the unit of control and organisation lies somewhere between the individual and the modern State. I suggest, therefore, that progress lies in the growth and the recognition of *semi-autonomous bodies within the State* -- bodies whose criterion of action within their own field is solely the public good as they understand it, and *from whose deliberations motives of private advantage are excluded*, though some place it may still be necessary to leave, until the ambit of men's altruism grows wider, to the separate advantage of particular groups, classes, of faculties -- bodies which in the ordinary course of affairs are mainly autonomous within their prescribed limitations, but are *subject in the last resort to Parliament*.

I propose a return, it might be said, towards medieval conceptions of separate autonomies. But, in England at any rate, *[pubic] corporations* are a mode of government which has never ceased to be important and is **[?]** sympathetic to our institutions. It is easy to give examples, from what already exists, of separate autonomies which have attained or are approaching the mode I designate -- the universities, the Bank of England, the Port of London Authority, even perhaps the railway companies. In Germany there are doubtless analogous instances. (288-89, italics added)

The historian Pollard, in his discussion of changes in industrial structures in Britain in the inter-war years, explains, in words that might have been written by Keynes, the rationale for the Public Corporation.

The Public Corporation was an attempt to cope with the problem of the administration of *large or nationally important industries, mostly requiring large capital sums*, a secure control of their market and a strong interest in general of social, as distinct from sectional, welfare. It was a compromise, *to avoid both the exploitation of the public by a private monopoly, and the day-to-day interference to which ordinary Departments of State are normally subjected.* The capital might be held by the State or by former owners, including private shareholders, but there was the most complete separation between ownership and control. ... [T]he Public Corporation enjoyed general support and roused widespread interest as a new administrative device. (1983, 106-07, emphasis added)

Keynes then argues that an increasing percent of the country's largest and most important private economic institutions are evolving toward a status that is, or could easily be made to be, similar for planning purposes to that of a public corporation. Such companies are very large, are in important industries, have substantial power, often in coordination with other large firms, to influence if not control their markets, and operate independently of the feelings of their stockholders - for example, "a big railway or big public utility, but also a big bank or insurance company." Keynes believed that "a new partnership had to be established between the government and the private sector to match the growing corporatism of industry" (Skidelsky, II, 231). The partnership was a necessity: since market competition could not control the actions of these firms, forcing them to act in the public interest, the government would have to take responsibility for doing so. Keynes calls attention to:

the trend of joint stock institutions, when they have reached a certain age and size, to approximate to the status of public corporations rather than individualistic private enterprises. One of the most interesting and unnoticed developments of recent decades has been the tendency of big enterprise to socialize itself. A point arrives in the growth of a big institution -- particularly a big railway or big public utility, but also a big bank or a big insurance company -- at which ... the shareholders, are almost entirely disassociated from the management, with the result that the direct personal interest of the latter in the making of profit becomes quite secondary [and] the direct interest of the management often consists in avoiding criticism from the public and from the customers of the concern. This is particularly the case *if their great size or semi-monopolistic position renders them conspicuous in the public eye* and vulnerable to public attack. (9, 290, italics added)

Their "great size" and "monopolistic position" made such corporations ideal objects for government regulation of one sort or another.

Keynes did not think that these developments were necessarily good news in and of themselves. "The same causes promote conservatism and the waning of enterprise. In fact, we already have in these cases many of the faults as well as the advantages of State Socialism" (290). *But his main point was that the emerging importance of the system of public and semipublic corporations and associations combined with the evolution of private, collusive oligopolistic inter-industry relations already provided the foundation for a qualitative increase in state control of the economy*.

Though the Liberal Party had long been a fierce opponent of private market power, Keynes publicly applauded the formation of industry cartels, orderly marketing agreements, interfirm collaboration on the "rationalization" of secular excess and so forth. Such institutional arrangements were more efficient in the context of generalized and chronic excess capacity than ruthless and destructive competition, and *they made it relatively easy for the government to influence industry decisions about capital accumulation, the elimination of excess capacity, plant location and labor relations. Since key decisions were already being made by conscious administrative judgment rather than by competitive market pressures, it would be relatively easy for government planners to involve themselves in the industry decision-making process.* Keynes "welcomed the 'aggregation of production' as tending to stabilise the economy" according to Skidelsky. Keynes believed that:

an interconnected elite of business managers, bankers, civil servants, economists and scientists, all trained at Oxford and Cambridge and imbued with a public service ethic, would come to run these organs of state, whether private or public, and make them hum to the same tune. (II, 227-28)

Moreover, existing trends toward administrative self-regulation also *required* increased government coordination of industry decisions. Even in conservative theory, market forces alone are incapable of efficiently coordinating an economy riddled with cooperative oligopolistic inter-firm relations.

Thus, a vast new wave of industry nationalization was not a precondition for effective national economic planning, Keynes argued. It is important to understand that *Keynes was not against increased nationalization per se*; contrary to orthodox belief, his approach to the issue of nationalization was pragmatic and case by case, not ideological. Thus, he argues, there is still a good case for nationalizing "many big undertakings, particularly public utilities enterprises and other businesses requiring a large fixed capital." (p ). But he was unalterably opposed to an ideologically-driven commitment to the creation of a detailed central plan based on a general nationalization of the economy, one that gave central planners quantitative control over all microeconomic aspects of accumulation, production and distribution (as envisioned in what Keynes calls the "doctrinaire State Socialism" of the Labour Party).

Not only would such a policy be economically inefficient and politically unpalatable to the majority of the electorate, in Keynes's view it was also unnecessary. Historical trends in the economy were in the process of creating the foundation needed to support effective government planning of those key aspects of the economy that needed central regulation and coordination. Once the more macro-oriented decisions - such as the determination of national income, the levels of investment and saving and the allocation of investment across broad industrial categories - were under government control, there would be no reason to nationalize most of industry. Public corporations and private firms in consultation with government planners could then make the more detailed micro-oriented decisions.

Experience and expertise should enable professional managers of both public and private enterprises to make such micro decisions as well as, and probably better, than government bureaucrats. What is the point, he asks, of forcing every large enterprise to be organized and controlled just like the rather stodgy, unimaginative, nationalized British Post Office?[[68]](#footnote-68) What is needed at this initial stage of development of a new mode of economic regulation is - again - experimentation, the encouragement of many modes and models of firm and industry organization and decision-making. Such experimentation will maximize economic flexibility while creating the empirical evidence that will ultimately be required to construct an efficient planning system.

The battle of Socialism against unlimited private profit is [already] being won in detail hour by hour ... We must take full advantage of the natural tendencies of the day, and we must probably prefer semi-autonomous corporations to organs of the central government for which ministers of State are directly responsible. I criticize doctrinaire State Socialism, not because it seeks to engage men’s' altruistic impulses in the service of society, or because it departs from *laissez-faire*, or because it takes away from man's natural liberty to make a million, or because it has the courage for bold experiments. All these things I applaud. I criticize it because it misses the significance of what is actually happening... (290)

It is crucial to keep in mind in assessing Keynes's thinking about whether an extensive additional nationalization program would be required to sustain the desired degree of State control of the economy, that he would soon (1927) present data to support the assertion *that the sum total of the capital controlled by socialized, semi-socialized, state regulated, not-for-profit, and cooperative enterprises was on the order of "two-thirds of the total capital of large-scale enterprises in this country."*  Thus, with two-thirds of large-scale capital already under public or semi-public control, and with important segments of private industry organized as oligopolies that could be induced or forced to cooperate with state economic objectives, effective state regulation of the main contours of economic life was already realistically within reach. (For one historian's view on the validity of Keynes's assumptions, see the afterward to this chapter on Pollard's assessment of this issue.)

Turning to the appropriate Agenda of government, Keynes argued that the important thing was for the state to perform those economic functions that the individual has no deliberate control over, not to take upon itself decisions that could be made efficiently at the level of the individual. He gives two examples. Building on ideas presented in both the *Economic Consequences of the Peace* and the *Tract*, and presaging the main idea in Chapter Twelve *of The General Theory*, the first example of required state action deals with the dysfunctional effects of uncertainty.

Many of the greatest economic evils of our time are the fruits of risk, uncertainty, and ignorance. ...[T]hese factors are also the cause of the unemployment of labour, or the disappointment of reasonable business expectations, and of the impairment of efficiency and production. Yet the cure lies outside the operations of individuals..." (292).

Keynes proposes two innovations to help alleviate problems caused by uncertainty. He had been crusading for the first one since the *Tract*: the "deliberate control of the currency and of credit by a central institution." The second innovation was "the collection and dissemination on a great scale of data relating to the business situation" (292). Both are remedies that retained his life-long support. The former would help stabilize the domestic price level, reducing the uncertainty associated with inflation and deflation, and thereby facilitating domestic capital accumulation. The latter would make it possible for business to make more efficient decisions and, most important, would provide government economic planners with the information they would need to perform their new economic regulatory functions effectively.

Keynes's second example of economic problems that require a collective solution relates to saving and investment. He made the radical argument that the broad outlines of *the saving and investment decisions of the community would have to come under central control*.

I believe that some coordinated act of intelligent judgement is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investments, and whether the present organisation of the investment market distributes savings along the most nationally productive lines. (292)

*These were extraordinarily powerful economic functions to propose to allocate to the British state in the 1920s*. The state was to choose: the percent of national income to be saved (and, therefore, the division of saving between the public and private sectors); the relation between foreign and domestic financial investment (a cause he was currently obsessed with, one that necessitated the use of capital controls); the allocation of domestic investment across competing uses, broadly defined; and, by implication, the level of national income itself. In addition, as we have seen, Keynes thought that the government should itself organize and finance a secular program of capital accumulation to stimulate and sustain the otherwise anemic forces of private investment.

Keynes understood that, however thoughtful and academic his tone, he was calling for a `revolution' in the organization of British economic life and in the power relations between the central government and the private sector. He understood as well that his proposals would be vehemently opposed by the most powerful elements of British society as radically irresponsible and the first step towards Bolshevism. Therefore, he went on in this essay to offer the reader his standard assurance when defending radical policies that his proposals were not only perfectly consonant with a continued important role for private economic enterprise and the maintenance of individual liberty, but also were the most effective way to preserve his beloved British "way of life" whose continued existence was in jeopardy in these economically and politically troubled times. He would do the same thing in the last chapter of *The General Theory*.

It has often been observed that Keynes wanted to "save capitalism," but most implicit definitions of precisely what it was that Keynes wanted to preserve are wide of the mark. Keynes always distinguished between capitalism as an economic system and capitalism as the material, structural foundation for *a social, cultural and political way of life*. Looking over the totality of his writings on economic and social questions, it is quite clear that Keynes was receptive to -- even enthusiastic about -- changes in the structure and organization of capitalism as an economic system so radical that they would shock liberals and social democrats in the West today. In 1926 Keynes wrote that

I am sure that I am less conservative than the average Labour voter; I fancy that I have played in my mind with the possibilities of greater social changes than come within the present philosophies of [socialists] Mr. Sidney Webb, Mr. Thomas, or Mr. Wheatley. The republic of my imagination lies to the extreme left of celestial space. (309)

But he remained unalterably opposed to any change that would create economic impediments to the continuity of the "way of life" of the British intellectual and cultural elite. In "The End of Laissez-Faire" Keynes clarified his position on this central question in the interpretation of his vision of political economy. Note that he uses a generic and elastic definition of capitalism here -- any economic system that depends heavily on material incentives is, apparently, capitalistic enough for Keynes. Skidelsky said that Keynes "defines capitalism as a spirit, not as a social system" (II, 236). Keynes wrote:

These reflections have been directed towards possible improvements in the technique of modern capitalism by the agency of collective action. There is nothing in them which is seriously incompatible with what seems to me to be *the essential characteristic of capitalism, namely the dependence upon an intense appeal to the money-making and money-loving* instincts of individuals as the main motive force of the economic machine. ... [T]he fiercest contests and the most deeply felt divisions of opinion [on the proper economic role of the State] are likely to be waged ... not round technical questions, where the arguments on either side are mainly economic, but round those which, for want of better words, may be called psychological or, perhaps, moral. ...

...

Many people, who are really objecting to capitalism as a way of life, argue as though they were objecting to it on the grounds of its inefficiency in obtaining its own objectives. Contrariwise, devotees of capitalism are often unduly conservative, and reject reforms in its technique ... which might really strengthen and preserve it, for fear that they may prove to be first steps away from capitalism itself. ... Nevertheless, a time may be coming when we shall get clearer than at present as to when we are talking about capitalism as an efficient or inefficient technique, and when we are talking about it as desirable or objectionable in and of itself. For my part I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable.[[69]](#footnote-69) *Our problem is to work out a social organisation which shall be as efficient as possible without offending our notions of a satisfactory way of life*. (293, emphasis added)

In "Liberalism and Labour" (1926) Keynes turned again to this question of the distinction between capitalism as an economic system and capitalism as a way of life. The political problem of mankind is to combine three things: economic efficiency, social justice, and individual liberty. The first needs criticism, precaution, and technical knowledge; the second, an unselfish and enthusiastic spirit, which loves the ordinary man; the third, tolerance, breadth, appreciation of the excellencies of variety and independence, which prefers, above all else, unhindered opportunity to the exceptional and to the aspiring. (311)

The source of efficiency, of technical expertise and constructive criticism, would presumably be provided by Keynes, his associates in the Liberal Party Summer School, the more conservative wing of the Labour Party ("educated, humane, socialistic reformers") and the left wing of the Tories ("educated, humane, Conservative free traders" (IX, 300). Labour would of course provide the thirst for social justice and the love of the ordinary man - it is not clear that Keynes himself ever knew an "ordinary man," much less cherished such men collectively.

The third point underlines Keynes's emphasis on the non-technical, non-economic aspects of the great problems of the age. It embodies his insistence that he will not support any economic transformation that threatens Britain's cherished "way of life." "Appreciation of the excellencies of variety and independence" and "Above all else, unhindered opportunity to the exceptional and to the aspiring" is Keynes's bottom line. The "exceptional" and the "aspiring", it is reasonable to presume, included Keynes and his friends and associates in the worlds of learning, culture and politics.

"Am I A Liberal," published in August 1925, after the return to the gold standard, is devoted primarily to an analysis of the strengths and weaknesses of the three major Parties as potential political vehicles for the implementation of the proposed 'Keynesian' revolution in the economic role of the state. All three are found wanting, though for different reasons. He concludes that an alliance between the Labour and Liberal parties is most promising, a hoary proposition in Liberal Party thinking. Labour would provide the "heart" of the alliance as well as the bulk of its electoral strength. The Liberal Party would contribute what he believed it to be so rich in -- intelligence and coolness of temperament; it was the party best able, in his view, to provide the requisite analytical skills and the emotional detachment needed to resist Labour's propensity to turn to dangerous electoral appeals to workers' emotions and to foment class conflict.

The essay again makes the point that the government institutions which regulate the economy must be controlled by technicians and experts, insulated in its ordinary workings, though not in its objectives, from the democratic process. *Public Corporations and regulated oligopolies remain the preferred vehicles, not nationalized industries*.

Our task must be to decentralise and devolve wherever we can, and in particular to establish semi-independent corporations and organs of administration to which duties of government, new and old, will be entrusted -- without, however, impairing the democratic principle or the ultimate sovereignty of Parliament. (302)

Most important for present purposes, the essay underscores Keynes's belief that the West had entered a completely new historical era in which the institutions and policies currently used to regulate economic life were totally inappropriate. He associates himself with the American economist John R. Commons's view that Europe and America were currently in transition to a new historic epoch in which the main task is to create a new "regime which deliberately aims at controlling and directing economic forces." Commons "distinguishes three epochs," Keynes tells us, "three economic orders, upon the third of which we are entering."

The first is the era of scarcity... In such a period `there is the minimum of individual liberty and the maximum of communistic, feudalistic or governmental control through physical coercion'. This was ... the normal economic state of the world up to (say) the fifteenth or sixteenth century.

Next comes the era of abundance. `In a period of abundance there is the maximum of individual liberty, the minimum of coercive control through government, and individual bargaining takes the place of rationing.' ... [I]n the nineteenth century this epoch culminated gloriously in the victories of laissez-faire and historic Liberalism. It is not surprising or discreditable that the veterans of the party cast backward glances on that easier age.

But we are now entering on a third era, which Professor Commons calls the period of stabilisation, and truly characterises as `*the actual alternative to Marx's communism'.* In this period, he says, `there is a diminution of individual liberty, enforced in part by governmental sanctions, but mainly by economic sanctions through concerted actions, whether secret, semi-open, open, or arbitrational, of associations, corporations, unions, and other collective movements ...

The abuses of this epoch in the realms of government are Fascism on the one side and Bolshevism on the other. [State] Socialism offers no middle course ...

The transition from economic anarchy to a *regime which deliberately aims at controlling and directing economic forces* in the interests of social justice and social stability, will present enormous difficulties both technical and political. I suggest, nevertheless, that *the true destiny of the New Liberalism* is to seek their solution. (304-05, emphasis added)

The central message in these three essays is unmistakable. *Laissez-faire* is dead; continued support for its domestic and international policies will reproduce economic stagnation and foster social and political unrest, perhaps revolution. The new epoch requires a qualitative increase in the power of the state to "control and direct economic forces," a "middle-way" revolution in economic and political organization that avoids the stupidity of *laissez-faire* as well as the political dangers of Fascism or Communism. Keynes does want to "save capitalism", but not as an economic system -- "Capitalism ... is a technique which, from having been experimental is now perhaps in danger of becoming obsolescent" (19, 441), and not because he favors "money-loving" as the motive force of economics.[[70]](#footnote-70) Rather it is because of the "way of life" of its most privileged classes. Fascism and Bolshevism must be rejected as models, but not because they are inherently economically inefficient.[[71]](#footnote-71) Rather, his great fear is that these more extreme, totalitarian variants of planning will destroy the "way of life" which he cherishes "above all else."

"The next step forward", Keynes concluded, "must come, not from political agitation or from premature experiments, but from thought" (IX, 294).[[72]](#footnote-72) To the Liberals he argued that, while there could be no blueprint for planning at this embryonic stage, the party must think through as carefully as possible its approach to the central issue of the economic role of the state in the new "epoch." "A party programme must be developed in its details, day by day, under the pressure and stimulus of actual events" (306). In July 1926, Lloyd George put up the money to finance the "Liberal Industrial Inquiry", precisely the kind of careful, well-researched policy study Keynes thought necessary. He worked hard on the project in 1926-27. It resulted in the publication of Britain's Industrial Future (the Liberal Party's "Yellow Book") in early 1928.

*Keynes's Assumptions About Britain’s Economy Compared to the Historical Record*

Was Keynes's belief that the necessary structural preconditions for state economic planning were already evolving and thus did not require a massive nationalization program consistent with the historical record? In one sense, the answer does not matter, for the general question we are investigating concerns Keynes's beliefs, not the veracity of his historical assumptions. But it may be useful to demonstrate that his arguments were not without historical support. His thesis that the rise of public and semipublic corporations and the increasing propensity toward the administrative regulation of competition in private industry were creating the foundation required for government economic planning does not seem to be in obvious contradiction with the historical record.

In *The Development of the British Economy: 1914 - 1980* Sidney Pollard provides evidence on the evolution of inter-war industrial organization broadly consistent with Keynes's interpretation of two key trends in British industry. *First, public and semi-public organizations did indeed control a very large per cent of British capital. Second, administrative substitutes for regulation through competition were indeed the order of the day in private industry in the inter-war years.*

After making general reference to the "greatly extended range of functions of the Government and other public authorities in industry, agriculture and transport" during the inter-war years, Pollard argues that this development represented "a distinct phase in the economic development of this country" (99).

A large share of industry and transport was, even in the 1920s, not controlled by private enterprise at all, but by various types of public or non-profit-making organisations, and *their growth is one of the most significant aspects of the period*. Among the most important of them were the co-operative societies, registered under the Industrial and Provident Societies Act, and the building societies, registered under the Buildings Societies Act; enterprises administered by charitable, educational and similar bodies; local authorities, administering over one-third of the gas works, two-thirds of electricity supplies, four-fifths of water supplies and of tramway mileage, virtually all the trolley-bus systems as well as a large proportion of omnibus and other services. There were, further, *ad hoc* authorities such as dock and harbour boards, including those of London, Liverpool and Glasgow, and the Metropolitan Water Board, established in 1902; companies established by Act of Parliament, mainly in the public utilities field, including the railways; enterprises administered directly by the State, including the Post Office, the dockyards, and the Crown Lands; and the Public Corporations. In 1928 the Liberal Industrial Inquiry found that the capital administered by these authorities came to about £4 billion (including £1 billion for roads and £1.15 billion for railways) and was thus of *the same order of magnitude as the aggregate capital of all joint-stock companies*.[[73]](#footnote-73) (1983, 99-100, emphasis added)

Using evidence from both the 1920s and 1930s, Pollard also provides support for Keynes's second assertion, that a distinct historical trend toward the regulation and control of competition through various organizational and administrative devices developed in the inter-war years. After presenting evidence on the growth in the scale of the typical production unit, he argues as follows.

Even this does not show fully the extent of industrial concentration, for many firms, while nominally independent, were being combined frequently in their own, but sometimes even in different industries in complex ways inadequately described as 'lateral' or 'diagonal' integration. The links between the firms forming a group were sometimes economic or technical, but often they were little more than financial. Holding companies or subsidiaries were the most common means of control, but there were also inter-locking capital holdings, frequently unknown to the public, and inter-locking directorates. ...

...

In the main, however, growing concentration was associated with restrictions of competition and the creation of monopolistic markets. The logical conclusion of this development was the creation of a single large monopolistic firm dominating an industry by controlling, say, 70% or more of its capacity. Several of these survived from before 1914.

Apart from the single firm, the most widespread form of monopoly to arise in the inter-war years was the trade association. At the end of the war, ... John Hilton, the Secretary of the Committee [on Trusts], estimated that over 500 associations were then in existence. ...

...

Many of these trade associations collapsed in the slump of 1921-2, but in the 'rationalization' movement of 1924-29, much of it Government supported, others were formed. By the late 1930s there were probably 1000-2000 in existence in manufacturing alone, with a similar number to be found in distribution and other spheres. Most of them were driven sooner or later to concern themselves with price fixing and control.

... Some trade associations went further and approached those of the German-type cartel by controlling not only prices, but also output quotas or capacity [i.e., investment]. (1983, 102-03)

Many of the most important of the cartels extended their field of control internationally, "sharing international markets according to prearranged quotas" (103). The end result, according to Pollard, was that:

Monopolistic combination of one kind or another became much more common during the inter-war years, to the extent that by the end of the period *restrictive practices had become the normal framework of economic life,* buttressed as they were by associations, agreements and Acts of Parliament. Trade 'was the subject of the most extensive, though not always coordinated, control instituted by producers, distributors, and consumers'. 'As a feature of industrial and commercial organisation', wrote an observer in 1937, 'free competition has nearly disappeared from the British scene'." (103-04, emphasis added)

Pollard also documents a "striking" change in the attitude towards monopoly on the part of the British public and the British government starting about the time Keynes was writing these essays. Initially, the change was simply an acceptance of the suppression of free competition in the name of economic rationality -- a sea-change for a people raised on the sanctity of competition as the foundation of *laissez-faire*.[[74]](#footnote-74) Later*, the government and the public came to believe, as Keynes argued in the mid 1920s, that acceptance of the administrative suppression of competition both necessitated government coordination of economic activity (since it removed the logical foundation for laissez-faire) and made such coordination more administratively feasible.*

The drive towards 'rationalization' of industry, first introduced in this country from Germany about 1924, was perhaps the first harbinger of change. It began as a movement to improve techniques, but it was soon mainly looking for savings by structural and economic, rather than technical, reorganization, 'the right arrangement of the relations of the producers to each other'. This often required the collaboration of firms to provide common services, or, more commonly, to provide a full load for the more up to date plant while scrapping the less efficient. Such measures were more logically applied to the whole of an industry, and thus rationalization led directly to schemes of control and monopoly. (104)

*By the end of the 1920s, Pollard argues, all three Parties supported the trend toward cooperative relations among dominant firms in markets organized as oligopolies and administrative industry planning.*

The new Labour members of the Committee on Trusts had as early as 1919 emphasized their belief that evolution towards combination and monopoly was 'both inevitable and desirable, as long as it was controlled in the public interest. Conservative opinion by the early 1930s was equally strongly in favour of regulation and control. Some Conservatives were even prepared to go further, and plan industry as a whole. (105)

"Even the Liberal Industrial Inquiry of 1928 was prepared to see free competitive competition in industry displaced" notes Pollard. But this shift in favor of industrial cooperation rather than all-out competition was not limited to the Liberal Party. Pollard quotes a 1933 book on economic reconstruction written by the influential Conservative politician Harold Macmillan, who later became the British Prime Minister from 197-1963. State economic planning:

[State economic planning] is impossible without the cooperation of industry. Production cannot be planned in relation to established demand while industries are organised on competitive lines. *In present circumstances there are no channels through which any economic policy at all can be effectively administered throughout the field of productive effort.* It is for this reason that I regard it as a matter of primary importance to produce an orderly structure in each of our national industries amenable to the authority of a representative directorate conducting the industries as self-governing units in accordance with the circumstances of the modern world. (105, emphasis in original)

Keynes, writing in the mid 1920s, shared this general view. The government could most efficiently regulate the level of saving and investment, the distribution of investment across industries, and so forth, only if the administrative apparatus within each industry was already in place and operational. The growing movement towards private sector regulation of competition in concert with the vast amount of capital controlled by public and semi-public bodies did seem to be in the process of putting the foundations needed for 'Keynesian' macro and micro planning or industrial policy into place.

**1926-1928 The Micro Foundation of Keynesian Policy: Competition, Industrial Policy and The Liberal Industrial Inquiry - 1926-1928**

Much of the post-WWI conventional wisdom about Keynes's policy views (as well as about his macro theoretical perspective) turns out, upon close investigation, to be quite misleading. For example, he is supposed to have drastically underestimated the contribution of structural as opposed to aggregate demand problems to inter-war unemployment and to have said little, if anything, about what to do about minimizing structural impediments to full employment. And, *he is thought to have been unaware that competition had been largely superseded by collusion among large firms in much of British industry; The General Theory, after all, is about a perfectly competitive economy*.

Both views could hardly be more wrong. In fact, from 1926 through the publication of Britain's Industrial Future by the Liberal [Party] Industrial Inquiry in 1928, Keynes was deeply engrossed in a detailed study and analysis of the structural and competitive character of British industry precisely in order to propose government policies that could both help eliminate unemployment and put industry on a more efficient footing. As already noted, he emphasized on many occasions that unemployment was indeed primarily structural in nature, centered in the traditional export sectors though, as we have seen, he believed that no solution to structural unemployment would be possible until the economy as a whole was put on a higher growth path by his proposed macro-policies of managed credit and public investment. And he had a great deal to say about how industry-level problems should be addressed: he and the Liberal Party had both an industry-level or industrial policy as well as a macro-economic program of state planning. *For Keynes in the mid to late 1920s at least, industrial policy and macro policy went hand in hand.[[75]](#footnote-75)*

Keynes's writings on industrial policy in the period leading up to the publication of Britain's Industrial Future are of two kinds: concrete studies of the coal and, especially, the cotton industry; and general observations derived from such studies on the implications for theory and policy of the end of the era of free competition and *laissez-faire*. The most important item in the latter category is an address to Liberal Party candidates in January 1927 called "Liberalism and Industry." The subject of the lecture is "the arrival of a new industrial revolution, a new economic transition" which needs guidance by the state if it is to lead to "an economically efficient and just society." It is an attempt to influence the attitude on the part of Liberals toward the role of the state in the new era. (19, 638).

Keynes speaks of two "great changes" in the current era, one psychological the other material. On the psychological side he cites the increasing power of unions, especially the political power of the "industrial wage-earning classes" who can now push the "industrial problems which concern them individually," and the shift in the "spirit of the age" from optimistic to pessimistic" (641). On the material side, the great change is the vast increase in economies of scale and scope in industry - "the day of the small unit is over" - and the end of the era in which the forces of competition could be allowed to guide and organize firms and industries has past as well (642).

The old picture, the old schematism as to the actual nature of the economic world we live in is hopelessly out of date; the picture of numerous small capitalists, each staking his fortune on his judgement, and the most judicious surviving, bears increasingly little relation to the facts. (641)

Moreover, he argues that a general separation of management and ownership has occurred. On the one hand, there is the evolution of the "great combines"; on the other, the loss of importance of the owner-entrepreneur. The combines have "innumerable small [share] holdings" and management by "salaried persons who risk nothing of their own fortunes" (642).[[76]](#footnote-76)

Perhaps his most important theoretical argument is that under modern conditions, the pure or perfect or "ruthless" or "cut-throat" competition, glorified as the creator of efficiency and stability in classical theory and in *laissez-faire* policy is, in those industries where it still exists, an economic disaster. Recall that the "costs" of ruthless competition were stressed by Keynes in his critique of orthodox theory in "*The End of Laissez-Faire.*" Here he applies this argument to the specific institutional conditions of the inter-war era.

In fact, under modern conditions the wastes and expenses of cut-throat competition and the beggar-my-neighbor business, which we used to applaud so whole-heartedly, are so devastating that every go-ahead and prosperous industry spends half its time trying to get rid of them; and those industries which still persist in small units and free competition -- like coal and cotton, to take two prominent examples -- are rapidly going bankrupt and will continue to go bankrupt until they alter their ways. (642)

One of the central failings of competition is that it cannot efficiently coordinate the downsizing of industries with excess capacity.

Methods which were well adapted to continually expanding business are ill adapted to stationary or declining industries. You can increase the scale of industries by small additions arranged by individuals. If there comes a need to shift from one industry to another, to curtail particular industries by small decrements, just as they have been expanded by small increments, no corresponding method is available to isolated, unorganised, individual effort. (642-43)

Therefore, in the new epoch competition must be deliberately replaced to a substantial degree by private-sector administrative coordination of inter-firm or intra-industry relations under the guidance and assistance of the state - as well as by government planning of inter-industry coordination and macro-economic dynamics. This has become possible, as well as necessary, because of the clear trend toward collusion and the rise of oligopoly in the core of the economy.

Combination in the business world, just as much as in the labour world, is the order of the day; it would be useless as well as foolish to try to combat it. Our task is to take advantage of it, *to regulate it, to turn it into the right channels*. (643, emphasis added)

*Keynes message here is that the main threat to industrial efficiency in this era is too much competition.* Certain key industries in desperate need of organized retrenchment and `rationalization' (to use the word popular at the time), such as cotton and coal, continue to be characterized by disorganized and inefficient, anarchic competition. *British industry needs more combination, cartelization and amalgamation, not less.* Keynes tells a story about how very few guards are needed to control a large number of "dangerous lunatics" in an asylum; the reason -- "lunatics never combine" (643*). It is up to the government to try to assist those industries that suffer from excessive competition to create collusion and cooperation under government regulation.* The "remedy", as he argued in "Liberalism and Labour" in reference to Common's three-epoch theory, is to move "onwards toward order, towards society taking intelligent control of its own affairs, but not through nationalization and "the highly centralized system of state socialism" proposed by the Labour Party. What is needed is not cut-throat competition or detailed central planning but "*regulated competition*" - a phrase Schumpeter later used to describe the most long-run efficient form of inter-firm competition in oligopolistic markets. (643).[[77]](#footnote-77)

Keynes suggests several contributions the state can make to the solution of this problem. The government should organize and oversee the collection of an extensive set of detailed economic and financial data about all the firms in each industry, and this for two reasons. First, as he explains in his analysis of the cotton industry, this kind of data base is what is needed *by the industry itself* in order that the firms can "combine" to regulate intra-industry competition efficiently. Secrecy may have been appropriate for the old competitively organized industries, but it is a disaster in the new era. "The industries themselves do not know what they should know about their own affairs. ... It is pure waste and efficiency to try to do without the pooling of knowledge" (644).

Second, the government must have a detailed and up-to-date data base *in order to regulate these collusive industries efficiently.*

The Government of the future ought to regard it as one of the prime tasks of statesman-ship to be prepared beforehand with facts and policies for industrial mishaps and maladjustments before they occur, to see them coming along and to be provided with some sort of matter of handling them before it is too late. (644)

In writings before and after this article Keynes and the Liberal Party stressed the importance of "publicity" in dealing with the problem of monopolies and combinations. The usual interpretation is that publicity is important to consumers, who can boycott large firms who do not treat them fairly. But, as Britain's Industrial Future also makes clear, the primary function of "publicity" - detailed data collection and its dissemination - is to allow the firms in an industry to rationally combine and the state to regulate them efficiently.

The government:

must also be prepared to experiment with all kinds of *new sorts of partnership between the state and private enterprise*. The solution lies neither with nationalisation nor with unregulated private competition; it lies in a variety of experiments, of attempts to get the best of both worlds.

In England there have been made already without due recognition a good many experiments in that direction. ... The Government must recognise the trend of soundly run business toward trusts and combines. It must be prepared to recognise their existence as beneficent institutions in right conditions; and it must adopt an attitude towards them at the same time of *encouragement and regulation*. (645, emphasis added)

The phrase "encouragement and regulation" captures precisely Keynes's attitude toward industrial concentration.

The Liberal Party had historically been associated with hostility to trusts and combinations. But this is:

a wrong policy in modern conditions. It should be not discouragement, but encouragement for [trusts and combines] to live and exist in right conditions conducive to the general welfare. So far from their being any natural incompatibility between [combination and the general welfare], I believe that these great concerns run by salaried persons with a sufficient degree of decentralisation may, if they are handled by politicians and statesmen in the right manner, become a pattern and model of the way in which the world of the future will get the best both of large units and of the advantages that might be expected of nationalisation, whilst maintaining the advantages of private enterprise and decentralised control. (649)

But the regulation of Public Corporations, and private monopolies, oligopolies, and industry associations, though it represents an enormous increase in the economic responsibility of government, is far from being the only additional state responsibility for industrial policy at the firm and industry levels in the new era.[[78]](#footnote-78) *The state must also regulate wages, hours and working conditions; education and training; and the transfer of labor from industries and areas where it is in surplus to those where it is needed.* Keynes's enthusiastic and consistent support for state control of most large-scale capital investment is not the only policy position overlooked by mainstream "Keynesian" economists; his support of detailed industrial and labor-market policy has escaped their attention as well.

It is not only in the direction of the regulation of capital that the state must be prepared for new functions. It must be prepared to regard the regulation of wages of great industrial groups as being not merely of private concern, *and it must quite deliberately in its wages and hours policy treat the gradual betterment of the workers as the first charge on the national wealth.*.. ... The problem of the education and the mobility of labour is going to be at least as important. ... It is not so much that there is no work to be done, but that men drop into occupations with no knowledge, by mere accident of circumstance and parentage and locality, often finding themselves in the wrong market, trained for something for which there is no demand, or not trained at all. There is no remedy for that by unregulated private action. It must be the concern of the state to know and have a policy as to where labour is required, what sort of training is wanted; and then where there are maladjustments, as there are in the coal industry, to work out plans for the transfer of labour from localities and trades where there is not demand to localities and other trades which are expanding and not declining. That is one example of the general policy which the Government has to be prepared for -- namely, the deliberate regulation from the centre in all kinds of spheres of action where the individual is absolutely powerless left to himself. ... I have given several examples of that, and as the machinery gets built up and the policy is developed, not a year will pass without an important addition to [these] spheres... (646-47)

Keynes acknowledges that his vision of state economic planning is greatly and radically ambitious: it "is a vast programme that I have briefly outlined -- one of great practical and technical difficulty", but that is "*the* task lying to the hand of the new Liberalism" (647, emphasis in original). *Keynes is so committed to this new direction for the Liberals that he threatens to leave the Party if it fails to support his radical policy initiatives*. Unless the Liberal Party is willing to undertake this task, Keynes says, he and others will not be able to sustain "any live interest in party politics." Fortunately, "an attempt is now being made to work out some first outlines of such a policy by the Liberal Industrial Committee, initiated by the Liberal Summer School and encouraged and supported by Mr. Lloyd George" (647).

We briefly divert our attention here to comment on perhaps the most dramatic political and economic event of the mid 1920s in Britain - the General Strike of May 1926 - because it sheds light on important aspects of Keynes's approach to the economics and politics of labor relations and the workings on the British labor markets, both of which receive emphasis in The General Theory. There had been bitter conflict in the depressed coal mining industry between owners and the miners' union for several years over how to restore prosperity to the industry. This conflict was put on hold in 1925 via wage and profit subsidies while a Royal Commission studied the problem, but the subsidies expired in April 1926. The owners locked out the miners on May 1st, leading to the ill-fated General Strike from May 3d to May 12th. The miners stayed out after the General Strike collapsed, but in the fall "starvation forced them back on the owners' terms" (Moggridge, II, 251).

These events created a split in the Liberal Party between Lloyd George, who sympathized with the miners and Lord Asquith and others who believed that the workers' movement had committed treason and "feared that a General Strike would pave the way to revolution" (Moggridge, 252). Keynes supported George. The "split has come about in such a way that any radical, who is not ready to subordinate his political ideas entirely to personalities, has absolutely no choice" Keynes wrote to his sister. "I find a unanimous -- astonishingly unanimous --- feeling that this is so amongst every single leftish Liberal whom I have spoken to this week" (Moggridge, 255). Keynes sympathies were with the workers who, he felt, were forced into their position by forces they neither understood nor controlled.

The strikers are not red revolutionaries; they are not seeking to overturn Parliament; they are not executing the first movement of a calculated political manoeuver. They are caught in a coil, not entirely of their own weaving, in which behaviour, which is futile and may greatly injure themselves and their neighbors, is nevertheless the only way which seems to them to be open for expressing their feelings and sympathies and for maintain comradeship and keeping faith. ... But my feelings, as distinct from my judgment, are with the workers. I cannot be stirred so as to feel the T.U.C. as deliberate enemies of the community, who must be crushed before they are spoken with. (19, 532)

Keynes wrote a number of articles dealing with the crisis in coal. He believed that the industry had permanently lost a large part of its prewar market and was now burdened with substantial excess capacity, an excessive labor force, and uneconomical mines -- exacerbated by the return to gold at par, as he had argued it would be in "The Economic Consequences of Mr. Churchill" in April 1925. These problems could never be sorted out by unregulated competition he argued, such competition only led to overproduction, then excessive price competition. "I should, therefore, put the formation of a cartel of British coal-exporters in the forefront of the remedies" to the problem, he said, and added that an agreement on minimum prices between a German and a British cartel would be especially helpful (535-36). But "in the absence of a pool or any other concerted action, this overproduction has resulted in a cut-throat competition which has driven down prices, mainly in the export trade, to a level that cannot yield a living wage." Therefore, "the urgent problems of the trade are ... to transfer men out of the industry, to curtail production and to raise export prices" and to arrange for "the closing down, temporarily or permanently, of a not inappreciable number of less efficient collieries" through combination and collusion (536). He referred to the coal as "an old-fashioned private industry, which is not organised in combines or cartels" and suggested that if the owners refused to set up "a pool" through which " a scheme of quotas, of standard prices, and of penalties is drawn up", "the industry must disappear of it must accept nationalisation" (528-29).

Indeed, in "The Control of Raw Materials by Governments" written in June 1926, Keynes argues that the problem of overproduction is inherent in many of raw materials traded on world markets. That is one reason there have been so many private and government schemes to control production or, at least, exports. Independent producers have large fixed costs and therefore find it rational to react to a drop in demand by continuing to produce even at a loss, a practice that is disastrous for the industry as a whole.[[79]](#footnote-79) If there are too many small producers to enable a private cartel to naturally evolve and, especially, if the industry is important to the country, or if its bankruptcy would impact strongly on an area of the country, "then it seems to me both inevitable and right that the government should intervene" to control the industry (550).

However, if we want to understand Keynes's views on industrial policy and the role of state planning in the 1920s we must turn to his discussion of the cotton industry, for *he was intimately and intensely involved in efforts to create a cartel in the American (or low-grade) section of the British cotton industry centered in Lancashire from late 1926 through 1928*.

