# Keynes & the Keynesians

## *Some Intellectual Legends — By* HARRY G. JOHNSON

FOR THE FIRST fifteen years after the publication of Keynes' *General Theory of Employment, Interest and Money* (1936), controversy raged in the pages of the learned economic journals over the meaning and validity of virtually every concept and proposition contained in the book. Thereafter there emerged very rapidly an orthodox consensus on what Keynes' contribution to economic theory and policy had been, and controversy virtually ceased—with the exception of an interchange in the pages of ENCOUNTER some years ago,[1] on the question of whether "we are all Keynesians now" in our ideas on economic policy, which interchange eventuated in the production of a rather pedestrian book by Robert Lekachman affirming and up-dating the orthodox consensus.[2] Thus Keynes became "the greatest economist of our time" (meaning that his contribution was so indisputable that no-one need concern himself over precisely what it was) and the *General Theory* an "acknowledged classic" (meaning that no active economist reads it, for fear of discovering that the master was himself confused about the message he had to impart to posterity). Meanwhile "Keynesian economics" has become the staple fare offered by the text-books and "Keynesian" ideas about the economic system have become the foundation of popular and governmental understanding of economic policy issues and policy formation.

The Keynesian approach to economic policy stresses the key importance of the national budget ("fiscal policy" in America) as an instrument of overall economic control. It tends to belittle the relevance and effectiveness of monetary policy (Bank rate and all that) as traditionally practised. This approach has been coming increasingly under fire from the resurgent exponents of the quantity theory approach to monetary matters (dubbed "monetarists" in the United States), a school of thought that Keynesians had believed vanquished forever by the "Keynesian Revolution." In this country the Keynesian approach has been severely discredited by the failure of Keynesian policies to make the Devaluation of 1967 the predicted success in the year following it, to the point where the Treasury has been obliged to convert to a "monetarist" approach to the handling of monetary policy. In the U.S.A. Keynesianism has been discredited, though to a lesser extent, by the failure of the tax surcharge recommended by "The New Economics" of the Keynesians (led by Walter Heller) to control the inflation associated with the war in Viet Nam.

In these politically exciting circumstances, the question of what Keynes was really driving at, and specifically whether orthodox "Keynesian economics" represents the essence of Keynes' contribution to the development of economic theory, itself becomes a live and exciting intellectual issue, and not merely a subject for arid scholarly debate among the downtrodden historians of economic thought. The publication of Axel Leijonhufvud's monumentally scholarly—but at the same time enjoyably readable—study of Keynes' economics[3] is therefore most appositely timed, from the point of view not only of the author's reputation but (as it turns out) of the repute of all other interested parties except the beleaguered Keynesians themselves—who in this context are to be identified with an American-led group of economists oriented towards mathematical and econometric model-building. For Leijonhufvud draws a sharp distinction between "Keynesian economics" and "the economics of Keynes." He shows that (on the one hand) the conventional beliefs of the Keynesians find virtually no support in the economics of Keynes, and that (on the other hand) Keynes was wrestling with basic theoretical problems of a kind which have attracted in recent times the attention of the neo-quantity theorists rather than the Keynesian model-

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[1] Robert Lekachman, "John Maynard Keynes", ENCOUNTER, December 1963, Roy Harrod, "Are We Really All Keynesians Now?" January 1964. See also the articles by Michael M. Postan, Harry Johnson and Michael Stewart in ENCOUNTER January, May and September 1968.

[2] Robert Lekachman, *The Age of Keynes* (Allen Lane The Penguin Press, 1967).

[3] Axel Leijonhufvud, *On Keynesian Economics and the Economics of Keynes* (Oxford University Press, 1968), 75s.

The main propositions of the book, and a perspective on its contribution, may be found in the author's subsequent pair of lectures at the London School of Economics, *Keynes and the Classics* (The Institute of Economic Affairs, Occasional Paper 30, 1969), 7s. 6d.

builders, while his views on economic policy questions broadly accord with the emphasis of the monetarists on the importance of money and of monetary policy.

