Soumitra Sharma
Professor of Economics at the Faculty of Economics, University of Zagreb (Croatia)

J. M. KEYNES: BEFORE, FIFTY YEARS AFTER AND BEYOND

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Nobel Laureate Sir John Hicks writes: "The historian...may well come to reckon the third quarter_as the age of Keynes. It is true that Keynes died (in 1946)_; but it is nothing unusual for a great thinker and teacher to make his greatest impact upon the world after he is dead. That surely is what one must judge Keynes to have done. Hicks, further adds: "For Keynes was a man of extremely active mind, whose thinking never stayed still but was always pushing on. Some of those who worked with him could not stand the pace: 'you never knew what he would be saying next'" (J. R. Hicks, Crisis in Keynesian Economics, Basil Blackwell, Oxford, 1975, p. 1 and 5). Thus this was the man with whose thought we are to deal with.

1. KEYNES BEFORE THE GENERAL THEORY

It was not until the Treaty of Versailles that Keynes achieved fame and began to make public the theoretical system on which he based his contributions to economic theory and policy.

Professional career of Keynes begins with a "solid and substantial" book Indian Currency and Finance (1913) which was very favourably accepted by his professional colleagues. At this juncture of time Keynes was primarily interested in achieving price stability for India and he supported his recommendations for stability which were based on purely classical insight. He suggested that India should have a gold exchange standard and that a central bank be set up to centralise the gold reserves for meeting extraordinary drains in times of crisis. He thought that his plan would provide greater stability to the Indian currency system than the strict gold standard could ensure.

At the outset of the 1st World War Keynes worked at the British Treasury on problems of French finance and war reparation question. He wrote some articles on the behaviour of money markets and banking system, but hardly anything of brilliance to attract attention.

His The Economic Consequences of the Peace (1919) was certainly the best-selling analysis of the Treaty of Versailles. Keynes devoted a chapter to economic process as it led up to the War. He looked with nostalgia at the pre-war system of free trade, ample investment opportunities, capital accumulation and population growth. His economic analysis of this millennium is very interesting.

The post-war economic issues such as inflation vs. deflation; stability of exchange vs. stability of prices, gold standard etc. provided the stimulus to much of Keynes' writings. Although Keynes was always in favour of price stability, but if economies had to be cured by price manipulation, he was invariably in favour of inflation against deflation (see A Tract on Monetary Reform, Hercourt Brace, New York, 1924, pp. 44-45; and his An Open Letter to the French Ministry of Finance (1926), recommending inflationary measures out of the three alternatives open to the Minister: levy capital tax, reduce interest rates, or raise prices). Although this was a part of his broader conception that a high level of investment is essential for economic growth under capitalism, but it was not until the investment opportunities sunk low that Keynes recognised their complicated character and the necessity for vigorous measures of revival of economic system. His desire for price stability is in line with Marshall's teachings. Keynes was unequivocal in his preference for domestic price stability over exchange rate stability so that the monetary authority can maintain control over the domestic economy. He specifically suggested to the Bank of England to quote a weekly spot and future price for gold. These prices were not supposed to be fixed but to fluctuate as conditions warranted.

For the analysis of the problem of price stability Keynes employed the theoretical apparatus of the classical quantity theory of money. Throughout 1920s we find him insisting on price stability with the policy measures based on the orthodox theory of money. Evidently the theory of determination of price level is based on Marshall's Money, Credit and Commerce.

From the appearance of Tract to the time when A Treatise on Money, Vol. I & II was published in 1930, there was one single most important problem that troubled England and which Keynes was attempting to solve. While in England in 1929 over a million people were unemployed and depression prevailed, other countries were fairly prosperous. The unemployment in England was largely confined to iron and steel, shipbuilding, and coal industry. The remedies suggested by Keynes for the improvement of the level of employment mostly involved monetary control and manipulation. He contended that the system was not perfectly self-adjusting and that laissez faire policies do not work for recovery. In fact he defined this state of prolonged depression of 1920s as one of pseudo equilibrium (see his Essays in Persuasion, 1933). His reaction to Beveridge's contention that overpopulation has little effect upon the level of employment, Keynes held that a phenomenon of economic malaise arising out of such causes as transition from lower to higher price level, attempts of labour unions to obtain an increase in wages and changing external markets etc., is the real cause of unemployment.