The American section of the industry was divided among "over 300 fiercely competing family firms", some of which were loosely associated through the Federation of Master Cotton Spinners (Moggridge, 261). Keynes became an adviser to and spokesman for a group of mill owners who were attempting to turn the industry into a tightly knot cartel -- the Cotton Yarn Association.

The main problem in cotton (as in coal) was that the industry had seemingly lost 30% to 40% of its prewar export markets. During WWI many of its former customers had engaged in substantial import substitution, sometimes under the protection of tariffs, and Japan had become a major competitor in course cotton, actually surpassing Britain in output in 1926. The industry reacted to the collapse in demand through anarchic competition or half-hearted and incomplete cooperation, rather than effective collusion. Thus, in Keynes's view, the reactions of both coal and cotton:

are founded on a belief that, is only the industries hang on, `normal' times will return when they may again hope to employ all their existing plant and labour on profitable terms. Neither industry has attempted what the Germans are calling `rationalisation', that it to say, the concentration of demand on the most efficient plants, which are worked at full stretch and the rest closed down. (579)

While coal had engaged in massive overproduction and price cutting, cotton had "ruined itself by organised short-term extending over five years" which drastically under-utilized capital (the spindles) and thus substantially raised production costs (578). What is needed, Keynes believed, is an industry cartel -- a "`rationalisation' process designed to cut down overhead costs by the amalgamation, grouping or elimination of mills" (584).[[80]](#footnote-80)

Keynes's writings on Lancashire cotton contain his clearest concrete or `empirical' observations about the costs of competition, about the myriad ways in which *disequilibrium competitive processes*, which may take years or even decades to work themselves out, can preserve or even worsen structural unemployment and reproduce, rather than eliminate, economic inefficiencies.

His basic line of argument is as follows. The entry point is the assumption that *real capital accumulation is an irreversible process,* a point stressed in The General Theory*.* Once financial capital is transformed into concrete industrial plant and equipment, and put in place in a specific production process in a specific plant in a specific location, it normally cannot be reconverted back into money form without substantial loss if and when it becomes unprofitable. Small firms operating independently may do a good job at adding capital to an expanding industry, "spindle by spindle, mill to mill." However, such a competitive structure: "includes no provision whatever for reversing the process, except the slow and dragging cure which time brings at last by decay and obsolescence. (590)

Suppose that, after industry capacity is built to a high level, there is a permanent drop in demand that creates a condition of substantial excess capacity. Each firm will be forced to cut prices in an attempt to maintain some reasonable degree of capacity utilization so that total cost per unit is minimized; competition will drive prices down until they hit variable cost.

What will happen in an unorganised industry? Competition between the owners ... will drive down prices towards the point at which no contribution at all is left towards overhead [i.e., fixed] expenses. Each individual will accept not the price which yields him a normal return, but the price which is preferable to is abandoning his plant altogether and closing down his organisation. (590)

Of course, each firm will have a different cost structure and thus a different structure of variable cost at various output levels. Economists usually assume that in a price war, the least efficient producers are the first to be driven out of business. *But this will often not be the case in what Keynes, in the Tract, referred to as the modern "regime of money contract."* It may be the most financially fragile or indebted firms -- not the least technically efficient ones -- that are first into bankruptcy, for debt is often incurred to finance new capital equipment designed to put a firm on the cutting edge in terms of cost structure. "If this [price war] goes on for long, the mills which are financially weaker, though not perhaps technically inefficient, will become bankrupt." But even bankruptcy will not necessarily solve the problem of excess capacity (and thus will not eliminate the downward price pressure) because the firms still in business (who hope to survive until the price war is over and profits are normal again) will buy the spindles from the bankrupt firms when the price is low enough.

The spindles of the bankrupt mills will not cease to exist. They will be sold at a low price and thus transferred into stronger hands on terms which will enable the competition to persist in conditions too severe for other businesses to earn their interest charges. And so the losses will continue until the gradual growth of demand over a long period or the obsolescence of the older mills restores the equilibrium at last. (590)

The problems created by "the forces of disorganised and beggar-my-neighbor competition" are, to borrow Keynes's characterization of prosperity, cumulative (593). The drive to stay in business on the part of these family firms leads them to finance losses through new debt and the run-down of working capital, which puts them in yet more desperate straits.[[81]](#footnote-81)

Excessive competition, resulting from excess capacity, has, in many cases, brought down the level of profits below that of interest charges and other unavoidable outgoings.[[82]](#footnote-82) The resulting losses have been provided out of bank loans and other resources which ought only have used as current working capital. The consequence is that the normal borrowing capacity of the industry has been exhausted in meeting losses, and is not available for new capital. In short, the spinners as a class, are frightfully hard-up, which leads to the pest of what is known as `weak selling' [in which the need to pay the bank and the need to get revenue just to obtain new raw materials] carries the trouble a stage further and leads to prices which are worse than closing down. (597-98)

Keynes argues that this "involuntary selling by financially necessitous mills" carries competitive pressure on price to totally irrational and destructive levels. "Not even the best-placed mill can profit from this" (598). "Does anyone advocate cut-throat competition, pricing below the cost of production?" he asks a Manchester Town Hall Meeting in September 1927: "Whom can such methods benefit in the long run?" (616).

What then should be done? The only rational solution to the problem of secular excess capacity and the need to shift production from the less efficient to the more efficient mills, especially in a debt-laden industry organized anarchically is:

the cartel, the holding company, and the amalgamation ... By these means, and by these means only, can the surplus capacity be withdraw from competition and held in reserve against future requirements, so that the rest of the industry can return normal profits meanwhile. (591)

The only alternative is to let the process of bankruptcy run its full course, but bankruptcy "would not take place without a grave struggle: and losses on the part of those made bankrupt would react on those not made bankrupt" (623). It could also badly damage banks that had made large loans to the firms in trouble.

The detailed history of the failed attempt to create the Cotton Yarn Association discussed by Keynes need not detain us. His advice was that all such firms should join an industry association so that collective decisions could be taken about minimum prices, production quotas, the elimination of `weak selling', the redistribution of production from weak to strong mills (through the sale of quotas), a collective "organisation for marketing and merchanting" (621), collective purchasing of raw materials, perhaps even a collective approach to borrowing ("cooperative credit"), and so forth. Such decisions would be enforced through legally- binding monetary penalties extracted from violators.[[83]](#footnote-83) Keynes was very concerned about the free-rider problem: for "by just underbidding the Association's minimum price, [non-members] can obtain all, and more than all, the advantages of the Association's regulation of output" (613). He proposed that the Board of Trade be given the power to make all Association decisions binding on non-members once membership covered a large enough percent of the industry (a proposal that would reappear in Britain's Industrial Future). The Association would thus:

have practically all the powers of the typical continental cartel. It may be that amalgamation and larger units will be required for full efficiency. But the Association will provide a framework within which these can be gradually organised. (600)

Of course, the Association would have to collect detailed statistics on all aspects of its members' businesses in order to be able to carry out these functions effectively. "The members will undertake to furnish prompt and complete statistics to the Association, including duplicate copies of every contract booked." (599) The "first task should be to ascertain the facts. It should set out to discover just what the costs are at every stage of production" so that it "might have some definitive idea as to where and how costs can be cut" (620).

In spite of Keynes's many interventions over two years on its behalf, The Cotton Yarn Association, which at one point included about 70 per cent of the mills, eventually collapsed under the twin burdens of declining demand and free-rider problems. However, "Partly as a result of [Keynes's] **[insert missing word-phrase]** the Lancashire Cotton Corporation was formed, with Bank of England backing, early in 1929; much of the management came from the Cotton Yarn Association" (Moggridge, 262). Keynes seemed pleased at the creation of:

a vast combine which will absorb at the start approaching one third of the whole industry -- and perhaps much more before long -- and will have at its command the best brains in the business and adequate financial resources to rationalise, economise, and experiment. (632)

The firms involved were refinanced and recapitalized: "the combine will have no fixed liabilities whatever, except in respect of the new money it will raise" (633). The Bank of England itself put up some £2,000,000 "on easy terms."

Keynes notes that the "incursion of the Bank of England -- somewhat late in the day but wholeheartedly in the end -- into the field of rationalisation is in itself a matter of much interest and, in my opinion, of congratulation" (634). The fact that the industry had proven itself incapable of overcoming the anarchy of competition, and required the assistance of the state to combine, was hardly shocking to Keynes --though it still must have been disappointing, given all his efforts. In his view, the state had two large tasks here: first, creating amalgamations and combinations in anarchically competitive industries; and second, regulating and coordinating such industries in the national interest.

Keynes believed that in "technical experience, in size, and in financial strength the new combine will start at a considerable advantage over its competitors in every country", but that the most important potential advantages of combination lay in the future.

But it may turn out that the larger advantages will come from certain other directions which can only be explored gradually. The specialization of individual mills on spinning a uniform product is one example. A further integration with other branches of the cotton industry -- the combine proposes from the start to absorb a considerable number of looms -- may be the beginning of a movement that will transform the whole structure of Lancashire's traditional organisation. … The Lancashire Cotton Corporation is a signal example of a piece of work where the hope of quick large profits for individuals has played a minimum part and the interest of carrying through a durable, constructive effort has been uppermost. (p )

Keynes's analysis of the coal and cotton industries in the 1920s demonstrates a number of important aspects of his economic and policy positions in this period. He totally rejected laissez-faire, with its belief that intense or perfect competition will generate economic efficiency. He believed that under then-prevailing conditions of scale and scope, oligopoly was the normal state of organization in crucial industries and that giant firms that dominate core industries should operate, to use Schumpeter’s word, corespectively. He supported "rationalization" or industrial self-organization in which giant firms operating through associations and cartels made crucial industry conditions collectively, and he believed that government should help them do so. He thought that the existence of an organized cartel or association would make it easier for the state to regulate and guide many important decisions of these cartels and associations to make them consistent with, and supportive of, government policies to determine output, employment, the division of income into savings and investment, and the extent to which savings were utilized domestically or moved into foreign financial markets. He supported the trade unions in their struggles with capital and the state. He wanted activist industrial policies to be used for many purposes. Of course, he also thought that most large-scale capital investment should be undertaken by the state and, to a lesser extent, by the private sector under the guidance of the state. He wanted an alliance between the Labour and the Liberal Parties to enact this agenda democratically.

In sum, Keynes's made a major effort to implement a peaceful economic revolution in Britain's economy in the face of bitter opposition from finance, industry, government, conservatives and most of the rich. Where do these facts appear in the "Keynesian economics" taught today? How is it possible that, in the main, academic scholarship, at least as reflected in the teaching of Keynesian economics, has buried the real Keynes in what Trotsky referred to as "the dustbin of history"?

**State Planning and Public Investment: 1927-31**

We shall see that Keynes was well acquainted with all the arguments that can be marshaled against the idea that the state can efficiently maintain a public investment program of sufficient magnitude to keep the center of economic gravity near the full employment level of output. We shall also see that while he shared some of the concerns of his critics, he continued right through WWII to maintain his belief in the viability of state planning centered on public control of investment. The key to understanding his position, as noted, lies in his belief that by the mid 1920s the lion's share of large scale capital investment *was already under public or semi-public control*.[[84]](#footnote-84)

In August 1927 Keynes, as was his practice, addressed the Liberal Party Summer School. He was heavily involved at this time with the Liberal Industrial Inquiry, a study of the causes of and possible cures for Britain's long-term economic malaise that would eventuate in two important Liberal Party publications that area central to an understanding of Keynes’s position on economic policy in this period: the "Yellow Book" in 1928 and the "Orange Book" (1929. These publications formed a crucial part of the economic platform on which Lloyd George based his 1929 election campaign, a campaign in which George pledged to cure the unemployment problem through a large scale public investment program.[[85]](#footnote-85)

The subject of Keynes's talk was "The Public and the Private Concern." Though his notes did not survive, one newspaper published a very detailed summary of the report. Keynes opened his remarks with the statement that, on the one hand, all sensible people regard "a great deal of public enterprise as unavoidable, necessary, and even desirable," while, on the other hand, "there is an enormous field of private enterprise which no one but a lunatic would seek to nationalise" (695). He then went on to discuss "what actually exists" with respect to capital assets held by non-private institutions. Bear in mind that Keynes's list of non-private capital is obviously incomplete; for example it excludes the government "Road Fund" used to finance road building and improvements, and it does not even consider military spending.

First of all, [Keynes] found that the great medley of socialised, semi-socialised, and other state-regulated enterprises from which the private-profit motive had been partly or altogether removed controlled no less an amount of capital than £3,500,000,000. Among the figures making up this sum were £100,000,000 in the case of docks and harbours, £100,000,000 controlled by water boards and other analogous bodies from which all the methods and criteria of private enterprise had already disappeared.

Then the Ecclesiastical Commissioners administered at least £50,000,000, the colleges, schools and universities £100,000,000 and the Charity Commissioners something exceeding £100,000,000. Building societies had accumulated in driblets more than £200,000,000 and co-operative societies had another £200,000,000. Moving steadily in the direction of normal private enterprise one found bodies, of whom the railway were concerns were the chief*, with capital raised privately under an Act of Parliament which laid down conditions as to rates which might be charged and profits which might be earned.*

The capital of all these contributed to the stupendous total of three hundred thousand five hundred millions, which was *two-thirds of the total capital of large-scale undertakings in this country. That, then, was the first fact to bear in mind -- that two-thirds of the typical large-scale enterprise of this country had already been removed, mainly by Conservative and Liberal Governments, out of the category of pure private enterprise.*

...

I suggest that we should give up pretending that there are no public concerns. We should take a good look at that great body of public concerns which we already have and learn how to handle them wisely and efficiently. Then it will be time enough to consider whether we ought to add widely to the scope and field of their operations." (19, 695-96, emphasis added)

Keynes will return to this politically and economically important point again and again. For example, in April 1929 he said that the government already has control over most national investment” since the amount of [government] expenditures on roads, electricity, telephones, ports, drainage, and also on railways and houses depends on its policies…” (810), while in May 1930 he insisted “that [private] industry is incapable at the best of absorbing more than perhaps a quarter (£1,500,000 a week) of our available [savings] - and that will take a great deal of doing” (20, 352).

Part of Keynes's message is directed to those Labour Party socialists and communists who were mainly concerned with further nationalization of the means of production as a precondition for Soviet-style quantitative central planning. He had already made it clear that he was not opposed to further nationalization of large private firms if it made economic sense: his approach to this issue was purely pragmatic, not ideological. But here, as in "The End of Laissez-Faire," he points out that with so much of national capital already held outside private hands, and with important segments of private industry organized in the form of co-respective oligopolies, and thus easy for the government to regulate, further nationalizations were just not that important. "The battle of Socialism against unlimited private profit is being won in detail hour by hour..." he wrote in the earlier essay. In this talk he states: "Here was all this diversity developed by experience to meet real problems and actual situations. What did the socialist think he would gain by assimilating it all to the model, say, of the Post Office?" (696).

The main point for our purposes is that Keynes clearly believed that with two-thirds of the large units of capital of the country already under direct or regulatory control by the state - "the first fact to bear in mind" - no revolutionary change in formal ownership of the means of production was needed to create an effective program of state planning for full-employment based on state control of capital accumulation.

**Britain's Industrial Future - 1928: The "Smoking Gun"**

In February 1928, the Liberal Party's Industrial Inquiry group published Britain's Industrial Future, hereafter BIF, the end product of an eighteen month study of the economic problems troubling the country. ***This may be the most important document of the 1920s for those who wish to understand precisely how Keynes envisioned the public and private institutions and policies that could be used to restructure British industry and use state control of most large-scale capital investment, among other things, to restore prosperity and attain long-term full employment.*** *The major contribution to our understanding of the evolution of Keynes's thinking about state direct and indirect control of capital investment is a fairly detailed description of his proposed* ***Board of National Investment****, a body that would both gather the necessary sources of finance and allocate them to pay for economically and/or socially efficient investment projects in a manner calculated to assure the full-employment of labor over the long run. As we will see, Keynes expressed his support for state control of most capital spending as the main instrument of government economic policy in several places in The General Theory, but he did not say how this could be done in either in that book or in any other place that I am aware of. This is why BIF is crucial to the defense of the main thesis of this manuscript. It is, so to speak, the "smoking gun" of the argument.[[86]](#footnote-86)*

Keynes was a member of the Inquiry's Executive Committee, along with such influential party figures as Lloyd George and Ramsey Muir. The historical record is unclear about the precise role played by Keynes and others in the collective work, but it is clear that *he was a - and probably the major force behind it*. According to Harrod:

Keynes' contributions were of central importance. He was able to get endorsement for his ideas on currency management, the stimulation of domestic investment programmes*, a public investment board*, which would also have regard to the scale of foreign investment, an Economic General Staff, greater publicity for the finance of companies, and *the encouragement of the semi-public concern as an agency of industrial operation intermediate between the state and private enterprise*. (392-93, emphasis added)

We know that he was primarily responsible for Books II - according to Moggridge he drafted most of it, and V, along with several other chapters, and that he co-authored chapters on taxation as well as the "Summary and Conclusions," and went over the text as a whole.

It is thus hard to be sure when Keynes is speaking in the book, when his influence is negligible, and when his more radical ideas (for he certainly was one of the most radical of the Liberals) have been muted in response to opposition from more conservative members. Moggridge reports an importance instance of muzzling by conservative voices. Robert Brand, a business man, objected to Keynes's emphasis on the centrality of the state-regulated public corporation under the day-to-day direction of a public board (rather than shareholders) but ultimately responsible to Parliament, and his stress on the need to 'rationalise' or cartelize industry under government guidance and regulation as discussed in the previous section.

Brand's objections proved decisive. Most of Keynes's evolutionary speculations were omitted from Book II ["The Organisation of Business"]; a strong section on the virtues of individualism was inserted; *the suggestion that the public concern might become the typical unit of industrial organisation was dropped; and proposals for reorganising business structure largely limited to making the existing forms of public concern more 'lively and efficient'* (Moggridge, 267, emphasis added)

Thus, it seems fair to conclude that: (1) Keynes influenced much of the book and was probably in general sympathy with most of the opinions expressed therein; and (2) opinions expressed in the sections of the book most closely associated with Keynes -- especially Book II -- *may have been more conservative (less 'statist' or interventionist, with more emphasis on the economic benefits of individualism and markets) than he would have preferred.*

There a number of interesting aspects of the book. It is long, almost 500 pages, and contains an astounding amount of institutional detail about many aspects of the British economy and the economic role of the state. Indeed, it was far too long to be widely ready and thus to politically effective. In a letter to his wife Keynes noted that “The Liberal Inquiry has had a rather bad press.” But he also said that the book:

“deserves it. Long-winded, speaking when it had nothing to say, as well as when it does… It would have been much better at half the length, speaking only what is new and interesting and important. As it is, any reader must be discouraged. (19, 735, emphasis in original).

BIF provides additional evidence that Keynes had an extensive institutional knowledge about the British economy, one not limited to domestic and international financial markets and central banking. The book also draws on the institutional and policy experience of many other European countries in dealing with the economic dislocations of the inter-war years; it looks to new experiments with the economic role of the state in, for example, Germany, Italy and France.

It is also very *corporatist* in tone. Several sections discuss the importance of uniting all the key actors in an industry - firms, labor and the public - into a governing board that can make key industry decisions cooperatively and administratively. Such boards could then be integrated into a national decision-making body. The corporatist language on industrial relations is clearest and most administratively concrete, but other aspects of industry decisions are to be made through cooperation, amalgamation or combination.

*The destructive force of class antagonism in industry receives careful attention*. In addition to labor representation on industry-wide industrial-relations boards, the book proposes a more egalitarian distribution of both private wealth and public services to reduce class distinctions, as well as mandatory reporting of business costs and profits so that unions would know to what extent companies were treating them fairly. It also proposes profit sharing and the evolutionary buildup of worker ownership of the companies that employ them, though it opposes direct worker control.

For our purposes perhaps the most interesting aspects of the book are: (1) it supports the Keynes-George 1924 proposal for a long-term policy of public investment and ***provides for the first time supporting institutional detail for its implementation****;* and (2) *it reflects Keynes's balanced, micro plus macro, state-guided industrial policy plus managed credit and public investment, approach to the solution of Britain's economic problems in this period.*

BIF repeats over and over again Keynes's belief that high unemployment is primarily the result of long-term structural problems in key export industries aggravated by deflationary government policies including the return to gold at par; it was not created by generalized domestic or global recession.[[87]](#footnote-87) The solution, then, must address these industry-level problems through the kind of state-guided industrial policy Keynes had been expounding for the past two years.

But, as Keynes himself argued many times, the transfer of labor out of the depressed industries and areas into new industries and areas would not take place *even given sensible industry restructuring* without a secular macro-economic stimulus to general economic growth provided by a large-scale program of state controlled public investment. Chapter XXI, which fleshes out the details of a program of large scale public investment program under the guidance of a central government "***Board of National Investment***", opens with an emphasis on the balanced approach.

[W]e must endeavor to awaken in British industry a spirit of joint endeavor, based upon frankness and fair treatment, and of striving after efficiency that will keep us in the forefront of material progress. The energetic pursuit of these [industrial] policies should in the long run ensure a substantial improvement in our employment situation. At the same time these results are likely to be slow, and if we are right in our conclusion that we are faced at present with a certain abnormal amount of unemployment of a quasi-permanent character, then it is not sufficient to rely solely on the gradual improvement of productive efficiency. Definite and energetic steps must be taken in other directions to restore the balance of our national economic life. We need an enlightened, energetic, and statesmanlike policy of development and reconstruction in other fields, *proceeding side by side with the improvements in industrial efficiency*...

...

We put therefore, in the forefront of our proposals a vigorous policy of national reconstruction embracing within its scope, *inter alia*, the rehabilitation of agriculture, still the largest of our national industries; an extensive programme of highway development; afforestation, reclamation, and drainage; electrification, slum clearance and town planning, and the development of canals, docks, and harbours. (280-81, emphasis added)

We turn now to a closer examination of some important sections of BIF. Book 1 summarizes the general condition of British industry. It stresses the great changes that have taken place in Britain since the turn of the century and, especially since the start of the War. The permanent decline of the great export industries on the nineteenth century is the focus of attention.

When the War ended and the short-lived post-war boom was over, Great Britain found herself faced not merely with internal dislocation, but with her pre-war international difficulties so gravely increased as to create a completely new situation. The War had produced not only in Europe but even in far-distant countries a condition of extreme economic isolation. Our customers in the Empire, the East, and elsewhere had been compelled to provide, either at home or from some alternative source, the goods and services we had formerly provided. (10)

In addition to this rise in self sufficiency of many of Britain's former customers, other problems mentioned include the huge war-induced excess capacity in the shipping industry, increased use of oil as a substitute for coal, and the advance of Japan as a competitor to Lancashire in coarse cotton trade. In sum:

The decline in the volume of exports and the consequent stagnation of the industries which are mainly associated with export is the principal explanation of our formidable post-war unemployment. Coal, iron and steel, engineering, shipbuilding, cotton and wool, are our great exporting industries, and [represent] a large proportion of our unemployment ... (23)

This section also insists that "there is not today, and there has not been for several years, a general trade depression... “(13).

Solving the unemployment problem in the export trades was made especially difficult by the fact that both the capital and labor employed there were substantially immobile. We discussed this problem earlier. Fixed capital is substantially ‘*irreversible.*’ Once in place it is industry-, firm-, and location-specific, and vulnerable to technological obsolescence. It cannot be withdrawn from its original use without substantial loss in value.[[88]](#footnote-88) But, Keynes observes, labor is also burdened to some extent with irreversibility. Jobs are location- specific and skill-specific, housing is location-specific and may plummet in value when a dominant local industry such as mining or ship-building or steel production goes into depression. Workers and their families are also part of social networks that are central to their well-being. This was not, in other words, a situation in which the decline in some particular industry is easily resolved by the absorption of redundant labor and capital into expanding industries. These export industries:

represent a very high degree of specialisation of plant and skill. They are concentrated very largely in particular localities. ... It would be impossible to view their decline with the same comparative equanimity with which we have been able in the past to view the decline of other industries against whom the tide of fashion or economic opportunity had turned. ... *But it is only necessary to ask to what alternative purposes a coal-mine or blast furnace could be converted in order to realise that the decline of our basic industries would confront us with an altogether formidable problem*. (40, emphasis added)

Moreover, as Keynes had stressed before, there were two considerable obstacles to labor mobility that did not exist in the previous century: the "housing shortage, trade-union restrictions, unemployment benefit"; and the sluggish rate of growth of the economy as a whole -- "the failure of even the prosperous industries to go ahead fast enough to draw the surplus labour out of declining industries" (44).

Book 1 points to the two kinds of solutions that are stressed in the rest of the work. First, "there is in some cases a certain amount of remediable inefficiency within the industries themselves," especially in coal, textiles and steel (42). One huge problem is industry's inability, as presently organized, to eliminate secular excess capacity. Part of the problem, then, can be remedied by industrial policy and changes in the organization of industry.

Second, on a more macro level, help can be found by following Keynes's advice to restrict foreign investment, and channel more of British savings into "a large expenditure of capital at home" -- "the setting up of new industries, the modernisation of old ones, the revolution in the modes of transport and in forms of power, the need to house our increased population, and to rebuild a part of our towns ..." (44). This macro policy, based on an unprecedented large-scale program of public or publicly-controlled investment, is the real key to the revitalization of the British economy.

It seems to us, therefore, that the time is now ripe for a bolder programme of home development which will absorb and employ the national resources of capital and labour in new ways. Such a programme, which we develop in Book 4, seems to us to be not only recommended in the national interest as a means of exploiting the technical developments of the modern age, but also as ***the best available method to break the vicious circle of unemployment***. (46, emphasis in original?)

The crucial macro dimension of the policy proposals of BIF are contained primarily in Book 2 written by Keynes, and Book 4, overseen by Lloyd George. Book 2 is central to understanding Keynes's evolving commitment to public investment as the core of macroeconomic policy. It lists in great detail the various categories of public and semi-public concerns, documenting their immense size and significance. The demonstration that there are enormous capital assets already under the direct control or the guidance of the state is a crucial step in the development of his general line of argument since May of 1924 in support of large-scale public investment (and against significant additional nationalization). *Book 2 also contains Keynes's first public support for a powerful "Board of National Investment", one central authority capable of overseeing, coordinating and financing all public investment programs at every levels of government and of influencing private investment.* Finally, this section supports and develops William Beveridge's earlier proposal for the creation of an "Economic General Staff" -- "a thinking department within the Administration, at the elbow of the inner ring of the Cabinet, which shall warn Ministers of what is ahead and advise them on all broad questions of economic policy" (116)

Book 2 begins with a forthright rejection of what it calls the "comprehensive State socialism" of the Labour Party. It stresses three advantages of decentralized enterprise decision-making and the inefficiency that direct, central state control of companies can inflict. Decentralized control: gives authority to those nearest to and most knowledgeable about important decisions, saving time in the process; it allows many individuals to seek the best answer to common problems through trial and error; and it provides a method of comparing the efficiency of individuals and of methods.

On the other hand, the chapter also acknowledges that "the pooling of knowledge, the elimination of the wastes of competition (which are very great), [and] the deliberate aiming at the general advantage ... are real advantages in central control and ownership" (65). Keynes forthrightly defends the concept of public management of business enterprise, rejecting the assumption that "the unrestricted private-profit motive" is the only way to motivate effort and efficiency in business decision-making.

The notion that the only way to get enough effort out of the brain-worker is to offer him unfettered opportunities of making an unlimited fortune is as baseless as the companion notion that the only way of getting enough effort out of the manual worker is to hold over him the perpetual threat of starvation and misery for himself and those he loves. It has never been even supposed to be true, at all events in England, of the soldier, the statesman, the civil servant, he teacher, the scientist, the technical expert. (66)

Since most managers of large private firms receive "a certain salary, plus the hope of promotion or a bonus" for their efforts, which is just what managers and directors of public concerns should expect, "the performance of functions by Public Concerns in place of privately owned Companies and Corporations would make but little difference to the ordinary man" (66).

On balance, Keynes concludes, the right approach is to expand public ownership of industry, but only moderately -- he mentions road construction and electric power. In general, the following kinds of private enterprises should be brought under public control: firms of great national importance which require large amounts of capital but may not receive adequate private capital because of the need to limit profits or "for some other reason"; large firms with monopoly power that make unregulated private enterprise dangerous to the public; or firms in which "the private shareholder has ceased to perform a useful function" (75). These three categories of firms that should be under state control or guidance constitute a huge proportion of the large-scale capital goods of the country. The last criterion is of special interest because Keynes is on the record as believing that *most* large firms have evolved to a position of managerial as opposed to stockholder control.

Keynes next task is absolutely crucial: to demonstrate that the public concerns over which the state already has direct or indirect control are, in the aggregate, so large that no substantial increment through nationalization is required to give the state potential control of the national capital accumulation process.

Section 2 of Chapter VI (The Public Concern) is called a "Survey of Existing Public Concerns. It organizes the socialized or semi-socialized firms into various groups and presents crude estimates of the amount of capital controlled by each of these groups.

The section begins with "National Undertakings operated by the Central Government itself." These are the so-called "nationalised" enterprises under the direct, day-to-day control of Government Departments. Keynes calls them "few in number"; the leading examples referred to are the Post Office, the Telegraphs, and the Telephones. In his opinion, they are not run in a particularly creative or efficient way. Next come "National Undertakings operated by officially appointed ad hoc Bodies" of which the leading examples are the British Broadcasting Company and the Central Electricity Board. Then come "Local Undertakings operated by the Local Authority itself" with some £700 Million in revenue-earning capital plant. These include locally-owned gas, electricity, transportation and water companies as well as housing. Next on the list are "Local Undertakings operated by officially appointed ad hoc Authorities" or Boards, including docks and harbors (of which the Port of London is the largest), Water Boards, and Public Authorities in London. Then we find "Companies under the Building Societies Acts and the Industrial and Provident Societies Acts." "So far we have been dealing with non-profit-making undertakings" it is explained, but we "now come to another category, where profit enters in, but either not on the usual capitalistic lines (e.g. Co-operative Societies) or not without some measure of regulation or restriction" (70). The penultimate category is "Parliamentary Companies", the leading categories of which are railways, tramways and gas water and electricity companies, though the Bank of England is included under this heading. Finally, reference is made to "Independent Undertakings not run for Profit" consisting of the "Ecclesiastical Commission", the Universities, Schools and City Companies, and Charities.

*Keynes conclusion about the cumulative size of these concerns and their implication for state planning (previously mentioned in regard to his 1927 speech to the Liberal Party Summer School) is of the utmost importance.*

Thus productive undertakings, mainly transport and public utilities, representing a capital in the neighborhood of £2,750,000,000 or £4,000,000,000 if we include roads, are already administered according to a variety of methods, all of which depart in some respect from the principles of private capitalism and unrestricted individualism. The transportation undertakings and public utilities included in this total, measured by the amount of capital involved, must compromise at least two-thirds of what could be called the large-scale undertakings of this country, though it would be a smaller proportion, measured in terms of the number of workmen employed.

...

These formidable total -- amounting to over £4,000,000,000 under all heads -- demonstrate what we have said above as to the unreal character of the supposed antithesis between Socialism and Individualism. What does the Socialist think he could gain by assimilating all this valuable diversity, developed by experience to meet real problems and actual situations, to a single theoretical model? Are not the abuses of private capitalism and unrestricted individualism capable of being reformed, in so far as they are still to be fund in these mixed types, by a further evolution along the lines already set? On the other hand, is the individualist really prepared to scrap all this elaborate special legislation by Governments of every political complexion under pressure of actual circumstances, and hand over the vast capital of our public utilities and railway system to the operation of uncontrolled individualism? If not, then there is no question of principle at stake but only on of degree, of expediency, of method. (74-75

*When this huge and diverse set of undertakings is brought under the coordination of a Board of National Investment, the potential impact of a long-term program of public investment could be large indeed.*

Therefore, the combination of publicly owned firms and publicly regulated or controlled privately-owned firms could play an increasingly important and, perhaps, ultimately dominant role in the economic life of Britain. It is useful to recall here Moggridge's statement that only the heated objections of conservative voices such as Robert Brand's prevented Keynes from arguing that the Public Concern might become the "typical unit of industrial organisation" in Britain (267).

The rest of the chapter is devoted to ideas about how to make the Public Concern more efficient. “We think that the balance of advantage requires some extension of the functions of the State, but above all a consolidation and reorganisation of those which it already performs. (66)

Keynes argues in favor of *public ownership of various kinds combined with day-to-day control by highly professional management under the guidance of a public board of directors responsible, in the end, to Parliament*. This is not the State Socialism of the Labour Party; it is not quantitative planning and public ownership of all means of production.

The best method of conducting large undertakings owned by the government and run in the public interest is by means of an *ad hoc* Public Board analogous to a Joint Stock Company, in which the capital is owned and the directors appointed by the State. (457)

There is no inherent reason, it is argued, "why such Boards ... need be any less efficient than the Boards of large public companies, which are managed by salaried directors and officials subject to no real or effective control by their shareholders" (77).

Keynes always put great stress on the need to create a kind of Civil Service of highly trained managers and skilled directors to run the growing number of public corporations, "a class of officials for running them as capable as the General Managers of great industrial companies" (81). This concern is reflected in BIF.

We need to build up an attractive career for business administration of this type open to all the talents. A regular service should be recruited for Public Concerns with a cadre and a pension scheme, with room for the rapid promotion of exceptional officials and with satisfactory prizes for those who reach the top. (80)

*Chapter IX (The National Savings) introduces Keynes's proposal for the creation of a Board of National Investment. The emphasis in this chapter is on the Board's control over the flow of national savings, the supply of financing for investment; Book 4 will deal with the Board's role in directing this saving into investment projects*.

The annual flow of new savings is estimated to be about £500 Million, of which about £100 Million currently passes through central and local governments. Keynes suggests that, once the BIF proposals for a large program of public investment under the Board of National Investment are implemented, *about half of the funds that currently flow abroad should be channeled instead to control by the Board*: "it would be to the advantage of the country if (say) £50,000,000 less were lent each year to public bodies abroad and £50,000,000 more were devoted to the development of the national resources and equipment at home" (111).

*It is imperative, Keynes argues, that the revenue flows to, and the capital expenditures by, various government agencies be consolidated under the authority of a single government body.* This is a position he will take many times in the future. A unified national "Budget of Capital Expenditure" needs to be prepared, similar to that prepared for the government of India. "With this object in view, we propose that there be established a Board of National Investment" as a subordinate department of the Treasury under the authority of the Chancellor of the Exchequer, "who should make periodic statements to Parliament nd give opportunities for discussion" (111).

"All capital resources accruing in the hands of Government Departments should be pooled in the hands of this Board." The Board would also be empowered to borrow on its own account, at the low interest rate made possible by central government backing. Loan-financed investment will provide the greatest stimulus to national spending. The Board would, in addition, be empowered to substitute its own debt for cash as payment from the Sinking Fund to holders of existing government debt, thus converting, as Keynes always put it, unproductive into productive debt. The Board "should also be authorised to issue, when necessary, either for cash subscription or in substitution for existing Dead-weight Debt, National Investment Bonds (as they might be called) having a government guarantee" (112). Since interest payments plus amortization of the National Debt is estimated later in the book to cost about 10% of national income (or about £800 Million per year), *the ability to substitute National Investment Bonds for cash repayments could provide a huge potential source of funding for the Board*.

The funds generated by the Board would be used to finance "new capital expenditures by all central, local, or *ad hoc* bodies [i.e., all Public Concerns], by means of advances precisely on the lines of those now made from the Local Loans Fund" (112).[[89]](#footnote-89) The interest rate charged by the Board would generally be slightly above the rate the Board itself has to pay. Since this is, in effect, government debt, the interest rate charged by the Board should be lower than that paid by even large private corporations. The local projects would have to be approved by the appropriate government Department. The scope of lending available to the Board would be quite wide. *Lending to private companies for approved investment projects that were congruent with Board objectives was specifically authorized.*

The Board should also be authorized to advance funds for new capital improvements to railways or other Parliamentary companies on terms to be mutually agreed, and also ... to any other Public Company, on the lines of the Trade Facilities Act. (113)

The Trade Facilities Act, which had recently expired, made loans "for approved purposes on behalf of private concerns but with the guarantee of the Government" (103). Keynes had mentioned on several occasions that the purpose of the Trade Facilities Act -- to give private concerns with investment projects considered to be in the national interest government backing for its loans - was quite sensible, but that its scope had been too limited.[[90]](#footnote-90)

Keynes and the Liberals clearly had high hopes for the scale and the potential economic impact of the Board's operations. Keynes estimates that it would be able to allocate about £150 million annually to begin with and up to £300 million in the foreseeable future. "In the course of time the annual installments of repayments for loans previously made would double this sum." (114). *Thus, in the Board of National Investment, Keynes believed he had proposed a concrete government body capable of efficiently organizing and implementing the public engine of capital accumulation which, he had argued in 1924 in "Does Unemployment Need a Drastic Remedy?", was needed to solve the British unemployment problem.* The Board was specifically instructed to take the level of unemployment into account when deciding how much investment should be undertaken. The potential goals of the Board were very ambitious indeed, recreating in modern Britain the boom conditions of the 19th century.

with the least possible disturbance, an instrument of great power for the development of the national wealth and the provision of employment. An era of rapid progress in equipping the country with all the material adjuncts of modern civilisation might be inaugurated, which would rival the great Railway Age of the nineteenth century. (114)

To oversee and coordinate all the diverse regulatory and control functions proposed for the state, Keynes calls for the "creation of what, following Sir William Beveridge, we may call an Economic General Staff" (117). It is his belief that at present the Prime Minister and the Cabinet have no adequate source of skilled economic advice, yet the proposed expansions in the economic role of the state will confront government with economic responsibilities of unprecedented peace-time dimensions. “It is, therefore, a vital need for a modern State to create a thinking department within the Administration, at the elbow of the inner ring of the Cabinet, which shall warn Ministers of what is ahead and advise them on all broad questions of economic policy.” (116)

In particular, it would be the duty of the Economic General Staff:

To suggest to the Government plans for solving fundamental economic difficulties, such, for instance, as measures for stabilising trade conditions, avoiding unemployment, and developing national resources. (118)

Continuing the military analogy, Keynes proposes that there be a Chief of the Economic General Staff, whose "position would be of such power and importance" that it would be comparable to that of the "First Sea Lord or the Chief of the Imperial General Staff" in time of war (118). The members of the General Staff would include, in addition to the Chief, the Permanent Secretary of the Treasury, and the permanent heads of the Board of Trade and the Ministries of Labour, Health and Agriculture. They would be assisted by a Secretariat of the Economic General Staff, staffed by a small number of the best experts available. Finally, Keynes envisioned a Committee of Economic Policy which would be a Standing Committee of the Cabinet under the chairmanship of the Prime Minister to which the Chief of the Economic General Staff would act as Secretary. This committee would consist of the Prime Minister, the Chancellor of the Exchequer, the President of the Board of Trade, and the Ministers of Labour, Health and Agriculture. Ultimately, the new and more powerful economic regulatory and control authority granted to government would be the responsibility of government's most powerful administrators.

In Book 2 Keynes also addresses the more micro-oriented issues of industrial policy that concerned him in his writings on the need for rationalization in the coal and cotton industries. He discusses various reasons why the management of individual firms has, in many cases, become ineffective -- inheritance of control by second and third generations of the founders family is an-oft cited concern of his, for example. But the really serious problems are those concerning "industry as a whole." "In no country is an obstinate prejudice to what is called "rationalisation" stronger than in Britain" (128). He discusses the problems caused by "individualism instead of cooperation" in coal, steel and flour-milling by way of example. They indicate the need for the industry as a whole to agree to: shift production from high to low-cost mines (coal); "distribute the orders among the different works in such a way that each would have the most continuous possible work on the smallest variety of sections" (steel); and reallocate orders to create geographical efficiency as well as economies of scale (milling) (128-29). What prevents the implementation of these aspects of rationalization is mainly "jealousy and mistrust among people at the top of the various concerns, vested interests of all kinds, the carrying on of things as they are, apathy and lack of imagination to realise the importance of reform" (130).