THUS KEYNES HIMSELF re-emerges as a brilliantly insightful student of the problems of a capitalist economy, whose ideas are directly relevant to ongoing scientific research at the frontiers of contemporary economics and not merely the fossilised relics of the intellectual evolutionary process. The neo-quantity theorists can dispute the credentials of the contemporary Keynesians, and claim the master's blessing for their own endeavours. At the same time, those Keynesians who followed Keynes for what they took to be his social message about capitalism—and have been both resentful and scornful of the way in which the mathematicians and econometricians have whisked Keynes the social critic beyond their (pre-eminently literary) intellectual competence and transformed his economics into an arcane quantitative expertise—can take comfort from the thought that those who snatched up and ran with the ball that Keynes put into play were after all heading for the wrong goal-posts and playing by the wrong rules. The only losers are those who have invested heavily of their time and intellect in perfecting the rules and the practice of a game in which Keynes himself was never interested. To put the point in terms of personalities: both Milton Friedman as the lead-quantity-theoretic critic of Keynesian economics and Joan Robinson as the leading custodian of the true Keynesian tradition can with a clear conscience commend Leijonhufvud's book to their students; Paul Samuelson, leader of the American Keynesian tradition, will find it embarrassing to do so.

While the general interest in Leijonhufvud's reinterpretation of Keynes lies in its implications for economic policy, the concern of the work is with Keynes' contribution to economic theory. As the author points out (in *Keynes and the Classics*), Keynes cannot really be accorded greatness on the basis of his contributions to thought on economic policy, since these ideas were very much in the air in the 1920s and his policy recommendations were by no means original.

AS A BACKGROUND to the understanding of Keynes' real contribution to theory, as Leijonhufvud reconstructs it, it is necessary to describe briefly the standard "income-expenditure" model of the economy which is the conventional representation of that contribution.

In this model there is one relation between the level of output and the rate of interest which will ensure equilibrium between demand and supply in the market for goods and services, and another relation between the same two variables which will ensure equilibrium between the demand for and supply of money. The two together determine a general equilibrium of the interest rate, output, and employment that will generally not be a full-employment equilibrium. The evolution of the orthodox interpretation of Keynes' contribution proceeded in two stages of counter-revolution.

First, the critics asserted that the Keynesian under-employment equilibrium depended on the assumption of wages being rigid in terms of money, because otherwise wage deflation would increase the quantity of money in real terms, hence lower interest rates and increase output and employment. To this the Keynesians replied that the expected result might not occur, either because investment and consumption were insensitive to interest rate changes, or because "liquidity preference" (the willingness to hold more money as interest rates fall) might become absolute, preventing the postulated fall in interest rates. The critics then brought in the "Pigou effect"—the effect of a rise in the purchasing power of money due to falling prices in increasing wealth and hence consumption, independently of any change in the interest rate. There the matter rested. The critics were content to have proved that Keynesian under-employment equilibrium was a special case of a more general "classical" economic model, resting either on wage rigidity or neglect of the "Pigou effect"; and the Keynesians were content to regard the special case as the practically relevant one, on the grounds of the observable reality of wage rigidity. Moreover, the Keynesians belittled the potential effectiveness of monetary expansion as a way of achieving by policy the effect that would follow automatically from wage flexibility if it existed. This was based on the grounds established in defence of Keynes against the first counter-attack, that both investment and consumption expenditure were in practice very insensitive to changes in interest rates. Instead, they placed their faith in fiscal policy, *i.e.*, direct operation on spending through the budget.

LEIJONHUFVUD'S INTERPRETATION of the economics of Keynes attacks the conventional income-expenditure model of Keynesian economics on two fronts.