Keynes denounced the British return to gold standard at pre-war parity because he considered it not only being a deflationary measure but also as an attempt to restore an automatic mechanism of balance of payment adjustment to which he has been opposed since the end of war. In The Economic Consequences of Mr. Churchill (1925) Keynes argues that the main source of British economic difficulties is the disadvantageous parity of internal and external prices. The suggested line of action according to him was to let the sterling depreciate abroad, or to force the domestic prices and wages fall in line with the sterling. Naturally, because of the fear of deflationary effects he ruled out the latter alternative.

In 1929 elections, Lloyd George pledged to reduce unemployment through spending on public works. Keynes with D. H. Henderson examined the common sense of the pledge and argued its economic reasoning (Can Lloyd George Do It? An Examination of the Liberal Pledge, Nation and Athenaeum, 1929). Keynes was optimistic about the success of his policy of public works in bringing about full employment. His recognition of the possibilities of induced effects over and above the government outlays presents the signs of his later theoretical evolutionary developments.

Everybody had eagerly awaited the long publicised A Treatise on Money which Keynes was writing for many years. In preface of the book he mentions that his ideas have undergone great change during the writing. The critics, however, highlight its "loosely knit theory with many lines of incomplete thought". But it certainly is a sum of all the lines of his thought that covered the debates of 1920s. The Treatise can be considered as a book based on two theories: the business cycle theory which makes investment fluctuations the prime mover of the capitalist system; and the theory that the rate of interest is determined in equilibrium by the equality of savings and investment. The whole aim of the Treatise seems to be to tell us how to keep prices stable; or what is the same, to keep savings and investment equal; or what is the same to keep the market rate of interest equal to the natural rate. Thus Keynes recommends monetary control; the banks by manipulating the rate of interest would influence the level of investment until the equilibrium can be achieved with the more stable rate of savings. This would give the desired aim of price stability. If interest rate adjustments prove to be insufficient, the open market operations were suggested as the measures of control. Keynes was convinced that by exposition of his "fundamental equations" he is providing the core of his theory.

Evidently, in the early years of 1930s Keynes had a good knowledge of the troubles in the economic system. Although he then did not have sufficient argument to formalise his theoretical frame, he supported policies that were similar to his future General Theory. It can be safely said that it was not his theory that led him to practical policies, but practical policies that led him to his theory. His popular writings of this period is a definite proof of it. In 1931 his radio address was a strong plea for increased spending to counteract the depression. In this address he attacked thrift because he saw the fallacy of providing large savings to be offset by investment when there was no offsets in sight.

A certain change of views can also be seen in Keynes of 1930s against Keynes of 1920s. In 1923 Keynes was of the opinion that protection could not help to improve employment. In 1931 in Addendum I of the famous Macmillan Report which was strongly supported by Keynes advocated for three alternatives of domestic monetary policy: a reduction of salaries and wages, control of imports and aids to exports, and state assistance to private enterprise and to investment. Keynes' lecture in summer of 1931 at Chicago still reflects his old theoretical frame of mind. In this lecture he made an excellent analysis of the economic situation and suggested policy cures but the theoretical basis was still unchanged.

In 1931 an important development took place. While economists (e.g. F. A. von Hayek, D. H. Robertson and others) were debating over Keynes' "fundamental equations", R. F. Kahn was formulating his theory of multiplier (The Relation of Home Investment to Unemployment, Economic Journal, Vol. LI, 1931) which later had a profound impact on Keynes' mind[1]. Kahn's impact on Keynes can be traced in 1933 (see his The Means to Prosperity, Macmillan, London, 1933). Here, Keynes makes a strong case by providing some new arguments for his public-works policy and makes extensive use of the principle of multiplier.

Economists see the seeds of origin of Keynes' General Theory in his dissatisfaction with his own Treatise of which he speaks in his letter of 14 September 1930 to his mother, in the prolonged international slump of 1929, and in the discussions of 1931 within the "Cambridge Circus" by his fellow colleagues (Joan Robinson, James Meade, Richard Kahn, Dennis Robertson, Roy Harrod, and Richard Hawtrey). It was only during the

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1 L. R. Klein suggests that according to P. A. Samuelson some significant developments in economic literature were taking place in 1933. Mrs. Joan Robinson in February 1933 points out to some subtle difficulties of the Treatise. ('A Parable of Savings and Investment,' Economica, Feb. 1933). It was seen as an attempt to bridge the differences between Keynes and Hayek. But her other article later the same year ('The Theory of Money and the Analysis of Output,' Review of Economic Studies, Vol. 1, No. 1, 1933) was definitely the first exposition of essential parts of Keynes' General Theory. (For detailed analysis on the subject see L. R. Klein, The Keynesian Revolution, Macmillan, London, 1966, pp 38-40.)

summer 1934, however, that Keynes was teaching from proof sheets of The General Theory of Employment.