The solution to such problems cannot be left to anarchic competition among large numbers of firms in unregulated markets. It:

is not to be secured these days by mere attempts to restore the old conditions of competition, which often involve waste and effort, the uneconomical duplication of plant or equipment, and the impossibility of adopting the full advantages of large-scale production. (93)

England had entered the era of modern industry in which large economies of scale in production and in distribution were quite common. In this era, as Keynes had argued before, *the only rational and efficient way to harness these scale economies was through the cooperative decision-making of large firms by way of industry associations and cartels. But, since such monopolistic institutions could easily operate in ways that did not serve the public good, the State would have to play a key role in regulating their activities.*

In modern conditions a tendency towards some degree of monopoly in an ever-increasing number of industries is, in our opinion, inevitable and even, quite often, desirable in the interests of efficiency.[[91]](#footnote-91) It is, therefore, no longer useful to treat cartels, combinations, holding companies, and trade associations as inexpedient abnormalities in the economic system to be prevented, checked and harried. The progression from purely private individualistic enterprises to the Public Concern is one of endless gradations and intermediate stages. We believe that there is still room at one of these intermediate stages for large-scale enterprises of a semi-monopolistic character which are run for private profit and controlled by individuals. We must find a place for such enterprises within our national economic system and create an environment for them in which they can function to the public advantage. (94)

It is clear that Keynes and the Liberals are groping here to try to find some way, some innovative combination of private industrial structure and public policy, capable of controlling this ongoing evolution of private industry in the public interest. Their attitude with respect to the private sector seems reasonably clear. Let firms grow large, and let firms - indeed, assist firms to - combine and collude. The analogy of industrial with military organization and discipline in the following quotation is instructive.

There is an urgent need, we believe, in many of our leading industries, struggling as they now are with adversities which seem beyond their control, for some kind of organisation in the industry as a whole which will enable it to steer a deliberate course, adapted to the conditions which it has to meet, instead of drifting helplessly before them. The particular system of organisation which circumstances render most appropriate and most feasible will vary from industry to industry; and we shall, therefore, not attempt to go further into detail. But it is vital that the need should be clearly recognized. Just as a nation may be able to rub along more or less satisfactorily in times of peace with very little Government and with a loosely organized industry structure, but will assuredly succumb in time or war unless it is capable of a high degree of collective discipline and corporate action, so, for an industry which can do well enough in ordinary times as a an unintegrated mass of independent atoms, a prolonged period of severe adversity brings the same need for closer organisation, for common purpose, for discipline, and above all for deliberate policy. (135)

To take but one example of how the state can help anarchic industries to organize, Keynes suggests here (reflecting his experience with the failed attempt to organize the Lancashire cotton industry) that when a Trade Association controls 75% of the members of an industry the Board of Trade should be empowered to enforce its decisions on those not in the Association under penalty of law. Another example of how "the State can help" is through a "new Ministry of Industry, with a bigger conception of its duties in stimulating and encouraging the efficiency of industry" (131). And, of course, *when private firms become large and powerful enough, they can, if necessary, be transformed into Public Concerns*.

Nevertheless, Keynes and the Liberals had yet to develop a clear and complete vision of the precise structures and functions of the state organs charged with regulating individual semi-monopolistic industries and coordinating their diverse activities. They have a tentative general outline of the institutions and policies needed by the state to guide the economy, but Keynes understands that it will take experience and experimentation to finally arrive at an efficient system. The set of suggestions made in this regard is helpful, but not fully adequate to its ambitious goals. For example, an important but not fully worked-out regulation is that when private companies become very powerful within their industry, BIF proposes that they be *forced* to register with the Board of Trade as "Public Corporations" subject to the (somewhat vague) regulatory powers of the Board and a new government body called the Trust Tribunal. "A Public Corporation should be required to conform to conditions appropriate to what is in fact a semi-public concern" (95). Or again, when "cartels and price rings" become large enough, the state should regulate them.

We propose that when a Trade Association comprises more than 50 per cent o a trade or industry, or a section of a trade or industry, whether national or local, it may become a recognised or incorporated Association, on the initiative either of the Board of Trade, which shall have a discretionary power to require incorporation, or the Association itself applying for incorporation. (98)

Keynes seems to have placed his hope in open-minded experimentation by the state and by private industry with various different kinds of structures and policies. More experience with new forms of organization and control, with different mixes of public and private power, would be needed before the most efficient system can be determined. And even then, the evolution of the private sector would presumably necessitate never ending experimentation with different forms of state regulation and control. That is, the shift from old system of *laissez-faire* to the new system of managed capitalism would take time and would require more information and experience. Given the radical nature of this shift, the need for time and experimentations is hardly surprising.

In conclusion, we would reiterate the idea which has been running through this and the preceding chapter, namely, that the divorce between responsibility and ownership worked out by the growth of Joint Stock Companies, an event which has occurred since the dogmatic ideas of Socialists took shape, together with the prominence of legitimate tendencies towards combinations, cartels, and Trade Associations, provide one of the clues to the future. Private enterprise has been trying during the past fifty years to solve for itself the essential problem, which the Socialists in their day were trying to solve, mainly, how to establish an efficient system of production in which management and responsibility are in different hands from those which provide the capital, run the risk, and reap the profit, and where the usual safeguards of unfettered competition are partially ineffective. Private Enterprise has had the great advantage over theoretical Socialism of being able to put forth a considerable range and variety of systems to put them into practice.

Private Enterprise by itself has, indeed, far from succeeded in finding an entirely satisfactory solution, but, in combination with the hand of the State (which has slipped in much more often than either theorists or the general public have recognised), it has provided us with a fine laboratory and many experiments, the results of which, for good and, sometimes, for evil, we are just beginning to reap. The task of modern statesmanship is to take full advantage of what has been going on, and to discern in the light of these manifold experiments which ideas are profitable and which unprofitable. (100)

The Liberal Party's "Britain's Industrial Future" (the 1928 Yellow Book), which Keynes took such an active part in creating, contained the modest kernel of just such a program, which was later summarized in an election pamphlet -- "We Can Conquer Unemployment" (the Orange Book of March 1929) -- which Lloyd George took before the electorate.

Keynes spent a good part of 1928 and 1929 publicly defending the Liberal program. In March 1929 he wrote a newspaper article in its support. His first point was that there no lack of public investment worth doing for its own sake; the problem was that the Treasury simply refused to fund them. Unfortunately, Keynes's argued, Treasury officials

have a voice in nearly all forms of capital enterprise which are capable of absorbing large sums of money -- housing, roads, and bridges, telephones, electricity, drainage, ports, etc.

...

For several years Royal Commissions, local authorities, and Government Departments have been putting forward all sorts of schemes as necessary and desirable and, often, as urgent, and the Treasury has been pigeonholing them" (805).

The Orange Book proposed an initial public investment program of £250 million over two years, or about 3 per cent of GDP each year. Keynes calls its list of programs mainly a recapitulation of projects already recommended by "Royal Commissions and other official and semi-official bodies." He then addresses the standard criticism that such spending will not lead to enough new jobs to make a serious dent in the unemployment problem. *His answer stresses the processes associated with the concept of "the multiplier," though its formal properties would not be worked out by Kahn for another two years. The use of the multiplier represents a breakthrough in the defense of the program's effectiveness.*

Would the demand for labour resulting from a practicable programme of capital development make an appreciable impression on the existing unemployment?

It is reasonable to suppose that an investment of £250, in types of capital production which do not depend heavily on imports, will provide wages to employ the equivalent of at least one man for a year, after meeting outgoings other than wages, and that man, in spending his wages, will set further miscellaneous productive activity moving.

Thus it is a conservative estimate, in my opinion, to assume that each £1,000,000 of the kind of investment contemplated by Mr Lloyd George's programme will reduce unemployment by at least 5,000 to 6,000 men, and perhaps by more.

For, once the impulse to prosperity has been started the effect will be cumulative. Accordingly, an investment programme of £100,000,000 might be expected to break the back of abnormal unemployment. (19, 807)

On Keynes's reasoning, a public investment program of the size proposed in the Orange book would lower unemployment by between 625,000 and 750,000. Since total unemployment in 1929 was 1.5 million, or 8 per cent of the total labor force, he is, in effect, shooting to lower the total unemployment rate to between 4 and 5 per cent. This target is consistent with most of his other writings and again demonstrates his belief that state controlled investment was the key to solving the unemployment problem.[[92]](#footnote-92)

Upon publication of the Yellow Book in early 1928 Keynes argued that its proposed public investment plans would not lead to significant budget deficits; they would, over the longer haul, be substantially self financing. This point is absolutely central to understanding his policy views. In February 1928 he wrote that "a large number of things which we propose would involve only capital expenditure, and that of a remunerative kind, so that they would bring no burden on the Budget proper" (19, 733). In spite of the almost universal belief among post-WWII commentators that the essence of Keynes's policy program was budget deficits to eliminate unemployment, the truth is that Keynes never proposed that the state incur either substantial or long-term deficits. It was budget-neutral public investment over the long term, not deficit-augmenting tax cuts and transfer payments, that was the core of Keynes's policy revolution.

**Activities Immediately After Britain's Industrial Future**

In May 1929 Keynes and Hubert Henderson co-authored the famous pamphlet "Can Lloyd George Do It?" in support of the Liberal Party's candidate`s "pledge" to end unemployment through a public investment program.[[93]](#footnote-93) It formalized and concretized many of the arguments already offered by Keynes in defense of the Liberals' agenda.

The pamphlet notes first that available data indicates that there are about 1.14 million people currently out of work, costing about £50 million per year in unemployment compensation. They estimate that excessive unemployment has cost the nation about £2 billion in lost output since 1921. Henderson and Keynes then argue that Lloyd George's proposal to spend £100 million a year on public investment "will bring back 500,000 men into employment" (9,93). They continue:

*This expenditure is not large in proportion to the waste and loss accruing year by year through unemployment*... ... It is equal to about 2.5 per cent of the national income. ... In short, it is a *very modest programme*. The idea that it represents a desperate risk to cure a moderate evil is the reverse of the truth. It is a negligible risk to cure a monstrous anomaly." (9, 93, emphasis in original)

The attitude expressed here sheds light on the nature of Keynes's hopes and expectations for his policies in early 1929. The total or cumulative spending financed by the government's Unemployment Grants Committee, the main (though not exclusive) source of state funding for public works in this era, was, between its inception in 1920 and January 1932, a mere £67 million.[[94]](#footnote-94) Thus Keynes's characterization of plans to spend £100 million a year (or, as in the Orange Book, £125 million) as a *"very modest programme*" with "negligible risk" even though it would represent an enormous increase in state spending on public investment and would, according to his own calculations, move joblessness down towards the vicinity of full employment, tells us a good deal about his state of mind.

The pamphlet makes some of Keynes's familiar arguments. There is no dearth of projects that need to be undertaken. The largest part of spending will be designed to bring the roads and railways up to date; "roads are entirely a state concern, whilst railways are semi-privately owned" (95). Housing is another priority. "The Liberal policy...would provide in ten years a million houses to meet the needs of the slums alone" (97). Rural preservation is addressed, as are "telephone development, electrical development and land drainage," and docks and harbors (99).

As soon as we have a new atmosphere of *doing things,* instead of one of smothering negation, everybody's brain will get busy, and there will be masses of claimants for attention, the precise character of which it would be impossible to specify beforehand. (99)

The arguments about the impact of expenditures on employment again make use of the general ideas behind the "multiplier," though the authors acknowledge that "it is not possible to measure effects of this character with any sort of precision" (107).[[95]](#footnote-95) The idea that public investment spending will have a "cumulative effect" reflects multiplier-like thinking.

The fact that many workpeople who are now unemployed would be receiving wages instead of unemployment pay would give a general stimulus to trade. Moreover, the greater trade activity would make for further trade activity; for the forces of prosperity, like those of depression, *work with a cumulative effect*. (106,emphasis added)

The authors, of course, address the crucial question; "What Will It Cost?" The persistent charges by the government, especially the Treasury, that these proposal would bankrupt the Exchequer had to be answered. The important points to note here are that, at least as Keynes sees it, most of the projects have a *positive gross present value* (gross of interest costs); and that, once induced effects on taxes and unemployment compensation are included in the analysis, *there are no significant permanent budget deficits associated with the program.* Keynes never altered his perspective on this crucial issue; he *never* supported permanent budget deficits as an important or a permanent tool of policy.

They begin their analysis with a worst case example in which the government borrows £300 million to be spent over several years on projects with no economic value. The interest would be £18 million a year.

This sum is about 2.5 per cent of the existing revenue. If increasing the employed population by 5 per cent were to raise the yield of the present taxes by 1.5 per cent, and if expenditure on armaments were to be reduced by 7.5 per cent, the bill would be met. (111)[[96]](#footnote-96)

But, they argue, this is not the scenario envisioned by Liberals. First, the cost of road work can be funded out of the accumulated balances of the Road Fund -- a trust fund for the financing of road construction and improvement fed by taxes on motorists. Second, the housing schemes will "bring in the shape of rents an appreciable return on the money spent" (111). Third, "many of the miscellaneous items in the programme, as, for example, telephones and Trade Facilities loans, will pay for themselves" (111).

But this is not the end of the calculation. We have made no allowance so far for the gain to the Unemployment Fund through the reduction in the numbers of the unemployed. ...

If the unemployed are reduced by 500,000, this will improve the position of the Fund by nearly £25 million a year. ... This includes no allowance for the saving to the Poor Law and, therefore, to the [tax] rates.

A quarter of the capital cost of each year's program will be balanced by the gain to the Unemployment Fund within that year.

Probably an eighth would be recovered ... through the gain to the [tax] revenue corresponding to the increased national income.

Thus, nearly a half of the capital cost would be recovered at the time. Accordingly there would be no appreciable national loss on the programme, even if it cost on the average 5 per cent per annum and brought in on the average 2.5 per cent. (112, emphasis in original)

"Why must the government play a part...?" they ask. Their answer, again, is that Britain had evolved to the point where the state directly or indirectly controls most of the large-scale capital investment of the nation.

A very large part of those economic enterprises which absorb substantial amounts of capital have fallen under the influence or the control of government departments. It has been an inevitable trend which has proceeded uninterruptedly under whatever political party has been in power.

Whether we like it or not, it is a fact that the rate of capital development in the transport system, the public utilities and the housing of the country largely depends on the policy of the Treasury and the government of the day.

... The choice between a well-equipped, up-to-date, go-ahead and efficient national plant depends on the mood and policy of the government.

Thus it is not a question of choosing between private and public enterprise in these matters. The choice has been already made. In many directions -- though not in all -- it is a question of the state putting its hand to the job or of its not being done at all.

Roads, afforestation, reclamation and drainage, electrification, slum clearance and town planning, the development of canals, docks and harbours; these are the things which need to absorb large sums of capital today, and in every case the initiative lies with a public authority. (113, emphasis in original)

Henderson and Keynes conclude with a call to the electorate to reject the "slogans of depression and decay -- the timidities and obstructions and stupidities of a sinking administrative vitality."

There is no reason why we should not feel ourselves free to be bold, to be open, to experiment, to take action, to try the possibilities of things. And over against us, standing in the path, there is nothing but a few old gentlemen tightly buttoned-up in their frock coats, who only need to be treated with a little friendly disrespect and bowled over like ninepins. (125)

The Government took the unusual step of issuing a White Paper in response to "Can Lloyd George Do It?" In Keynes's reply (May 18, 1929), he first claims that it is his "heresy" on public investment, not the orthodox "Treasury view," which commands the allegiance of most economists. He then turns to the all-important question of the cost of a £125 million a year program of public investment. Again he argues that when all the direct and indirect effects of the program are taken into account, they are largely self financing, with no significant drain on the budget.

Most of Keynes's interventions in BIF and its aftermath were in behalf of the Liberal Party's attempt to gain electoral victory in 1929. In the end, Keynes's electoral efforts in this regard were not successful. Labour won the election, with 288 seats in the Commons, while the Conservatives took 260 seats and the Liberals 59.

**After the 1929 Election Defeat**

**[Comments on the Treatise on Money 1930 here?]**

In November 1929, following the collapse of the US stock market, the Chancellor of the Exchequer appointed a Committee on Finance and Industry under the chairmanship of a Scottish judge named Macmillan. Keynes was one of a large number of committee members, as was Ernest Bevin of the Transport and General Workers Union. The Macmillan Committee met about 100 times; it issued its Report in May 1931, *after the onset of the Great Slump*. Keynes "dominated the proceedings of the Committee, both in examining witnesses and shaping [its] report" (20, 38). The transcript of his own testimony before the committee early in 1929 occupies over 100 pages of Volume XX of the Collected Works. Keynes's work with and for this committee provides valuable insight into his thinking in this period.[[97]](#footnote-97)

In his testimony to the Committee Keynes critically analyzed all the main proposals -- good and bad -- for dealing with Britain's now *almost decade old economic m*alaise. He declared that his "own favorite remedy -- the one to which I attach the greatest importance" was a program of public investment (20, 126). Hazarding a guess that about 20 per cent of such new investment would be counterbalanced by induced imports, Keynes acknowledged that "in order to increase the total investment by £100,000,000 you might have to increase the home investment by £125,000,000," as in the Orange Book proposal (132).[[98]](#footnote-98) Net investment of £100,000,000 per year "which is only 2.5 per cent of the national income, would cure nearly half of the existing unemployment...," i.e., drop it to about 5 or 5.5 per cent (132). How much would it cost? Recall that Keynes assumes that most of the projects have positive present values, gross of interest costs. Thus the financing question comes down to asking where the state will get the money to pay the difference between the expected *positive* rate of return on the projects and the interest rate at which the Treasury can borrow money. When you take account of the multiplier, he says, the program will substantially raise income and profits, and thus taxes, and will dramatically reduce spending on the "dole" -- "with the increase of employment you automatically get the resources for at least half of what you are doing out of the `dole' and analogous resources" -- you can see why he believes there will be no significant budget deficits generated.[[99]](#footnote-99)

His opponents, he says, contend "that it is in fact impracticable to find objects of an economic character which are, as it is sometimes expressed, sufficiently productive to justify the expense (137). What they mean is that the projects to be undertaken will yield less than the going rate of interest. Suppose the interest rate is five per cent and the projects are expected to yield only four. Should they be undertaken? The "choice may be between investing at four per cent and not investing at all; between getting a four per cent return and getting nothing with the savings... ... [R]ather than get less than five per cent on £100, [his opponents] would prefer that someone should lose the £100" (137).

The problem, Keynes says, comes from confusing sensible policy under the current dramatic disequilibrium with policy when the economy is in market-clearing equilibrium. In conditions of equilibrium, net present value calculated at the current rate of interest may be an efficient criterion for the selection of investment projects. But under current conditions:

new investment yielding four per cent or in special cases three per cent would be nationally preferable to unemployment and business losses. It is better that we should have a man employed in using plant which will produce an investment to yield four per cent in perpetuity than that the man and the plant should be unemployed. It is not a choice between investing at four per cent or five per cent; it is a choice between investing at four per cent and having 80 per cent of the [national] savings wasted and spilled on the ground. (138)[[100]](#footnote-100)

Keynes goes on to argue that the particular division of direct responsibility for large-scale investment programs among public and semi-public bodies gives the central government control of only about 20 per cent of public investment. As a result, the most effective lever available to the state to guide investment spending might be providing those bodies which do have effective control with loans at subsidized interest rates. That is, Britain needs:

encouragement by the Treasury, and other Whitehall Departments, of expenditure by local authorities and public boards. I believe that this might be on a very large scale, as soon as one admits that is legitimate to let them have money at a lower rate of interest than that which is fixed by conditions abroad. ... [That is,] to say to local authorities `If you will anticipate your expenditure, or produce anything that is at all reasonable we will let you have money out the Local Loan Funds below the standard rate of 5.25 per cent, or whatever it is now, going down to 4 per cent or even 3 per cent as a temporary expedient to employed only so long as there is a serious difficulty in home investment.' (144)

This argument reflects several aspects of Keynes's thinking at this point (March 1930). First, he believed that many of the biggest long-term public or semi-public capital projects under the state's influence were interest elastic. Housing was one example he cited frequently; each one per cent decline in the interest rate paid on the borrowed capital would substantially reduce the rent or mortgage payments needed to make the project viable. Second, in the absence of capital controls, domestic interest rates might be far too high to sustain capital accumulation at the needed rate. Third, the proposal is consistent with his general support of policies of credit allocation.

Finally, it incorporates his hope (which ebbed and flowed with events and, after the Great Slump set in' disappeared completely and permanently) that while a crash program of public investment would be needed for the medium term to restore full employment, once the economy got back to general health public investment might not need to play such a dominant role.[[101]](#footnote-101) He returns to this again. Keep in mind that the whole purpose of his testimony to the Macmillan Committee is try to persuade a reluctant and conservative government to undertake what was seen by key government figures as a dangerous and radical policy. Thus, there is a tendency for Keynes to present his policy proposals in as moderate and non-radical a form as possible when dealing with government authorities, because moderate policy improvements are the best he can realistically hope for. We have seen propensity to tack to the prevailing wind before and we will see it again later. He is usually far more ambitious when addressing the general public.

We must look to a bold Government programme to lift us out of the rut; and if that is done, if it has the effect of restoring business profits, then the machine of private enterprise might enable the economic system to proceed once more under its own steam; and since I should look forward to that, I also look forward to being able gradually to diminish the amount of government intervention.[[102]](#footnote-102) (147)

Note the clear implication here that Keynes expects, under the normal or general condition of less than full employment, that public investment will have a significant "crowd-in" effect on private investment. His belief in a significant crowd-in effect never wavered, whether he was arguing that a large scale public investment program would be temporary or permanent. This particular Keynes-effect is missing from many contemporary discussions of "Keynesian" policy.

In testimony in December 1930 Keynes emphasized a persistent concern -- the critical need to upgrade the data base available to whatever agency or agencies would be in charge of economic planning. He argues that the Bank of England would be a good choice for implementing a much more ambitious policy of data gathering and dissemination, provided it was "rid of unnecessary secrecy and mystery" and open to "informed outside criticism" (262). The Bank could then publish monthly figures of all statistics of general interest. More important:

attempts ought to be made to build up, first of all, sample statistics, and eventually comprehensive statistics [of virtually all important economic variables]. ...

...

If we had all those figures, we could build up in time a true and accurate picture of the economic life of the country and the movements in that life, and we could really put our finger on what was going wrong when anything was going wrong, and see where we were. We could understand whether the fluctuations were of a fundamental character or were not of a fundamental character. It might take five or ten years' experience to make a good job of it. ... We should then have a means of investigating the national economic life, and we should be able to watch and control every movement in a way which today would be considered completely utopian. ...

... I feel that if our monetary system is to be managed and our economic life is to be regulated at the source, there can be no possible instrument of this except the Bank of England. ... Without any break of continuity or traditions, everything which seems desirable to a radical thinker, like myself, can, I am sure, be achieved. (264-65)

A five-person drafting committee was formed to work on the Committee report over the winter of 1930-31. Keynes was a active member. In the end, the full Macmillan Committee could not agree on many of the key policy specifics, so a fairly innocuous Report was prepared with four addenda setting out the views of various contending members. One addendum was written by "a group centred around Keynes" (20, 280). The group of six included Ernest Bevin, the trade union leader. Keynes and Bevin agreed on most of the issues considered by the Committee.

The addendum argues that there are only three policies that might be able to bring about a serious reduction in unemployment: cutting wages and salaries; import tariffs and export subsidies; and state action or state subsidies to raise domestic investment. The signers believe that the first option -- the one favored by the government and conservative economists -- was likely to be disastrous; "the social costs of an attempt which failed would be incalculable" (308). *They support the second and third options -- thus putting Keynes on the record for the first time as a former free trader*. The section on "Schemes of Capital Development" begins with a refutation of the government claim that public investment will cause private investment to decline. The signers believe in *the "crowd-in" thesis*.

But in general, provided the schemes are wisely chosen, we see no presumption in favour of the view that `official' investment need seriously compete or interfere with `unofficial' investment. Indeed, on the contrary, *if `official' investment is successful in restoring the volume of output and of profits, this may help restore the business optimism which is a necessary condition of expansion.* (302, emphasis added)

Standard objections to Keynes's public investment schemes are then reviewed and refuted. The claim that such schemes will generate no significant budget deficits is stressed.

It is feared that state-aided schemes are likely to put some burden on the Budget and therefore to lead to the evils of increased taxation. If, however, we lump together -- as we should for purposes to this argument -- the Budget and the Unemployment Fund, we feel quite confident that the relief to the Unemployment Fund and the additional yield of taxation, resulting from the increased employment provided by the schemes in question, would materially outweigh the direct cost to the state. (304)

The fact that is difficult to design and organize well-conceived investment plans on a large scale is acknowledged. The solution is to plan rather than improvise decisions about public investment, to prepare a prioritized portfolio of such projects two to three years prior to the need to implement them. The need for such schemes is likely to exist for "some time to come." We recommend, therefore, that we should now attack the task of capital development in this country in a much more systematic and far-sighted manner than hitherto. (306)

It is not their job to present a structure of planning in detail, the signers argue, but they do offer some general observations. First, there needs to be a central institution whose job is to design and direct the program as a whole, especially in light of the current fragmentation of authority over public investment. The crucial *Board of National Investment* had already been proposed by Keynes in 1928 in the Liberal Party's Yellow Book ("Britain's Industrial Future").

It may be that we should develop an improved organisation for handling all matters of this kind. It would be outside our scope to pursue this subject in detail. But we think that efficiency and forethought might be much increased if a body were to be set up which might be designated the *Board of National Investment*, in the hands of which all matters relating to the deliberate guidance of schemes of long-term national investment would be concentrated. This Board might be entrusted with the duty of raising funds not only for the local authorities which now borrow through the Local Loans Fund but also for other local authorities including municipalities, for the telephones, for the roads and for such further schemes of national development as those we have suggested above. (307, emphasis added)

Second, the scope of important potential public investment projects is extremely large. For example;

A considerable part of the larger towns and industrial centres of the country need rebuilding and replanning on a comprehensive scale. ... Much of the industrial housing of the country is of an age when buildings of that character are, of necessity, only fit to be demolished. It seems an insanity to keep a large proportion of the building trade out of employment when this is the case.

Some of our staple industries need to be refitted and replanned on modern lines, at the cost of a substantial capital expenditure. In several cases, there is much to be said for replanning an industry as a whole. ... In cases of proved necessity, we should not be opposed to measures of compulsion, in conjunction with the provision of adequate and cheap finance. (306-07)

Thus, even though Keynes may be presenting a minimalist version of his vision of planning in the context of this official Report, his stress on the centrality of an undeniably ambitious scheme of public or publicly subsidized investment is clear.

As the severity of the slump became manifest in mid-1930 Hubert Henderson, the co-author of "Can Lloyd George Do It?," began to back away from Keynes's more radical perspectives. He began to fear that the large scale public investment program that Keynes and he had proposed in 1929 as a remedy for what Henderson saw as a temporary, if deep and serious, bout of high unemployment might not, in the light of current world economic conditions, have to be put on a permanent basis. Henderson believed that a permanent program of this size would increasingly come to rely on uneconomic or wasteful projects that might generate increasingly large budget deficits just at the time when there was increasing stress on exchange value of the pound. Such projects might require a permanent subsidy of up to 50 per cent of their cost, he argued, forcing the government to raise taxes substantially or run large deficits. In correspondence with Keynes he seemed almost in panic over this emerging problem.

Keynes's response suggests that he did not share Henderson's pessimism about the viability of the public investment planning. He agreed that *if* the program turned out to be permanent, and *if* it ran at a sustained loss of half of its cost, then "the finance of it would have to be found from some new source. As you know, I have no objection to this" (361).[[103]](#footnote-103) That is, Keynes reiterated that he did not intend the program to create large, sustained budget deficits. "But if this proves to be a permanent problem, I should not hope to solve it by making subsidies out of the Budget" (361).

He then went over the budgetary arithmetic relevant to the standard example - which is calculated net of induced imports - of public capital investment of £100 million per year. Undeterred by Henderson's pessimism, Keynes continues to assume that the projects will have a positive gross present value, with the state required to subsidize half the interest payments involved. Stressing the rise in taxes from increased employment and decreased business losses (which were rising rapidly as the slump gathered force), he concludes that there need be no deficits involved. He then suggests that this conclusion would hold even for a *permanent* program.

It is not obvious that this would not pay *as a permanency* AS COMPARED WITH HAVING THE BUSINESS LOSSES AND THE MEN UNEMPLOYED. (362, emphasis and capitalization as in original)

Keynes concludes this letter with the comment that he believes the key difference between them now is that Henderson no longer shares Keynes's belief in the applicability of the positive gross present value assumption.

Keynes begins his next letter to Henderson with the jibe "I wonder if you became a Conservative..." (364). He goes on to argue that as the current budgetary problems are caused by unemployment, their solution must be through a policy that will generate full employment. The rate of interest, which should be drastically reduced, is, under the gold standard, outside Britain's control. "Therefore I twist and turn about trying to find some reasonable mean of permitting investment of a fairly sensible kind to take place in spite of its not yielding the current market rate of interest" (366). A large scale program of public and publicly subsidized investment seems to be the only workable solution. As far as Henderson's fear of ballooning deficits: "I have not yet been shown that the cost of a development programme on the Budget is not of rather trifling dimensions compared with other things" (366). He adds, in consonance with the position he took in the Macmillan Committee, support for a revenue tariff, to limit the imports induced by the growth stimulated by an investment program and to reduce budgetary problems. But, he insists that only an aggressive public investment program is powerful enough to get the main job done. Obviously, Henderson's pessimism did not shake Keynes's positive attitude towards state investment planning.

Keynes was a member of the government's Economic Advisory Council. On July 10, 1930, at Keynes's suggestion, the Prime Minister appointed a five member subcommittee called the Committee of Economists with Keynes as chair. Though this committee, in the end, could not agree on either the cause or the solution to Britain's economic problems, Keynes's contributions provide us with useful information. Publicly-supported investment remains the key for Keynes. Having now a firmer estimate of the value of the multiplier - his best guess at this time is about two (442), - Keynes is aggressive, in a draft report, in arguing for a substantial state subsidy to investment programs not under direct government control.

In cases where it is clear that the projects would not be entered upon without a subsidy, it would be easy, generally speaking, to justify a subsidy amounting to fully one-third of the interest cost. Indeed, on certain assumptions as to the [value of the multiplier], a subsidy up to a half of the interest cost which would have to be paid in the open market would be justified.

We think, therefore, that any projects, of which the prospective yield reaches 2.5 to 3 per cent, are worthy of assistance... (447)

Turning to projects directly under the auspices of either the central government or local governments, Keynes simply states that the case in their favor is now so widely accepted by economists that there is not much point in reviewing it here.

"We should dwell in this remedy at greater length if it were not for the fact that the advantages of such schemes are now generally accepted, and that the obstacle to pushing this remedy still is to be found, not so much in theoretical views, as in the difficulty in finding suitable schemes to assist" (447-48)

Keynes's draft report for the sub-committee was too optimistic about public investment for the conservatives, who were placed on the Council, as is often the case with "Blue-Ribbon" committees appointed to take the heat away from politicians who wish to avoid controversial decisions, to make sure that no policy suggestion could get unanimous approval. Robbins and Henderson took the position - one with the enthusiasm of the true believer, the other in a rising sense of panic - that wage cuts and balanced budgets, not a large public investment program, were the only viable resolution of the crisis.

In December 1930 Sir Oswald Mosley, who had resigned from the Cabinet earlier in the year, published a widely discussed "Manifesto" signed by 17 Labour M.P.s that called for national economic planning centered on public investment as the only viable solution to what he believed to be a politically explosive economic situation. He was substantially influenced by Keynes's long-term support of a policy of this general character.[[104]](#footnote-104) Keynes reviewed the Manifesto in The Nation and Athenaeum. In the review, his language and his enthusiasm for a radical approach to national planning are obviously liberated from the substantive restrictions and muted tone he imposed on himself in the official government discussions and reports that we have been reviewing. Keynes notes that he does not agree with every detail in the Manifesto.

But I like the spirit which informs the document. A scheme of national economic planning to achieve a right, or at least a better, balance of our industries between the old the new, between agriculture and manufacture, between home development and foreign investment; and wide executive powers to carry out the details of such a scheme. That is what it amounts to. ... [The] manifesto offers us a starting point for thought and action. (474)

The Manifesto will shock many readers of The Nationand Athenaeum, he says, "who have *laissez-faire* in their craniums... ... But how anyone professing and calling himself a socialist can keep away from the manifesto is a more obscure matter" (475). (Recall that Keynes considered himself to be a liberal socialist.) The choice faced by Britain

will be ever more openly and obviously set between forcing a reduction of wages and a scheme of national planning. But, however this may be, looking further ahead I do not see what practical socialism can mean for our generation in England, unless it makes much of the manifesto its own -- this peculiar British socialism, bred out of liberal humanitarianism. big-business psychology, and the tradition of public service. (475)

On March 7, 1931 published an article titled "Proposals for a Revenue Tariff." It is Keynes's first *public* rejection of free trade (as opposed to free capital flows, which he long ago rejected). Of course, in private correspondence and internal government documents he had been in support of a revenue tariff for some time. The editors of The Collected Writings note that "*as the recantation of an avowed free trader, it caused a sensation"* (9, 231,emphasis added). Its relevance for our purpose is that Keynes defends a tariff on the grounds that it facilitates, under the restrictions of the gold standard, a program of vigorous domestic expansion. The stress on the budget and on "confidence" may reflect his desire to assuage the concerns of others, concerns he did not share.

I am of the opinion that a policy of expansion, though desirable, is not safe or practicable today, unless it is accompanied by other measures which would neutralise its dangers. ... There is the burden on the trade balance, the burden on the budget, and the effect on [business and financial] confidence. (9, 236)

Keynes proposes that the tariff rate be set such that it generates between 50 and 75 million pounds per year, enough to finance a very large program of public investment of the kind he has in mind.

In a follow up piece Keynes makes the following prophesy.

But if I look into the bottom of my own heart, the feeling which I find there is, rather, that a tariff is a crude departure from *laisser-faire* [sic], which we have to adopt because we have at present time no better weapon in our hands, but that it will be superseded in time, not by a return to *laisser-faire*, but by some comprehensive scheme of national planning. (495).

Keynes left England for America on May 30, 1931, returning in mid July. This visit was of great importance for the evolution of his thought because *when he left he believed that America would take the lead in pulling the world out of the Great Depression, but his visit convinced him that this hope was totally without foundation. From this time on, Keynes believed that Britain would have to isolate itself as best it could from the depressive and deflationary pressure of the international economy and find a purely domestic solution to its economic problems.* Later writings, such as "National Self-Sufficiency" and The General Theory must be read in light of Keynes's reactions to this trip.

One manifestation of this change was *Keynes's new belief that a policy of wage reduction is not only so socially explosive that it might be impossible to obtain in a democracy, but, even if successful, would be both futile and dangerous.* It is futile because with prices falling everywhere, there is no export payoff to the price deflation caused by falling wages. This means, in effect, that the impact of wage deflation should now be analyzed in a "closed economy" model, where

business costs are the same thing as the incomes of those whom business employs, and that business receipts are partly the result to spending those incomes. Thus if a reduction of business costs means cutting down business receipts by an equal amount, business will be no more profitable than it was before. (547)

Therefore, income and employment will not rise in response to falling wages. This idea will return in The General Theory.

It is dangerous not only because it might trigger class conflict, but also because the world has become so debt-ridden. While this observation could hardly have come as a revelation to the author of The Economic Consequences of the Peace and the creator of the "regime of money contract," his trip showed him that America was far more financially fragile than he had imagined.

Thus national debts, war debts, obligations between the creditor and debtor nation, farm mortgages, real estate mortgages; -- all this financial structure would be deranged by [deflation]. A widespread bankruptcy, default and repudiation of bonds would necessarily ensue. Banks would be in jeopardy. (547)

He was particularly taken back by the catastrophic condition of the American banking system. "There is a possibility at any moment of bank runs breaking out in different parts of the country, similar to what was lately experienced in Chicago" (556). As a result, banks are "extraordinarily nervous" and have "an absolute mania for liquidity" (556). Thus, he notes, "it is the weakness of the banking system which primarily stands in the way of the usual remedy, cheap and abundant credit, failing to take effect" (557)

Throughout the 1920s, Keynes had considered the American economy to be much more `fluid' and `flexible` than Britain's, more capable of withstanding whatever downward wage and price flexibility might be needed to achieve equilibrium, and, because of its higher growth rate, better able to handle problems of structural unemployment. The trip punctured this optimism. "The truth is that the financial structure of the United States is no more able than the rest of the world to support [a major] change in the value of money" (571).[[105]](#footnote-105)

The 1931 world financial crisis had begun in May with the failure of the Credit-Anstalt in Vienna. In July sterling came under severe pressure. The government raised the interest rate. It also recommended cuts of £97 million in government spending (including a cut of 20 per cent in the dole) to head off a deficit forecast at £120 million. Keynes wrote a letter to Prime Minister Ramsey MacDonald proposing that England get off the gold standard -- "the gold standard has become a curse laid upon the economic life of the world" (600) -- and, having put exchange difficulties behind them, "proceed to organise activity and prosperity at home and abroad along the boldest possible lines" (592). Organizing activity "abroad" refers to Keynes long time proposal, repeated in this letter, for a new "Currency Union" [not yet discussed?] composed of "all Empire countries" under the leadership of Britain (592).

On August 24th MacDonald became head of a new National Government committed to budget cutting and defense of the pound. Keynes wrote to his mother.

One's hopes were always precarious and now they have disappeared. The country has been stampeded into an attempt to make this deflation effective, and heaven knows how it will all end. (596)

His mood was as somber when he addressed a group of M.P.s in September.

I speak from a full heart. The course of policy pursued so far has reduced us to a point of humiliation one could not have conceived. During the last 12 years I have had very little influence, if any, on policy. But in the role of a Cassandra, I have had considerable success as a prophet. I declare to you, and I will stake my reputation on it, that we have been making in the last few weeks as dreadful errors of policy as deluded statesmen have ever been guilty of. (611)

Britain was finally forced off the gold standard - again - on September 30, 1931. In November, Keynes published Essays in Persuasion, reinserting some of his most radical visions of new epochs and new eras into the current policy debate.[[106]](#footnote-106) In February, 1932 he assessed the current situation as follows.

The immediate problem for which the world needs a solution is different from the problem of a year ago. Then it was a question of how we could lift ourselves out of the state of acute slump into which we had fallen, and raise the volume of production and of employment back towards a normal figure. But today the primary problem is to avoid a far-reaching financial crisis. There is now no possibility of reaching a normal level of production in the near future. Our hopes are directed towards the attainment of more limited hopes. Can we prevent an almost complete collapse of the financial structure of modern capitalism? ...

The immediate causes of the world financial panic - for that is what it is - are obvious. They are to be found in a catastrophic fall in the money value not only of commodities, but of practically every kind of asset. (51)

One effect of this qualitative decline in economic prospects was that Keynes was now more confident than ever that even with the demise of the gold standard, cheap and abundant credit by itself could not restore prosperity. "I am not confident, however, that on this occasion the cheap money phase will be sufficient by itself to bring about an adequate recovery of new investment" (21,60). For this reason, "there will be no means of escape from prolonged and perhaps *interminable depression* except by direct state intervention to promote and subsidise new investment" (60, emphasis added).

**VISIONS: 1931-33**

The onset of the world depression, the collapse of international trade and international lending, the world deflation, the British turn towards budget deficit reduction as the focus of policy, the fall of the `youthful, and fluid' US economy (which was previously thought to be structurally immune to the economic malaise of the arthritic European economies) into depression and deflation, combined to convince Keynes of the utter desperation of the current economic situation in Britain. *It was clear now that there would be no revival in the US to lead the world out of depression.* And Britain's international links would remain transmitters of deflation and depression for the foreseeable future. Keynes's search, therefore, had to be for a purely domestic solution to Britain's woes - though the term domestic here includes the `Empire.. These circumstances may help explain why The General Theory is based on a closed-economy macro-model and why Keynes's break with free trade was so complete. They also help situate the three visionary essays discussed in this section. But they do not explain why Keynes became "radical" in this period. His policy positions were set years before. However, his commitment to them did deepen.