First, Leijonhufvud contests the relevance of the framework for assessment of Keynes' contribution provided by a model of the economic system in which wages and prices are assumed to be perfectly flexible. The essence of Keynes' "long struggle to escape" from the classical tradition of economic theory, he argues, was precisely that Keynes had a vision of the dynamics of the economic process in which the economy responds to disturbances, not by adjusting prices in order to clear markets at unchanged output levels, but by adjusting quantities of goods produced and labour employed in order to adjust output to prices regarded as "normal." This procedure is perfectly rational in view of uncertainty about whether changes in demand are temporary or permanent, and in the light of the contemporary theory of information in the market, according to which it is worth while within limits to hold supplies off the market in the hope of ascertaining whether a better price than that immediately available can be obtained by waiting. But the implication of the switch from the assumption of a price-adjusting to that of a quantity-adjusting market-clearing process is precisely the cumulation of disequilibrium through the famous Keynesian multiplier process. This is a concept which contemporary Keynesian theory has tended to abandon as an unnecessary fifth wheel on the elegant coach of general equilibrium theory.

Second, Leijonhufvud contests the interpretation of Keynes' economics as "the economics of the [Keynesian] special case." This requires him to marshal a great deal of complex modern economic theory to set the stage for making his point; and he has to depend heavily on exegetical analysis of some brief and ambiguous passages in the *General Theory*, as well as to draw on aspects of Keynes' *A Treatise on Money*, which he regards as having been subsumed in (whereas many Keynesians have regarded them as replaced by) the analysis of the *General Theory*. Very briefly, Leijonhufvud argues that the essential distinction drawn in the model-construction of the *General Theory* is between short-lived and long-lived assets, the latter including both bonds and real capital assets. The real capital assets in Keynes' approach must be distinguished from consumption goods, the former having a rising marginal cost of production in terms of the latter. Hence, in Keynes' view, a fall in the money rate of interest must have a substantial stimulative effect on investment, by raising the present value of income streams from long-lived capital assets; hence the demand price offered for newly produced real assets of this kind; and hence the current rate of production of capital goods.

Leijonhufvud further argues that, in sharp and admittedly very controversial contrast with the accepted reading of Keynes' concept of the "propensity to consume" as a relation between current income and current consumption expenditure, Keynes placed great store on the effect of a fall in the interest rate in increasing the perceived wealth of owners of long-lived assets, and so increasing their consumption expenditure. This argument gets him into the very deep theoretical water of how to rationalise this "second psychological law of consumption"—since a change in the rate of interest does nothing immediate to alter society's stock of real capital, future flow of output, and consequently objective wealth. His answer is that, because of the limitation of human life expectancy and the nature of capital, the typical wealth-owner has a flow of expected income outlasting his expected needs; so that a fall in the interest rate increases the present value of future income more than that of future needs and makes him feel subjectively wealthier than before. This point Leijonhufvud takes to be the essence of Keynes' concept of "liquidity preference," the preference for holding wealth in immediately realisable form.

Since, according to Leijonhufvud, Keynes believed that a fall in the interest rate would powerfully affect spending on investment and consumption, the essence of his theory of underemployment equilibrium must lie in those forces in the money economy that prevent the interest rate from falling automatically sufficiently to prevent the multiplier process from doing its fell work of propagating unemployment. Here Leijonhufvud appeals to Keynes' emphasis on expectations about the future rate of interest as an influence on the current interest rate, and the inelasticity of these expectations in response to downward pressures on the currently prevailing rate. But, Leijonhufvud argues, Keynes did not believe in the power of the speculators to frustrate the use of monetary policy to maintain employment, except during a deep depression. In these circumstances, as Leijonhufvud interprets him, he thought that the problem might be a collapse of the confidence of entrepreneurs in the profitability of investment, rather than too high a market rate of interest. In that case, the appropriate policy would be public investment of a pump-priming nature, rather than monetary expansion aimed at reducing interest rates.

On this interpretation, Keynes appears as both far more perceptive as an economic theorist—and far less devoted to the superiority of fiscal over monetary policy as an economic policy adviser—than contemporary Keynesians would like to believe.