2. THE KEYNESIAN REVOLUTION

Although the foundations were already laid, the Keynesian Revolution did not begin until the appearance of his The General Theory of Employment, Interest and Money published twice by MacMillan of London in 1936.

But, unlike the highly publicised Treatise the new book Keynes was working on was not at all known to public but only to a few of his close friends and colleagues. In his 1935 New Year letter to Bernard Shaw, Keynes gives only an inkling what he is busy in writing. He writes:

> "To understand my 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. When my new theory has been duly assimilated and mixed with policies and feelings and passions, I can not predict what the final upshot will be in its effect on actions and affairs, but there will be a great change and in particular the Ricardian Foundations of Marxism will be knocked away. I can not expect you or anyone else to believe this at the present stage, but for myself I don't merely hope what I say. In my mind I am quite sure. (The Collected Writings of John Maynard Keynes, Vol. XIII, Macmillan, London, 1971, p. 492.)

Later in the summer of 1936, he mentions about it in his letter to R. F. Harrod in the following words:

> "I have been much preoccupied with the causation, so to speak, of my progress of mind from the classical position to present views, - with the order in which the problem developed in my mind. What some people think as an unnecessarily controversial tone is really due to the importance in my mind of what I used to believe, and of the moments of illumination which were for me personally moments of illumination _You don't mention effective demand or more precisely, the demand schedule for output as a whole, except in so far as it is implicit in the multiplier. To me the most extraordinary thing, regarded historically, is the complete disappearance of the theory of demand and supply for output as a whole, i.e. the theory of employment, after it had been for a quarter of century the most discussed thing in economics. One of the most important transition for me, after my Treatise on Money had been published, was suddenly realising this. It only came after I had enunciated to myself the psychological law that, when income increases, the gap between income and consumption will increase, - a conclusion of vast importance to my own thinking but not apparently, expressed just

like that, to any one else's. Then, appreciably later, came the notion of interest being the measure of liquidity of preference, which became quite clear in my mind the moment I thought of it. And last of all, after an immense amount of muddling and many drafts, the proper definition of the marginal efficiency of capital linked up one thing with another". (Letter from Keynes to Harrod, 30 August 1936, CW, Vol. XIV).

In February 1936, the book finally appeared and it was being sold for 5 shillings to encourage wide readership. It was still 8 shilling 6 pence in 1960.

The book created a stir in the professional community. Polemical as well as favourable reviews appeared. While reviews by A. P. Lerner[2], W. B. Reddaway[3], and J. R. Hicks[4] could be considered favourable, A. C. Pigou[5], F. H. Knight[6], Gustav Cassel[7] were among the bitter dissenters. Keynes himself was aware of such reactions, as he himself writes:

"Those who are strongly wedded to what I shall call 'the classical theory' will fluctuate, I expect, between a belief that I am quite wrong and a belief that I am saying nothing new. It is for others to determine if either of these or the third alternative is right." (Preface, The General Theory, 13 December 1935).

Some how the book was not well comprehended at that time. Commenting upon reviews of The General Theory, Lawrence R. Klein remarks:

"Neither Keynes nor his immediate reviewers understood the full implications of the theoretical model. Much of the later polemical literature presented wasted paper, but by no means were all the discussions worthless_but such a lack of comprehension merely serves to emphasise the revolutionary character of the work" (L. R. Klein, The Keynesian Revolution, 1966, p. 91).

To be honest we must mention that it is not difficult to find in previous literature many of the same ideas but Keynes certainly said

2 Mr Keynes' 'General Theory of Employment, Interest and Money," International Labor Review, Vol. 34, 1936, p. 435.

3 'The General Theory of Employment, Interest and Money,' Economic Record, Vol. 12, 1936, p. 28.

4 Mr. Keynes and the 'Classics': A Suggested Interpretation', Econometrica, Vol. 5, 1937, p. 147.

5 'Mr. J. M. Keynes's General Theory of Employment, Interest and Money,' Economica, Vol. 3, 1936, p. 115.

6 'Unemployment: and Mr Keynes' Revolution in Economic Theory,' Canadian Journal of Economics and Political Science, Vol. 3, 1937, p. 100.