In December 1931 Keynes delivered an address to the Society for Socialist Inquiry (which appeared in early 1932 in The Political Quarterly). Perhaps the most interesting aspect of this address is that *it makes clear Keynes's sympathy for, comfort with, and general allegiance to beliefs he himself refers to as "liberal socialism*" - a "system where we can act as an organised community for common purposes and to promote social and economic justice, whilst respecting and protecting the individual -- his freedom of choice, his faith, his mind and its expression, his enterprise and his property" (21, 500). The tone of the discourse is from one socialist to others. The central message -- an old theme for Keynes -- is that the only sensible and effective way to move from the disastrous political economy of the present to an efficient and humane organization of economic life is through a thoughtful evolutionary transition towards a planned socialist economy, one with a significant though subsidiary role for markets and private enterprise, rather than a revolutionary path which will "stir up the embers of the class war" and destroy the economic and political foundations necessary for the construction of the ideal republic.[[107]](#footnote-107)

For it will have to be on the basis of increased resources, not on the basis of poverty, that the grand experiment of the ideal republic will have to be made. ... To be sufficiently deep-founded on the best intelligence and finest and strongest emotions of the community, to be able to keep up steam when things are going reasonably well; to thrive, not on the vapors of misery and discontent, but on the living energy of the passion for right construction and the right building up of a worthy society -- that is the task. (21, 34-35)

There are two good reasons to support evolutionary institutional and policy reform over a revolutionary strategy bound to be economically disastrous in the short run, Keynes argues. The first is that in the current era the evolutionary reforms needed to restore prosperity in fact lead in the direction of the eventual socialist objective - a planned economy based on the central control of capital accumulation and dedicated to social justice.

I am convinced that those things which are urgently called for on practical grounds, such as the central control of investment and the distribution of income in such a way as to provide purchasing power for the enormous potential output of modern productive technique, will also tend to produce a better kind of society on ideal grounds. (37)

The second is that the economic payoff to society from unleashing the enormous potential productivity of today's economy, with its unused resources and its powerful technical and engineering knowledge, is simply too large to pass up. "For it may be capable of solving once for all the problem of poverty" (37). Thus, for Keynes, the Keynesian evolution towards middle way planning was also the best initial path toward the future goal of socialism as well.

In March 1932, with the insured unemployment rate in excess of 20 per cent and investment in a state of collapse, Keynes delivered a radio lecture (later published) titled "The State and Industry," enthusiastically supporting State economic planning. Its main message is that state planning is a good idea whose time has come -- the wave of the near future. Soviet Communism and Italian Fascism are merely two particular variants of the kind of change in economic organization that must take place for any country to defeat the current forces of deflation and depression and unleash the great potential productivity available to them. *The striking thing about this lecture is how comfortable Keynes is with the boldness of these experiments.* He wants the British experiment in central planning to be equally ambitious, so long as it protects democracy, individual liberty, and a continued (if more circumscribed) role for markets and the profit motive. The broadcast opens as follows.

There is a new conception in the air today -- a new conception of the possible functions of government ... It is called planning -- state planning; something for which we had no accustomed English word for even five years ago. It is not [State] Socialism; it is not Communism. We can accept the desirability and even the necessity of *planning* without being a Communist, a Socialist or a Fascist. But whether it is going to prove possible to carry out *planning* in actual practice without a great change in the traditions and in the machinery of democratic government -- that is the big question mark. It is perhaps *the* problem of problems which the post-war generation of young Englishmen, who will be in their prime of life over the next twenty years, have to solve. (21, 84, emphasis in original)

There are two forces driving state planning onto the British political agenda. The first is the example of those countries currently undertaking "magnificent experiments" with central planning.

The Russian Five-Year Plan has assaulted and captured the imagination of the world. This dream is not yet a realized success -- it is much too soon to say that -- but it is not the preposterous failure, which many wise and experienced people expect it to be. ...

...

[L]et us not belittle these magnificent experiments or refuse to learn from them. For it is a remarkable and a significant thing that the two most extraordinary political movements of the modern age, approaching their task from opposite moral and emotional poles, should agree in this vital particular -- that state planning, that intelligence and deliberation at the centre must supersede the admired disorder of the 19th century. (85-86)

The second is that the "absolute failure in terms of their own potentialities" of the unplanned economies of England and the United States has established a "*prima facie* case for planning," and war planning was a huge success.

War planning provides yet another, on balance positive, example.

For what are the economic events of the modern world which must most strike the apprehension of the dullest observer? The extraordinary capacity for the production of material wealth ... which we developed during the War; and the opposite picture today of starvation amidst plenty, our incredible inability to carry to our mouths the nourishment which we have produced with our hands. (?) For the War was the nearest thing we have ever had in this country to a planned regime. The environment was unfavourable, the haste was excessive and hurried improvisations were inevitable. Yet it showed us the potentialities of modern technique to produce. (87).

Keynes calls his listeners' attention to the crucial distinction between Soviet style planning and the planning he envisions. He supports central control of the "general organisation of resources" -- of the level of aggregate economic activity, the allocation of resources across broad categories of competing uses, and the distribution of income - "as distinct from the *particular* problems of production and distribution which are the province of the individual business technician and engineer" (87, emphasis ?). Modern capitalism suffers from a chronic incapacity to actualize its potential capacity to produce. This failure is not just a problem of the slump, but is general. To remedy this institutional incapacity it is necessary to bring in collective intelligence and central deliberation through planning. But we have to remedy this failure without committing the excesses of totalitarian planning -- "without impairing the constructive energy of the individual mind, without hampering the liberty and the independence of the private person" (88).

If the England of the coming generations can solve that problem -- and my proud patriotic heart harbours a hope that our national qualities may be best of all suited to do it -- we shall have contributed, I think, something more valuable to civilisation than the Bolshevist of the Fascist can; -- though I do not overlook that each of these movements may be capable in its way of contributing something to the dignity of human nature which transcends the field and the scale of operation that I attributed to national planning however complete and however successful.

... [S]tate planning ... differs from Socialism and from Communism in that it does not seek to aggrandise the province of the state for its own sake. It does not aim at superseding the individual within the fields of operations appropriate to the individual, or of transforming the wage system, or of abolishing the profit motive. Its object is to take deliberate hold of the central controls and to govern them with deliberate foresight and thus modify and condition the environment within which the individual freely operates with and against other individuals. (88)

Keynes goes on to list various examples of appropriate areas for centralized decision-making, including town planning, rural preservation, and "deliberate planning to influence the localisation of industry." The most important object of state planning remains

the maintenance of the general level of industrial production and activity at the optimum level and ... the abolition of unemployment. ... [This] will lead us to far more deliberate and more far-reaching policies of credit control, to a greater preoccupation with the appropriate level of the interest rate. and in general to an attempt to control the rate at which new investment is encouraged and facilitated to take place. ... [I]t is the failure of the unplanned industrial world ... which is predisposing many persons to consider without prejudice those far-reaching experimental projects of the most constructive minds of the post-war world which go, conveniently, by the name of planning. (91)

Keynes ends his talk with a repetition of some standard political themes. There is no need to suffer a loss of individual liberty and initiative to enjoy the fruits of ambitious central planning. Totalitarianism could make the task of planning easier but democratic planning will have the enthusiastic support that accompanies popular consent for planning and will have greater and more disinterested talent available to it. Finally, as always, planning institutions should have "semi-autonomy" from democratic control.

Moreover, it should be compatible with democratic and parliamentary government to introduce modern improvements and new organs of administration. ... State planning, as I conceive it, would not be administered or supervised in detail by democratically elected bodies. The latter would be judges, not of the first, but of the final instance, reserve forces to effect a change when grave mistakes have been made. The day-to-day tasks of state planning would be carried out in the same sort of way and with the same kind of instruments of administration under a democratic government as they would under an autocratic government. ...

... It may be that other countries will enjoy the rare opportunity of seeing three experiments carried on simultaneously, differing vastly on the surface yet each directed to the solution of the same essential problem, -- the Five Year Plan in Russia; the Corporative State in Italy; and *state planning by Public Corporations responsible to a democracy in Great Britain.* And as lovers of our species, let us hope that they all will be successful. (92, emphasis added)

In April 1933 Keynes delivered a lecture entitled "National Self-Sufficiency" to a packed hall at University College Dublin. The lecture was published a few months later both in England and in the United States. It was thus a widely noted and important address. Though rarely read by current day economists - it was read by a modest number of progressive and radical younger economists in the late twentieth century - this essay nevertheless may be the best known of Keynes's "radical" writings.[[108]](#footnote-108) The essential thing to understand about this article is that it contains not one "radical" belief or opinion that Keynes had not held for many years and had not publicly expressed many times before. (His defection from free trade was of most recent vintage. He had rejected this doctrine at least three years ago in the addendum to the Macmillan Committee Report and two years earlier in his public writing.) And it contains no important belief or opinion that Keynes did not continue to hold and to publicly propagate for the rest of his life. Far from being an aberrant and temporary response to his disappointment over the inability of the major powers to agree on international cooperation, as his official biographer Roy Harrod claimed, "National Self-Sufficiency" is simply Keynes's carefully considered views as they had evolved over the previous decade. *It is, simply put, the mature Keynes!*

The article is devoted in the main to an exploration of Keynes's positions on international economics. It takes his long-held and well known support for state planning built around an extensive program of public capital accumulation more or less for granted. It also assumes that the listener and reader are aware that there are ambitious experiments in national economic planning and in national control of international economic activity ongoing in many countries, including in Ireland, where the lecture was delivered. (Keep in mind that Hitler came to power in March 1933) It opens with a moving description of Keynes's early and almost religious belief in "free trade" and open capital markets.

I was brought up, like most Englishmen, to respect free trade not only as an economic doctrine which a rational and instructed person could not doubt but almost as part of the moral law. I regarded departures from it as being at the same time an imbecility and an outrage. I thought England's unshakable free-trade convictions, maintained for nearly a hundred years, to be both the explanation before man and the justification before heaven of her economic supremacy. (234)

He goes on to explain that nineteenth century free traders believed their position to be consistent with economic efficiency (through comparative advantage), individual liberty, and international peace; he does not argue that they were wrong in that specific historical context.

But time and circumstance have changed; we are, as Keynes had been insisting since 1919, in a qualitatively new era. Under modern conditions, he argues, the ancient verities no longer hold. The first concern he expresses is about the relation of free trade and especially international capital mobility to world peace.

[I]t does not now seem obvious that a great concentration of national effort on the capture of foreign trade, that the penetration of a country's economic structure by the resources and the influence of foreign capitalists, that a close dependence of our own economic life on the fluctuating economic policies of foreign countries , are safeguards and assurances of international peace. It is easier, in the light of experience and foresight, to argue quite the contrary. The protection of a country's existing foreign interests, the capture of new markets, the progress of economic imperialism -- these are a scarcely avoidable part of a scheme of things which aims at the maximum of international specialisation and at the maximum geographical diffusion of capital wherever its seat of ownership. Advisable domestic policies might be easier to compass, if, for example, the phenomena known as `the flight of capital' could be ruled out. The divorce between ownership and the real responsibility of management ... when ... applied internationally ... is, in times of stress, intolerable -- I am irresponsible towards what I own and those who operate what I own are irresponsible towards me. ... [E]experience is accumulating that remoteness between ownership and operation is an evil in the relations between men, likely or certain in the long run to set up strains and enmities which will bring to nought [all] financial calculation. (236)

These ideas lead Keynes to what might seem to post-WW II Keynesians to be shocking conclusions.

I sympathize, therefore, with those who would minimise, rather than with those who would maximise, economic entanglement between nations. Ideas, knowledge, art, hospitality, travel -- these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible; and*, above all, let finance be primarily national*. ...

For these strong reasons, therefore, I am inclined to the belief that ... a greater measure of national self-sufficiency than existed in 1914 may tend to serve the cause of peace, rather than otherwise. (236-37, emphasis added)

In fact, as noted, no one who followed Keynes's public discourse over the decade would be at all shocked by these conclusions; they were just Keynes. He had supported permanent capital controls since 1924. He had been leery of the implications for world peace of international financial entanglements since the negotiations over the Treaty of Versailles. In 1921 he wrote that "the practice of foreign investment, as we know it now, is a very modern contrivance, a very unstable one, and only suited to peculiar circumstances" (9, 39). The Treatise (1930) argues that the case for British free trade has been weakened by "the gradual disappearance, in a world of mass-production and of the universal adoption of modern techniques, of the special advantages in manufacturing which used to be ours, and to the high real wages (including in this the value of social services) to which our workers are accustomed as compared with our European competitors ..." (6, 169). And in mid-1930 Keynes had written in an internal government memorandum: "I am no longer a free trader ... in the old sense of the term to the extent of believing in a very high degree of national specialisation and in abandoning any industry which is unable for the time being to hold its own" (20, 379).

Of course, one should note that while Keynes's positions on these questions had not changed qualitatively, the recent world trend toward higher protectionist tariffs, and toward increased economic autonomy in many nations had hardened or solidified his views. And it is important to understand that Keynes was *not* arguing in favor of autarky.

I must not be understood to carry my argument beyond a certain point. A considerable degree of international specialisation is necessary in a rational world in all cases where it is dictated by wide differences in climate, natural resources, native aptitudes, level of culture and density of population. But over an increasingly wide range of industrial products, and perhaps of agricultural products also, I become doubtful whether the costs of national self-sufficiency is great enough to outweigh the other advantages of gradually bringing the producer and the consumer within the ambit of the same national, economic and financial organisation. (238)

This gets us to the crux of the paper. Decreased international specialization may cost less than it used to, but it still costs something. Is there some national purpose with sufficient prospective benefits that requires greater national autonomy or at least greater national control over international trade and investment to achieve? In Keynes's words:

National self-sufficiency, in short, though it costs something, may be becoming a luxury which we can afford if we happen to want it. Are there sufficient good reasons why we happen to want it? (238)

*Keynes's answer is yes - to make national economic planning possible!* *The most urgent task facing Britain is to find the right path leading to a "transition towards greater national self-sufficiency and a planned domestic economy"* (245).

Keynes stressed the fact that while many countries were currently experimenting with national economic planning of one sort or another, there were no satisfactory models of democratic and efficient national planning in existence for the British to copy. There simply were no blueprints available. Thus, the transition towards a planned economy had to be accomplished through bold but careful experimentation, taking care at every point to ensure that no irreparable damage was done in the process to democracy, individual liberty or economic efficiency. His discussion of the need to experiment opens with a statement which very few economists today would recognize as Keynes`s. In fact, they might find it shocking.

The decadent international but individualistic capitalism, in the hands of which we found ourselves after the War, is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous -- and it doesn't deliver the goods. In short, we dislike it and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed.

Each year it becomes more obvious that the world is embarking on a variety of politico-economic experiments .... ... Russia is still alone in her particular experiment, but no longer alone in her abandonment of the old presuppositions. Italy, Ireland, Germany have cast their eyes, or are casting them, towards new modes of political economy. Many more countries after them will be seeking, one by one, after new economic gods. Even countries such as Great Britain and the United States, though conforming in the main to the old model, are striving, under the surface, after a new economic plan. We do not know what will be the outcome. We are -- all of us, I expect, about to make many mistakes. No one can tell which of the new systems will prove itself best. (239).

The main point is that these experiments in national planning would prove impossible to conduct if each country remained tightly tied into an orthodox international financial and trading system. In particular, Keynes believed that very low long-term interest rates were a necessary condition for the large scale public investment program he supported because high interest rates might lead to unsustainable budget deficits. But under the traditional system of international finance, low interest rates, by triggering a flight of capital from Britain, would be impossible to maintain. And bold experiments challenging the status quo would themselves be enough to frighten off internationally mobile capital.

The whole point of national self-sufficiency is to untie the economy; to free it up for experimentation with an economically more powerful state. Keynes was simply making the argument -- which he *never* recanted -- that the government would have to *manage* trade and capital flows as part of an overall state planning process - and that England should continue to produce domestically whatever goods or services were thought to be essential to the quality of Britain's economic or social life, even if such commodities could be purchased elsewhere more cheaply).

We wish -- for the time being at least and so long as the present transitional, experimental phase endures -- to be our own masters, and to be as free as we can make ourselves from the interferences of the outside world. Thus, ... the policy of an increased national self-sufficiency is to be considered not as an ideal in itself but as directed to the creation of an environment in which other ideals can be safely and conveniently pursued. ...

... I have become convinced that the retention of the structure of private enterprise is incompatible with the degree of material well-being to which our technical advancement entitles us, unless the rate of interest falls to a much lower figure than is likely to come about by natural forces operating on the old lines. Indeed, the transformation of society, which I preferably envisage, may require a reduction in the rate of interest towards the vanishing point within the next thirty years. But under a system by which the rate of interest finds ... a uniform level throughout the world, after allowing for risk and the like, this is most unlikely to occur. Thus, ... economic internationalism embracing the free movement of capital and loanable funds as well as of traded goods may condemn this country for a generation to come to a much lower degree of material prosperity than could be attained under a different system.

But this is merely an illustration. The point is that there is no prospect for the next generation of a uniformity of economic systems throughout the world, such as existed, broadly speaking, during the nineteenth century; that we all need to be as free as possible of interference from economic changes elsewhere, in order to make our own favorite experiments towards the ideal social republic of the future; and that a deliberate movement towards greater national self-sufficiency and economic isolation will make our task easier, in so far as it can be accomplished without excessive cost. (240-41)

Keynes ends this essay with a warning. Looking to the experience of Russia and Germany with national autonomy and central planning, he finds much that is stupid as well as much that is politically and socially frightening. "I must not be supposed to be endorsing all those things which are being done in the political world today in the name of economic nationalism" (244). He list three particular dangers. "The first is Silliness -- the silliness of the doctrinaire." Here he stresses the importance of economic efficiency and the tendency of social movements to let ideology dominate good sense. "An experimental society has need to be far more efficient that an old-established one if it is to survive safely." The second danger is "Haste." This is a theme he has stressed over and over again -- careful evolutionary change offers much greater prospects of eventual success than hasty revolutionary change.

We have a fearful example in Russia today of the evils of insane and unnecessary haste. The sacrifices and losses will be vastly greater if the pace is forced. This is above all true of a transition towards greater national self-sufficiency and a planned domestic economy. (245)

The third danger is "Intolerance." Referring to Russia again, Keynes warns against the practice of forcing one's views on society through violence rather than persuasion. It may be a natural tendency, he suggests, for revolutionary movements to continue to practice the same methods in power that they used in the struggle to acquire power. Only a deeply-rooted commitment to the foster criticism can create an atmosphere of tolerance for critics that is essential for successful experimentation. Keynes makes it clear that he would personally prefer *laissez-faire* - with all its inefficiency, waste, injustice, and propensity for war -- to a Stalinist mode of economic development.

Yet the new economic modes, towards which we are blundering, are, in the essence of their nature, experiments. We have no clear idea laid up in our minds beforehand of exactly what we want. We shall discover it as we move along, and have to mould our material in accordance with our experience. Now for this process bold, free and remorseless criticism is a *sine qua non* of ultimate success. We need the collaboration of all the bright spirits of the age. Stalin has eliminated every independent, critical mind, even when it is sympathetic in general outlook. ... Let Stalin be a terrifying example to all who seek to make experiments. If not, I, at any rate, will soon be back again in my old nineteenth-century ideals ... (246)

The central themes of this essay, especially the necessity for managed trade and capital controls to facilitate domestic planning, were to find explicit embodiment in the 1940s in Keynes's proposals for a new international financial system -- the "Keynes Plan" for an international Clearing Union, as well as in his ongoing campaign for domestic full-employment policy based on state control of investment.

**State Planning and Public Investment: 1932-35**

In May 1932 Harold Macmillan, who would later become Prime Minister in a Conservative government, circulated a policy paper advocating selective protection, low interest rates, and an "Investment Development Board." Macmillan was considered a very liberal Conservative. Keynes sent him comments.

My main feeling is that you are not nearly bold enough with your proposals for developing the investment functions of the state. You are trying it would seem to get your results by a sort of combination of private enterprise and subsidy... ... But at the present time it would be extraordinarily difficult to bring about an adequate volume of investment even if one had the whole force of the state behind one. The greater part of investment is concerned with building, transport and public utilities, and the scope for private enterprise is in modern times somewhat limited. (109)[[109]](#footnote-109)

MacMillan wrote Keynes that he agreed with all his criticisms "in theory." But, he said:

I am still trying the perhaps hopeless task of influencing the Government in the direction I want them to go, and, for this purpose, I have to *conceal a certain amount and to preserve certain political tendencies*! I am going to try to make some modification in the way you suggest, if I can do it without destroying the chance of anybody in my party reading and being influenced by my pamphlet. (111, emphasis added)

And this is precisely the dilemma one confronts when trying to explain the modesty of Keynes's policy proposals to, or testimony before, various government commissions as compared to his more adventuresome statements to the general public. He too seems to "conceal a certain amount" in order to attempt to influence the decisions of conservative politicians and civil servants.[[110]](#footnote-110)

The end of the gold standard allowed British authorities more discretion in setting interest rates. In the spring of 1932 short term interest rates began a decline from 6 per cent to 2 per cent where they remained until late 1939. Long term rates did not at first decline proportionately.

Late in 1932 Keynes wrote an evaluation of a Labour Party policy pamphlet containing resolutions to be presented to the coming Party Conference. He took the resolutions quite seriously. One proposal was for the nationalization of the Bank of England. Keynes had been clear that the formal nationalization of the Bank was not a major issue one way or the other to him because, in his view, it was already structured to implement government policy, not pursue shareholder profits. Here he also makes clear that *he is not in principle against the nationalization of the "Big Five" private banks either.*

This time they have left in abeyance their former proposal to nationalise the joint stock banks. Wisely and prudently in my opinion. For, in the first place, the control of the Big Five, otherwise than through the Bank of England, is not necessary for handling the vital controls [of the economy], whilst as a piece of socialism it belongs to a late stage of socialisation and is not one of the indispensable first steps. (130)

He criticizes the Bank nationalization proposal as too vague, and lays down six principles to guide the nationalization process. These are designed to make sure the process is "exactly what *we* want" (131, emphasis added) to reflect the fact that Keynes had many admirers in the Labour Party hierarchy. The last one embodies one of Keynes's unwavering concerns.

The less direct the democratic control and the more remote the opportunities for parliamentary interference with the banking policy the better it will be.

If the Bank of England is to carry out the monetary policy which is proposed in this pamphlet, it will be engaged in the practice of a very difficult technique, of which the Parliament will understand less than nothing. A planned economy will be impracticable unless there is the utmost decentralisation in the handling of expert controls. I would suggest to the Labour Party that the demand for democratic interference is not socialism but an echo of nineteenth-century Liberalism. (131)

The proposal which most interested Keynes, not surprisingly, concerned a "National Investment Board" whose main purpose was to regulate private investment through control of external finance.

I welcome warmly the acceptance of the principle of setting up a National Investment Board. But the resolution does not go nearly far enough for me. ...

... The real problems, as I see them, are concerned with the quantitative, rather than with the qualitative, control of new investment, partly with securing that the amount of *foreign* lending should be appropriate to the circumstances. The resolution also seems to overlook the smallness of the part which purely private enterprise now plays, and is likely to play in the future, in the direction of home investment. Moreover, home investment by private enterprise is not only on a comparatively small scale, but proceeds to a very great extent independently of the new issue market out of profits made by industry and reinvested within the business. ...

... Apart from the control of overseas loans, which certainly should not be left in the future to *laissez-faire*, ... the main issue is concerned with the regulation of the pace of that predominant proportion of new investment at home which has already passed irrevocably out of the control of private enterprise and into the control of public and semi-public bodies. (133-34, emphasis in original)

Keynes shows Macmillan data on the size of investment spending financed by local authorities and by building societies to make his point.

Thus £200,000,000 was invested through these two channels, in 1930 compared with £30,000,000 in 1914. The above omits capital expenditure by the central government (including the Post Office) or by public boards such as the Central Electricity Board, the Port of London, the Metropolitan Water Board, the Agricultural Mortgage Corporation, and the component parts of what will be the London Traffic Authority, or by universities and hospitals and the like. ...

Thus in the two years 1930 and 1931 the aggregate finance provided by building societies was appreciably greater than the ... aggregate of new capital for all purposes within the United Kingdom. In short, *considered quantitatively. private industrial investment is very far from being of the first importance*. (135, emphasis added)[[111]](#footnote-111)

Keynes then sums up the major tasks that must be addressed by central state planning.

*What we need is a co-ordinated policy to determine the rate of aggregate investment by public and semi-public bodies, in which case we could safely leave industry to raise what funds it needs as and when it chooses*. Here is a task of great importance... ... I would urge that it is this which should be the main preoccupation of the proposed National Investment Board....

The task of the National Investment Board, as I conceive it, is, therefore, first, the maintenance of equilibrium between the flow of new investment on the one hand, and on the other hand the total resources available for investment at the price-level which we are endeavoring to maintain, i.e., so as to avoid both inflation and deflation; and secondly a division of the aggregate of new lending between foreign and domestic borrowers which is appropriate to the foreign exchange level best suited to the stability of domestic prices. I see no likelihood of our being able to maintain a stable value for sterling unless this task is attacked with knowledge and authority. For the desired equilibrium is most unlikely to come about of itself; and, failing it, nothing can prevent an instability in the price level. The Board's main instrument would have to consist, I think, in some method of pooling a considerable portion of the funds accruing for investment and then ensuring an adequate demand for them, partly by making them available at a rate of interest which would attract a sufficient demand, and partly by stimulating the undertaking of particular investment propositions. (137, emphasis added)

Here, in September 1932, in the depths of the Great Slump, there is no question as to whether Keynes sees the need for state control of investment to be temporary or permanent.

Occasionally it would be the duty of the Board to damp down the rate of investment. But, as a rule, I should expect that its chief problem would be to maintain the level of investment at a high enough rate to ensure the optimal level of employment. Without such an instrumentality we may be sure that the disastrous fluctuations in the volume of employment will continue in the future as severely as in the past, and perhaps more severely.

... The grappling with these central controls is the rightly conceived socialism of the future. (137)

Keynes again focused attention on housing in an article in February 1933. He was disgusted by the stupidity of the Ministry of Health`s "famous Anti-Employment Memorandum to local authorities" (of September 1931) which, he claimed, cut local authorities' construction spending by £30 million, throwing "some 250,000 men out of work" while there was a desperate need for affordable rental housing (155).

If we look round to discover the outstanding capital requirements of today, it is obvious, beyond controversy, what it is -- the provision of houses available *to be let* at modest rentals. ...[T]here is today a deficiency of at least 1,000,000 houses. The great work done by the building societies in recent years is meeting the demand for houses *to be owned* by the occupiers. There is no means as yet of dealing with the problems of the slums... (158)

The time is ripe to solve this problem, he wrote. There is massive unemployment among construction workers; building costs have fallen up to 30 per cent since 1929; and the long term interest rate had fallen by a third. At the lower rentals now possible, "there [would be] an insatiable demand" (160). Keynes proposed the creation of a "National Housing Board" authorized "to borrow, under Treasury guarantee, up to, say, £100,000,000 in the first instance" to deal with this problem. It would make the money available through all the existing home building organizations, including town planning organizations. "In particular, it might make a beginning with the organized rebuilding of London on the south side of the river. … Would such a body need a subsidy, beyond the Treasury guarantee for its loans? I do not see why it should. (160)

In early 1933 Keynes published a *major* policy statement, both in Britain and in the United States, called "The Means to Prosperity." It provoked wide discussion in both countries.

Its primary purpose was to support "schemes of capital development at home as a means to restore prosperity" (339). *In developing his analysis Keynes was now armed with the formal multiplier theory which appeared in Kahn's famous article in The Economic Journal in June 1931.* After taking the reader through the potential "leakages" from the income stream following an injection of spending, Keynes estimates the value of the multiplier in Britain to be two (343), with the American multiplier "greater than two" (345).[[112]](#footnote-112)

The importance of these articles, in my view, is that they combined the "magic" of the multiplier with Keynes's long-held belief that there were a huge number of large scale public investment projects which either had a positive gross present value or, if not, at least limited prospective losses to a modest per cent of the project's cost. Together these assumptions carried the logical implication that an aggressive public investment program could be undertaken which would have at best a positive impact on the government budget, and at worst cause no increase in the current deficit. This argument was obviously designed to disarm the most vociferous critics of his policies in both countries.

Keynes assumes that it requires "£150 primary expenditure to put one man to work for a year" and that "Great Britain has the task of putting at least 1 million men back to work" (364). Keynes is clearly being conservative here because in 1933 Britain had over 2.5 million insured unemployed. He thus estimates that "we should need an increased loan-expenditure *plus* an increased foreign balance amounting altogether to £150 million" (364). Since there is no hope at present for improvement in the foreign balance, the burden must fall entirely on loan-expenditure, preferably debt-financed investment. Though £150 million is required just to get the insured unemployment rate down to about 12 per cent, Keynes suggests, again conservatively, that "we have an urgent need of the addition of at least £100 million to our annual primary expenditure from increased loan expenditure at home" (365) and uses that figure as his numerical example.

To calculate the effect of this level of spending on the Budget*, Keynes estimates the savings on the dole and the induced revenue which would follow upon the projected -- and "multiplied" -- increase of national income of £200 million.* He concludes that "the total benefit to the Exchequer of an additional loan-expenditure of £100 is at least £33 [reduced spending on the dole] *plus* £20 [increased taxes], or £53 altogether, i.e., a little more than a half of the loan-expenditure" (347*). Now in Keynes's view there is a vast -- almost unlimited -- reservoir of large scale investment projects which will return half or more of their cost (in present value terms)*.[[113]](#footnote-113) Thus, there is no budgetary impediment to a major program of public investment.

Take, for example, the proposal to spend £7 million on the new Cunarder [a large ocean liner]. I say that this will benefit the Exchequer by at least half this sum ... which vastly exceeds the minimum aid which is being asked of the exchequer.

Or take the expenditure of £100 million on housing whether for rebuilding slums or under the auspices of a National Housing Board, this would benefit the budget by the vast total of some £50 million -- a sum far exceeding any needful subsidy. If the mind of the reader boggles at this and he feels that it must be too good to be true, let him recur carefully to the argument which has led up to it. (348)

Since it is the depression itself that created the large budget deficits of the era, the argument that we should avoid large public investment programs because they will raise the deficit are tragically mistaken. "There is no possibility of balancing the budget except by increasing the national income, which is much the same thing as increasing employment" (347).

Keynes argues that recent attempts to raise public investment failed to generate representative effects on output and employment because, when the government modestly raised such spending in 1930 and 31, the foreign balance declined, offsetting the effect, and when the foreign balance rose again in 1932 "it brought no increase in employment, because it has been offset by the drastic measures of the National government to reduce loan-expenditure" (365).[[114]](#footnote-114)

With the budget deficit problem disposed of, Keynes presses home the urgency of large scale public investment. His standard caveats are here. Bank credit must be "cheap and abundant." The long term interest rate must be "low for all reasonably sound borrowers" (353). The foreign balance must be protected from the deterioration which domestic expansion in a stagnant word economy would bring under *laissez-faire* through capital controls or, even better, a new international financial system or Currency Union supportive of expansion. Finally, the task of domestic economic renewal would be easiest to accomplish if programs of public investment and easy money were undertaken worldwide.

We are again reminded that private investment can only be expected to rebound "*after* output is increasing" (354). And, that

in modern communities a very large proportion of our *normal* programmes of loan-expenditures are undertaken by public and semi-public bodies. The new loan-expenditure which trade and industry require in a year is comparatively small even in good times. Building, transport, and public utilities are responsible at all times for a very large proportion of current loan-expenditure. (354, emphasis in original)

Thus, public investment must be the key to prosperity.

[T]he first step has to be taken on the initiative of public authority; and it probably has to be on a large scale and organised with determination, if it is to be sufficient to break the vicious circle and to stem the progressive deterioration, as firm after firm throws in the sponge and ceases to produce at a loss in the seemingly vain hope that perseverance will be rewarded." (354)

Keynes concludes the essay, as was his style, with the combination of an attractive policy solution and a *dire warning* to his powerful critics in and out of government. Governments have tried the deadly combination of trying to protect the foreign balance while shrinking domestic loan-expenditures, he says.

On the other hand, Great Britain has the other combination still untried -- the policy of protecting the foreign balance and at the same time doing all in our power to stimulate loan-expenditure.

I plead, therefore, for a trial of this untried combination in our domestic policy; and for the [coming] World Economic Conference an advocacy of an expansion of international reserve money on the general lines proposed above.

For we have reached a critical point. ... Few of us doubt that we must, without much more delay, find an effective means to raise world price; or we must expect the progressive breakdown of the existing structure of contract and instruments of indebtedness, accompanied by the utter discredit of orthodox leadership in finance and government, *with what ultimate outcome we cannot predict*. (366,emphasis added)

In an article defending this analysis in the face of considerable criticism, Keynes takes a surprisingly moderate position on the aggressiveness with which the public investment program should be pushed. After defending the theoretical soundness of the argument for a bold approach, he says that he

is not unmindful of the delays and disappointments which await those who take the responsibility for an active policy. It will be extraordinarily difficult to contrive a judicious programme; and difficult above all to combine a judicious choice of schemes with speed of execution. (180)

While he would "welcome" an increase of public investment by £100,000,000 a year, he claims he would "be surprised if it could be accomplished" (181). Now it would be extremely helpful in trying to understand Keynes's general thinking on this issue if he told us what it was that stood in the way of a more ambitious program -- political expedience in a conservative era, a great fear that in such perilous times the "good" must not stand in the way of the "possible," the long start-up time for an efficient large program, or a dearth of desirable projects? Given all his other writings, it seems inconceivable that it could be the latter reason. And he does make clear that the slump will not end for a long time: "abnormal unemployment, though not on the present scale, may be a chronic problem with us for several years to come" (182). Moreover, when reviewing the list of attractive public investments, he again paints a picture of a vast reservoir of outlets for public capital.

In any case, he considers "that an increase of £60,000,000 a year would be satisfactory" since tax cuts could make up the difference, leading to an increased employment of 750,000, as in "The Means to Prosperity" (181). Tax cuts -- which of course *will* increase the deficit -- are to be used in the case of either a delay or a disappointment in the implementation of the public investment program. "The greater the prospective delay and the [more?] modest our hopes concerning capital works, the more important is it to press for a quick relief of taxation. A relief of taxation will operate quickly" (183). We know from many other statements by Keynes about the relative importance of public investment versus tax cuts, that he believed that the time for a major role for the latter (i.e., for stimulating consumption rather than investment) was a long way off -- a generation or more. Therefore, it is hard to avoid the conclusion that the 60-40 split proposed here reflects a combination of pessimism about the prospect that the government can be convinced to substantially increase public investment and fear that, if this turns out to be the case, only tax cuts can prevent further economic decline.

Keynes then takes up the problem of the adequacy of outlets for public investment again in an exchange of correspondence with the Ministry of Health, which had the authority to reject many local authority investment projects. The Ministry told Keynes that local authority spending was down to about£ 40,000,000 for 1932-33 from a high of £96,000,000 in 1926-27 (192). When he considered that tax contributions to repay old debt on local projects (the sinking fund) were currently running about £60 million a year (and rising), Keynes was extremely pessimistic about the prospect that policy could be aggressive enough to counter this drag.

Who on earth is going to absorb the resources thus set free, in addition to current savings, I cannot imagine. It indicates to me that unless we could engineer a considerable fall in the rate of interest, and at the same time organise every possible form of capital expenditure, we shall be totally unable to replace the gap left by the cessation of foreign investment; and activity in this is unlikely to be resumed on anything like its former scale, if ever, simply because we shall not have a favourable foreign balance to finance it.

If this line of thought is correct, the problem of today will be chronic for some time to come, and we cannot afford to neglect any even plausible outlet for funds. (193)

Keynes expressed concern that under these dire conditions it would be very difficult to "find outlets on an adequate scale and to keep it up" (193-94). Any serious attempt to do so would require some "re-organised machinery expressly designed for handling this problem." (194) This is a theme he has stressed at least since the Liberal Industrial Inquiry of the late 1920s.

My own pet plan, as perhaps you know, would be some central Government body which would co-ordinate the investment plans of the different departments and form a considered judgement as to the aggregate scale on which operations would be advisable year by year. (194)[[115]](#footnote-115)

A few days after making these observations Keynes went to Dublin to deliver his radical manifesto on "National Self-Sufficiency."

In June 1933, during the World Economic Conference, Keynes addressed the London Political Economy Club. The notes from the talk indicate that his primary domestic policy proposal was the expenditure by the Treasury of "about £150,000,000, perhaps more -- by public works or relieving taxation" (273). So here we are back to the more ambitious figure of £150 million -- about 4 per cent of 1933 national income and an increase of about 18 per cent in government spending [?]. Yet Keynes refers to this as "a modest programme" (273).

Starting in December 1933 Keynes began a running commentary on economic conditions in the US and on the policies of President Roosevelt. In the earliest article he stressed his new order of priorities.

In the field of domestic policy, I put in the forefront...a large volume of loan expenditure under government auspices. ...

I put in the second place the maintenance of cheap and abundant credit, in particular the reduction of the long-term rate of interest. (296-97)

Reinforcing the secondary importance of low interest rates, Keynes later observed: "It is important that monetary arrangements should not hamper business expansion, but it is not easy to bring about business expansion *merely* by monetary manipulation" (308,emphasis ?).

Keynes went to the US again, arriving on May 15, 1934 and leaving on June 8th. He met with a large number of important American political and financial figures. On May 28th he had an hour-long meeting with President Roosevelt. According to the editors of the Collected Works, Keynes found the meeting "fascinating," while FDR "reported that he had `a grand talk with Keynes and liked him immensely'" (320-21).

Before leaving the US Keynes wrote an analysis of Roosevelt's policy problems and perspectives for both the New York Times and the London Times. In it he provided a quantitative analysis of the fiscal policy of the preceding year, one which is extremely important for our purposes. Whether his data was accurate or his conclusions correct -- interesting questions, both -- need not concern us here. What matters is that Keynes believed that fiscal policy had been, for a while, extremely expansionary and that he clearly approved of the aggressiveness of the program.

Stimulus to production and employment, he said, must depend chiefly on "the Government's [loan financed] emergency expenditure" (325). The specific programs mentioned are the Civil Works Administration and the Public Works Administration. Such spending had fluctuated between about $100 million and $400 million a month over the previous nine months. Each $100 million represents about 2.75 per cent of monthly national income according to Keynes. Thus, to raise such loan financed spending from the lower figure to the higher represents an increase of a little over *8 per cent of national income*. Keynes believes that such a policy would "increase the national money income by 25 to 30 per cent" (326). By implication, he believes the applicable multiplier to be about 3 to 3.5. And he thinks that fluctuations in US government spending and income over the past year have already confirmed his basic analytical framework.

Some five months ago I wrote that the relapse [in income] in the latter half of 1933 was the predictable consequence of the failure of the Administration to organise new loan expenditure...on an adequate scale. ... Fortunately the expenditures did increase, rising from less than $100,000,000 in the month preceding my letter to an average of $300,000,000 in the next four months. As I predicted the fruits of this have been enjoyed, and I estimate that there has been an improvement of something like 15 per cent in output, incomes and employment. This is an immense achievement in so short a time. But latterly, the expenditures have been declining and, once more as a predictable result, a recession of 3 per cent and perhaps 5 per cent is impending. (328-29)

Keynes enthusiastically supports this policy! Yet a analogous or proportionate policy for Britain would call for increased public loan-financed expenditures of about £330 million per year, *or more than twice as much as larger of the two figures Keynes had been using in his public policy proposals*. Even if we adjust for the fact that the maximum rate of total unemployment in Britain was only about 70 percent of the maximum American rate, we still get a British equivalent of £230 million per year or almost *6 per cent of national income*. Using Keynes's estimate that the British multiplier is at least two, an increase of loan expenditure of £230 million implies a reduction of the 17 percent total unemployment rate to perhaps 7 per cent, a result more in line with the generally ambitious tenor of his policy thinking.