As with any reinterpretation of a classic writer in the light of subsequent scientific progress, there must be a residual doubt as to how far Leijonhufvud's re-reading of Keynes is snatching at straws in order to prevent the breaking of the camel's back and to retain the beast as a working member of the caravan of progress. But there can be no doubt that this work has cleared the air of a stultifying ideological controversy, and paved the way for further advance in the understanding of the workings of a monetary economy.

# Auden's Longer Poems

**Collected Longer Poems.** By W. H. Auden. *Faber and Faber*, 45s.

ONE BEGINS to wonder whether long poems are called for more often by critics than by poetry readers generally. Certainly lament for the death of the long poem has become a favourite critical theme. But while the old adage that long poems are written by poets who cannot write short ones remains largely true, it may be argued that the most influential poems of this century have in fact been long. *The Waste Land* and the *Four Quartets* have been as influential as any shorter work; and Pound's *Cantos*, Carlos Williams' *Paterson*, and Ginsberg's *Howl* have all had—for better or for worse, and often for disaster—their varying degrees of influence. Ask any young poet from Greenwich Village or Liverpool to name the most important poem in *his* life and it is likely that he will point to *Howl*. A young poet from Oxford might well pick one of the others, or turn elsewhere, but I would be surprised if the choice fell on any of the six works in W. H. Auden's *Collected Longer Poems*.

Yet, Leavis apart, the majority of critics would seem to grant Auden his just place as the most accomplished and versatile of living poets, and one who has been, and who remains, exceptionally influential. Clearly, he dominated the generation of the 1930s with a power and range that few could approach. Master of an impressive number of forms, from the Ballad to the Blues, he was all the more able to contain the see-sawing beliefs and passions of the time. Committed, yet distanced, his poetry was remarkable for its surface calm, the pincers moving obliquely but firmly over their subject. The tension could be riveting, especially where the aural matrix was based on popular tradition, as in *Refugee Blues*:

*Went to a committee; they offered me a chair;*
*Asked me politely to return next year:*
*But where shall we go to-day, my dear, but where shall we go to-day?*

*Came to a public meeting; the speaker got up and said:*
*"If we let them in, they will steal our daily bread";*
*He was talking of you and me, my dear, he was talking of you and me....*

The influence of music on Auden's verse, apparent in this poem and throughout the longer works, has always been salient: even his worst lines often "sound" impressive. Indeed the poems on which his reputation will finally come to rest may well be the magnificent early lyrics—far away from the world of Spain and Fascism against which he cried out so forcefully in much-quoted poems he no longer favours.

With his move to America in 1938, Auden's area of interest and commitment changed visibly. By 1940 the Auden conception of love had moved away from an ideal union of man and woman, or of a brotherhood of man ("we must love one another or die") to a Christian ideal, making one aware of what Spender has called "the odd impersonality" of Auden. Coated more with the philosopher's semantics, the four long poems of this later period (*New Year Letter*, *For the Time Being*, *The Sea and the Mirror*, *The Age of Anxiety*) are in the main colder, more distant, more cerebral than any of Auden's previous work; they contrast strikingly with the earliest of the longer poems included in this Collection, *Paid on Both Sides* (published 1930) and *Letter to Lord Byron* (published 1937)—the first a rather earnest, at times muddled, verse play concerning a blood feud (or is it school-gang rivalry, or both?), the second a rollicking, deliberately chatty "long" poem full of the dry self-aware wit of which Auden is master.

*Letter to Lord Byron* is an inventive, technically dazzling piece of writing, a triumph of taste. It sets a tone and, for all its length, rarely slips from it. As befits its subject the poem is self-mocking, but it mocks also many sacred establishment shrines. To read it is to eavesdrop on witty gossip about the age and its values and to learn something also about the author's own life and tastes, for it contains a vivid section of autobiography. The poem is a lap of honour taken at high speed. "I like your verse because she's gay and witty" writes Auden to Byron, and here one might pay the same compliment to Auden.

The outward setting of Auden's *New Year Letter* (January 1, 1940) is his newly-adopted America. Already the change in tone from the only slightly earlier *September 1, 1939* is