7 'Mr. Keynes' 'General Theory,'" International Labor Review, Vol. 36, 1937, p. 437.

something quite different as compared to most other economists. What is true is that no single economist before him ever devised a model to solve unemployment problem based on the propensity to consume, marginal efficiency of capital, and liquidity preference[8].

It is widely believed that Keynes' exit from professional life caused by a heart attack in 1937 left the way clear for the emergence and elaboration of 'Keynesian economics' as something quite different from the 'economics of Keynes' and the burgeoning of The General Theory into 'the Keynesian Revolution'. At this stage it was only a revolution on the plane of theory[9], but Keynes will not have to wait long, as it will extend speedily to the policies especially in the years following the 2nd World War. Thus it is at the end of the war (which economically considered, as Sir John Hicks said, was hardly over before 1950) that the age of Keynes, in practice, begins.

Harry G. Johnson provides a well balanced and dispassionate appraisal of the Keynesian revolution. According to him a revolutionary theory had to depend for its success on five main characteristics[10]. Keynes' General Theory did possess all these characteristics.

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8 The extent of impact Keynes exercised on economics of his time is evident in A. Marget's remark: "Indeed if one needs further proof of the 'strangeness' of the Keynesian episode, one needs ask only at what other time since Adam Smith, a position avowedly presented as revolutionary and heterodox, has become for so large a number of professional economic theorists a new ('modern') orthodoxy in so short a period". (A Theory of Prices II, Prentice Hall, New York, 1942, p. xxii)

9 Mrs Joan Robinson comments on the significance of the revolution in following words: "On the plane of theory the main point of The General Theory was to breakout of the cocoon of equilibrium and consider the nature of life lived in time, the difference between yesterday and tomorrow, here and now, the past is irrevocable and the future is unknown. This was too great a shock. Orthodox (neo-classical) theory managed to wind up into a cocoon again. Keynes had shown how money is necessary feature of an economy in which the future's uncertain and he showed what part monetary and financial institutions play in the functioning of the real economy_.In the Keynesian theory after the war this simple point is lost. The whole of Keynes' argument is put to sleep. Keynes is smothered and orthodox equilibrium theory is enthroned once more. Keynes was writing and arguing against the prevailing orthodoxy. He had to argue first and last that something could be done. (Mrs. Joan Robinson, Collected Economic Papers, V, MIT Press, Boston, 1980, p.121).

10 "First, it had to attack the central proposition of conservative orthodoxy - the assumed or inferred tendency of the economy to full employment - with a new but academically acceptable analysis that reversed the proposition. This Keynes did with the help of Kahn's concept of the multiplier and his own invention of the propensity to consume." "Second,

It must also be noted that the very success of Keynesian revolution, however, ensured that someday it would in its turn become an established orthodoxy and in the mid 1950s it did become just that, just ripe for an attack in exactly the same way as what Keynes chose to call 'classical economics' and to attack in the 1930s. It has had the same two vulnerable characteristics: inability to prescribe for what has come to be considered a major social problem - inflation, in contrast to unemployment of Keynes's time - and a dependence on the authority and prestige of senior scholars which is oppressive to the young.

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the theory had to appear to be new, yet absorb as much as possible of the valid or at least not readily disputable components of existing orthodox theory. In this process, it helps greatly to give old concepts new and confusing names, hence in The General Theory marginal productivity of capital became marginal efficiency of capital; the desired ratio of money to income - the k of the Cambridge tradition - became a minor constituent of the new theory of 'liquidity preference'; and the ex post identity of savings and investment_ became the sina qua non of right reasoning." "Third, the new theory had to have appropriate degree of difficulty to understand_Keynes' General Theory managed to achieve: it neatly shelved the old and established scholars, like Pigou and Robertson, enabled the enterprising middle and lower middle aged like Hansen, Hicks, and Joan Robinson to jump on and drive the bandwagon, and permitted a whole generation of students to escape slow and soul-destroying process of acquiring wisdom by osomosis_.Economics, delightfully, could be reconstructed from scratch on the basis of a little Keynesian understanding and a lofty contempt for the existing literature - and so it was." "Fourth, the new theory had to offer to the more gifted and less opportunistic scholars a new methodology more appealing than those currently available. In this respect Keynes was lucky both in having a receptive audience available, and to hit somewhere conveniently between the old and new emerging styles of economic theorising. The prevailing methodological orthodoxy was that of Marshall_.The new methodological challenge was coming from the explicitly mathematical approach of Hicks and Allen, an approach whose empirically and historically almost empty generality was of little general appeal. The General Theory found a middle ground in an aggregated general-equilibrium system which was not too difficult or complicated to work with_ and which offered a high degree of apparent empirical relevance to those who took the trouble to understand it." "Finally, The General Theory offered an important empirical relationship for the emerging tribe of econometrician to measure - the consumption function, a relationship_a relationship for which the development of national income statistics provided the raw material needed for estimation, and which could be estimated with surprising success given the limitation of the available data to approximately a single business cycle." "In my judgement these factors accounted for the success of the Keynesian revolution". (Elizabeth S. and Harry G. Johnson, The Shadow of Keynes, Basil Blackwell, Oxford, 1978, pp. 188-191)