This article thus provides further evidence in support of the view that Keynes's more modest proposals reflect his judgment as to what might be possible in the current political environment rather than his view of what would be optimal given political *carte blanch*. This interpretation is strongly supported by a letter Keynes wrote in January 1935 to a former Labour M.P. who had raised the question as to "the measures which public opinion is ready for" (346). In reply *Keynes points out that his preferred policies are much more radical than anything the public is prepared for, and that an attempt to implement more extreme policies would not be wise because no current political party could be trusted to do the job effectively*. "If extreme things are done in the near future, either by the Right or by the Left, they are almost certain to be ill conceived" (347). Thus, he has been proposing only "stop-gap" policies because "no one is prepared" for policies strong enough to restore full employment.

Meanwhile, it appears to me, that there are many important matters of great, though in a sense secondary, importance to occupy us, obviously worth doing for their own sakes and thoroughly acceptable to all that is sound and strong in contemporary opinion.

You may very well be right that these sorts of measures will be far from sufficient to maintain steady prosperity. My point is, you see, that those measures which will, in my opinion, restore steady prosperity are measures *for which no one is prepared* and which have not been sufficiently thought out.

Thus, in my sense, *my `liberal' policy is a stop-gap policy*. I find it hard to judge whether my ultimate policy would strike the ordinary person as violently drastic or evolutionary. For, what I am primarily interested in supplying is as sound and scientific way of thinking about our essential problems. Before this way of thinking can be translated into practice, it has to be mixed with politics and passion just like any other way of thinking, and the nature of the outcome is something I cannot foresee in detail.

Probably it is best of all that for the next few years the existing [Conservative] Government should gradually drift into a reformist policy. (348, emphasis added)

*This letter appears to solve this fascinating and important problem of interpretation we have been concerned with*.

In a Redbook piece in December 1934, Keynes is perhaps even more enthusiastic about the efficacy of public investment, raising his estimate of the American multiplier to a very, probably overly, optimistic level.

[F]or each man actually employed on the government scheme, three , or perhaps, four, additional men are employed in providing for his needs and for the needs of one another. In this way a given rate of government expenditure will give rise to four or five times as much employment as a crude calculation would suggest. Thus there would be some advantage even if the scheme itself were to yield but little revenue hereafter. If, however, it is even a moderately sound scheme capable of yielding (say) three per cent on its cost, the case for it is overwhelming. (336)

And he stresses for the American audience his standard argument that a public investment program is unlikely to raise the budget deficit.

Unemployment involves a serious financial strain to the municipal, state, and federal governments. The alleviation of unemployment, as a result of government expenditure, means a considerable reduction in the outgoings on the support of the unemployed. At the same time the receipts from taxation mount up as the nation's taxable income increases, and as real property values are re-established. These important factors must be allowed for before it is possible to say how far government expenditure involves additional unproductive debt. The residue cannot be very large. (337)

In 1935 Keynes was largely occupied with completing The General Theory (as well as with the Arts Theatre in Cambridge).

**VISIONS: 1936 and The General Theory**

**[I intend to add material on how the GT altered to a considerable degree the theoretical foundation of his policy conclusions - maybe 20 pages or so]**

At first glance, The General Theory appears to be primarily about economic theory, not about concrete policy proposals. In fact, it is a clear and conscious effort by Keynes to convince his fellow economists that the radical policy proposals he had championed for over a decade to resolve the secularly high unemployment plaguing Britain for the past 15 years were the right ones for the country, and that the orthodox or classical understanding of the problem used by his enemies to attack his proposals was fatally flawed. The new macro-economic theory unveiled in the book was designed to provide an impregnable defense of his policy positions. Keynes believes this to be a revolutionary book. As he wrote to George Bernard Shaw in 1935:

To understand *my* state of mind, however, you have to know that I believe myself to be writing a book on economic theory which will largely revolutionise -- not, I suppose, at once but in the course of the next ten years -- the way the world thinks about economic problems. (13, 493, emphasis ?)[[116]](#footnote-116)

Keynes tells the reader that the book is a breakthrough in theory with little concrete discussion of policy implications. The Preface opens with the following statement: "*This book is chiefly addressed to my fellow economists*. I hope that it will be intelligible to others. *But its main purpose is to deal with difficult questions of theory, and only in the second place with the applications of this theory to practice"* (GT, xxi, emphasis added).

Nevertheless, the book reflects Keynes's radical vision and has clearly-stated implications for the policy debates of the period. Its main purpose is to help create a consensus about macro theory among the most influential economists of the time, including those in the worlds of government, business and finance as well as the academy that would be supportive of the radical policy views Keynes had defended since 1924. *It really is a book about, or in defense of, policy*, and its radical policy implications are spelled out in numerous places.

The General Theory’s is connected to the voluminous outpouring of Keynes's speeches, professional and popular writings, and official and unofficial advice to government officials and agencies since the War in the sense that both were designed to accomplish the same goal. *Indeed, it would be reasonable to argue that Keynes had reached his policy conclusions first, starting in 1924, and only after they had reached maturity did he set about in The General Theory to create a grand theoretical foundation adequate to support them.*

One relevant precursor of The General Theory interpreted as an attempt to create a policy consensus-building device for economists stands out. In July 1930 Keynes proposed to Prime Minister Ramsey MacDonald that he appoint a committee of elite economists to try to come to agreement on the causes of, and possible remedies for, the economic ills of the day. MacDonald was Labour Party Prime Minister in 1924, and again from 1929 to 1931. He was also Prime Minister in a National Coalition Government from 1931-1935.

It is essentially a matter of economic diagnosis, the sort of thing for which economists, if they are any good at all, should be useful. ... I think it would be worth trying to see if a small committee, composed of leading professional economists, could agree amongst themselves sufficiently to produce an answer. ... It may be that economics is not enough of a science to be able to produce useful fruits. But I think it might be given a trial... I do not feel confident that the experiment would be successful. But I think it might be worth trying. (20, 368-69)

MacDonald did appoint a Committee of Economists (as a subcommittee of his Economic Advisory Council) shortly thereafter, with Keynes as its Chairman. The other members of this blue-ribbon committee were A.C. Pigou, Lionel Robbins, Hubert Henderson, and Sir Josiah Stamp. Richard Kahn was a committee secretary.

Unfortunately, this experiment by Keynes in consensus-building among economists through their participation in an official government policy advisory committee ended in failure. It would appear that it was designed by MacDonald to fail. He personally opposed Keynes’s more radical policies, but wanted to give the public the impression he sought the best policy advice from the most prestigious economists of this troubled time. However, since the committee was composed of economists who were adamantly at odds over economic theory and policy, it was unlikely to never reach a policy consensus. The conservative Robbins refused to sign its final report. Neither the Economic Advisory Council nor the Cabinet gave the Committee's report serious consideration*.*[[117]](#footnote-117)

Perhaps this experience led Keynes to conclude that he needed a new strategy to gain adequate support for his radical policy proposals that would augment his old strategy of tireless proselytizing through: scholarship, speeches, newspaper articles, radio broadcasts, work with government bodies, efforts to create political power for the Liberal Party, attempts at political alliances with the Labour Party, and so on. Keynes wrote The General Theory to accomplish the same objective through a different and hopefully more fruitful approach - to convince a large majority of influential economists in the academy, in government, in business and finance - of the soundness of his views. He was especially interested in influencing the younger generation of economists on the reasonable assumption that older and more experienced economists rarely change their mind about theoretical perspectives. *Keynes wanted, in other words, to have his theoretical views eventually become the conventional wisdom among economists, and in this way to create a political environment supportive of his policy positions*.

The General Theory reflects Keynes's theoretical vision in a number of ways. One of the main grounds for his rejection of classical theory is Keynes's belief that its core assumption set is profoundly unrealistic - at odds with the reality it wants to explain. Contrary to the methodological views of the current US economics profession, which are based on positivism or instrumentalism, Keynes insists that the realism of the assumption does matter to the explanatory power of a theory. On the first page of the book Keynes says the following.

I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium. Moreover, the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience. (3)

Keynes’s attack on the realism on the assumptions of classical theory was not meant to apply to all historical periods. Indeed, he argued that the assumptions underlying classical theory were not dramatically inconsistent with the institutional reality of nineteenth century Britain, which is why he believed that freedom of trade and capital flows and domestic *laissez-faire* were not inconsistent with a high rate of growth and the relatively low unemployment and relative price stability *in that era*. Though The General Theory is purposely shorn of all but the skimpiest specification of institutional conditions, Keynes clearly intends his audience to understand him to be arguing that it is ***the institutionally specific and historically contingent "modern" capitalism of the post WWI era[[118]](#footnote-118)*** *--* with powerful labor unions and a welfare state; large oligopolistic corporations in crucial industries (in which ownership is divorced from management); unstable, speculative financial markets that fund capital investment and thus strongly influence economic growth and employment; and major new competitors for England's traditional export markets - to which the classical assumption set no longer applies. The central argument of the book, in other words, directly reflects Keynes's long-held belief that the world had entered a "new era" in which old verities - such as described by classical theory and embodied in *laissez-faire* policy - no longer held because the assumption set used to construct the theory no longer bore any relation to current-day reality.

The book does not hide the fact that Keynes envisions a major new economic role for the state based on public control of most large-scale capital investment, and makes clear that the new economic powers to be given to the state mark a radical transformation of Britain's political economy. **This dimension of the book totally escaped the attention of post-WWII "Keynesian" economists.** If modern Keynesians have somehow failed to "see" the more radical statements about the economic functions of government in The General Theory, or have chosen to interpret them as inconsequential *obiter dicta*, that is not primarily Keynes's fault.[[119]](#footnote-119) He wrote clearly and often about them in the book. Britain's intellectual and political elite, of course, did not make this mistake because, u*nlike today's economists, Keynes's contemporary audience was quite familiar with his writings on public investment and national planning since 1924. They knew he was a 'liberal socialist' who had campaigned relentlessly for the adoption of democratic economic planning.*

One major policy conclusion in the book is that monetary policy should focus on securing a secularly low long-term rate of interest in support of government attempts to use public investment to achieve long-term full employment. Though modern "Keynesian" economics is almost universally understood to lead to the conclusion that counter-cyclical monetary and fiscal policy are the only appropriate macro policy, in fact Keynes argues here *against* counter-cyclical monetary policy. In chapter 22 on the trade cycle he insists that a high rate of interest is not an appropriate tool for dampening an over-exuberant boom, and that the interest rate variability presumed in such a policy would increase the sense of uncertainty about the future and thus make it impossible to keep the trend rate of interest low enough to help secure full employment. He also expresses his belief that low interest rates alone are incapable of achieving permanent full-employment. The appropriate policy is permanently low interest rates in support of planned public capital spending in pursuit of permanent full-employment.

Chapter 12 argues that private investment spending depends heavily on stock price movements, and that modern financial markets are inherently volatile - an explosive combination of circumstances. This leads Keynes to conclude that *if* a moderate policy is the only available option, a substantial financial turnover tax on financial security trades should be adopted, not primarily to raise revenue, but rather to help reduce the speculative instability of the British and American financial "gambling casinos." Keynes argues that this instability is the main cause of excessive volatility in capital spending, growth and employment, and is a major cause of Britain’s slow secular growth in capital accumulation. This has come down to us as a "Keynes" or "Tobin" or "Robin Hood" tax.

His most important discussion of the new role of the state takes place in Chapter 24, "Concluding Notes on the Social Philosophy Towards Which The General Theory Might Lead," where he argues for a "somewhat comprehensive socialisation of investment" (378). There is a widespread belief that Keynes's support here for when is seen as an ill-defined concept of the socialization of investment is just an isolated, last-minute whim unconnected to and unsupported by the core of the book or, for that matter, Keynes's other writings. For example, a macro textbook written by two prestigious progressive American economists, Sandy Darity and James Galbraith, states: "There is no evidence to suggest that Keynes promoted his proposal for socializing investment, and it only surfaces briefly in the latter pages of The General Theory. (1994, 53)

As we have seen, this interpretation is profoundly mistaken. Even if we confine ourselves to the text of The General Theory, we find that Keynes stated his support for this position any number of times. For example, he concludes the crucial Chapter 12 (on "Long-Term Expectations”) with the same argument. Note Keynes's insistence, expressed in the last paragraph, that the state will have to "**directly**" control investment.

Finally there is a growing class of investments entered upon by, or at the risk of, public authorities, which are frankly influenced in making the investment by a general presumption of there being prospective social advantages from the investment, whatever its commercial yield may prove to be within a wide range, and without seeking to be satisfied that the mathematical expectation of the yield is at least equal to the current rate of interest, -- though the rate which the public authority has to pay nay still play a decisive part in determining the scale of investment operations which it can afford.

Thus ... we are still entitled to return to [the rate of interest] as excercising, at any rate, in normal circumstances, a great, though not a decisive, influence on the rate of investment. ...

For my own part I am now somewhat skeptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for **directly** organising investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency for different types of capital, calculated on the principles I have described above, will be too great to be offset by any practicable changes in the rate of interest. (163-64, emphasis added)

There are numerous other examples of his support for public control of the capital accumulation process. In Chapter 16, while discussing the optimal long-term policy to support capital accumulation, Keynes refers to his decade-old belief that the state should itself undertake sufficient public investment to ensure full employment. The context is his belief that Britain could eventually reach capital "saturation, which would lead to "the elimination of the rentier class, one of "the objectionable features of capitalism" (221). He notes that:

This disturbing conclusion [about possible stagnation] depends, of course, on the assumption that the propensity to consume and the rate of investment are not deliberately controlled in the public interest but are mainly left to the influences of laissez-faire. (219)

Finally, on the socialization of investment as a factor that can bring about the “euthanasia of the rentier”:

Let us assume that steps are taken to ensure that the rate of interest is consistent with the rate of investment which corresponds to full employment. Let us assume, further, that State action enters in as a balancing factor to provide that the growth of capital equipment shall be such as to approach saturation-point... (220)

Keynes concludes his analysis of the trade cycle as follows.

In conditions of *laissez-faire* the avoidance of wide fluctuations on employment may, therefore, prove impossible without a far-reaching change in the psychology of markets such as there is no reason to expect. I conclude that the duty of ordering the current volume of investment cannot safely be left in private hands. (320)

Later in the same chapter he calls for "a socially controlled rate of investment" (325).

In Chapter 23, in discussing state policy under nineteenth century *laissez-faire*, Keynes notes that, unlike modern capitalism, this was "a society where there is no question of direct investment under the aegis of public authority" (335). Further along in the chapter, when lamenting the fact that under current conditions a free trade and free capital mobility policy is more likely to promote war than peace, he states his own belief in public control of investment - and in the capital controls required to be able to set an "autonomous" interest rate.

It is the policy of an autonomous rate of interest, unimpeded by international preoccupations, and of a national investment programme directed to an optimum level of domestic employment which is twice blessed in the sense that it helps ourselves and our neighbors at the same time. (p 349)

The final chapter on "social philosophy" is infused with Keynes's vision, including his views on the economic responsibilities of the state. It is a tricky chapter to interpret, however, because here Keynes is doing two things at once that operate, to some extent, at cross purposes. On the one hand, he reminds the reader of his radical vision, of his belief that only "middle way" state planning - midway between laissez-faire and communism or fascism or even the Labour Party's State Socialism - can restore peace and prosperity to the modern world. On the other hand, **the main purpose of the book is to convince his fellow economists, on the whole a conservative lot, to join him in this crusade**. This requires that he assure his audience of economists that his crusade is not all *that* radical, and *that its only alternatives might well be war and/or revolution*. A coherent reading of this seemingly schizophrenic chapter requires that both objectives be constantly kept in mind.

The chapter begins with a reminder that the theory constructed in the book disarms the traditional argument that a very unequal distribution of income and wealth is necessary to generate the high savings rate required for a high rate of economic growth. It thus can be used to justify much more egalitarian economic policy. Since, in general (i.e., except at full employment), increases in inequality lower the propensity to consume, they also lower aggregate demand and equilibrium income. Thus, significantly less inequality of income is consistent with economic efficiency and is preferable on grounds of social justice as well. Moreover, though there is, in Keynes's view, justification for a modest degree of income inequality- much lower than at present - there is no impediment on economic grounds for a confiscatory inheritance tax. Finally, since, in general, higher saving is caused by higher investment (and not, as in classical theory, the other way around), and since high investment is facilitated by a secularly low interest rate (made possible through strict capital controls), in the world Keynes envisions interest rates and interest income will be cut to a minimum.[[120]](#footnote-120) This will not only reduce inequality, it will also eliminate one of the most oppressive aspects of the capitalist form of organization - a powerful rentier class. His policies:

would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity value of capital. ... I see, therefore, the rentier aspect of capitalism as a transitional phase which will disappear when it has done its work. And with the disappearance of its rentier aspect much else in it besides will suffer a sea-change. It will be, moreover, a great advantage of the order of events which I am advocating, that the euthanasia of the rentier, of the functionless investor ... will need no revolution. (376)

Keynes next repeats a theme presented at various points in the book: that state policy should use public control over investment to rapidly accumulate capital for a generation or so, until capital is, in the technical sense, no longer scarce. It should then use progressive taxation and "communal saving through the agency of the state" to raise the propensity to consume.

The appropriate economic power of the state is the subject of the next section. Here one can detect the residue of the political sugar-coating on Keynes's message, though his insistence that middle way planning is economically and politically superior in his mind to either Bolshevism or State Socialism because it is more consistent with traditional individual liberty is something he sincerely believes. "In some other respects the foregoing theory is moderately conservative in its implications," the section begins. It continues: "For whilst it indicates the vital importance of establishing certain central controls in matters which are now left in the main to individual initiative, there are wide fields of activity which are unaffected." (377-78) "There will still remain a wide field for the exercise of private initiative and responsibility," he argues. "Within this field the traditional advantages of individualism will still hold good." (380) After he lists some of the key responsibilities of the state, he tries to calm his readers' nerves with the following assurance: "But beyond this no obvious case is made out for a system of State Socialism [the official, if in practice toothless policy of the Labour Party] which would embrace most of the economic life of the community. It is not the ownership of the instruments of production which is important for the State to assume." (378) Keynes goes on to argue that after the state has determined the level of output, its split between consumption and investment and between its domestic and foreign allocation, and the broad parameters of income distribution through the tax and social welfare systems, there is no objection to letting markets determine the mix of commodities, the organization of production and the specifics of factor pricing.

The problem for Keynes is that his conservative readers' nerves were likely to remain on edge because the powers to be vested in the state were, by the standards of 1930s Britain or, for that matter, current-day America, enormous. He lists some key state responsibilities.

The State will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest, and partly, perhaps, in other ways. Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment; though this need not exclude all manner of compromises and of devices by which public authority will co-operate with private initiative. ... If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rewards of those who own them, it will have accomplished all that is necessary. Moreover, the necessary measure of socialisation can be introduced gradually and without a break in the general traditions of society. (378)

We have seen that Keynes thought that the state should use a combination of progressive income taxes, confiscatory inheritance taxes, and historically low interest rates to substantially reduce inequality and, after a time, virtually eliminate the rentier class. Here he adds control of the propensity to consume (and, therefore, of the national savings rate), *the rate of profit on capital* ("the basic rewards" to the owners of real capital), and the "somewhat comprehensive socialisation of investment" -- which we know from numerous writings and speeches over twelve years refers to direct state control of the lion's share of all large-scale capital spending as the centerpiece of aggregate demand management. Of course, Keynes's contemporary readers also know he is on public record in favor of the idea that it is the responsibility of the state to manage trade and control the flow of financial capital across its borders; the latter point is repeated several times in The General Theory itself.[[121]](#footnote-121)

While Keynes is quite correct to insist that this "middle way" represents a less radical departure from the status quo than the detailed physical planning of production and distribution under state ownership of all important means of production envisioned by State Socialists, it nevertheless constitute a plan to dramatically transform Britain's economy and society, as well as its distribution of political power. *With capital accumulation - and therefore employment and unemployment - no longer controlled by private capitalists, and with strict capital controls that would prevent the capitalist class from pulling their money out of the country if policies they opposed were enacted, the capitalist class would lose its two most important levers of economic and political power*. Of course, the capital class also understood this, which is why they so ferociously opposed his policies. His acknowledgement that "the enlargement of the functions of government ... would seem ... to a contemporary American financier to be a terrific encroachment on individualism" has well withstood the test of time.[[122]](#footnote-122)

Keynes ends the substantive part of the chapter with a three-pronged appeal for his readers' sympathy and support. First, he repeats the thesis that his system protects at least some of the advantages of individualism. His wording reflects both his own values and his understanding of the stupidity and venality involved in some of the more extreme contemporary experiments in national planning.

Let us stop for a moment to remind ourselves what these advantages are. They are partly advantages of efficiency -- the advantages of decentralisation and of the play of self-interest. The advantage to efficiency of the decentralisation of decisions and of individual responsibility is even greater, perhaps, that the nineteenth century supposed; and the reaction against the appeal to self-interest has perhaps gone too far. But, above all, individualism, if it can be purged of its defects and its abuses, is the best safeguard of personal liberty in the sense that, compared with any other system, it greatly widens the field for the exercise of personal choice. It is also the best safeguard of the variety of life ... the loss of which is the greatest of all the losses of the homogeneous or totalitarian state. For this variety preserves the traditions which embody the most secure and successful choices of former generations; it colours the present with the diversification of its infancy; and, being the handmaiden of experiment as well as of tradition and of fancy, it is the most powerful instrument to better the future. (380)

Second, Keynes expresses his sincere belief that an international system of Keynesian planned economies would greatly reduce the likelihood of future wars. As he so forcefully argued in "National Self-Sufficiency," continuance of the status-quo promised only stagnation and war.

But if nations can learn to provide themselves with full employment by their domestic policy (and, we must add, if they can also attain equilibrium in the trend of their population), there need be no important economic forces calculated to set the interest of one country against that of its neighbors. There would still be room for the international division of labour and for international lending in appropriate conditions. But ... [i]nternational trade would cease to be what it is [in the 1930s], namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle, but a willing and unimpeded exchange of mutual advantage. (382)

His last argument is, if one accepts it, certainly the most powerful. It is an old standard for Keynes. *Either Keynes's middle way planning - radical though it is - will be accepted by Britain’s economic and political elite, or Britain will ultimately end up with a working-class revolution, totalitarian planning, or both*. Where he says “the world will not much longer tolerate…” present-day capitalism, he clearly means that ‘the working class will not much longer tolerate” it. Referring to his policies as a whole, Keynes argues:

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.

...

The authoritarian state systems of to-day seem to solve the problem of unemployment at the expense of efficiency and freedom. It is certain that the world [i.e. the working class] will *not much longer tolerate* the unemployment which, apart from brief intervals of excitement, is associated -- and, in my opinion, *inevitably associated* -- with present-day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom. (381, emphasis added).

In the exit paragraphs of the book, Keynes raises the important question of whether hidebound conservative ideas, or “vested interests,” (or alternatively put, class interests or material interests) posed the greatest threat to the implementation of his proposed new policy regime. He argues that, in the long run, ideas are more powerful that class interest.

[The] ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. … But, soon or late, it is ideas, not vested interests, which are dangerous, for good or evil. (383-84).

It seems to me that in this paragraph *Keynes incorrectly assumes that there is no relation between ideas and material or class interests*. Marx is better on this question. He too believed that ideas could be a powerful political force, but he also believed that there was an important, though not a mechanistic, relation between dominant ideas and material interests in every historical era. In The German Ideology he wrote the following.

*The ideas of the ruling class are in every epoch the ruling ideas*, i.e. the class which is the ruling material force of society, is at the same time its ruling intellectual force. The class which has the means of material production at its disposal, has control at the same time over the means of mental production, so that thereby, generally speaking, the ideas of those who lack the means of mental production are subject to it. The ruling ideas are nothing more than the ideal expression of the dominant material relationships, the dominant material relationships grasped as ideas. **(p?, emphasis added)**

**State Planning and Public Investment: 1936-39**

In 1936 the political situation in Europe deteriorated. Hitler occupied the Rhineland and the Spanish Civil War broke out. The British economic upturn of the mid 1930s slowed, coming almost to a halt in 1936-37. Average real working class income declined between 1934 and 1937, though the rate of unemployment continued to fall.[[123]](#footnote-123) However, in 1936 Britain announced a large five year defense buildup program which was bound to have a significant impact on output and employment.[[124]](#footnote-124) **Indeed, by April 1939 Keynes will declare that, due to war spending, "the problem of abnormal unemployment will cease to exist during the financial year 1939-40"** and that "Government priorities, an acute shortage of skilled labour, trade union restrictions, the task of shifting workers to the districts where demand is greatest, the curtailment of unessential services -- all the problems of the last War -- are round the corner" (**21**, 509 and 511). *Thus, all of Keynes's statements in the remainder of the 1930s must be interpreted in light of his understanding of the dimensions of this military buildup.*

For example, much has been made of the following statements that he wrote in January 1937.

I believe that we are approaching, or we have reached, the point where there is not much advantage in applying a further general stimulus at the centre. So long as surplus resources were widely diffused between industries and localities it was no great matter at what point in the economic structure the impulse of increased demand was applied. But the evidence grows...that (for example) building activity in the home counties is less effective than one might have hoped in decreasing unemployment in the distressed areas. ... We are in more need today of a rightly distributed demand than of a greater aggregate demand... (385)

These statements have been taken to mean that Keynes believed that the then current unemployment rates of about 12 per cent of the insured and 9 per cent of the total work force represented structural rather than demand-deficient unemployment. But this is inconsistent with everything he wrote on this issue. A far more reasonable interpretation is that with the ongoing increase in fiscal stimulus associated with the war buildup, Keynes knew that there was no need for additional aggregate demand stimulus. £500 of loan-financed military spending was a huge kick to aggregate demand. Indeed, the demands of the war machine would be likely to create localized excess demands for certain kinds of labor, and perhaps inflationary pressures for certain kinds of products. In the absence of this war buildup, it is almost certain that Keynes would have continued to push for increased public investment.

In January 1937 Keynes published a series of articles in The Times on controlling the business cycle. These pieces contain many interesting ideas. He acknowledges that the extreme instability of private investment, emphasized in The General Theory, makes what would later be called `fine tuning' difficult. He anticipates an argument he will make in greater detail in the 1940s that public investment of the right kind can be used as a *counter-cyclical* “make-weight" to balance fluctuations in private investment. This is a different argument from his standard thesis that large, long-term public investment projects should be used to raise the secular *trend* of the economy. He states that *under no circumstances* should tight money and high interest rates be used to slow an over-heated boom.

We must avoid it, therefore, as we would hell-fire. … For if we allow the rate of interest to be affected, we can not easily reverse the trend. A low enough long-term rate of interest cannot be achieved if we allow it to be believed that better terms will be obtainable from time to time by those who keep their resources liquid. The long-term rate of interest must be kept *continuously* as near as possible to what we believe to be the long-term optimum. It is not suitable as a short-period weapon. (389, emphasis in original)[[125]](#footnote-125)

Rather, to slow an over-exuberant boom, the authorities should, temporarily, raise taxes, let in a greater volume of imports, and postpone the starting date of suitable public investment projects.

Keynes also argues that the chief task at the moment is not to "avoid the perils of a somewhat hypothetical boom," but to insure that the current moderate upturn not, at some point, fall back into a slump. And he picks up a theme from The General Theory: after investment has contributed all it can, the state should use its powers of taxation to progressively redistribute income and, in so doing, raise the propensity to consume.

The concluding section of the articles ("Planning Investment") is most interesting. Keynes stresses yet again the importance of creating an institutional structure adequate to the new role of investment planning. Keep in mind in interpreting his arguments about managing the long-term rate of interest that the existence of strict capital controls is assumed.

The capital requirements of home industry and manufacture cannot possibly absorb more than a fraction of what this country, with its present social structure and distribution of wealth, chooses to save in years of general prosperity; while the amount of our net foreign investment is limited by our exports and our trade balance. Building and public transport and public utilities lie half-way between private and public control. They need, therefore, the combined stimulus of public policy and a low rate of interest. But a wise public policy to promote investment needs, as I have said, long preparation. *Now is the time to appoint a board of public investment* to prepare sound schemes against the time that they are needed. If we wait until the crisis is upon us we shall, of course, be too late. We ought to set up immediately an authority whose business it is not to launch anything at present, but to make sure that detailed plans are prepared. The railway companies, the port and river authorities, the water, gas, and electricity undertakings, above all, perhaps, the London County Council and the other great Corporations with congested population, should be asked to investigate what projects could be usefully undertaken if capital were available at certain rates of interest... The question of the general advisability of the schemes and their order of preference should be examined next. What is required at once are acts of imagination by our administrators, engineers, and architects, to be followed by financial criticism, sifting, and more detailed designing; so that some large and useful projects, at least, can be launched at a few months' notice.

... *In special cases subsidies may be justified. but in general it is the long-term rate of interest which should come down to the figure which the marginal project can earn.* If we know what rate of interest is required to make profitable a flow of new projects at the proper pace, we have the power to make that rate prevail [assuming strict capital controls]. A low rate of interest can only be harmful and liable to cause an inflation if it so low as to stimulate a flow of new projects more than enough to absorb our available resources. Is there the slightest chance of a constructive or a forethoughtful policy in contemporary England? Is it conceivable that the Government should do anything in time? Why shouldn't they? (398-99, emphasis added)

Thus, the mature or post- General Theory Keynes here lays out a fairly sophisticated view of macro planning. It presumes capital controls and managed trade. It proposes that taxes, imports and public investment -- not monetary policy -- be used to moderate the instability inherent in the capitalist investment process. For the long-term it envisions a national investment board of technical and financial experts who will initiate investment projects as well as facilitate their initiation by others, creating a prioritized portfolio of projects available for implementation so as to set an optimum average level of national income. The potential scope of such projects is vast. The Treasury and the Bank of England should set interest rates with the sole objective of facilitating the board's efforts to match investment with full employment savings. Unusually low long-term interest rates may be required, but they will be possible to achieve because of capital controls and the prohibition against raising short term rates to control the cycle. The board will subsidize projects if and when this is necessary to fulfill the plan, but, in general, it is expected that there will be no deficit in the capital budget of the state.

In March 1937 Keynes evaluated the likely economic impact of the Government's plan to borrow £80 million a year for the military buildup. His comments again stress the need for an improved set of institutions to facilitate state economic control.

He estimates that this spending increase might raise national income by perhaps 4.5 per cent at a time when the insured unemployment rate was "as high as 12.5 per cent." He did not think this spending would cause inflation provided that "measures to ensure that all possible orders are placed in the Special Areas [of high unemployment] where surplus resources are available" are taken (407). However, for the short term there might be "some congestion" because capital spending was still on the rise. Therefore:

It is essential to set up at the centre an organisation which has the duty to think about these things, to collect information and to advise as to policy. Such a suggestion is, I know, unpopular. There is nothing a Government hates more than to be well-informed; for it makes the process of arriving at decisions much more complicated and difficult. But, at this juncture, it is a sacrifice which in the public interest they ought to make. It is easy to employ 80 to 90 per cent of the national resources without taking much thought as to how to fit things in. For there is a margin to play with, almost all round. But to employ 95 to 100 per cent of the national resources is a different task altogether. It cannot be done without care and management... (409)[[126]](#footnote-126)

*By early 1938 the US had sunk back into severe recession and the British recovery had faltered*. Keynes wrote a personal letter to President Roosevelt imploring him to undertake a more aggressive policy of public investment to restart the US economy and, in the process, help other nations with their own recoveries). The problem in the US, according to Keynes, was that the policy required to restore prosperity -- a consistent, large-scale, long-term increase in public investment -- had never been implemented. The banking system had been repaired and credit was now cheap, but, as he stressed in The General Theory, this is a necessary but not sufficient condition for recovery. "An increased [credit] supply will not by itself generate an adequate demand." (435) Note in the quote to follow Keynes's habitually pragmatic approach to the question of nationalization. The traditional view that Keynes was ideologically opposed to the nationalization of industry is simply not true. His clear preference here is for public ownership of the American public utility and railroad industries. But note as well his clear message to Roosevelt. Either nationalize these industries so that you can directly raise their levels of investment, or stop subjecting them to legal hassles and the *threat* of nationalization, both of which almost guarantee low rates of capital investment.

Now one had hoped that the needed ... factors would be organised in time. It was obvious what these were -- namely increased investment in durable goods such as housing, public utilities and transport. ... Can your Administration escape criticism for the failure of these factors to mature? ... Housing is by far the best aid to recovery... ... In this country we partly depended for years on direct subsidies. There are few more proper objects for such than working-class houses. If a direct subsidy is required to get a move on..., it should be given without delay or hesitation.

Next utilities. ... Is it not for you to decide either to make real peace [with the privately-owned utilities] or to be much more drastic the other way? Personally, I think there is a great deal to be said for the ownership of all utilities by publicly owned boards. But if opinion is not yet ripe for this, what is the object of chasing the utilities round the lot every other week? *If I was in your place, I should buy out the utilities at fair prices*... But elsewhere I would make peace on liberal terms, guaranteeing fair earnings on new investments and a fair basis of evaluation in the event of the public taking them over.

Finally, the railroads. ... Whether hereafter they are publicly owned or remain in private hands, it is a matter of national importance that they be made solvent. *Nationalise them if the time is ripe.* If not, take pity on the overwhelming problems of current managements. ...

I am afraid I am going beyond my province. But the upshot is this. A convincing policy, whatever its details may be, for promoting large-scale investment under the above heads is an urgent necessity. Those things take time. Far too much precious time has passed.

...

Forgive the candor of these remarks. They come from an enthusiastic well-wisher of you and your policies. *I accept the view that durable investment must come increasingly under state direction. ... I regard the growth of collecting bargaining as essential. I approve minimum wage and hours regulation.* But I am terrified lest progressive causes in all the democratic countries should suffer injury, because you have taken too lightly the risk to their prestige which would result from a failure measured in terms of immediate prosperity. (437-38, emphasis added)

He repeated the core of this message in his response to Roosevelt's reply.

[F]urther experience since I wrote you seems to show that you are treading a very dangerous middle path. You must either give more encouragement to business or take over more of their functions yourself. If public opinion is not ready for the latter, then it is necessary to wait until public opinion is educated. Your present policies seem to presume that you possess more power than you actually have. (440)

At about the same time, in an address to life insurance executives, Keynes stressed that effective central planning was not a threat to economic and political "freedom," but the only way to preserve it. *Under modern conditions the effective choices were depression, war and totalitarianism, or state planning*.

For the difficulty of avoiding disastrous depression in the modern world can scarcely be exaggerated. ... A great deal is at stake. We are engaged in defending the freedom of economic life in circumstances which are far from favourable. We have to show that a free system can be made to work. To favour what is known as planning and management does not mean a falling away from the principles of liberty which could formerly be embodied in a simpler system. On the contrary, we have learnt that freedom of economic life is more bound up that we previously knew with deeper freedoms -- freedom of person, of thought, and of faith. (**21**, 446)[[127]](#footnote-127)

In September Keynes wrote an article reviewing a report evaluating technical change and the rapid rise in labor productivity over the past ten years. He was quite impressed with the data, but worried that the maldistribution of productivity growth across industries contributed to structural unemployment. He also concluded that there was a greater margin for growth in the economy than was generally assumed, even with the rise in military spending. *And he worried again about whether Britain could hope to successfully compete with the planned German economy unless she adopted her own democratic variant of planning.*

This helps to explain what may otherwise perplex us in the German economy. If British industry could be fully occupied at modern standards of efficiency, the additional output beyond what was sufficing for our needs a few years ago would be enough to provide a prodigious volume of resources available for purposes of peace -- or defence. ... We are still allowing a great volume of potential wealth to evaporate. ... How can we hope to keep pace with a form of government [in Germany] which has devised a means of producing and maintaining full employment? This is the critical task before us, if we are to maintain the supremacy of our own notions of what civilization should mean. (481-82)

In a supplementary note to this piece, Keynes argues that the combination of rapidly rising labor productivity and sluggish final demand was creating a situation in which the depreciation reserves of industry were more than enough to finance their new investment needs. In The General Theory he had warned about the disastrous consequences of this condition for long-term growth. Under these conditions,

it becomes increasingly improbable that anything approaching full employment can be maintained without normal loan expenditure by the Government on one ticket or another. At any rate, it is certain that in the last quarter century such a state of affairs has never existed, apart from very brief periods in abnormal conditions, in any industrial country in the world, except perhaps in the United States in 1928.

The problem thus presented is the outstanding problem of today, and cannot be solved by turning a blind eye to it. (483)

*Its solution, he adds, will require managed trade* -- the creation of "new and necessary machinery for linking up exports with imports, so as to make sure that those from whom we buy spend a reasonable proportions of the proceeds in corresponding purchases from us" (483).

In terms of a chronicle of the evolution of Keynes's thinking about policy and planning, early 1939 marks the end of an era. From here on, war spending and the war itself will substantially altery the economic and political context within which Keynes must struggle. In April he wrote:

The Chancellor of the Exchequer should frame his Budget on the assumption that the problem of abnormal unemployment will cease to exist during the financial year 1939-40, and that all plans and special provisions for dealing with this problem should be dropped forthwith as being a waste of time and money. (509)

He estimates that loan expenditure for the coming year would be on the order of £200 million greater than the previous year. *With a multiplier of about two, this would raise national income by 8 per cent and increase employment by well over one million. And there were immediate plans to add 200,000 young men to the military.* (532)

Government priorities, an acute shortage of skilled labour, trade union restrictions, the task of shifting workers to the districts where demand is greatest, the curtailment of unessential services -- all the problems of the last War -- are round the corner. (511)[[128]](#footnote-128)

But the restoration of full (and even overfull) employment would not change his belief that the era of *laissez-faire* ended with WWI, and that Britain would have to move, once the current war crisis ended, to an entirely new economic role for the state as the fulcrum of a democratic planned economy. The war effort would occupy his time and further drain his energy. *He was largely responsible for planning Britain's system of war finance, for creating Britain's proposals for a new post war international system, and for negotiating with the Americans over the structure of this system and the terms of the reconstruction loan.*

These efforts left him with limited time to devote to discussions of the post- war planning system. Nevertheless, *the historical record makes clear that Keynes's thoughts about post- war economic planning were completely consistent with the trajectory of his thinking through the 1920s and 1930s.* Perhaps the main difference was that**,** as the war unfolded, he became increasingly convinced that post-war state planning for full employment (as well as a more comprehensive social welfare system) was inevitable; **political reality would demand it**. The relevant question for Keynes, then, became not whether state planning would be created, but what its form and content should be.

The inevitability of post-war full-employment planning, which the war period cemented in his mind, seemed clear to Keynes before the war effort was even under way.

[T]he grand experiment has begun. If it works, if expenditures on armaments really does cure unemployment, I predict that we shall never go all the way to the old state of affairs. If we can cure unemployment for the wasted purposes of armaments, we can cure it for the productive purposes of peace. Good may come out of evil. We may learn a trick or two which will come in useful when the day of peace comes, as in the fullness of time it must. (532)[[129]](#footnote-129)

This theme is reflected in his correspondence with his sister Margaret in June 1939. She was on a Royal Commission studying the feasibility of a public Board responsible for the location of industry. Keynes reminded her that he had not written anything recently on the subject of a National Investment Board, that his first proposals on this "were not published in my own name," but included in the report of the Liberal Industrial Enquiry (in 1928), and that he had "got something similar somewhere into the report of the Macmillan Committee*." He then suggested that at war's end the Party in power would be likely to create some form of National Investment Board.*

My own feeling is that, when we are ready for reforms again, opinion will be found to have hardened a good deal in this direction. Any government except an ultra-Conservative one might be expected to make a beginning towards introducing it. I am interested that you are meeting with the argument that it is not possible to find work of a useful and public character to employ any very large number of men. This used to be the argument of Neville Chamberlain and the Government in the last slump. But most people, I had thought, had quite given it up. It is a wholly untenable position. It is some time since anyone had the face to use it in public. ... Anyhow, I should say that practically all reforming minds are in favour of making some move in the direction of the establishment of a National Investment Board.

... If a National Investment Board were to be set up, it would be most advisable that it should work in close collaboration with a Board for the location of industry. But the functions of the former body would go...very far beyond those of the latter... (591)

**VISIONS: 1939-42**

In January 1939 The New Statesman published an important "conversation' between Keynes and the editor Kingsley Martin; the topic was "Democracy and Efficiency." The main points stressed by Keynes are the urgent need for ambitious central planning in the new era and the complete compatibility of such planning with democracy and liberal values. He calls his preferred new system "***liberal socialism***."

Martin opens with this statement: "You have held that private capitalism is an out-of-date institution incapable of meeting the requirements of the twentieth century." Keynes responds: "I agree entirely" (492). He continued:

In contemporary conditions we need, if we are to enjoy prosperity and profits, *so much more central planning than we have at present that the reform of the economic system needs as much urgent attention if we have war as if we avoid it*. The intensification of the trade cycle and the increasingly chronic character of unemployment have shown that private capitalism was already in its decline as a means of solving the economic problem. But the breakdown of international good faith and the constant threats to peace are making it still more obvious that, quite apart from war, we have to move a long distance along that very road which actual war would make it imperative for us to take. ... But it is not the threat which the necessary [planning] measures might offer to personal liberty and democratic institutions which stands in the way of what wants doing to make us prosperous within and safe without. Any such threat is so remote from the first and the next and the next things that want doing, that it is not now, and is a long way from being, a practical issue. (492, emphasis added)

Since Keynes was quite familiar with the extreme degree of planning which war entails from his experience in government during WWI, his view that we had to go "a long way along that very road" even if war did not occur is quite informative.

Martin then asks: what is preventing the country from satisfying the "desperately obvious" need for planning? Keynes responds that, first, the public is lukewarm "towards the particular amalgam of private capitalism and state socialism which is the only practicable recipe for present conditions" (492). Second, the needed reforms are "not in tune with the inherited slogans" of any of the major political parties.

Keynes next stresses the importance of maintaining an important role for private property and private enterprise in a new system of planning because of their "profound connection" to personal and political liberty. But he immediately adds the caveat that he does not defend the "fact that the lawyers of the eighteenth century perniciously twisted this into the sanctity of vested interests and large fortunes..." Martin agrees.

I know of no more extraordinary confusion than that which identifies the right to own the fruits of one's own labour in pre-industrial society with the right of Mr Rockefeller or the Duke of Westminster to own the labour and control the conditions of life of thousands of other people. Surely the monopoly ownership of our day is one of the great enemies of liberty. But I agree that the right of personal property is inseparable from the conception of liberty, and that this confusion between personal property, which no intelligent Socialist has ever wished to take away from anyone, and property in the sense of the right to play the money market, and employ, sack or pay what wages one likes, has had very serious results. (493-94)

Keynes then takes up the question of the lack of sympathy for his views in the Parties. The problem is not that there are no sympathizers within each Party; there are in fact many liberals (with a small letter l) in all three. But their views lack "organised expression."

There is no one in politics today worth sixpence outside the ranks of liberals except the post-war generation of intellectual Communists under thirty five. Them, too, I like and respect. (494-95)[[130]](#footnote-130)

Martin suggests that the political situation is hopeless unless liberals and Communists can work together, which is why he finds the anti-communism of the Labour Party so disturbing -- "they seem intent rather on fighting their own left than on providing an alternative to the capitalist governments they are supposed to be opposing" (496). Keynes agrees.

Yes; the attitude of the official Labour Party towards all this strikes me as one of the silliest things in the history of British politics. ... I sympathise with Mr Bevin in fighting shy of contact with the professional Communists, regarding their body as a Trojan horse and their overtures in doubtful faith. But I should risk contact all the same, so as not to lose touch with the splendid material of the young amateur Communists. For with them in their ultimate maturity lies the future... (495-96)

Keynes then moves on to another major obstacle to the radical changes needed in the economic role of government -- the Civil Service. *This is extremely important to Keynes because of his belief that planning must be conducted primarily by "expert" civil servants, not politicians.*

[T]he present heads of our Civil Service were brought up in, and for they part still adhere to, the *laissez-faire* tradition. For constructive planning the civil servants are, of course, much more important than Ministers; little that is worth doing can be done without their assistance and good will. There has been nothing finer in its way than our nineteenth-century school of Treasury officials. Nothing better has ever been devised, if our object is to limit the functions of government to the least possible and to make sure that expenditure, whether on social of economic or military or general administrative purposes, is the smallest and most economical that public opinion will put up with. But if that is not our object, then nothing can be worse. *The Civil Service is ruled today by the Treasury school, trained by tradition and experience and native skill to every form of intelligent obstruction.* And there is another reason for the heads of the services being what they are. We have experienced in the...years since the War two occasions of terrific retrenchment and axing of constructive themes. This has...inevitably led to the survival and promotion of those to whom negative measures are natural and sympathetic. ... I am afraid that they are becoming a heavy handicap in our struggle with the totalitarian states and in making us safe from them. (496-97, emphasis added)

Finally, Martin observes that the totalitarian states have been able to use central planning to fully utilize their national economic capacity, but unfortunately this success is directed towards war and "has wiped out liberty, decency and indeed almost everything that makes life worth living." As a result, "we in Britain are doomed unless we can make the essential changes quickly and without these unnecessary and appalling sacrifices" (499-500). "Yes. That is the truth," Keynes replies. But he adds that there is no need to be concerned about such losses in Britain, at least not for a long time to come. "I say that we are so far from such a situation that the risk does not now exist" (500). He concludes his remarks with a call for "liberal socialism" in Britain.

The question is whether we are prepared to move out of the nineteen-century laissez-faire state into an era of liberal socialism, by which I mean a system where we can act as an organised community for common purposes and to promote economic and social justice, whilst respecting and protecting the individual -- his freedom of choice, his faith, his mind and its expression, his enterprise and its property. (500)

In April 1942 Keynes gave a radio address as part of a BBC series on post-war planning. His subject was the financial aspects of planning, though most of the talk was devoted to general prospects for state planning after the war. As in virtually all of his 1940s writings, his enthusiasm for state planning is undiminished and his view of its economic potential is, if anything, more optimistic than before.

Keynes first comments on the critical difference in public expectations about the retention of the war time economic controls into the post war era between the first and second wars.

In 1919 public opinion and political opinion were determined to get back to 1914 by scrapping at the first possible moment many of the controls which were making the technical task [of war planning] easier. I do not notice today the same enthusiasm to get back to 1939. I hope and believe that this time public opinion will give the technicians a fair chance by letting them retain so long as they think necessary many of the controls over the financial machinery which we are finding useful, and indeed, essential. (27, 266).

*The central objective of planning is the achievement of full employment, the "second task" the avoidance of excess-demand induced inflation.* The initial priority must be to meet the minimum daily needs of the country and to rebuild the export industry. Reconstruction through public investment requires surplus production beyond these two necessities. A major theme is that the potential for reconstruction and renewal through planning is enormous -- though care must be taken to avoid haste and inefficiency.

To make sure of good employment we must have ready an ample programme of re-stocking and of development over a wide field, industrial, engineering, transport and agriculture -- not merely building. Having prepared our blue-prints, covering the whole field of our requirements and not building alone -- and these can be as ambitious and glorious as the minds of our engineers and architects and social planners can conceive -- those in charge must then concentrate on the vital task of central management, the *pace* at which the programme is put into operation, neither so slow as to cause unemployment nor so rapid as to cause inflation. ...

... It is extremely difficult to predict accurately in advance the scale and pace on which [building and construction plans] can be carried out. In the long run almost anything is possible. Therefore do not be afraid of large and bold schemes. Let our plans be big, significant, but not hasty.[[131]](#footnote-131) (268)

The key to an efficient construction plan is consistency: the building industry cannot be made to grow and shrink in short order. It is essential that there be a believable commitment to a *long-term* plan. The firm expectation of *sustained* full employment is crucial to the success of all parts of the plan. "For if the building industry is to expand in an orderly fashion, it must have some assurance of continuing employment for the larger labour force" (268, emphasis?).

Keynes then makes some crude guesses about the likely initial level of construction spending in the immediate post-war period.

Now these are very large sums. Continued, year by year, over a period of ten years or more, they are enormous. We could double in twenty years all the buildings there are now in the whole country. We can do almost anything we like*, given time*. We must not force the pace -- that is necessary warning. In good time we can do it all. But we must work to a long-term programme. (269,emphasis in original)

It is not just the provision of the basic necessities of daily life that can be achieved through successful planning. Properly designed and implemented, *state planning can enormously enrich social, cultural and public life in Britain as well* -- *it can create the "New Jerusalem."* **Keynes's commitment to, and optimism about, an ambitious scheme of *long-term* postwar planning is unmistakable here**.

I should like to see that the war memorials of this tragic struggle take the shape of an enrichment of the civic life of every great centre of population. Why should we not set aside, let us say, £50 million a year for the next twenty years to add in every substantial city of the realm the dignity of an ancient university or a European capital to our local schools and their surroundings, to our local government and its offices, and above all perhaps, to provide a local centre of refreshment and entertainment with an ample theatre, a concert hall, a dance hall, a gallery, a British restaurant, canteens, cafes and so forth. Assuredly we can afford this and much more. Anything we can actually *do* we can afford. Once done, it is *there*. Nothing can take it from us. ...

Yet these must be only the trimmings on the more solid, urgent and necessary outgoings on housing the people, on reconstructing industry and transport and on re-planning the environment of our daily life. Not only shall we come to possess these excellent things. With a big programme carried out at a regulated pace we can hope to keep employment good for many years to come. We shall, in fact, have built our New Jerusalem out of the labour which in our former vain folly we were keeping unused and unhappy in enforced idleness. (270,emphasis in original).

**State Planning and Public Investment: 1941-45**

In October 1941 the Government set up an inter-departmental Committee on Post-War Internal Economic Problems, which included the Treasury and the Economic Section of the War Cabinet, charged with identifying prospective major economic problems of the post-war era, analyzing them, and recommending solutions to the appropriate Ministers. Keynes was involved with a good deal of the Committee's efforts.

One of the key roles played by Keynes in these discussions was to serve as a counter-weight to the pessimism of the Treasury - including his old friend and collaborator Hubert Henderson who was now a conservative- about post war prospects. The Treasury foresaw a few years of inflationary boom followed by a downturn and slow growth -- as was the case after WWI -- as well as a slow rate of technical progress. *All of Keynes's interventions assumed fairly rapid technical progress, and an average rate of unemployment after the war of at most 5 per cent as the result of effective planning.* "I do not at all share the pessimism" in Henderson's memo, Keynes asserted. "I think the memorandum greatly under-estimates the consequences of full employment and of the improvement in technical production, which will not cease to take place but will in some directions have been even accelerated during the war period." (272) This debate affected all others; it obviously made an enormous difference to the potential generosity of social welfare policy, for example, whether the economy would be in a slump or running at full capacity.[[132]](#footnote-132) The paper co-authored by Keynes and Richard Stone on "National Income and Expenditure After the War" (27, 280-98) formed the centerpiece of the debate.

One of the strongest of Keynes's arguments in support of his working assumption of an unemployment rate of 5 per cent or less *was his continued insistence that the post-war public would not politically tolerate anything worse*. *The high unemployment rates of the interwar years would no longer be politically feasible after the war once the public had experienced the effectiveness of wartime planning and had irrefutable evidence that the state could maintain full employment through planning if it had the will to do so.* Put somewhat differently, the working class that had sacrificed and died for King and country in the war would not meekly return to economic stagnation and penury thereafter. He forcefully reminded the reader of this political fact of life.

But it is quite a misunderstanding to suppose that the 5 per cent [figure I have been assuming] is a prophesy of what will happen if nothing is done and pre-war methods, generally speaking, are continued. Mr Stone and I chose as our basic assumption [5 per cent unemployment], chiefly on the ground that it seemed to us that this was about the highest that the public would stand in post-war conditions without demanding something very drastic to be done about it, coupled with the fact that it did not seem to us impracticable to take drastic steps which would bring down the figure to this total. If one was to put in, as Sir H. Henderson suggests, a figure approaching 2 million men normally out of work after the war [or 12.5 per cent unemployed], I should have expected the rejoinder that we were wasting our time in assuming a situation which could not possibly happen. (299)

Keynes reinforced this position in a memo written the next day.

I consider [5 per cent] rather on the pessimistic side. It certainly does not assume a continuance of the pre-war situation. ... That is to say, we are assuming a reasonable government policy in the face of the actual circumstances and the change which will have taken place in public opinion in the light of war experience as to the practical possibilities of keeping unemployment at a reasonable figure.

I am afraid I am quite impenitent after having read the comments up to date about our assumptions being too optimistic. Indeed, further reflection is leading me, if anything, rather in the other direction. (303-04).[[133]](#footnote-133)

Some of Keynes's early 1940s comments on post-war policy were stimulated by the reorganization of Britain's social welfare system proposed by William Beveridge. He tried to help Beveridge get serious government consideration for his proposals by suggesting cost reductions on the one hand and arguing against a pessimistic Treasury that post-war economic conditions would not be prosperous enough to afford any reasonable variant of the program on the other.[[134]](#footnote-134) His correspondence on the Beveridge plan was substantial. Moreover, Keynes devoted the draft of his maiden speech before the House of Lords on February 24, 1943 to support of the Beveridge Report, arguing that it was unlikely to create substantial budgetary problems, even in the long run.[[135]](#footnote-135) His optimism was based in part on the assumption that the degree of technical progress between 1938 and the early post war years was likely to be substantial. "We could increase output in both industry and in agriculture by at least 50 per cent compared with 1938 merely by putting to work modern methods and techniques that already exist" (259). He then issued a general call to defeat the pessimists who oppose comprehensive social welfare reform out of fear that it will be too expensive -- it was Keynes's "we have nothing to fear but fear itself" speech.

The future will be what we choose to make it. If we approach it with cringing and timidity, we shall get what we deserve. If we march on with confidence and vigour the facts will respond. It would be a monstrous thing to reserve all our courage and powers of will for War and then, crowned with victory, to approach the Peace as a bunch of defeatists.

... The real problems of the future are first of all the maintenance of peace, of international co-operation and amity, and beyond that the profound moral and social problems of how to organise material abundance to yield up the fruits of a good life. (260-61)

Meanwhile, James Meade, who was attached to the Economic Section of the War Cabinet, had proposed that automatic variations in the contributions to the social insurance fund be used as part of counter-cyclical fiscal policy after the war. In May 1942 Keynes wrote Meade that while he found the plan interesting, he thought there were rather tight limits on the extent to which one can stabilize consumption in the face of downturns caused by reductions in investment demand. (His enthusiastic support for relying on public control of most capital investment as the foundation of high long-term or secular growth was unabated.) "One can perhaps prevent an aggravation of the falling off of effective demand by stabilising consumption," he wrote, "but that is the best one can hope for" (207).[[136]](#footnote-136) On the other hand, he wrote more optimistically to Sir Richard Hopkins of the Treasury.

Mr Meade will be putting forward a proposal, which I think deserves consideration, namely, that the amount of contribution from employers and employed to the Social Security Fund should vary in amount according to the state of employment, rising when unemployment falls below a critical figure and falling when it rises above it. (278)

Since, under the Beveridge plan, contributions for social security could be made to fluctuate between £400 million and zero per year, "there is a fairly large sum to play with, quite free from the objections to interfering with the normal tax system for such a purpose" (278).

In this memorandum Keynes tried to clarify the Treasury's understanding of his budgetary proposals. Keynes projects that total national debt would rise for many years due to war borrowing and the need to raise loan-financed public investment substantially in the post-war years. He wanted Current budget surpluses to be transferred to the capital Budget Sinking Fund to hold down the rate of increase of the debt. Over their lifetimes, of course, the investment projects would be expected to be more or less self financing. Keynes also reiterates his belief that fluctuations in public investment should be the main tool of counter-cyclical policy.

I should aim at having a surplus on the ordinary Budget, which would be transferred to the capital Budget, thus gradually replacing dead-weight debt by productive or semi-productive debt on the lines which the Government of India have successfully pursued for many years. But this would not involve repayment of debt, since I should expect for a long time to come that the government debt or government-guaranteed debt would be continually increasing in grand total.

It is probable that the amount of such surplus would fluctuate from year to year for the usual causes. But I should not aim at attempting to compensate for cyclical fluctuations by means of the ordinary Budget. I should leave this duty to the capital Budget. (277-78)

Correspondence with Meade later in the year again showed restrained enthusiasm. One problem was that Meade was using a long-run assumption in a short-term argument according to Keynes, in asserting that the reduction in employers' contributions in the presumably short-term downturn would lead them either to increase jobs (due to increased profit margins) or to substantially cut prices. These are "likely not to happen at all precisely because the reduction in question is by hypothesis temporary." He suggested that Meade limit the proposal to employees' contributions, where there might be more bang-per-buck. Still, he agreed, it was an "important and interesting contribution to a vital problem" (311).

His last important correspondence on the Meade proposal was a memo to the Treasury defending it against Treasury critics. The memo opens with a reference to "the great potentialities of the Meade proposals." It then restates Keynes's core assumption that virtually everyone now believes that the state should and will take responsibility for the maintenance of full employment through aggregate demand management at war's end.

[Meade] was assuming that measures of increased general purchasing power as a cure for unemployment were now widely approved, both by experts and the general public, and he was considering the best technique for injecting purchasing power, assuming one wishes to do so. (311)

Keynes next discussed the merits of Meade's proposal, which suggested that social insurance contributions should drop by about 1 per cent of national income for every 2 per cent rise in the rate of unemployment above its target level. "The multiplier is generally taken as being, in this country, a trifle above 3," but Keynes assumes a value of 2 for purposes of analysis. Given this assumption, he argues that the mechanism might function effectively.[[137]](#footnote-137) But, he warns, "neither Meade nor anyone else has suggested that his proposal is in fact adequate *by itself* to maintain a constancy of employment. But he can argue, I think, that its quantitative effect is highly significant relative to the evil it attacks" (312). This statement reflects Keynes's own assessment of the Meade proposal. First, he believed that fluctuations in investment, not consumption, should be the first counter-cyclical line of defense. Second, Meade's plan, especially if focused on employees' contributions as Keynes suggested, might be an effective secondary instrument of support.

Keynes's memoranda and letters to other government officials about post war economic planning during 1943 are of the greatest possible significance to anyone interested in the policy views of the mature and supposedly more conservative Keynes.[[138]](#footnote-138) In 1944 his attention would be focused almost exclusively on British-American negotiations over the shape of the post war international financial system and the size and character of the American loan. Thus, it is primarily to the 1943 writings that we must turn to assess whether his commitment to state planning centered on publicly controlled investment (facilitated by capital controls and managed trade) -- first announced in 1924 -- matured and deepened or, as is sometimes claimed, evaporated as he became more conservative towards the end of his life.

In January 1943 James Meade wrote Keynes a fascinating letter in which he tried to get Keynes to take the lead in the internal government debate over post-war employment policy. It was a flattering letter, with an offer that, if Keynes accepted the writer's premises, would seem awfully hard for him to refuse. It essentially asked Keynes to write the definitive government report on post-war domestic economic planning. Of course, he was already in charge of creating Britain's approach to post-war international economic planning and of trying to get the Americans to accept its general principles.

The great public support which the Beveridge Report has received has suggested to me that there ought really to be a similar publication on the subject of post-war employment. The enthusiastic public reception of the social security proposals shows that there is an exceedingly strong feeling in the country about post-war internal reconstruction and that people are in such a mood as they have never been before for the reception of imaginative ideas for social reform. ... People do not realise that the Government is giving any serious attention to [the prevention of large scale post war unemployment] and it would be my guess that a really imaginative approach to this problem would now have such a reception as permanently to influence the course of post-war policy.

... A public investigation and report on this topic should not be very politically controversial, but would put new heart into the public and would probably ensure once and for all that a sensible government policy in this field would in fact have to be adopted by any post-war government.

...

It may be that there are better methods of getting these ideas across, but it occurs to me, to be quite frank, that what we really require is a Keynes Report to follow up the Beveridge Report. (314-15)

Keynes wrote what seems to me to be a surprisingly brief - 13 line - and surprisingly negative reply to such a stimulating and attractive proposition. Keynes was rarely bashful about taking the lead on key policy issues. His reply said that three key differences between post-war social welfare and post-war employment policies informed his negative response. First, policy planning cannot be concretized and neatly packaged into the precise form required for legislation, and no new legislation is necessary to get the job done: "Post-war unemployment is far less a question of a really concrete plan and would involve little, if any, definite legislation." Second, the operation of employment planning will depend on the nature of the new international financial institutions, the size of the U.S. loan, and the state of British exports: "it is very much more mixed up with external policy." Third, several government bodies are already working on the problem and progress is being made:

Above all, all sorts of aspects of it are already being worked out by different Departments and by various Hurst Committees. It seems to me impossible to have a new commission working alongside all the present activities. Moreover, it is much too soon to decide that those activities are not being quite well and fruitfully conducted. (315)

Work on post-war employment planning moved ahead. James Meade contributed a paper on the maintenance of full employment to the inter-departmental Committee on Reconstruction Priorities. He wrote Keynes a letter about it, stressing concerns with Keynes's insistence that the budget be divided into a current and a capital budget, with the former kept strictly in balance. His paper argues that the state should control investment so as to prevent serious fluctuations in national income, but he is concerned that the level of such investment could not be always altered "fully and promptly" enough to do the job. In this case, tax cuts to stimulate consumption might be needed. His plan for counter-cyclical social insurance contributions would help, especially because they are "an instantaneous automatic stabiliser" (318). But they might not pass into law. And the state must consider situations where it foresees a future slump in demand coming and needs to cut taxes in anticipation of it. But this requires the freedom to run intentional budget deficits.

[W]e must be free to plan taxation (and so the deficit of the current budget) ahead. I conclude, therefore, that we want both a potent `instantaneous automatic stabiliser' such as the social security scheme and freedom to plan ahead year by year for a deficit or a surplus in the current budget; and I fear that the latter freedom would be prejudiced by a division of the budget. (318)

The main point made in Keynes's response is that fluctuations in investment, not consumption, should be the center piece of counter-cyclical policy. If there is need for a cyclical stimulus to aggregate, new investment projects from the portfolio of potential investments prepared by the national investment board should be undertaken sooner and/or ongoing projects should be accelerated. There are two reasons why this is the case. First, since people have customary standards of living which they will not alter substantially in the face of temporary changes in income, a counter-cyclical policy that relies primarily on shifting tax burdens on consumers will not work.

People have established standards of life. Nothing will upset them more than to be subject to pressure constantly to vary them up and down. A remission of taxation on which people could only rely for an indefinitely short period might have very limited effects in stimulating their consumption.[[139]](#footnote-139) And, if it was successful, it would be extraordinarily difficult from the political angle to reimpose the taxation again when employment improved. (319)

To the extent that changes in personal tax rates are used for this purpose, Keynes prefers the automatic stabilizer property of Meade's social insurance scheme to discretionary changes in income tax rates. Not only is Meade's plan automatic, but it puts purchasing power into the hands of the working class, who are most likely to respond with some alteration of spending. Income tax cuts involve "a huge time lag" between policy change and consumer response and "short-run changes are most inconvenient" politically (319).

Second, there are several positive reasons to rely primarily on raising public investment to sustain employment in the face of declining demand. The state already has the power to alter public investment. And recessions provide an opportunity to accelerate the pace of capital accumulation which is desirable for reasons independent of its ability to raise aggregate demand: "it is better for all of us that periods of deficiency expenditure should be made the occasion of capital development until our economy is much more saturated with capital goods than it is at present" (320).

Finally, public investment is less likely than income tax cuts to raise budget deficits. Of course, it had been Keynes's consistent position that the investment projects he envisioned would have positive gross, if not net, expected present value, and, therefore, involve at most very modest direct budgetary subsidies that would likely be more than compensated over time by the tax revenues increases, user fees and unemployment compensation reductions they induce. Tax cuts are

a much more violent version of deficit budgeting. Capital expenditure would, at least partially, if not wholly, pay for itself. ...

Moreover, the very reason that capital expenditure is capable of paying for itself make it much better budgetwise and does not involve the progressive increase of budgetary difficulties, which deficit budgeting for the sake of consumption may bring about or, at any rate, would be accused of bringing about. (320).

Hubert Henderson circulated a pessimistic critique of Meade's memorandum on employment policy. Keynes then wrote a critique of the Henderson analysis - "The Long-Term Problem of Full Employment" - in May 20, 1943. He begins by explaining that the institutions and social practices prevalent at war's end would determine the level of savings generated at full employment. He called this the "indicated" level of savings. The main task of employment policy was to see that investment equaled the indicated savings level.

There were likely to be "three phases" of the post-war era. The immediate post-war years were likely to see a boom fueled by pent-up demand, with an excess of investment over indicated savings "in the absence of rationing and other controls." This would be phase one. Phase two would be the crucial era

when the urgently necessary investment is no longer greater than the indicated level of savings in conditions of freedom, but it is still capable of being adjusted to the indicated level by deliberately encouraging or expediting less urgent, but nevertheless useful, investment. (321)

Phase three would begin when the point Keynes called *"capital saturation"* was achieved, when all potentially productive capital investments had already been made; "*when investment demand is so far saturated that it cannot be brought up to the indicated level of savings without embarking upon wasteful and unnecessary enterprises"* (321, emphasis added).

Keynes had discussed this prospect in The General Theory and elsewhere. It is an idea which only begins to make sense if one is aware that he expected the state to undertake a major long-term program of capital accumulation as the central component of employment policy. He was not, as we have constantly stressed, proposing that budget deficits be used to maintain full employment while the decision on the size and composition of investment is left to the profit motive and the private sector. If one considers the grand ambition of this public investment program and the vast field of its potential application, it becomes somewhat easier to envision a point at which, at least for the intermediate future, most of the attractive economic, social and cultural infrastructural projects will have already been implemented. At this point, Keynes had argued, fiscal policy should begin to shift its emphasis from public investment to tax cuts designed to progressively redistribute income both for the sake of social justice and to raise the propensity to consume.[[140]](#footnote-140)

In the first phase, demand will have to be restrained by controls on all kinds of investment, on consumption rationing "and the like." Guiding the economy through this will be a "ticklish business" he admits: it "will require a sensitive touch and the method of trial and error operating through small changes" (322). This phase might last five years - "it is anybody's guess." The middle phase is the crucial period. Keynes's vision for planning in this period is quite clear and consistent with all his thinking in the previous two decades. Since this quotation is from 1943, it clearly demonstrates that he did not abandon the bold ambition of his radical policies during the war.

Sooner or later it should be possible to abandon both types of controls [on private consumption and investment] entirely (apart from controls on foreign lending). We then enter the second phase which is the main point of emphasis in the paper of the Economic Section. **If two-thirds or three-quarters of total investment is carried out or can be influenced by public or semi-public bodies, a long-term programme of a stable character should be capable of reducing the potential range of fluctuation to much narrower limits than formerly,** when a smaller volume of investment was under public control and when even this part tended to follow, rather than correct, fluctuations of investment in the strictly private sector of the economy. ... *The main task should be to prevent large fluctuations by a stable long-term programme*. If this is successful it should not be too difficult to offset small fluctuations by expediting or retarding some items in the long-term [investment] programme. (322, emphasis added)

Keynes goes on to acknowledge that the size of public investment spending that will be required to maintain full employment is impossible to accurately predict, but in any case it will be quite large.

It will depend on the social habits and propensities of a community with a distribution of taxed income significantly different from any of which we have experience, on the nature of the tax system and on the practices and conventions of business. But perhaps one can say that it is unlikely to be less than 7.5 per cent or more than 20 per cent of the net national income, except under new influences, deliberate or accidental, which are not yet in sight. (323)

Keynes states that the secular trend of public investment in phase two should be set so as to maintain full employment, which, as he has made abundantly clear, refers to a measured unemployment rate of at most 5 per cent and no less than 3 per cent. Of course, uncontrolled and even unforeseeable shifts in private segments of aggregate demand will, from time to time, generate disequilibrium problems. But he is also clear, again, that deliberate fluctuations in the pace of public investment must bear the primary burden of counter-cyclical policy as well. Changes in tax rates to affect consumption along with their attendant impact on the budget are to play a subsidiary role even in counter-cyclical policy.

Emphasis should be placed primarily on measures to maintain a steady level of employment and thus to prevent fluctuation. If a large fluctuation is allowed to occur, it will be difficult to find adequate offsetting measures of sufficiently quick action. This can only be done through flexible methods by means of trial and error on the basis of experience which has still to be gained. If the authorities know quite clearly what they are trying to do and are given sufficient powers, reasonable success in the performance of the tasks should not be too difficult.

I doubt if much is to be hoped from proposals to offset unforeseen short-period fluctuations in investment by stimulating short-period changes in consumption. But I see very great attractions and practical advantage in Mr Meade's proposed for varying social security contributions according to the state of employment. (323-24)

*Keynes is surprisingly -- even shockingly -- optimistic about the pace at which the "golden age" of capital saturation can be achieved*. Whereas in The General Theory he speculated that a "generation" might be enough time, here he suggests that it could be as soon as "five or ten years" (323). On the other hand, by way of balance, he warns that "the saturation of investment is far from being in sight" (324). And, a few months later, estimates it will take "twenty years of large-scale investment" (350). In any case, once the third phase does appear imminent:

It becomes necessary to encourage wise consumption and discourage saving, -- and to absorb some part of the unwanted surplus by increased leisure, more holidays (which are a wonderfully good way of getting rid of money) and shorter hours.

Various means will be open to us with the onset of this golden age. The object will be slowly to change social practices and habits so as to reduce the indicated level of saving. Eventually depreciation funds should be almost sufficient to provide all the gross investment that is required. (323)

Keynes concludes this particular intervention by associating himself with certain general perspectives expressed in Henderson's paper. He approvingly quotes Henderson as follows.

Opponents of Socialism are on strong ground when they argue that the State would be unlikely in practice to run complicated industries more efficiently that they are run at present. Socialists are on strong ground when they argue that reliance on supply and demand, and the forces of market competition, as the mainspring of our economic system, produces most unsatisfactory results. Might we not conceivably find a *modus vivendi* for the next decade or so in an arrangement under which the State would fill the vacant post of entrepreneur-in-chief, while not interfering with the ownership or management of particular businesses, or rather only doing so on the merits of the case and not at the behest of dogma?[[141]](#footnote-141) (324)

Sir Wilfred Eady, a high ranking Treasury official, wrote Keynes a note in which he agreed to the circulation of his critique of Henderson. But, he added, Keynes's ideas are "a voyage in the stratosphere for most of us. ... You will find you official colleagues obtuse, bat-eyed and obstinate on much of this!" (325) Keynes was not amused.

Very sorry, but it does seem to me quite essential that all of you should become accustomed to the stratosphere -- if that really is what it is! For, if the argument which I have tried to bring into the open in my paper is not understood by those responsible, they are understanding nothing whatever. ...

And, after all, it is very easily understood! There is scarcely an undergraduate of the modern generation from which these truths are hidden. And once they have been digested and have entered into the apparatus of the mind, it is possible for most people to move fairly safely over a terrain otherwise most dangerous. (325-26)

Keynes sent his note along to Meade, with an accompanying letter evaluating Meade's employment paper. He criticized Meade's short-run focus, noting his own stress on the use of public investment to influence the long-term trajectory of the economy.

The note suggests that the "Keynesianism" that dominated macro economics in the post-war period inverted Keynes's approach to policy. The post-war "Keynesians" taught that Keynes's policy was strictly limited to counter-cyclical fiscal and monetary intervention. They taught either that Keynes wasn't interested in the long run - "In the long run we are all dead" - or that free markets, under the guidance of "perfect" competition, would achieve the optimal growth rate if macro policy kept cycles constrained. This was the celebrated "Keynesian-Neoclassical Synthesis."

**[All these quotes are from Volume 27 Activities 1940-46P Shaping the Post-War World Employment and Commodities]**

We have seen that the assumption that intense competition forces free markets to function optimally was totally rejected by Keynes, and that he believed that overwhelming focus of policy must be on the long run, not on cycles. He repeats here his insistence that the key to post-war prosperity was state control of "the bulk of investment" with the growth rate of capital accumulation selected to sustain full-employment over time. His readers understand that to be successful, this policy must be supported by permanently low interest rates -which itself must be supported by strict capital controls, managed trade, and other dimensions of effective industrial policy. By assuring a relatively constant rate of capital accumulation, the state could provide a knowable center of gravity for the rate of economic growth that would drastically reduce private corporations' sense of uncertainty, thereby making private investment more stable as well.

(1) I think you lay too much stress on cure and too little on prevention. It is quite true that a fluctuating volume of public works at short notice is a clumsy form of cure and not likely to be completely successful. On the other hand*, if the bulk of investment is under public or semi-public control and we go in for a stable long-term programme, serious fluctuations are enormously less likely to occur.* I feel, therefore, that you do a little less than justice to investment under public auspices by emphasising the deficiencies of this method in the short period, *whilst underestimating their efficiency for preventative purposes and as a means of avoiding the sharp fluctuations which, once they have occurred, it is so difficult to offset*.

(2) I have much less confidence than you have in off-setting proposals which aim at short-period changes in consumption. I agree with Henderson that one has to pay great attention to securing the right long-period trend in the propensity to consume. But the amount one can do in the short period is likely to be meagre. (326)

Keynes concluded the letter with a rather puzzling comment -- that there was no reason for the government to immediately begin work on the design and implementation of the structures of state investment planning. This seems quite strange given the ambitious goals he had set for government planning and the obvious necessity for institutional innovation and strategic planning if his hopes were to have any chance of fulfillment at war's end -- not to mention Keynes's own statements about the need to create new planning institutions. Moreover, some set of fairly elaborate government economic controls would have to be used in phase one to guide the economy, and decisions would thus have to be made about the relation of these controls to the phase two planning apparatus.

It did not seem to me that Henderson's document was really inconsistent with yours. It was largely concerned with a more distant period. Both of you are getting a little too academic for the purposes of the Ministers. The only matters about which it is necessary that they should take immediate decisions relate to the first phase, whereas you, as it seems to me, are largely concerned with the second phase, and Henderson with the third phase. (326)

James Meade saw the fundamental problem in Keynes's position on this. In early June, he and Keynes had exchanged two quite important letters concerning Meade's belief that the government had to begin decision-making about the phase-two post war planning system now. Meade's letters outline in some detail the important tasks that the government had to confront at the moment in order to be in a position at war's end to successfully plan the post-war economy. Their importance lies in the fact that Keynes expresses his complete agreement with Meade on key issues on which he himself had not been as forthright as might have been expected. We learn more of his own thinking on these issues through his agreement with Meade. For this reason, we quote Meade at substantial length. The first letter implored Keynes to prod the government to begin *now* to create the institutions and policies that would be needed in phase two.

I confess, however, that I cannot so readily assent to your suggestion that Ministers need not at the moment take decisions relating to anything later than the first post-war period in which supplies will be scarce and effective demand will be high. There are a number of reasons for taking the opposite view:

(i) ... If it is *possible* (even if it were not probable) that we shall, after two years of peace, be back where we were in the 1930s, Ministers should by the end, say, of the first year of peace have taken more or less final decisions on the broad lines on which they intend to deal with the situation. In view of all the complex problems they will have to deal with in the post-war period and of the hectic political situation in which they will have to operate, it is certainly not too soon for them to start work on this subject now in the calm of war.

(ii) Much work *has* already been done and many decisions by Ministers *have* already been taken on the immediate post-war problems. ... Having taken general decisions on the first stage, and having started detailed work on that stage, they are being asked now to prepare to take general preliminary decisions on a stage only a little further on.

(iii) What we plan to do in the immediate post-war transitional period should be related to our longer aims. There is a grave danger that Whitehall will plan to deal with these immediate transitional problems as if the problems were completely separate from the subsequent problems [of phase two]. For example, Civil Servants always treat the problems of `physical reconstruction' and of `public works policy' as if they existed in separate universes. In your note you properly show that, fundamentally, the same analysis applies to the three periods which you analyse; and the same should be true to a certain degree in our administrative mechanisms for dealing with them. In fact, some of the immediate post-war mechanisms...can be used to stabilise and stimulate as well as restrain, and it might be wise to turn these into more or less permanent features of the economy from the start. Is it, for example, really political wisdom to suppose that we shall have any chance of success if we put off discussing the scheme for variations in social security contributions until the close of the transitional period...when the willingness on the part of politicians to consider radical change will have passed? This is the surest way to assure that we shall get no [radical change].

(iv) ... The public are, I am told, more concerned about employment prospects after the war than about any other post-war issue. As the prospects of victory become clearer, this public interest will become more and more marked. Already Beveridge has set up his bureau to deal with the problem.[[142]](#footnote-142) He will probably get the answer wrong; but if his is the only answer in the field, and if the Government has not its own answer ready (and an answer which does not refer merely to good projects for employment for a year or so after the war) there will be another first-class political row.

(v) Finally, I feel it would be truly tragic if this opportunity were lost. The policy which is advocated is one which is in the interests of all political parties[[143]](#footnote-143); it is one for the success of which intellectual enlightenment rather than a change of heart is required and we have at the moment the unique opportunity of all political parties in a government which is seriously willing to consider social innovations. The opportunity is unlikely to recur. Perhaps you would allow me to add the personal note that, in these matters of a full employment policy, I have always regarded you as the guiding intellect and the moving force; and I believe that in this I am typical of the younger generation of economists. (327-29, emphasis in original)

Keynes's response to this second intriguing, imploring and flattering letter from Meade was again surprisingly brief -- ten lines this time. One senses his sympathy with Meade on the general issues, yet he claims to not understand precisely and concretely what it is that Meade wants him to agitate to get the Ministers to do. He tells Meade:

I should find it easier to say whether I agree with you that there are further decisions which Ministers ought to take in the near future if you would tell me what the decisions are which you think they ought to take.

You will have noticed that in my paper I deliberately excepted your social security contributions proposal from deferment. I agree with you that it deserves early consideration. But I am not clear what else there is, which does not depend on the actual progress of events for it to be ripe for ministerial decision at this stage. (329-30)

Meade responded to Keynes's letter with one of his own the very next day listing important issues on which "Ministers might fruitfully take decisions in the near future."

(i) We are agreed that the social security contributions proposal falls into this category. ... [I]f for some reason or another it should be rejected, Ministers should then proceed to consider the possibility of continuing into normal times of peace a scheme of deferred income tax credits...

(ii) *There are decisions which should be taken now on the control of investment. It should be realised that the forward planning, control and timing of public investment is important both in the immediate transitional period, in order to restrain and spread out the demands for physical reconstruction, and also in the longer period for the stimulation of such investment.* For example, it might be decided, in principle, that public authorities should prepare and revise annually a five-year plan for their future capital works, and this should be reviewed periodically by a central body for the purpose of the timing of expenditure. Certain inducements might be considered to persuade local authorities to keep in step with such a plan, e.g., by varying the rate of state grants for different types of works, according to the period in which they were undertaken. Here surely is a field of action and of administration, which is equally relevant to the immediate -war period of restraint and to the subsequent period of stimulation. The danger is that if Civil Servants and Ministers concentrate exclusively on *ad hoc* mechanisms of restraint immediately after the war, they will fail to have built their controls in such a way which will also be useful for stimulation later on. ...

(iii) I am pretty sure that the same principle might be applied in perhaps a lesser degree to the control of private investment. Various measures will be used immediately after the war for its restraint. Which of these measures of control will, and which will not, be useful after to stimulate private investment. The question should be considered now, since it should influence the way in which the controls are constituted in the immediate post-war transitional period.

(iv) ... We have suggested in our paper...that it may be worth while controlling the terms of hire-purchase finance [i.e, purchase of goods on an installment plan] in such a way as to impede such purchases when restraint is needed and to ease them when stimulation is required. Here again is a mechanism which...could subsequently be readily used to stimulate buying. ...

(v) There are broad issues on which Ministerial decisions should be sought for the purpose of dealing with `structural' unemployment. ... Labour movement must be regarded as a continuing [post-war] need, and decisions should be take now to perpetuate, and, in certain cases, to develop so much of the Ministry of Labour machinery as is considered desirable. Here, in my view, is an outstanding case of the need for considering the long-term problem when decisions are being taken on the maintenance of controls for the transitional period. ...