However, The General Theory was successful, precisely because, by providing an alternative theory to the prevailing orthodoxy, it rationalised a sensible policy that had hitherto been resisted on purely dogmatic grounds. Similarly, the monetarist counter-revolution has been partly successful only because it has encountered a policy problem for which the prevailing orthodoxy was able to prescribe only policies of proven or presumptive incompetence (in the form of incomes or guidelines policy), but for which the monetarist counter-revolution has both a theory and a policy solution.

3. KEYNES AFTER THE GENERAL THEORY

In 1939 Keynes was by far the most distinguished economist of his time. His public status gave him much greater access to and opportunities to influence official and unofficial opinion. During the war Keynes did not have any official position like in the previous war. He was simply an influential member of the British Chancellor's consultative council. Thus he was very much of a political economist whose influence played an important role in British economic policy. According to D. E. Moggridge, Keynes activities and influence can best be studied by looking at his role in the internal and external war and post-war finance.

From the very beginning Keynes involved himself in the problems of war finance on two fronts: maximising the possible under the existing constraints and easing the constraints themselves. The outbreak of war brought a rapid response at first in a letter to The Times on loan policy and later in the ideas How to Pay for the War (1940). Keynes had first introduced the ideas of this pamphlet in a talk to the Marshall Society on 20 October 1939. Initially the talk was entitled, 'War Potential and War Finance', but four days later he circulated the draft copies of his proposals under the heading, 'The Limitation of Purchasing Power: High Prices, Taxation and Compulsory Savings' to the editor of The Times, the Chancellor and others. So as to make his proposals more acceptable both to the Labour and trade union leaders, during this period of two publications, Keynes involved himself in extensive discussions. After the publication, he continued to press privately and publicly for the adoption of his policy.

The success of German campaign in West Europe brought along an increase in expenditure and downfall of Neville Chamberlain. The new Chancellor took Keynes in his advisory council. Now Keynes had his chance to get his proposals accepted in official circles. Since the outbreak of war Keynes' primary concern was the best way of transfer of resources from peacetime to wartime uses especially from consumption. According to Keynes, the government could procure additional resources from consumption by voluntary reduction in personal consumption, compulsory savings, official inflationary policies, a policy of comprehensive rationing, and by increased taxation.

Soon after the war began, Keynes also became involved in discussions of external finance policy sending two memorandums: one on exchange control policy to the Treasury and the other on financial aspects of the blockade against Germany to the Ministry of Economic Warfare. Keynes argued that an effective exchange control policy is necessary to conserve British overseas assets. He favoured effective exchange control, limited sale of foreign assets, access to maximum volume of foreign resources from sterling areas etc.

However, Keynes' concern with the post-war world did not end with a consideration of the possible post-war consequences of policies war effort maximisation. Keynes used his Treasury position to ensure his position in shaping of the post-war world would see positive steps to avoid a repetition of economic events of the inter-war period.

Keynes' influence on the development of post-war internal economic policy in Britain emerged most clearly in three directions: the methods of analysis used in assessing the impact of various post-war policies, the White Paper on Employment Policy (1944), and National Debt Enquiry (1945).

Keynes macroeconomic approach was successfully implemented in the budget of 1940/41. It also came to be used in other areas of policy formulation. However, the most frequent use of Keynesian analysis came in discussions of post-war employment policy. He himself was not involved in writing the Treasury documents for the Committee on Post-war Internal Economic Problems. It was James Meade who provided the impetus. Keynes used his influence in passage of certain proposals to be included in the Beveridge Reports, White Paper on Employment Policy (1944) and White Paper on Social Insurance (1943). But his most substantial contribution came in the area of monetary policy. In capacity of a member of the National Debt Enquiry Committee, Keynes continued dominating the proceedings, giving evidence on monetary and debt management policy. His proposals were incorporated in Committee's report and among them was that of the post-war cheap money policy.