(vi) The same is true of the location of industry. The problem of bringing work to the men (as a supplement to bringing men to the work) should be regarded as a continuing one...

The above are examples of important economic issues on the long-run aspects of which discussions and decisions should be started now. ... [As] I mentioned in my earlier letter, ...many of these things will require considerable legislative or administrative changes and that these changes may be politically possible now or immediately after the war, and impossible later on.

The overriding argument, in fact, for taking decisions now, in my opinion, is yet another political consideration. *The public are demanding plans for post-war employment policy; and if the Government have not fairly soon reached preliminary decisions on the matter (extending well beyond the immediate post-war transition) there will be another political explosion.*

May I end by an *argumentum ad hominem*? In the international sphere you have advocated an International Clearing Union. In the immediate post-war years the principles of such a Union could not be fully applied. ... The Clearing Union scheme is, in essence, a longer-term measure for more normal times. Why, in this case, did Ministers need to take these decisions of long-term principle *before* they considered all the detailed hugger mugger of the process of adjustment? The answer, in my view, is clear: it was in order that they might see where they were going before they started to go there. Is this not true of internal policy as well? (330-332, longer italicized segments added)

This is a most interesting and impressive Ministerial agenda that Meade presents for Keynes's consideration. It calls for *legislative, administrative and policy* changes to implement Keynes's vision of long run post war planning for full employment. The changes proposed need to be integrated with those mechanisms that will be used to reconvert the economy from a wartime footing to normalcy. Public investment policy is, of course, the key, but administration and planning must be prepared for the guiding private investment, for credit allocation, for dealing with labor mobility and the location of new industry. The political environment is now ideal for creating and getting government approval for a radical reconstitution of the economic role of the state, Meade argues. Failure to do so might trigger a political explosion. Finally, the scope and detail of these plans should be similar to those contained in Keynes's superbly ambitious International Clearing Union, which contained a fairly detailed plan for a post war international financial system radically different from the old gold standard.

*Keynes expressed complete agreement with Meade's position*. The misunderstanding arose, according to Keynes, because he could not see that any of the key *proposals in Meade's and Henderson's memoranda* required immediate Ministerial attention. Of course, he agrees, such attention *is* necessary for the implementation of *his* vision of state planning.

Substantially *there is nothing with which I disagree* in the list given in your letter of June 3rd of the [six] main points on which Ministers might take early decisions. Indeed, the first page and a half of your letter seems to me to give much more suitable material for a brief memorandum for Ministers that the documents actually in their hands.

When I said there was nothing on which Ministers could take early decisions, I did not mean to rule out these various important matters. *My point -- not clearly expressed -- was that it did not seem to me that any matters arose either out of yours or out of Henderson's memorandum which led up to decisions which out to be taken now*.

... These [six] points have the great advantage of bringing the issues back to practical matters and away from a debate [between Meade and Henderson], which seemed to me was getting academic and might be endless. (332-33, emphasis added).

This exchange of letters seems to resolve the paradox posed by the apparent lack of interest shown by Keynes in his initial response to Meade's administrative and legislative preconditions for the construction and implementation of state planning.

In July 1943 Keynes received a letter from Sir Josiah Wedgewood, a fellow director to the Bank of England and an old friend. Wedgewood was somewhat belatedly working through The General Theory and wanted to see if he understood its main ideas. He was concerned about the relative importance of low interest rates versus state controls as means to guide investment spending, and the relative importance Keynes attached to the stimulation of consumption.[[144]](#footnote-144) Keynes wrote back:

It is not quite correct that I attach primary importance to the rate of interest. What I attach primary importance to is the scale of investment and am interested in the low interest rate as one of the elements furthering this. But I should regard state intervention to encourage investment as probably a more important factor than low rates of interest taken in isolation.

The question then arises as to why I should prefer rather a heavy scale of investment to increasing consumption. My main reason for this is that I do not think we have yet reached anything like the point of capital saturation. It would be in the interests of the standards of life in the long run if we increased our capital quite materially. After twenty years of large-scale investment I should expect to change my mind. (350)

Wedgewood asked about the use of social welfare spending to stimulate consumptions demand. Keynes responded that using transfer payments to stimulate employment would require tax increases if the budget deficit were not to rise increased. For this reason "it is very much easier socially and politically to influence the rate of investment than to influence the rate of consumption" (350).

The Treasury was working on a response to the Economic Section memorandum by Meade at this time. Keynes wrote a lengthy critique of a draft by Sir Wilfred Eady. One of its most important points is Keynes's insistence that budget deficits should *not* be an important part of the post war employment policy. He stressed the necessity of a capital budget through which the Chancellor of the Exchequer could use to forecast capital expenditure by all bodies, public and private, and compare this with prospective savings as the first step in the planning process. Note Keynes's insistence once again, this time in 1943, Keynes insists that the primary tool of state planning is to be public investment, its level is to be set to influence the *long run equilibrium path* of the economy, and “two-thirds of three quarters of total investment [must be] under public or semi-public” control. Counter- cyclical policy is a decidedly secondary, though not an unimportant concern, and deficits are to avoided if at all possible.

The capital budget will be a necessary ingredient in this exposition of the prospects of investment under all heads. **If, as may be the case, something like two-thirds or three quarters of total investment will be under public or semi-public auspices, the amount of capital expenditures contemplated by the authorities will be the essential balancing factor. ... It has nothing whatever to do with deficit financing**.

Quite apart from this is the proposal that if, for one reason or another, the volume of planned investment fails to produce equilibrium, the lack of balance would be met by unbalancing one way or another the current Budget. Admittedly this be a last resort, only to come into play if the machinery of capital budgeting had broken down.

*Thus the capital budgeting is a method of maintaining equilibrium; the deficit*

... Personally I like Meade's social security proposal. It is not open to many of the objections of other forms of deficit finance. Indeed, it can be defended on the ground that it will actually promote stability of the social security fund itself. It is arguable, that is to say, that in periods of increasing unemployment the fund will actually make up a significant part of what it loses through reduced contributions through having to pay out less unemployment relief than would otherwise be the case.

About other forms of deficit financing I am inclined to lie low because I am sure that, if serious unemployment does develop, deficit financing is absolutely certain to happen, and I should like to keep free to object hereafter to the more objectionable forms of it.

...

So very decidedly I should...not lead the critics to think that the Chancellor is confusing the fundamental idea of a capital budget with the particular, *rather desperate expedient of deficit financing*. (352-54, emphasis added)

Keynes next agrees that it is appropriate to focus on structural unemployment, but he warns Eady against the Treasury tendency to over stress structural unemployment relative to unemployment caused by a deficiency of "effective demand" - a central concept in the macro theory developed in The General Theory. **[Check whole quote?]**

I wonder if the Chancellor of the Exchequer appreciates into what deep water the adoption of the more pessimistic expectation on this heading leads him. ... It might turn out to be true that anything at all closely resembling free enterprise is capable of dealing with the problem of structural unemployment. If so, I feel sure that free enterprise will go by the board to the necessary extent. I have not abandoned the view that something like free enterprise can be made to work. I think we ought to have a good try at it. And that try ought to be based on the assumption that the underlying conditions are not such as to make it impossible.

... I fancy he will find himself open to some rather unexpected rejoinders if he takes a defeatist line about the possibility of free enterprise dealing satisfactorily with the outstanding problem of the age. ...

... Would it not be much better to end up with a recommendation for the preparation of detailed proposals how to handle structural unemployment in a free enterprise environment? (354-55)

Keynes concludes by suggesting a more positive and activist tone for the memo, with effective demand problems and investment planning handled simultaneously.

The Chancellor could then conclude by saying that the problem really seems to divide itself into two main headings. The first is the means of ensuring stability in the long-term investment programme coupled with proposals for adjusting its tempo to unforeseen changes.[[145]](#footnote-145) …

The second aspect is the problem of structural unemployment. This comprises the question of the location of industry and inducements of private enterprise to come here rather than go there. It also involves the mobility of labour with particular reference to social security. Finally it is particularly concerned with the question of our new industries, where we start with a fairly free hand as to location. Pari passu, therefore, with the study of the investment programme should be a study of structural unemployment under the above headings**. (p ??)**

Keynes was discouraged by Eady's next draft and criticized it as too pessimistic and non-activist. He was also worried that the government would be too stringent in their use of the powerful direct controls of the immediate post war period, and end up deflating public support for the controls needed in phase two.

Controls over demand, as distinct from prices, will have to be exercised with great elasticity and sensitiveness, if we are to avoid making the controls unpopular by giving colour to the conclusion that they themselves are actually creating unemployment. If the controllers overdo it and the level of unemployment is attributed to them by the public, with indeed some measure of reason, it will end in the controls being prematurely abolished. We shall then have too little control, and for the ensuing inflation it will be the cautious souls who will really be guilty. (358)

In yet another letter to Eady in July 1943 Keynes reiterated a number of central points about state planning. First, the need to use state control of effective demand to stabilize national income at the full employment level is a "long-term problem" (360). Second, counter-cyclical policy around this long-term stable path would be primarily, though not exclusively, through regulating the pace of state investment.

When we come down to strictly short-term fluctuations, such as those which arise out of the trade cycle, the alternative remedies are to try to off-set fluctuations of general demand by increasing investment, or to try to off-set it by stimulating consumption. Personally I favour the first alternative. (361).

He again refers to the policy switch point at *capital saturation*, at which a progressive redistribution of wealth must be undertaken**. [Note to me: maybe he is thinking of the saturation of *public capital*, which may not seem to him to be subject to rapid technological and thus productivity improvements.]**

[S]ooner or later, we shall be faced, if not with saturation of investment, at any rate with increased difficulty in finding satisfactory outlets for new investment. It is very difficult to predict when this will come about. When it does come about, we shall then have to start on very important social changes, aimed at the discouragement of savings and a redistribution of the national wealth and a tax system which encourages consumption and discourages saving. (360)

Keynes's wrote a critical evaluation of the Steering Committee's report of January 1944. His order of points, which I follow, reflects the structure of the Steering Committee document. He begins by supporting "the possibility of directly influencing the pace of private investment." "Something might be done," he suggests, "if the major, private firms were brought to regard it as their duty to pay attention to the indications of the official barometer" (365). The next point is crucial and harkens back to his correspondence with Meade over the need to create more effective planning institutions. The report points out the inadequacy of present government procedures for approving investment projects, and refers to "the delays to [public] investment caused by the present complicated parliamentary procedure." Improved administration of investment planning is essential. "This is very important. Should not there be a specific recommendation for the improvement of the existing expensive and out-of-date machinery of the private bill?" (365)

Keynes makes a number of points. Meade's social security plan had failed to win Committee approval. This stupidity reminded Keynes of Lord Balfour who, he said, took the position that "he believed in progress but it should be as slow as possible." Keynes expressed enthusiastic support for regulation of "Hire Purchase" or buying on installment. "There should be a prescribed minimum down payment and maximum period over which installments may be spread...and that these conditions should be stiffened up in good times and relaxed in bad times" (365-66).

The longest section of Keynes's note is devoted to exposing the fallacy embodied in the report that full-employment planning entails substantial budget deficits. *"Exactly the opposite is the truth."* The notion that the maintenance of full employment must:

unstabilise the national budget, is surely topsy-turvy. It would be a *failure* to adopt a remedy for severe cyclical unemployment which might have that effect. There appears to be no glimmer of recognition that measures to stabilise the national income are *ipso facto* measures to stabilise the national budget. The additional charges falling on the budget in years of bad unemployment are, in fact, almost negligible; whilst the effect on the revenue of maintaining the national income should be obvious. The Committee give the impression that, whilst the measures they propose to avoid unemployment are necessary and advisable, a price has to be paid for them in the shape of budgetary deficits and perhaps a weakening in international confidence in our position. Exactly the opposite is the truth. It would be a failure to take such measures which would inevitably unstabilise the budget and weaken confidence. (366, emphasis in original)

Keynes sees two key reasons why the Committee report is marred by this error. First, in spite of the fact The General Theory was published more than seven years ago, "there is no hint of the operation of what economists call `the multiplier', that is to say the effect of injecting additional demand into the system in increasing national income by at least double its own amount." Second, the report fails to incorporate in its analysis of the post-war budget the revenues to be generated by the investment projects that are the core of employment policy. This point is absolutely essential for understanding Keynes's argument that post war employment policy will *not* involve secular budget deficits. Public investment projects such as housing, road building, public utilities, and so forth will produce enough direct tax revenue over their lifetimes that they ultimately will require at most modest subsidies; and these subsidies will be smaller than the induced or indirect taxes that will flow from the rise in national income created by the multiplied effects of the new investment. Keynes uses a hypothetical example to make these two points crystal clear.

Suppose for example that additional investment of £100 increases the total national income and output by £200 (which is probably an under-statement), and that the additional investment will not have a genuine permanent value in excess of £80 (which, one may hope, will also be an understatement). It follows that the net result to the nation's production, strictly valued, will not be a loss of (as some once argued) but a gain of £180. It follows that, if the increment of [tax] revenue exceeds one ninth of the increment of national income (which it certainly does), the transaction taken as a whole positively benefits the Exchequer there and then. The additional taxes, collected as a result of the induced investment in that very year in which it takes place, should be more than enough to write off the excess of the investment's cost over its true value. How slow dies the inbred fallacy that it is an act of financial imprudence to put men to work! (367)

Thus, Keynes criticizes the Committee not for its concern over large-scale budget deficits -- "By all means emphasise the importance of maintaining budget equilibrium" - but for associating large secular budget deficits with the public investment program that is the heart of Keynes's full employment planning policy. Let an analysis of the policy's effect on the budget "be represented as an important argument in [its] favour...as it most truly is, and not as an argument against [it]" (367).

Keynes then discussed the importance of a capital budget to the planning process.

A capital budget, in the sense in which I understand it, means a regular survey and analysis of the relationship between sources of savings and different types of investment and a balance sheet showing how they have been brought into equality for the past year, and a forecast of the same for the year to come. If aggregate demand gave signs of being deficient, the analysis would indicate a deflationary gap exactly corresponding to the inflationary gap which we have so often discussed during the war. This survey and balance sheet might well be presented on the occasion of the regular Budget Statement and form a part of the Budget White Paper. It would give an annual opportunity for examining whether the state of demand during the ensuing year looked like being adequate to maintain employment and national income at the desirable level and for the Government to explain to Parliament what steps it had in view to remedy a prospective disequilibrium in either direction. Such a procedure as this might give greatly increased confidence to the public that the maintenance of employment and national income was now an avowed and deliberate aim of financial and economic policy. (369)

The note contains another urgent plea by Keynes for the government to dramatically upgrade its collection, analysis and dissemination of economic statistics. For example, he wants the Board of Inland Revenue to have a statistical staff "on the scale of the statistical staff of the Bank of England." Once they did, extraordinary improvements in fiscal policy and in general administration, as well as in knowledge, diagnosis and forecast would become possible.

With the Ministry of Labour handling labour statistics on the lines proposed, the Board of Trade conducting a continuous census of production..., the Inland Revenue digesting and analysing the vast body of information which passes through its files, and the Bank of England continuing its running analysis of our external position, the new era of the "Joy through Statistics' (I do not write ironically) can begin. (371)

Keynes believes that he had created a theoretical structure which made state planning feasible. But it required a greatly enriched statistical capability to turn state economic planning into a truly scientific endeavor. Without it, the planning process cannot be made efficient.

Theoretical economic analysis has now reached a point where it is fit to be applied. Its application only awaits the collection of the detailed facts which the economist, unlike the scientist, cannot collect in a laboratory by private enterprise. The authors of the Report would, I think, have written with more confidence about their plans for the future and in a spirit of more buoyant hope if they had fully appreciated what knowledge is capable of doing in making the future different from the past as soon as we decide to furnish the social sciences with *data* comparable to the *data* of the other sciences... ... [Until this is done], no one can quantify his recommendations or say except in the most general terms what ought to be done, and [when such data is available], it will all be obvious and as clear as the daylight with no room left for argument. (371-72, emphasis in original)

Keynes put great faith in the historic importance of Britain's project of constructing an effective and democratic state planning process to maintain full employment, one that eliminates the gross inefficiency of *laissez-faire* yet avoids the extremes of totalitarian planning. He hopes it "will be the role of this country to develop a middle way of economic life which will preserve the liberty, the initiative and (what we are so rich in) the idiosyncrasy of the individual in a framework serving the public good and seeking equality of contentment among all..." (369).

The official Government "White Paper on Employment Policy" was drafted in March and April 1944. *Keynes was ill during this period and generally engrossed in Anglo-American negotiations over the post war international financial system. As a result, he had little direct input into the White Paper.*

Hubert Henderson sent Keynes a copy of a memo he wrote condemning the White Paper. Keynes circulated his response to Henderson's views. Henderson believed Britain's post-war export situation would be bleak, a fact that the White Paper failed to sufficiently consider in its recommendation for a full-employment policy. Keynes agreed that the export picture was not good, but drew different conclusions than Henderson. He *argued that Britain would have to manage trade*; in particular, imports would have to be restricted. But import restrictions would be good for the effort to raise domestic employment.

Henderson also believed it would be good for Britain's access to international credit "if we allow large-scale unemployment." Keynes thought this to be a "plain delusion." "It will improve our external credit if we are seen tackling the problem of internal unemployment vigorously, and just to stand aside will have the opposite effect" (374). Keynes's trump card against Henderson's position was the fear of domestic unrest in the face of a post war depression. His statement again demonstrates that he believed the political situation to be such *that a post-war full-employment policy of some kind was inevitable*.

Finally, Sir H. Henderson does not appear to expect, or does not at any rate attach any importance to, the social and political consequences of deliberately using domestic unemployment as a remedy for external disequilibrium. Even if this policy had its advantages, it is surely obviously out of the question and might mean the downfall of our present system of democratic government. (374)

The White Paper was distributed in May 1944. Keynes sent the Chancellor suggestions for his consideration in preparing his speech to the House of Commons in defense of it. Much of the material is quite familiar. Keynes repeats his prohibition against the use of high interest rates to restrain the boom. And he stresses the fact that a full-employment policy centered on public investment will help avoid budget deficits, not create them. "A forward employment policy is therefore entirely compatible with budgetary equilibrium; and not only so, but it is in fact the best way of ensuring budgetary equilibrium" (377).

A key focus is on the possible criticism that the White Paper, while putting the government behind the principles of post-war planning, does not specify its unemployment target or the precise policies required to achieve it. Keynes agrees that the "illustrative" figures presented are on the cautious side. (After all, he had been a persistent internal critic of the timidity of the White Paper.) But his main point is that the specifics of planning -- the blueprints -- cannot be constructed until *after* the government approves the general lines of the policies proposed. Obtaining the commitment of the government and the public to full employment as the main policy goal and to the broad outline of the proposed policy process is the most important thing for Keynes at this stage. Once this commitment was firm, the experts and technicians inside and outside the government could finally get on with the creation of the administrative, legislative and strategic infrastructure needed to make his vision a reality.

All that the Government is attempting to lay down at this stage is the general line and purpose of policy, the basic assumptions on which it proposes to accept as correct. The quantitative and detailed working out can only be done satisfactorily over a period of time. It would be quite premature to attempt something of that sort now and any attempt that might be made would almost certainly be inaccurate by events. As soon, however, as the general policy has been laid down, then it will be the duty of the various Departments and all other authorities concerned, to work out the details, with far greater particularity than has been done, or could be done, up to this point. The object of the White Paper is to choose the pattern of our future policy. This must not be confused with the technical working out of the very extensive blue prints, which will be needed to implement this policy, when it has been approved by Parliament. To the preparation of these blue prints, those concerned will of course proceed, as soon as the general line has been laid down and approved by Parliament. (378-79)

Keynes expressed the same position about the White Paper more concisely in a letter to Austin Robinson in June 1944.

[I]t is better to have something, even if it is wrong in detail, because I believe the Civil Service has infinite power of making things work out it is clear it intends to work it. My own feeling is that the first sentence [committing the Government to the maintenance of full employment] is more valuable than the whole of the rest. (in Moggridge, 1992, 709)

Keynes's made a number of relevant comments on post-war planning in his letters. One was to Sir William Beveridge concerning his 1944 book Free Employment in a Free Society. After expressing general agreement with the main points of the book Keynes commented on Beveridge's target unemployment rate of 3 per cent. "No harm in aiming at 3 per cent unemployment, but I shall be surprised if we succeed" (381).[[146]](#footnote-146)

Keynes also wrote Kalecki on the occasion of the publication of his 1944 book The Economics of Full Employment. In this letter he stressed *the centrality of managed trade* to post-war employment planning. "If, as is alleged, I said that the International Monetary Plan `would ensure the conditions necessary to maintain full employment at home irrespective of conditions abroad and without further direct control of foreign trade', I must have been out of my mind" (382-83).

In a letter to T.S. Elliot in April 1945 Keynes argues that while it is possible that the implementation of an efficient full-employment planning policy will be thwarted by “vested interests” or the power of the capitalist class and wealthy elites determined to undermine these policies because they will erode their economic and political power, it was more likely to fail because wrong-headed theory pervades the minds of both the public and government officials and insufficient expertise is brought to bear on the problem. His statement here is consistent with one he made in the final section of the last chapter of The General Theory in which he said that, in the end, “it is ideas, not vested interests, which are dangerous for good or evil.” (384)

It may turn out, I suppose, that vested interests and personal selfishness may stand in the way. But the main task is producing first the intellectual conviction and then intellectually devise the means. Insufficiency of cleverness, not of goodness, is main trouble. And even resistance to change may have many motives besides selfishness. (384)[[147]](#footnote-147)

In June 1944, on his way to the US for the Bretton Woods negotiations, Keynes read Hayek's The Road to Serfdom. When he arrived he wrote Hayek a letter about his reactions to the book. This letter again demonstrates the continuity of Keynes's commitment to his "middle way" or liberal socialist economic planning from 1924 to the last years of his life. It also shows his hostility towards totalitarian planning as well as his belief that Hayek’s' unplanned capitalism would be catastrophic. Keynes argues that while the totalitarian planned economies have demonstrated the economic superiority of planning, technical progress will permit both prosperity and individual liberty even in a less economically efficient moderate planning. Above all, it reminds us of his belief in the centrality of the moral values of the planners and the community in determining the social and political outcome of planning; it will be safe to grant substantial economic power to state planners provided they hold the right values. Since this interchange is between two prestigious economists most associated with the opposing sides of this great historical class of ideas, it makes sense to quote Keynes at length.

In my opinion it is a grand book. ... morally and philosophically I find myself in agreement with virtually the whole of it...

... It seems to me...that the Communist doctrine is so desperately out-of-date, at least in its application to U.S.A. and Western Europe. They ask us to concentrate on economic conditions more exclusively than in any earlier period in the world's history precisely at the moment when by their own showing technical achievement is making this sacrifice unnecessary. This preoccupation with the economic problem is brought to its most intense at a phase in our evolution when it is becoming ever less necessary.

The line of argument you yourself take depends on the very doubtful assumption that planning is not more efficient. Quite likely from the purely economic point of view it is efficient. That is why I say that it would be more in line with your general argument to point out that even if the extreme planners can claim their technique to be more efficient, nevertheless technical advancement even in a less planned community is so considerable that we do not today require the superfluous sacrifice of liberties which they themselves would have to admit have some value.

...

I come finally to what is my only serious criticism of the book. You admit here and there that is a question of knowing where to draw the line [between plan and market]. You agree that the line has to be drawn somewhere, and the logical extreme is not possible. But you give us no guidance whatever as to where to draw it. In this sense you are shirking the practical issue. It is true that you and I would probably draw it in different places. I should guess that according to my ideas you greatly under-estimate the practicability of the middle course. But as soon as you admit that the extreme is not possible, and that a line has to be drawn, you are, on your own argument, done for, since you are trying to persuade us that as soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice.

I should therefore conclude your theme rather differently. I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more planning. But the planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your own moral position. Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issue. This is in fact already true of some of them. But the curse is that there is also an important section who could almost be said to want planning not in order to enjoy its fruits but because morally they hold ideas exactly the opposite of yours, and wish to serve not God but the devil. Reading the New Statesman & Nation one sometimes feels that those who write there, while they cannot safely oppose moderate planning, are really hoping in their hearts that it will not succeed; and so prejudice more violent action. They fear that if moderate measures are sufficiently successful, this will allow a reaction in what you think the right and they think the wrong direction. ...

What we need therefore, in my opinion, is not a change in our economic programmes, which could lead in practice to disillusion with your philosophy; but perhaps even the contrary, namely an enlargement of them. Your greatest danger ahead is the probable practical failure of the application of your philosophy in the U.S. in a fairly extreme form. No, what we need is the restoration of right moral thinking -- a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly. (385-88).

Keynes's last major intervention on domestic aspects of planning came in Spring 1945. He had been appointed to the National Debt Enquiry committee which was to advise the Government on post-war monetary policy in generally, and on the problem of the post-war interest burden of the national debt in particular. In March and April 1945, about a year before his death, Keynes made several presentations to the Enquiry concerning post-war monetary policy and other subjects. *His main messages in these presentations was that, with the existence of exchange and import controls and the removal of interest rates from counter-cyclical policy, the monetary authorities can achieve whatever rates of interest they desire* - "The monetary authorities can have any rate of interest they want" (390) - and that low interest rates were desirable both because they helped sustain investment spending and minimized the interest burden or the Treasury -- he proposed a one-half percent Treasury bill rate and 1.5 and 2 per cent rates on five and ten year Treasury bonds.[[148]](#footnote-148)

In June he presented a memorandum to the Enquiry on "The Concept of a Capital Budget" devoted primarily to the mechanics of state investment planning. In it he distinguished among an Exchequer Capital Budget, a Public Capital Budget and a National Investment Budget. The first referred to the costs and revenues associated with longer-term projects under the direct control of the central government.[[149]](#footnote-149) A more inclusive Public Capital Budget is needed because:

It has been the practice of this country hitherto to entrust most capital expenditure of a public character to Local Authorities or Public Boards. I am not aware of any intention to change this. If so, the significance of the Exchequer Budget will be incomplete if taken in isolation, and it should be regarded rather as an item required in building up the Public Capital Budget, which should also comprise the capital expenditure of all bodies, boards, authorities and institutions which are scheduled as belonging to the public, as distinct from the private, sector of the national economy. (408)

The primary burden of maintaining full employment, as we have seen, is to be placed on Public Capital Investment. *The major policy planning tool is to be the annual national Investment Budget. The Investment Budget will project total investment spending -- including expected private sector investment and those public investment projects previously approved -- for the coming period. If total national investment spending for the coming period appears to be too small to sustain full employment, the Treasury (and not a National Investment Board detached from the other Ministries as Keynes had previously proposed) will be the body responsible for accelerating public investment -- and vice-versa.* The shift from his support of a National Investment Board in Britain's Industrial Future in 1928 raises a difficult problem of interpretation that we have seen many times before. Has he really changed his mind on this important issue, or has he accepted the political reality that the only way he can get his hoped-for public investment planning process is through an Investment Board housed in the Treasury Department - the long-term enemy of all his planning policies?

It is an integral part of the Government's full employment policy, as I understand it, that some authority will exist (the Treasury I hope) charged with the duty of examining and reporting on the state of the Public Capital Budget as a whole, not merely after the event but also prospectively. At one time I had conceived that this should be the task of a semi-independent statutory authority the be called the National Investment Board. But with modern developments of policy, decisions on such matters have become so much a part of the Government's economic programme as a whole that they should not be dissociated from the Chancellor of the Exchequer as the responsible Minister and his official Department. (408)

To discharge this major new responsibility efficiently, the Treasury would require credible relevant economic statistics on a timely basis.

I suggest that the continuous current collection both of the statistics of current performance and of prospective plans by the private sector should be entrusted to the Ministry of Trade and Production (if that is to be its name), which would be charged with the duty of passing and absolutely up-to-date information to the Capital Budget division of the Treasury (409).

The objective of the Treasury would be to try to ensure that total national investment, public and private, would equal what Keynes previously called the "indicated" or full-employment level of national savings. The following statement of that objective makes reference to the Sinking Fund -- taxes or fees used to reduce the national debt. Keynes suggests that the ordinary, current or Revenue Budget include a "modest normal contribution" to the Sinking Fund. If it does,

the normal programme of the Public Capital Budget would have to aim at providing sufficient total investment to cover the dead-weight Sinking Fund of the Revenue Budget, in addition to current amortisation, public and private, and the current net savings of the private sector. This would have the added advantage of making it possible to offset a modest unforeseen disturbance of investment-savings equilibrium by reducing the normal sinking fund to zero, avoiding to this extent the necessity for budgeting for an actual Revenue deficit. This seems to me to be the correct doctrine of the Sinking Fund when taken in conjunction with a full employment policy. In fact, on the assumption that the outlets for public investment are not yet nearly saturated and that we are, for the time being at least, more concerned with increasing the capital equipment of the nation than with raising the immediate standards of private consumption, the larger the `normal' Sinking Fund of the Revenue Budget the greater will be the latitude possessed by the Treasury for quickly offsetting unforeseen disturbances without budgeting for an actual deficit. (411)

[**Manuscript kind of just peters out here as I closed up shop and headed off to the airport to fly home from Japan.]**

A letter of June 1945 points out two difficult problems for post-war planning in England and Australia. The first is the variability of exports: people tend to "under-estimate the difficulty of stabilising incomes where exports play so large a part." The second is the tendency of money wages to rise at sustained full employment: "One is also, simply because one knows no solution, inclined to turn a blind eye to the wages problem in a full employment economy" (385).

It is important to emphasise that it is not part of the purpose of the Exchequer of the Public Capital Budget to facilitate deficit financing, as I understand this term. On the contrary, the purpose is to present a sharp distinction between the policy of collecting in taxes less than the current non-capital expenditure of the state as a means of stimulating *consumption*, and the policy of the Treasury's influencing public capital expenditure as a means of stimulating *investment*. There are times and occasions for each of these policies; but they are essentially different and each, to the extent that it is applied, operates as an *alternative* to the other. (406, emphasis in original)

Toward the end of the memorandum Keynes emphasizes the point that the level of public investment might have to be quite large in the intermediate future to compensate for the drag on aggregate demand associated with the large expected trade deficit and the absence of any prospective Treasury deficit spending. *In the absence of very ambitious public investment spending, "severe unemployment is bound to result" along with "colossal deflationary pressure" (413).*

**[ I need an ending to this section - whatever it is called, followed by a conclusion]**

1. "These factors of order, security and uniformity ... prepared the way for the organization of that vast mechanism of transport, coal distribution, and foreign trade which made possible an industrial order of life in the dense urban centers of new population" (16). [↑](#footnote-ref-1)
2. Keynes argued both that the entrepreneurial class of the period invested in their companies and the rentier class saved and lent their money long term at low interest more as a "way of life" than as the result of rational optimizing calculations. Perhaps this is why he labeled the conditions that facilitated the high savings, low interest rates, and high investment of the period "psychological" rather than economic. See Crotty (1990) for a more extensive discussion of Keynes's analysis of the differences between the pre- and post-war stages of capitalism. [↑](#footnote-ref-2)
3. .Keynes believed that the best way to deal with the internal war debt was through a large wealth tax, the receipts of which could be used to retire it. "I am one of those who believe that a capital levy for the extinction of the [internal] debt is an absolute prerequisite of sound finance in every one of the European belligerent countries" (280). [↑](#footnote-ref-3)
4. Being Keynes, he not only advised government officials on these matters, and reported them to the British public through the press, he also utilized the insider or specialist information gained in this process to speculate on currency movements using money borrowed from friends and family. [↑](#footnote-ref-4)
5. As Skidelsky put it: "He could see no justice in appreciation -- nor could he see justice in depreciation as an alternative to a capital levy for reducing the burden of large post-war national debts -- for the average age of contracts in existence was low and did not justify the costs of industrial depression" (II, 382-3). [↑](#footnote-ref-5)
6. Skidelsky remarks that although:

   Keynes did not explicitly say so, such a policy implied a devaluation of sterling -- abandoning the attempt to restore the pre-war sterling-dollar exchange rate of 4.86 dollars to the pound. On this analysis the equilibrium exchange rate with the dollar was certainly no higher than 3.50 dollars to the pound. (II, 133) [↑](#footnote-ref-6)
7. And, he argues, further deflation will only serve to raise the burden of an already devastating internal, primarily war-induced, debt shouldered by the British taxpayer. Keynes puts the current yearly debt service at about 40 per cent of total government spending, or 70 per cent as large as all government spending other than debt service (63). Indeed, he will argue here (as well as on many other occasions) that the proper way to handle this kind of problem is through a substantial, one-time, "capital levy" or wealth tax, which, when applied in an appropriate and timely way, is "the justest [sic] and wisest instrument, because you can make the burden fall in the right place" (48). See also his discussion of the capital levy on pages 62-64. [↑](#footnote-ref-7)
8. The "In the long run we are all dead" part of this quotation is almost always taken out of context and interpreted to mean that Keynes was not interested in the long run. Nothing could be further from the truth. [↑](#footnote-ref-8)
9. Keynes was especially concerned that the seasonal nature of much of Britain's trade in food and raw materials would inevitably, in an unregulated system, cause seasonal exchange rate fluctuations which would then be magnified by speculation. [↑](#footnote-ref-9)
10. Keynes made frequent use of *The Nation* as a vehicle to disseminate his views on the political and economic issues of the day. Skidelsky reports that over the life of the journal - "from May 1923 to February 1931 155 items by [Keynes published in *The Nation*] are listed in *the Collected Writings*" (II, 136). [↑](#footnote-ref-10)
11. Keynes put the argument that Britain should be prepared to control its economic destiny relatively independently of the performance of the rest of Europe in a more provocative from in his important 1933 article "National Self-Sufficiency" that is discussed below. [↑](#footnote-ref-11)
12. Of course there were other powerful impediments to increased production and employment as well, such as the conversion from a wartime to peacetime economy and the so-called structural employment problems associated with the decline of many sectors of British exports. [↑](#footnote-ref-12)
13. It is interesting to note that Keynes never changed his mind on this point. He stresses it, for example, in several passages in *The General Theory*. In an economy that requires entrepreneurs and rentiers to make commitments and contracts in money terms whose success or failure will not be established until far into the future, severe price instability is anathema; a "regime of money contract" cannot tolerate it. Yet Keynesian economics has been portrayed for decades by neoclassical economists as a theoretical system in which unemployment is caused by rigidities -- not volatility -- in the price system, one in which all markets would clear if only prices were free to fluctuate without restriction. [↑](#footnote-ref-13)
14. Trouble for the rentier class had begun before the war. "Between 1896 and 1914, ... the capital value of [an] annuity had fallen by about a third" (14). But this decline merely gave up gains achieved in the previous decade or so. [↑](#footnote-ref-14)
15. In chapters 3 and 5 Keynes proposes that the Bank of England should create a forward market in the international exchange of sterling with other currencies, and suggests a basic outline of how this could be done. (See pages 110-13 and 146-50.) He proposes to eliminate some of the uncertainty facing British merchants: "With free forward markets thus established no merchant need run an exchange risk unless he wishes to, and business might find a stable foothold even in a fluctuating world" (111). [↑](#footnote-ref-15)
16. In an earlier version of this argument about the problems caused by time and uncertainty in a regime of money contract (published in The Nation in August 1923), Keynes argued that when individuals and businesses expect falling prices:

    They put off their purchases, not because they lack purchasing power, but because their demand is capable of postponement and may, they think, be satisfied at a lower price later on. It is these postponements which are at the root of remediable unemployment. (19-I, 115-6)

    Keynes will later make this a central distinction between a "co-operative" or barter economy and a "money-wage or entrepreneur economy." In the latter but not the former, agents can 'flee' commodities and flock to money in times of uncertainty or of certain deflation; thus Say's Law is invalid in a money-wage economy. [↑](#footnote-ref-16)
17. A similar argument is made in The General Theory where the culprit is volatile expectations of the profit rate. In chapter 12,vthe problem is caused by excessive instability in stock prices. [↑](#footnote-ref-17)
18. This view was recycled in the late 20th century where a mainstream consensus developed in support of the proposition that if Central Banks could ensure price stability through monetary policy, market-clearing growth would be achieved my "free markets" in goods and services with no need for fiscal policy manipulation or tight regulation of markets. [↑](#footnote-ref-18)
19. .Many commentators have pointed out that at this time Keynes had not focused on the theory of aggregate demand and had not yet analyzed the causes of cyclical or secular swings in aggregate demand. [↑](#footnote-ref-19)
20. .Keynes does acknowledge that domestic prices were relatively stable under the gold standard between the Napoleonic War and the end of the nineteenth century, but he argues that this outcome was historically contingent, resting on several circumstances which no longer existed. "But the conditions of the future are not those of the past. We have no sufficient ground for expecting the continuance of the special conditions which preserved a sort of balance before the war" (133). [↑](#footnote-ref-20)
21. Keynes was always partial to religious imagery in his discussion of gold. On page 155, in a comment about post-war US monetary policy, he noted: "From that day gold was demonetised by almost the last country which still continued to do it lip-service, and a dollar standard was set up on the pedestal of the Golden Calf." [↑](#footnote-ref-21)
22. We have, he said:

    reached a stage in the evolution of money when a 'managed' currency is inevitable, but we have not yet reached the point when then management can be entrusted to a single authority. The best we can do, therefore, is to have **two** managed currencies, sterling and dollars, with as close a collaboration as possible between the aims and methods of management. (159) [↑](#footnote-ref-22)
23. This chapter (footnote 1, p. 145) contains the argument that interest rates and the quantity of credit supplied to the market are, to some substantial degree, independent of one another. In later work he will use this idea to argue that the (short-term) interest rate can be held at whatever level is needed to achieve external balance, while the quantity of credit is adjusted in pursuit of full-employment aggregate demand. [↑](#footnote-ref-23)
24. This sentence continues "though the other [Big Five] banks, if they strongly opposed the official policy, could thwart, or at least delay it to a certain extent -- provided they were prepared to depart from their usual proportions [of reserves to deposits]" (145). Fear that the big private banks might sabotage an attempt by a future Labour government to regulate the economy lay behind Labour Party proposals in the 1930s to nationalize not only the Bank of England, but the Big Five banks as well. Keynes, who claimed to take a pragmatic rather than an ideological perspective on the question of nationalization, argued that nationalization of the Big Five was an issue of secondary importance belonging to a later, rather than an initial stage of socialism in Britain. See, for example, ? . [↑](#footnote-ref-24)
25. This is position Keynes also took in the contorted final chapter of *The General Theory*. In that chapter, he first lists a series of radical proposals for changing Britain's political economy. He then argues that his policy proposals were really not as radical as they looked - and as they in fact were. And finally he says that if you - the economists, government officials and influential bankers and businessmen who control British politics - do not adopt the program I have developed in this book, all hell will break loose. "It is certain the world will not much longer tolerate the unemployment which, apart from brief periods of excitement, is associated - and in my opinion inevitably associated - with present day capitalistic individualism." (381). In other words, join my policy revolution or the working class will undertake a revolution of their own that you will not like at all. [↑](#footnote-ref-25)
26. His argument clearly implies that the "financial factors" he refers to influence aggregate demand, but he has not yet developed this concept theoretically. [↑](#footnote-ref-26)
27. .See, for example, Volume 19-1, pages 162-4. [↑](#footnote-ref-27)
28. In *The General Theory* Keynes defined full employment in two different ways. One was the standard definition - the level of employment at which the supply of labor equals the demand for labor. The other (p. ) was the level of employment at which an increase in aggregate demand led only to rising prices and not to additional employment. The latter definition is most compatible with his estimate here that sustainable full-employment is reached at an unemployment rate of 3 per cent. [↑](#footnote-ref-28)
29. The following line of reasoning about why monetary expansion might lead to inflation rather than domestic economic growth is consistent with the main line of argument taken by Keynes in this debate. Given the low level of the demand for credit by government and domestic business, very easy credit conditions would be likely to lead to a substantial rise in the volume of foreign rather than domestic loans. This would cause a substantial decline in the value of the pound which would raise input prices and, in so doing, initiate a process of cost-push inflation.

    Note that the public investment program he will propose has the advantage (in comparison with monetary policy) that it can be targeted toward those industries and those areas where unemployment is highest. Given the excess capacity and high unemployment in these industries and areas, targeted increased public investment might not generate significant cost-push inflationary pressure. [↑](#footnote-ref-29)
30. Skidelsky notes that in interpreting Keynes's reluctance to attack labor one "must remember that the Russian Revolution was on every middle-class reformer's mind. No more than his friends or anyone else in (even Conservative) government was Keynes prepared to risk fighting the class war to unjam the economy" (II, 186). [In text?] [↑](#footnote-ref-30)
31. .Keynes was also concerned with the question of how to accommodate the substantial current rate of growth in the labor force. [↑](#footnote-ref-31)
32. In *The General Theory* Keynes would say that the first dimension of the unemployment problem was the result of deficient aggregate demand. [↑](#footnote-ref-32)
33. For example: "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…" (31) Keynes explanation in *The General Theory* of why the return on real capital has decreased over time is discussed below. It differs from the explanation offered in the article under discussion here. [↑](#footnote-ref-33)
34. The Trade Facilities Act to which Keynes refers was designed to provide credit at below-market interest rates to export-oriented firms. [↑](#footnote-ref-34)
35. In a 1922 article in defense of free trade (against the call for protectionism from Conservative Prime Minister Stanley Baldwin) written in 1922 he expressed a similar worry. Capital is drifting abroad that is needed at home, in part because financial markets are biased in favor of foreign loans.

    Now, if we are to interfere at all with the natural course of trade, surely it should be with the object of keeping capital at home, not of driving it abroad. With our shortage of housing and the need of factories and equipment to render efficient our growing supply of labour, we need to keep more capital at home... There is already, in my opinion, too much encouragement to the export of our capital. (148-49)

    And, he stressed, Britain gets no benefit from this outflow of capital, at least in the short run. We will return to this issue. [↑](#footnote-ref-35)
36. For a historical survey of the place of public works in British economic policy, see Garside (article and book chapter). Aldcroft notes that "the use of government-financed public works for employment purposes already had a reputable lineage going back to at least Elizabethan times," but that "such works were to be employed [only] sporadically during the interwar years" (1986, 23) [↑](#footnote-ref-36)
37. The idea that it is not possible to know in advance precisely which methods of government economic planning and what kinds of plans will turn out to be best in the longer-run is sound. There are no existing models of government planning that should be emulated directly. The only way to proceed effectively is through experimentation carried out in an environment that facilitates constructive criticism. [↑](#footnote-ref-37)
38. When Keynes and the Liberal Party created more concrete mechanisms for state control of large-scale capital investment in 1929 and 1930, they included state financing at below-market interest rates of private investment projects deemed compatible with government objectives. [↑](#footnote-ref-38)
39. He would later call for tight government control over all financial flows into and out of Britain. [↑](#footnote-ref-39)
40. The term "Geddes Axe" refers to the government Committee on National Economy, or so-called "Geddes Axe" committee, whose purpose was to find ways to reduce government spending. Aldcroft refers to the "sharp cuts in most categories of expenditures, especially on social services, following the famous Geddes Review of 1922. Thus through to 1923 central government spending fell by nearly one quarter from the 1920 level" (1986, 25-6). [↑](#footnote-ref-40)
41. "He tried to explain why a modern industrial society could not stand a policy of *laissez-faire*. He developed an imagery of fluids and sticky masses to explain the contrast between old and new forms of industrial life, and to pinpoint the need for a new type of statesmanship. The building of an economic theory was much more difficult. He came to realise that the economics he had been taught simply assumed away the *Sturm und Drang* of actual economic life" (Skidelsky II, 173-74). [↑](#footnote-ref-41)
42. "The Trustee Acts restricted the type of investments which could be made by trustees of estates or charities to a 'trustee list' which included all British and colonial government bonds, but excluded practically all shares of private companies" (Skidelsky II, 183)

    See Crotty 1981 [JEL] on Keynes's commitment to capital controls. [↑](#footnote-ref-42)
43. To take but one example, in July 1926 he wrote the following.

    I think that a central control of the volume of foreign investment is a permanent necessity for Great Britain, just as much as a rational Bank rate policy. ... We ought to devise a permanent centralised control for the regulation of foreign investment. ... We need a regular official plan for the control and rationing of [all] foreign investment business. (19, 573) [↑](#footnote-ref-43)
44. Of course one key reason why the return to large scale investment was low was that the economy was stuck in a high unemployment, high excess capacity and low aggregate demand trough. [↑](#footnote-ref-44)
45. Keynes made the point several times that regulatory constraints on the profits of those firms operating in the industries designated as public utilities could not and would not be removed - "There is no going back on this." He does not explain at this point *why* there is no going back on this, but he later presented, as discussed in detail below, a theoretical and empirical defense of this proposition. The defense is based on the rise of economies of scale and scope in crucial industries that led to monopoly and oligopoly market structures across Britain. These industries could not possibly be left unregulated. [↑](#footnote-ref-45)
46. The political stakes were quite clear to Keynes. In a letter to Charles Addis, a governor of the Bank of England and a supporter of the return to gold at par, Keynes stated them succinctly. The choice was between radical reform and revolution.

    The more I spend my thoughts on these matters, the more alarmed do I become at seeing you and others in authority attacking the problems of the changed problems of the post-war world -- I know you will excuse my saying so -- unmodified pre-war views and ideas. To close the mind to the idea of revolutionary improvements in the control of money and credit is to sow the seeds of the downfall of individualistic capitalism. Do not be the Louis XVI of the monetary revolution. For surely it is certain that enormous changes will come in the next twenty years, and they will be bad changes, unwisely and even disastrously carried out, if those of us who are at least agreed in our ultimate objectives are aiming at the stability of society cannot agree in putting forward safe and sound returns. I am now told by a good many friends that I have become a sort of disreputable figure in some quarters because I do not agree with the maxims of City pundits. But I ought not to be considered so! I seek to improve the machinery of society not overturn it. (19-1, 271-72) [↑](#footnote-ref-46)
47. As we will see below, in its more mature form, Keynes's plan for state control of most large-scale capital investment projects included provisions for public financing of private investment projects congruent with state planning at below-market interest rates. [↑](#footnote-ref-47)
48. Though the Labour Party supported a revolutionary change from current-day capitalism to Soviet-style planning as their ultimate objective, they also believed that until this radical change was accomplished, the British government should, even under Labour Party leadership, adopt the conservative policies supported by British industry and finance. [↑](#footnote-ref-48)
49. See Clarke 1988, chapter 4. [↑](#footnote-ref-49)
50. .Moggridge argues that by late 1924, as he began to do his initial thinking about a new book on theory and policy, Keynes's "emphasis tended to centre more on the home versus foreign investment issue than on the capital works and unemployment issue." In November 1924, he says, Keynes changed his mind, temporarily, about the necessity for public investment spending: "Keynes came to the conclusion that 'the expenditure, on the production of **fixed** capital, of public money raised by borrowing, can do nothing in itself to improve matters [in a slump] and it might do actual harm" (423).

    In fact, the interpretation of the passage cited here (from XIII, 23) is not as straightforward as Moggridge implies because at this point Keynes is discussing the specific problem of insufficient working capital (goods in process) in the slump. Thus, he seems to be saying only that the initiation of large-scale public investment projects "can do nothing in itself" to directly increase working capital, an indisputable proposition. It is not at all clear that Keynes is here arguing that public investment is of no help with other key problems of the slump, such as the absence of an incentive to accumulate private capital. Moreover, it seems obvious from the debate in The Nation that Keynes considers it important to distinguish between policies designed to mitigate cycles around full employment and policies intended to move the economy from one 'equilibrium' position to another. Keynes would seem to be discussing the former problem in the section cited by Moggridge. [↑](#footnote-ref-50)
51. .Many of the arguments in this pamphlet are presented in even greater detail in Keynes's testimony before the Committee on Industry and Trade on July 9, 1925. See the Collected Works, Volume XIX, pages 383-416. [↑](#footnote-ref-51)
52. The phrase "over-stocked" with plant suggests one reason why the profit rate on capital and thus the incentive to invest in large-scale project in these industries was so low in the post-WWI era. [↑](#footnote-ref-52)
53. In August in a letter to *The Times* defending "The Economic Consequences of Mr Churchill" Keynes concluded that the appropriate policy was to reject gold, reduce foreign investment and utilize the released funds at home by increased public investment.

    But the right way to achieve this result ... is by the deliberate organisation of investment at home, resulting in an increase in the rate of interest, at which foreign borrowers can sell their bonds here, above the corresponding rate in New York, and, above all, by the organised transference of labour out of the export industries.

    ...

    I should take steps, other than the embargo [on foreign issues], such as an alteration of the Trustee Act and the encouragement of expensive new capital projects at home. (19, 433-34) [↑](#footnote-ref-53)
54. Even a simultaneous reduction of all wages by 10 per cent would entail some costs. It would greatly increase the burden of the national debt ("thus wiping out all our laborious contributions to the Sinking Fund since the war") and would "transfer about 1,000 into the pockets of the rentiers out of the pockets of the rest of us ..." (213) [↑](#footnote-ref-54)
55. And the depression might get out of control. Keynes had already written at great length about the fact that an ongoing deflationary process sets in motion forces that reinforce the downward momentum in production and employment that initiate the deflation. [↑](#footnote-ref-55)
56. Keynes discusses the relation between sheltered and unsheltered industries in the context of the gold standard at length in testimony before the Committee on Industry and Trade on July 9, 1925. [↑](#footnote-ref-56)
57. Here Keynes adds that if the politicians told the truth about this process to the electorate, they would not be able to successfully implement it. "The question is how far public opinion will allow such a policy to go. It would be politically impossible for the Government to admit that it was deliberately intensifying unemployment..." (225). [↑](#footnote-ref-57)
58. The idea that the needed adjustments are achieved through the deliberate application of force is reflected in the following comment. "We are depending for the reduction of wages on the pressure of unemployment and of strikes and lockouts; and in order to make sure of the result we are deliberately intensifying the unemployment" (220). [↑](#footnote-ref-58)
59. This sentence prefigures an attack on classical theory in The General Theory. Classical theory, he acknowledges, is elegant and logically coherent. Its fatal flaw is that its assumptions conflict with the institutions and facts of the modern economy. In the one-page chapter one of that book Keynes writes: "I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case… Moreover, the characteristics of the special case assumed by the classical theory happen to not be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience. (3) [↑](#footnote-ref-59)
60. This proposition as applied to Keynes work is the subject of Crotty 1990. [↑](#footnote-ref-60)
61. Keynes gave a two lectures in Moscow in September 1925 which are in the same category; they follow fairly closely the themes of "Am I a Liberal?" See XIX, pages 434-42. [↑](#footnote-ref-61)
62. While Skidelsky briefly mentions the arguments Keynes presents here, as noted below, he fails utterly to appreciate their significance. [↑](#footnote-ref-62)
63. Keynes is not arguing against the necessity of abstraction in economic theory. But he does claim that the assumption set must eventually incorporate, even if in simplified form, all of the core characteristics of the aspect of the economy under investigation. He consistently supported the fundamental principle that 'the realism of assumptions' matters to the assessment of the usefulness or empirical validity of a theory, a proposition contested by modern neoclassical economists. [↑](#footnote-ref-63)
64. For the core of Schumpeter's theory of competition, see chapters 6 through 8 of "Capitalism, Socialism and Democracy" (1944). [↑](#footnote-ref-64)
65. Keynes's analysis here prefigures much of the modern criticism of Walrasian general equilibrium theory. [↑](#footnote-ref-65)
66. .Keynes makes use of a 'feeding' metaphor here that derives from his earlier use of a Darwinian example of competition among giraffes for access to tree leaves. [↑](#footnote-ref-66)
67. Many observers would give the "best Keynes biography" award to Roy Harrod, who wrote Keynes's 'official' biography, but I might opt for Skidelsky. [↑](#footnote-ref-67)
68. .Moggridge explains Keynes's views on these matters as follows.

    Here there were questions of whether the Post Office or the telephone system should be run as a department of state under a Minister or as a public corporations, ultimately subject to Parliament but autonomous in its day-to-day operations. Similar considerations arose in connection with municipal enterprises. In all these cases, Keynes came down on the side of autonomy and professionalism, even at the cost of some centralisation, to provide varied, wide-ranging careers for the employees.

    Under a related heading came the matter of the organisation of the private sector, where he observed a tendency towards large units of operation, the separation of ownership from control, cartels, trade agreements and monopolies. Here Keynes put his faith in greater publicity in general and regulation in particular to protect investors and the general public. He was not averse to bigness itself: in many cases he argued it was inevitable. (456-57) [↑](#footnote-ref-68)
69. .Ironically, one of capitalism's most socially and morally objectionable characteristics for Keynes is also its economically defining characteristic -- dependence on the love of money as its main motive force. [↑](#footnote-ref-69)
70. In 1925, in a statement he would often repeat, Keynes denounced the love of money as immoral, even though he considered the pursuit of money to be a defining characteristic of capitalism.

    [I]t seems clearer to me every day that the moral problem of our age is concerned with the love of money, with the habitual appeal to the money motive in nine-tenths of the activities of life, with ... the social approbation of money as the measure of constructive success, and with the social appeal to the hoarding instinct as the foundation of the necessary provision for the family and for the future. (9, 268-69) [↑](#footnote-ref-70)
71. In September he observed in Moscow that the "experimental technique [of Leninism] is necessarily a matter of most high interest. We in the West will watch what you do with sympathy and lively attention, in the hope that we may find something which we can learn from you" (19, 441-42). [↑](#footnote-ref-71)
72. .Keynes made the following insightful observation on the difficulty of generating a qualitative change in the economic role of the state.

    Material poverty provides the incentive to change precisely in situations where there is very little margin for experiments. Material prosperity removes the incentive just when it might be safe to take a chance. Europe lacks the means, America the will, to make a move. [↑](#footnote-ref-72)
73. It might seem odd to use the Liberal Industrial Inquiry as corroboration for Keynes's first thesis since he himself was so heavily involved in its research and writing. But since Pollard cites the study without criticizing its methods or conclusions, the reader must assume he believes it to be a reliable source. [↑](#footnote-ref-73)
74. To switch from the widespread presumption that economic efficiency could only be achieved through "free competition" to a general belief that it could only be achieved through "the suppression of free competition" was a sea-change indeed. [↑](#footnote-ref-74)
75. In the 1930s, his interests naturally focused on how to respond to the British and global depression - a mostly macro issue. [↑](#footnote-ref-75)
76. His arguments here obviously anticipate the influential work of Berle and Means (1932) in the United States. They also argued that the separation of management from ownership and the rise of giant corporations in the heart of the economy called for innovations in government control of the economy. [↑](#footnote-ref-76)
77. Schumpeter also used the terms "corespective competition" and "edited competition" in the same way. [↑](#footnote-ref-77)
78. We abstract here from consideration of new state macroeconomic responsibilities such as public investment, the regulation of credit, and the tight control of capital flows into and out of the country. [↑](#footnote-ref-78)
79. This argument is also central in Schumpeter's theory of "corespective" oligopolistic competition. If a company has large fixed cost and a low level of capacity utilization, it will also have very high fixed cost per unit produced. This in turn will lead to high losses per unit if price is driven down to marginal cost through price competition. But marginal cost is everywhere below total cost per unit; with large economies of scale it is much below total cost per unit. Such losses provide a strong incentive to raise their capacity utilization by taking sales away from their competitors by "cut-throat" price slashing. (Schumpeter 1944) [↑](#footnote-ref-79)
80. One reason why this had not happened (in addition to the industry's anarchic structure) was that the banks who had loaned money to the now-unprofitable mills, especially in the speculative bubble of 1919-20, had a vested interest in seeing that they remained in operation, even at a loss, in order to keep some portion of the interest payments flowing to the banks. [↑](#footnote-ref-80)
81. This is not a problem for small firms alone. Once a giant firm has purchased and put into place its vast array of fixed capital goods it is likely not to exit its business lines even when times are bad because it stands to lose a large proportion of the money it spent on capital when it exits. If bad times look like they may last for many years, there will be little demand to buy these industry-specific capital goods. The firm will thus suffer large losses upon exit. The expected value of remaining in the industry in hard times, but then earning the profit that will be available once good times return may well exceed the losses sure to be experienced upon exit. For a more detailed treatment of this issue see Crotty 2005. [↑](#footnote-ref-81)
82. In chapter 17 of Theories of Surplus Value Marx makes a similar argument. The main reason a crisis is triggered when the rate of profit falls substantially at the end of a boom is that many firms have incurred large fixed costs that cannot be paid. In a downturn:

    The rate of profit falls… The fixed charges - interest, rent, - which were based on the anticipation of a constant rate of profit and exploitation of labour, remain the same and in part cannot be paid. Hence crisis. Crisis of labour and crisis of capital. (Volume II, p. 516)

    Minsky's theory of the development of "financial fragility" toward the end of vigorous expansions is also based on the difficulty firms face in meeting high fixed costs if revenues decline, here interest and principal repayment. [↑](#footnote-ref-82)
83. "The members will be pledged to loyalty to the Association's orders under penalties both financial and personal" (599) [↑](#footnote-ref-83)
84. Some readers may be familiar with statements made by Keynes in 1943 such as "if the bulk of investment is under public or semi-public control and we go in for a stable long-term programme, serious fluctuations are less likely to occur," (27, 326) and "if something like two-thirds to three-quarters of total investment will be under public or semi-public auspices, the amount of capital expenditures contemplated by the authorities will be the essential balancing factor" (27, 352). They may not know, however, that Keynes had already reached this conclusion in the mid 1920s. [↑](#footnote-ref-84)
85. .See Volume 19, page 731, for a description of the process leading up to the publication of "Britain's Industrial Future" (the "Yellow Book") in 1928. [↑](#footnote-ref-85)
86. Some readers might not be familiar with the expression "smoking gun" used here. In a murder mystery, the police or a private detective may have collected a good deal of circumstantial evidence that a particular suspect is guilty, but do not have enough evidence to assure conviction in a trial. What is needed is additional evidence that will assure a guilty verdict, for example, the "smoking gun" used to kill the victim in the hands of the murderer. [↑](#footnote-ref-86)
87. See, for example, pages 3, 23, 274, 341, 348 and 412. [↑](#footnote-ref-87)
88. Irreversibility of capital is a necessary assumption in Minsky’s theory of financial cycles. Suppose fixed capital was perfectly reversible, so that firms could always sell their capital-in-place for what they paid for it minus depreciation when the industry experienced a revenue collapse at the end of a boom. Then the concept of financial fragility evaporates because corporate debt is never a problem. A firm can sell off capital goods and use the funds it receives to pay off all their debts. When prosperous conditions are restored, these firms can borrow money and buy new capital goods. Conversely, the assumption that capital goods are reversible is a necessary assumption in the neoclassical theory of investment, associated most closely with Dale Jorgenson, which concludes that firms are indifferent between buying and renting their capital goods. GM can produce autos one day, sell their capital and buy Treasury bills when business turns sour, then sell their Treasury bills and buy auto-producing capital goods when an industry upturn takes place. [↑](#footnote-ref-88)
89. .The Local Loans Fund was a central fund which could be used to finance investment by Local Authorities and other bodies which were permitted by law to do so. [↑](#footnote-ref-89)
90. .Over the life of the Trade Facilities Act from 1921 to 1927, guarantees were given for a total of £74 Million worth of private sector borrowing. [↑](#footnote-ref-90)
91. This was a central assumption of Schumpeter’s theory of competition as well. [↑](#footnote-ref-91)
92. .Keynes stressed in a companion piece that he was no recent convert to the belief that public investment was the key to the restoration of prosperity.

    I began advocating schemes of National Development as a cure for unemployment four years or more ago -- indeed, as soon as I realised that, the effect of the return to gold having been to put our money rates of wages too high relatively to our foreign competitors we could not, for a considerable time, hope to employ as much labour as formerly in the export industries. Right or wrong, I have been singularly consistent -- indeed, obstinate. (812-813)

    In fact, as we have seen, Keynes announced his support for such programs a year before Britain returned to the gold standard. [↑](#footnote-ref-92)
93. Henderson was part of the group that organized the Liberal Party Summer Schools. In 1923, Keynes turned the editorship of *The Nation and Athenaeum* over to Henderson, a position he held for seven years. He also was involved in the project that led to BIF. As discussed below, he and Keynes later drifted apart. [↑](#footnote-ref-93)
94. .Data from Garside, page 313. See Garside, chapter 11, for a detailed discussion of public works expenditures in Britain in the interwar years. The UGC approved expenditures of £191 over this period, but only about one third of this total was actually spent. (313) [↑](#footnote-ref-94)
95. .Keynes's first use of the complete and formal multiplier analysis will appear in "The Means to Prosperity" in March 1933. [↑](#footnote-ref-95)
96. It would appear as if Henderson and Keynes failed to see that a reduction of military spending would also have a multiplier effect that would counterbalance, to some degree, the stimulation to employment of the increase in public investment. [↑](#footnote-ref-96)
97. .Peter Clarke's book provides an excellent analysis of this period in Keynes's thinking. See also Skidelsky (19 , chapter ). [↑](#footnote-ref-97)
98. Contrary to the argument put forth by Allen Meltzer ( ), the Orange Book figure of £125 million per year of public investment is the one contemporaries most associated with Keynes in 1929-30. [↑](#footnote-ref-98)
99. This is the same message contained in the quotation from "Can Lloyd George Do It?" cited above. There "would be no appreciable national loss on the [investment] programme, even if it cost on the average 5 per cent per annum and only brought in on the average 2.5 per cent" (112). [↑](#footnote-ref-99)
100. .Keynes, of course, adds his standard argument that capital controls will be needed to make such a program effective. "I believe that some abandonment of laissez-faire towards foreign investment will be necessary to this country as a permanency" (141). Keynes is, of course, correct that the interest rate measures the real opportunity cost of capital investment *only* in equilibrium. [↑](#footnote-ref-100)
101. Keynes makes a similar comment in early 1931. See (20, 273). [↑](#footnote-ref-101)
102. At this point in his testimony Keynes moves his attack on freely mobile capital to a broader level, making a powerful argument against the globalization of finance that anticipates both "National Self-Sufficiency in 1932, and, based on its effects on wages, income shares and working conditions, "The Question of High Wages" in (1930).

     I should, however, like to say this, that I do very greatly doubt whether we shall ever be free in this country to return to unbridled laissez-faire in the matter of foreign lending. If individuals are free to lend their savings without discrimination in whatever quarter of the world they obtain the greatest reward, this means, broadly speaking, that the proportion of the joint product which we award to labour as compared with the proportion we award to capital cannot be greater here than it is in other parts of the world, *If we have complete liberty of foreign investment, that must necessarily mean that we cannot run more than a very little ahead of the rest of the world in our treatment of labour ... relative to its efficiency.* ... [E]ither we shall be in a state of chronic disequilibrium between the pressure to lend abroad *or we shall have to force down wages in England until capital gets the same proportions of the as in [say] Germany*. ...

     We have now reached this point, that our wages policy is definitely set to a more liberal remuneration of the worker relative to his efficiency that prevails in a good many other countries. ... *[I]f it be the case that there is any important part of the world which is going to treat the worker less favourably than we, then this wages policy of ours, I think, is definitely incompatible with the policy of laissez-faire towards the foreign investor.* (147-48, emphasis added)

     Keynes took this point further in testimony in November 1930. The "Russian model" of trade referred to here is complete state control of imports and exports.

     If we had no freedom of foreign lending then it would be possible to have a much wider discrepancy in the level of money incomes. ... If we wish to have our money incomes move differently from the rest of the world, but nevertheless remain on an international standard, we may be able to do it by handling our foreign trade on the Russian model. The Russian model has immense theoretical interest for me from that point of view, and it may be that some day we shall come much nearer to the Russian model than we think probable at this moment. (184) [↑](#footnote-ref-102)
103. .Keynes then added: "But I should not make it a *sine qua non*. Far from it!" (361). [↑](#footnote-ref-103)
104. .See also the Keynes-Mosley correspondence in Volume XX, pages 312-15. [↑](#footnote-ref-104)
105. In his memorandum to the Economic Advisory Council Keynes applied to America an argument he had previously made about Britain: while large scale investments, which in Britain are public or semi-public, are quite interest sensitive, manufacturing investment is not. And, private investment is not big enough to lead the US out of depression anyway. References to "building" in the following quote include residential construction,

     Would it make any significant difference if the rate of interest for large, typical classes of borrowers were to come down? Here I am prepared to make two concessions. I do not think it would make much difference to purely industrial borrowers for the purpose of extending manufacturers' plants. That class of experience can only come *after* business profits have been revived, not before. ...

     If, however, the rate of interest can be brought down sufficiently, then I do feel confident that the demand for loans will in due course develop for buildings, for transport and for public utilities. For these are three big sources for borrowing. Manufacturing enterprise is never capable of absorbing any large proportion of current savings. It is above all of building that we must think, and after that of public utilities, when we are considering how to stimulate investment. (??) [↑](#footnote-ref-105)
106. .In December 1931 Keynes addressed the Society for Socialist Inquiry on the topic "The Dilemma of Modern Socialism." As examples of "those things which are urgently called for on practical grounds" he cited "central control of investment and the distribution of income in such a way as to provide purchasing power for the enormous potential output of modern productive technique" (21, 36-37) [↑](#footnote-ref-106)
107. .In the mid 1920s Keynes had commented on the following paradox confronting supporters of radical change in economic institutions.

     Material poverty provides the incentive to change precisely in situations where there is very little margin for experiments. Material prosperity removes the incentive just when it might be safe to take a chance. Europe lacks the means, America the will, to make a move. (9, 294) **[Repeat?]**

     Keynes saw himself as one who was persistently forced to argue for evolutionary radical change in a sluggish to depressed economic environment. And he consistently criticized revolutionary socialists for their failure to understand how difficult it would be to create just and efficient state central planning in the chaotic and impoverished conditions that would accompany revolution. [↑](#footnote-ref-107)
108. .Roy Harrod, Keynes's "official" biographer, tried to explain away the radical character of this essay by arguing that it was written while Keynes was in a fleeting mood of deep depression triggered by his profound disappointment at the collapse of the World Economic Conference in July of 1933. "It may have been partly by revulsion from the futility of the Conference," Harrod argued, that Keynes wrote and published this article (which he does not mention by name). "He was depressed by the gathered wisdom of the nations." The article "lacked his usual precision of thought," and was "a little rambling" in Harrod's view. (See Harrod, 446).

     Unfortunately for Harrod's thesis, Keynes delivered the lecture two months before the conference even began. In any case, Keynes is on the record as being rather pessimistic about any progress being made at the Conference. Prior to its opening, he said that "it will be extraordinarily difficult to avoid a fiasco" (21, 251). [↑](#footnote-ref-108)
109. .Shortly thereafter, in an article in The Economic Journal, Keynes reiterated this point.

     The funds administered by the building societies are no so enormous that this is a movement of the very first importance. We do not always remember the gigantic growth of these institutions since the War; -- their advances on mortgage were about £90,000,000 in each of the years 1930 and 1931, as compared with £9,000,000 in 1913 and no more than £25,000,000 even in 1920. Indeed the amount of new investment within this country, otherwise than through the building societies and public or semi-public authorities and boards, is now so paltry as to have but little effect on the total**.(citation?)** [↑](#footnote-ref-109)
110. .By 1932, Keynes's believed that the government was too reactionary to be influenced by progressive argument. He states this view in another letter to MacMillan.

     The main point in my opinion is that we are now in the grip of reactionary forces, and however fair-spoken those in authority may be, they fully intend to take advantage of present circumstances to reverse a great deal of what they regard as semi-socialistic policy. They also conscientiously disbelieve in the kinds of schemes for planning, etc., which you and I favour. There is probably no practical sense in any efforts except those deliberately aimed at ousting them**.(citation?)** [↑](#footnote-ref-110)
111. .Keynes made the same point in a slightly different way a few months later.

     I doubt if private enterprise at home , even in its palmiest days, ever absorbed half the national savings, and considering the extent to which public utilities are in public hands today, I am sure that they never will in the future. I am all for giving private enterprise a run, and using all the capital it can, but I believe one is living in a false paradise if one supposes that in any foreseeable future it will be able to take up the amount which this country could save when it was prosperous and everybody properly employed. (152) [↑](#footnote-ref-111)
112. .Keynes wrote an article ("The Multiplier" (21, 171-78)) a month later extending this analysis. [↑](#footnote-ref-112)
113. .He observed that "I should accept [the] criterion that budget subsidies, direct or indirect, should in no case exceed 50 per cent of the new capital expenditure" (185). [↑](#footnote-ref-113)
114. .Keynes took up this line of argument in an article designed to counter the many published criticisms of "The Means to Prosperity."

     Compared with 1929, which for us was already an unsatisfactory year, the foreign balance declined by £75,000,000 in 1930 and by no less than£ 207,000,000 in 1931. But the Labour Government's loan expenditure was inevitably on a much smaller scale than this, so that of course unemployment increased -- though no by as much as it would have done if there had been no loan expenditure. ...

     By its tariff policy and its exchange policy the National Government improved our foreign balance in 1932 by £74,000,000 compared with 1931; and the balance looks better still in 1933. ... Yet unemployment has not declined. Where are we to look for an explanation? ... We can find it nowhere, I suggest, except in the decline of our loan expenditures, as the result of our no longer borrowing for the dole and of our restraining the capital expenditure of all public authorities. [↑](#footnote-ref-114)
115. .He expressed a similar thought in the article just discussed.

     In the details of execution we require the greatest decentralisation. But there should be, I suggest, some central authority under the Chancellor of the Exchequer, charged with the initial selection of schemes, and, where necessary, with the provision of finance. (182) [↑](#footnote-ref-115)
116. Keynes then noted presciently: "When my new theory has been duly assimilated and mixed with politics and feelings and passions, I can't predict what the final upshot will be in its effect on action and affairs" (13, 492-93). [↑](#footnote-ref-116)
117. The committee was probably doomed by the logic of its construction. In order for the government to accept any such committee as representative of economists as a group, its membership would have to include economists of all important persuasions, a condition which would virtually exclude the achievement of consensus on such an ideologically charged and controversial issue as economic policy. It is probably not just fortuitous that The General Theory was not written by a committee. [↑](#footnote-ref-117)
118. For a defense of the proposition that, as a core methodological principle, Keynes insisted that all useful economic theory is institutionally specific and historically specific, see Crotty 1990. [↑](#footnote-ref-118)
119. This is not to deny that he could have given even greater emphasis to the policy implications of the book. [↑](#footnote-ref-119)
120. Movements toward "capital saturation" brought on by high rates of public investment will, in his view, also force interest rates down. [↑](#footnote-ref-120)
121. See, for example, page 203. [↑](#footnote-ref-121)
122. Note there is not a word in this chapter about deficit spending. [↑](#footnote-ref-122)
123. See Aldcroft (1970), page 33. [↑](#footnote-ref-123)
124. In February 1937 the Government announced it would borrow £500 million over five years for military purposes. [↑](#footnote-ref-124)
125. See also (21, p. 549 and 565). [↑](#footnote-ref-125)
126. Keynes suffered a severe heart attack in May 1937 [?] which slowed him down his work pace considerably in the subsequent months. [↑](#footnote-ref-126)
127. .In an article in The Economic Journal in September 1938 (calling for state control of the storage of important commodities on order to minimize the fluctuations in the their prices and supplies) Keynes observed, not for the last time, that state will spend its way to full employment in war but not in peace.

     If we could tackle the problems of peace with the same energy and whole-heartedness as we tackle those of war! Defence is old-established as a proper object for the state, whereas economic well-being is still a *parvenu*. ... Nevertheless, we are at this moment allowing war expenditure for defence to help solve our problem of unemployment as a by-product of such spending, whereas if disarmament had prevailed we might have allowed a serious recession to have developed by now before introducing loan expenditure on a comparable scale for the productive works of peace. (463) [↑](#footnote-ref-127)
128. Still, in June 1939 Keynes believed that "there is room for a very substantial increase of the national income, say, by something between 5 and 10 per cent..." (548). [↑](#footnote-ref-128)
129. .He observed, a bit later:

     The armament programme will bring abnormal unemployment to an end. Some day, and the sooner the better, we hope to stop the existing abomination and return to the ways of peace. Is that to mean a return to abnormal unemployment? It will go hard with the fabric of society if it does. To avoid this outcome, it will be necessary for productive investment, public and private, out of borrowed money to continue at a rate at least as high as this year`s programme. (546) [↑](#footnote-ref-129)
130. He continued.

     Perhaps in their feelings and instincts they are the nearest thing we now have to the typical nervous nonconformist English gentlemen who went to the Crusades, made the Reformation, fought the Great Rebellion, won us our civil and religious liberties and humanised the working classes last century. (495) [↑](#footnote-ref-130)
131. .Keynes stressed the need for central coordination. "The problem of pace can be determined rightly only in the light of the competing programmes in all other directions" (268). [↑](#footnote-ref-131)
132. Keynes hammered home the same basic point in a June 1943 piece estimating likely post-war income and employment. He criticized a report which forecast average post war unemployment to be 1,200,000, or 7.5 per cent of the workforce. Note again his complete confidence that there would be a near universal, effective political demand after the war that the unemployment rate be maintained at or near full employment.

     [E]ven 1,2000,000 is a pessimistic assumption in the light of the greater knowledge and experience of these problems and, above all, of the greater will to grapple with them and to regard their solution as one of our primary responsibilities, which exists in all quarters. We cannot, on this view, regard the unemployment problem as substantially solved so long as the *average* figure is greater than 800,000, namely 5 per cent of the wage-earning population, or rest content without resort to drastic changes of policy so long as it exceeds 1 million. (335) [↑](#footnote-ref-132)
133. The 5 per cent figure, he argued, includes reasonable estimates of the virtually unemployable, seasonal factors, men moving between jobs and "misfits of trade or locality due to lack of mobility." "It compare with...less than 1 per cent...unemployed at the present time..." (305). [↑](#footnote-ref-133)
134. Keynes wrote to Beveridge in his initial letter (of March 17, 1942) that, though he had concerns about particulars and about cost, he was "in a state of wild enthusiasm for your general scheme" (204). He also told him in October that the final draft was "a grand document" (255). He also claimed to be "very keen on your proposed dismissal tax" (205). The idea was that an employer who laid off a worker would have to contribute some payment to the insurance fund for the time he was laid off. He also wrote James Meade that he was "very much attracted by Beveridge's proposal for dismissal charges" (207). [↑](#footnote-ref-134)
135. Keynes did not deliver this speech as planned. He wrote his mother that "great pressure has been put on me not to speak" in support of the Beveridge Report by the Treasury which opposed it. He succumbed to the pressure. "I value too highly my present relations with everyone in the Treasury to want to run the risk of disobliging them" (256). [↑](#footnote-ref-135)
136. One reaction by Keynes was to insist that if Meade's proposal was accepted it must be incorporated into the separate Capital Budget he thought essential to facilitate efficient planning.

     [ I]t will be doubly important to keep it out of the ordinary Budget. For the ordinary budget should be balanced at all times. It is the capital Budget [including the social security fund] which should fluctuate with the demand for employment. ( )

     And again:

     "No account is taken [in Henderson's memo] of the separation between the normal budget for expenditure out of income and the so-to-speak capital budget, which surely we shall have to set up after the war (275). [↑](#footnote-ref-136)
137. Of course, the impact of a change in employees' income on aggregate demand will depend on the short- run propensity to consume, which is, as Keynes stressed in The General Theory, quite variable over the cycle. [↑](#footnote-ref-137)
138. He had become Baron Keynes of Tilton at the age of 59 in June 1942. [↑](#footnote-ref-138)
139. .In the late 1960s macro economists rediscovered the insight that income tax cuts understood by their recipients to be temporary would not have a significant impact on consumption. Many criticized Keynes for bequeathing the profession a simplistic and misleading theory of consumption on which to base counter-cyclical policy. This is but one example of a number of instances in which Keynes's views were first severely distorted and oversimplified by his followers, after which he was criticized for being naively simplistic. The two chapters on consumption theory in The General Theory demonstrate quite clearly that *Keynes anticipated almost all the subsequent so-called revisions to his version of consumption theory.* [↑](#footnote-ref-139)
140. Keynes's analysis neglects the effect of technical change on the attractiveness of investment projects. This is confusing because, as we know, he had stressed the rapidity of technical progress in the recent past and extrapolated it into the intermediate future. On the other hand, we also know that Keynes believed that private industrial investment, where much of the technical change was taking place, was dominated quantitatively by public and semi-public investment. Perhaps he thought that the rate of technical change was much more modest in this public sector. **[to text?]** [↑](#footnote-ref-140)
141. .In addition to expressing Keynes's view on nationalization quite well, this statement is reminiscent of one he made in The Treatise on Money in 1930:

     But the choice may conceivably lie between assuming the burden of a prospective loss, allowing the slump to continue, and socialistic action by which some official body steps into the shoes which the feet of the entrepreneurs are too cold to occupy. (6,335) [↑](#footnote-ref-141)
142. .Sir William Beveridge was conducting his own private study of post-war employment prospects and appropriate policies to ensure full employment. Since the Beveridge Report on post-war social welfare policy had received widespread public interest and acclaim, it was likely that his report on post war employment policy would be widely read and discussed. It was eventually published as Full Employment in a Free Society (London, 1944). [↑](#footnote-ref-142)
143. This assertion was the conventional wisdom. It was generally believed that a thorough transformation of the British economy along some variant of the policies Keynes had supported for years would be forced on any ruling Party by the demand of the electorate and fear of the political consequences of a relapse into depression after the end of the war. The precise nature or details of this transformation would, of course, be affected by the ruling Party. [↑](#footnote-ref-143)
144. Wedgewood understands quite clearly the necessity for capital controls in Keynes's policy plans.

     Presumably, if home investment is to be stimulated by an `artificially' low rate of interest, foreign investment must be strictly controlled also (and perhaps differential taxation on it introduced?) This alone means continuance of national Government Exchange Control, doesn't it? [↑](#footnote-ref-144)
145. .Keynes stressed again that "long-term stability of employment may largely depend on having a stable long-term investment programme." Thus, we shall "have to have a periodic survey of investment prospects of which the capital budget may be an important ingredient; and, if we can find ways of retarding or accelerating the long-term programme to offset unforeseen short-term fluctuations, so much the better" (356). [↑](#footnote-ref-145)
146. The reason Keynes thought that 3 per cent was an impractical goal was that he foresaw a substantial, perhaps severe, trade imbalance after the War. [↑](#footnote-ref-146)
147. He also told Elliot that "full employment by means of investment" is only one way to get the job done. Though he personally favored the investment based policy, he suggested that a shorter work week would be adequate in the case of the U.S.. "Less work is the ultimate solution (a 35 hour week in the U.S. would do the trick now)" (384). [↑](#footnote-ref-147)
148. Keynes made several other arguments worth noting. One referred to the asymmetric effect of the interest rate on investment spending. "Experience shows, however, that whilst a high rate of interest is capable of having a dominating effect on inducement to invest, it becomes relatively unimportant at low levels compared with the expectations affecting the inducement" (390).

     Another is the role of convention in influencing the public's liquidity preference, an argument that flows directly from chapters 13-15 of The General Theory.

     What determines the reward the individual requires to surrender his liquidity for a long or short period. In practice, of course, what some stockbroker who knows nothing about it advises him, or convention based on old dead ideas of past irrelevant experience. But assuming enlightened self-interest ( which probably influences convention) it is your expectation of or a lack of expectation and temporary uncertainty about future *changes* in the [rate of interest]. If it was certain that there would be no changes in present short-term, longer dated would always be best. ... But suppose, you just don't know and are chiefly interested in protecting yourself form possible loss in the event of your desiring liquidity, then the shorter are preferable and you need to earn a risk premium to lock yourself up longer. (391) [↑](#footnote-ref-148)
149. Keynes argued that monetary profit or loss should not be a major criterion for the selection of investment projects: "With a full employment policy, we should not be biased as between two useful projects because one will bring in a direct cash return and the other a social or indirect cash return" (407). [↑](#footnote-ref-149)