Keynes, contributions to official discussions of post-war external economic policy centred around the creation of Bretton Woods institutions, a scheme for the international regulation of primary product prices, Britain's post-war commercial policy, and Allied reparations policy.

On request from Anthony Eden to prepare a statement in reply to Germany's plan for a New Order in Europe, Keynes gave some thought to the issue which resulted in his Proposals to Counter the German "New Order". His approach rested upon the following principles: friendly co-operation with the US as she was the only country to have resources; post-war international currency arrangements departing entirely from laissez-faire practices of 1920-33; post-war institutional arrangements for currency and demand management which would be compatible with an extensive international trade and equal access for all to world markets; and organised relief and reconstruction aid to post-war Europe.

Such a framework of ideas served Keynes in subsequent discussions on the post-war international economic arrangements. In the 18 month after these were drafted Britain produced plans for post-war currency arrangements, commodity policy and international trade. Behind the first two was the pen of Keynes and the third was drafted by James Meade.

Between December 1943 and May 1944 Keynes was deeply involved in discussions on the International Monetary Fund. By the time he died in April 1946, agreement on the American Loan, the IMF and a draft outline on commercial policy has been reached.

4. REACTIONS ON THE OTHER SIDE OF THE ATLANTIC

Before the publication of The General Theory, Keynes had urged his ideas directly on President Roosevelt, most notably in his letter to the New York Times on 31 December 1933. He also visited the President in the summer of 1934, to plead his case but not very successfully.

However, in the words of John K. Galbraith, "the trumpet_that was sounded in Cambridge, England was heard most clearly in Cambridge, Massachusetts. Harvard was the principal avenue by Keynes's ideas passed to the United States." ('How Keynes Came to America' in Milo Keynes (ed.), Essays on John Maynard Keynes, Cambridge University Press, 1975, p. 135).

While Paul Samuelson at MIT was already an acknowledged leader of younger Keynesians, Alvin Hansen at Harvard was one of the early converts. Hansen proceeded to expound the ideas of Keynes in books, articles and lectures to apply them to the American scene. He became the "leader of a crusade" in which he was joined by his colleague Seymour Harris. Samuelson put the Keynesian ideas into what became the world's leading text book in economics. Lloyd Metzler applied Keynesian ideas to international trade. At Yale, Lloyd G. Reynolds gathered a younger group of economists to discuss the new trends.

Soon after the publication of the book and Hicks' seminal paper, the American economists had seized upon the IS-LM technique which was based upon Walras' general equilibrium approach, and used it as the foundation of their neo-classical synthesis. As Tobin points out, students were told that they did not have to read Keynes difficult General Theory, but could study instead the IS-LM which their professors assured them encapsulated all Keynes' important ideas.

In the US the neo-classical synthesis was led by Paul Samuelson and supported by such noted economists as Franco Modigliani, Don Patinkin, Robert Solow, Lawrence Klein, James Tobin and others was fiercely attacked by the monetarists.

Meanwhile the monetarism of 1960s centred around Milton Friedman. As time and understanding of both theory and reality progressed, the interest of monetary theorists has shifted from demonstrating the neutrality of money to investigating the conditions of monetary equilibrium and dis-equilibrium. The appropriate tool was not the 'quantity theory of money' but the so called 'dynamic equation'. Much of the work of 1920s and 1930s was reinvented by Clower (1965), Leijonhufvud (1968) under the brand name of 'monetary growth models'. The authors of these models particularly Robert Lucas (1975, 1977) and Sargent (1976) preserved the classical assumption of a system in real full employment equilibrium, and hence were constrained to treating business cycles and similar fluctuations either in terms of changes in the composition of a given full employment output, or in terms of unemployment and idle capacity that was either unexplained, or explained in terms of neo-classical mechanism of an excessively high level of real wages. It was Keynes' rejection of this assumption that led to the counter-revolution.

In early 1980s macroeconomic theory was in disarray. The question of interest was whether the monetarist counter-revolution will sweep the board and become the orthodoxy of the future, or whether it will gradually go away. It was being challenged by the monetarists on the one hand and by new classical economists on the other. Robert Lucas even went to the length of saying that people '_take offence if referred to as "Keynesians". At research seminars, people don't take Keynesian theorising seriously any more; the audience starts to whisper and giggle at one another'[11].

But, towards the end of 1980s the tide seems to have turned and the "crude monetarism" of Milton Friedman died, and the new classical macroeconomics is slowly dying[12].

According to Johnson, the most serious defects of the monetary counter revolution are on one hand, the abnegation of the restated quantity theory of money from the responsibility of providing a theory of the determination of prices and of output, and on the other hand, its continuing reliance on the methodology of positive economics[13].

The monetary onslaught against Keynesianism which was started by Milton Friedman was at its climax in mid 1970s because this system failed to provide any workable solution to the inflation problem plaguing the world. By this time, Keynesian revolution had invited the wrath of its critics particularly from Axel Leijonhuvud[14] and Robert Clower the same

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11 R. Lucas, 'The Death of Keynesian Economics', Issues and Ideas, Winter, 1980.

12 See for details e.g. Alan Blinder, 'The Fall and Rise of Keynesian Economics', Economic Record, December 1988.

13 op. cit., p. 200.

14 "Does the market system tend to move "automatically" towards a state where all market excess demands and supplies are eliminated." "But the Keynesian Revolution did not quite succeed in making a clean sweep. The older view survived and has grown in strength as the 1930s recede from

way the classical theory had invited the barrage of criticism from Keynes[15].Now in 1990s, in the US and elsewhere, there are definite signs of revival of Keynesian ideas and policies.

On the policy plane in the US, ten years after publication of The General Theory the 1946 Employment Act gave the Keynesian System the qualified support. It recognised that unemployment and insufficient output would respond to positive policies. The responsibility of the federal

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memory and mass unemployment on that scale has failed to recur." "Clower's original venture into the uncomfortable no-men's land between Neo-classicism and Keynesianism sought to provide a microtheoretical foundation for the core concept of Keynesian theory - Effective Demand." (Axel Leijonhuvud, 'Effective Demand Failures', Swedish Economic Journal, 75 (1), pp. 27-48.)

15 Robert Clower's criticism is very vehement and is based on the following grounds. In his own words, "But if _ Keynes intended to deny the validity of the orthodox theory of household behaviour, one can only say that he was singularly unsuccessful in providing a rationale for his attack. "The second item in Keynes' bill of particulars is essentially the same as the first: classical theory is charged with failure to recognise the existence of involuntary unemployment (The General Theory, pp 15-18). Again, the basic question is: Are 'involuntary unemployment' and 'chronic dis-equilibrium' synonymous terms for the same objective phenomenon or is 'involuntary unemployment' a special kind of dis-equilibrium particularly associated with the breakdown of the orthodox theory of household behaviour." "The third and final item in Keynes indictment is a denial of the relevance of Walras' law (The General Theory, pp. 18-21). Most later writers (e.g. Ohlin, Goodwin, Patinkin) have argued either that this portion of Keynes indictment is wrong, or that the propositions which Keynes attacks is not in fact the one he thought he was attacking. Most economists have opted for the second explanation, partly in deference to Keynes' acknowledged intellectual powers, partly because they recognise that if Keynes seriously meant to question the validity or relevance of Walras' law, he would have to reject orthodox theory of household behaviour and propose an acceptable alternative - and the alternative would have to include orthodox theory as a special case, valid under conditions of full employment." "The conclusion which I draw_may be put in one phrase: either Walras' law is incompatible with Keynesian economics, or Keynes had nothing fundamental to add to orthodox economic theory." "Thus we are caught on the horns of a dilemma. If Keynes added nothing new to orthodox doctrine, why have twenty five years of discussion failed to produce an integrated account of price theory and income analysis? If Keynes did add something new, the integration problem become explicable: but then we have to give up Walras' law as fundamental principle of economic analysis. It is precisely at this point, I believe, that virtually all previous writers have decided to part company with Keynes." (Robert W. Clower (1965), 'The Keynesian Counter-Revolution: A Theoretical Appraisal', in Hahn and Breechling (eds), The Theory of Interest Rates, Macmillan Publishers Ltd, London.)

government to act was affirmed. The Council of Economic Advisers became a platform for expounding the Keynesian view of the economy.

Arthur F. Burns, President Eisenhower's Chairman of the Council of Economic Advisers, a Columbia university professor and critic of Keynes, in his 1946 NBR report 'Economic Research and the Keynesian Thinking of Our Times', criticised a version of the Keynesian underemployment equilibrium and concluded, "the imposing schemes for governmental action that are being bottomed on Keynes' equilibrium theory must be viewed with scepticism". Although Kennedy and Johnson administrations will continue with the Keynesian policies for some years but by then the ball has already started rolling towards a counter-revolution.

The Republican administrations of Presidents Richard Nixon, Ronald Reagan and George Bush have energetically pursued monetarist and supply-side policies which resulted in huge budget and trade deficits with negative consequences for employment and growth. In mid 1990s there seems to be a tilt towards Keynesian policies.

5. KEYNESIAN POLICIES AND THE FUTURE

Just ten years after the publication of his monumental book, Keynes died in 1946. These fifty year after his death, had been a period of success for his theory and policies, controversies and criticisms, revival and renewed appreciation. Until the early 1970s there was a generally accepted broad consensus in macroeconomics which revolved around the Keynesian model. By the early 1980s the conventional wisdom was shattered and was replaced by competing schools of thought.

Economic theories always have policy implications and therefore bound with value judgements. Various schools of thought have different set of theories and policy conclusions. The consensus of the 1960s was that mixed economies should be regulated by Keynesian demand management policies. Since then there has been a polarisation of views. Keynesian policy has been questioned both on theoretical and pragmatic grounds.

The fundamental idea behind the Keynesian approach to macroeconomic policy is that government intervention at macro level will improve the overall performance of the economy if compared leaving adjustments to private sector markets. Whether the government intervention is necessary centres around the question of how well markets adjust to changes and uncertainty. In Keynesian model private sector is unstable and prices fail to adjust. The adjustment burden falls on output and employment, thus giving rise to a case for government intervention. The core of Keynesian policy is that by changing the effective demand the government can change the aggregate supply.

Both in Keynesian and in neo-classical synthesis approach, if the output is below the full employment level, increase in effective demand increases the supply only if it reduces the real wage rate. The crucial assumption that both approaches do have that workers will accept reduced real wages if it is achieved through an increase in the price level. Expansionary fiscal and monetary policies work because they increase effective demand and reduce the real wage rate by raising price level.

The post-war experience with inflation has shown that it is difficult to sustain the assumption that workers will not seek to prevent a decline in real wages if prices rise. Under such circumstances expansionary fiscal and monetary policies will fail to increase aggregate supply except in the short run, while the expected inflation rate is less than the actual rate so that real wages are lower than they would be otherwise. Once expected inflation has adjusted to the actual, real wages return to their previous level. Those who favour the traditional Keynesian policy need to show that a reduction in real wage is not necessary so as to raise the output through effective demand or that there are people willing to work given the opportunity i.e. off the supply curve. This is shown by the neo-Keynesian quantity constrained models in which both the household and firms are rationed sellers. Such models are appealing to workers unions. The neo-Keynesian analysis rests on the assumption that market fails to clear because the price adjustments do not occur quickly. Whether or not such market failure consistent with rational behaviour of economic agents is an unresolved question.

The monetarist criticism has been directed against the presumption of the 'synthesis' that workers will accept reduction in real wages that are due to inflation. In fact, real wage reductions are only necessary if there are diminishing returns to labour. The 'new microfoundations approach' demonstrates that expansionary policies can only provide a temporary boost to output. Here too the increase in the supply of output depends on a fall in the real wage.

Use of rational expectations by the new classical economists is a rather more serious attack on the Keynesian policies. Given a new classical aggregate supply function the government can only increase output if it can create a divergence between actual and expected prices. With price expectations being rational and private sector fully informed of the situation of economy, there is no possibility that systematic fiscal and monetary policy can cause price divergence and thus affect the output.

J. M. Keynes firmly believed that economists should attempt to model the state and the real world rather than an idealised long-run unrealistic system. He did not believe in the neo-classical long-run solutions for real world economic problems. In his most frequently quoted remark, he regarded on facile the neo-classicists' claim that free markets assure long-run full employment and stable price level. He wrote:

> "_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."

One could agree with the Post-Keynesians that economic theory must deal with problems in an institutional, historical setting where uncertainty regarding future events affects current economic decisions and policies. The institutions of non-neutral monetary system and use of future contracts represent core of a real world. The ideal neo-classical model on the other hand involves a fully anticipated statistically predicted future. Hence, according to them, money and liquidity play no important roles in determination of output and employment. It is lately argued that since in a temporal real world setting the neo-classical system can not function even as an ideal, the results should not be used by policy makers. Keynes considered that neo-classical 'teaching is misleading and disastrous if we attempt to apply it to the facts of experience'.

To conclude, If Keynesian policies cease to offer a viable economic policy option, then this would have profound political implications. Keynesian policies promise to improve the functioning of markets by means of modest government intervention and thus offer a middle way between complete state governance on the one hand and free market forces on the other. If the middle way does not work, let us keep looking for the solutions.

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