

The General Theory of Employment, Interest, and Money
By John Maynard Keynes

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PREFACE

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. For if orthodox economics is at fault, the error is to be found not in the superstructure, which has been erected with great care for logical consistency, but in a lack of clearness and of generality in the premisses. Thus I cannot achieve my object of persuading economists to re-examine critically certain of their basic assumptions except by a highly abstract argument and also by much controversy. I wish there could have been less of the latter. But I have thought it important, not only to explain my own point of view, but also to show in what respects it departs from the prevailing theory. 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. My controversial passages are aimed at providing some material for an answer; and I must ask forgiveness. If, in the pursuit of sharp distinctions, my controversy is itself too keen. I myself held with conviction for many years the theories which I now attack, and I am not, I think, ignorant of their strong points.

The matters at issue are of an importance which cannot be exaggerated. But, if my explanations are right, it is my fellow economists, not the general public, whom I must first convince. At this stage of the argument the general public, though welcome at the debate, are only eavesdroppers at an attempt by an economist to bring to an issue the deep divergences of opinion between fellow economists which have for the time being almost destroyed the practical influence of economic theory, and will, until they are resolved, continue to do so.

The relation between this book and my *Treatise on Money* [JMK vols. v and vi], which I published five years ago, is probably clearer to myself than it will be to others; and what in my own mind is a natural evolution in a line of thought which I have been pursuing for several years, may sometimes strike the reader as a confusing change of view. This difficulty is not made less by certain changes in terminology which I have felt compelled to make. These changes of language I have pointed out in the course of the following pages; but the general relationship between the two books can be expressed briefly as follows. When I began to write my *Treatise on Money* I was still moving along the traditional lines of regarding the influence of money as something so to speak separate from the general theory of supply and demand. When I finished it, I had made some progress towards pushing monetary theory back to becoming a theory of output as a whole. But my lack of emancipation from preconceived ideas showed itself in what now seems to me to be the outstanding fault of the theoretical parts of that work (namely, Books III and IV), that I failed to deal thoroughly with the effects of *changes* in the level of output. My so-called 'fundamental equations' were an instantaneous picture taken on the assumption of a given output. They attempted to show how, assuming the given output, forces could develop which involved a profit-disequilibrium, and thus required a change in the level of output. But the dynamic development, as distinct from the instantaneous picture, was left incomplete and extremely confused. This book, on the other hand, has evolved into what is primarily a study of the forces which determine changes in the scale of output and employment as a whole; and, whilst it is found that money enters into the economic scheme in an essential and peculiar manner, technical monetary detail falls into the background. A monetary economy, we shall find, is essentially one in which changing views about the future are capable of influencing the quantity of employment and not merely its direction. But our method of

analysing the economic behaviour of the present under the influence of changing ideas about the future is one which depends on the interaction of supply and demand, and is in this way linked up with our fundamental theory of value. We are thus led to a more general theory, which includes the classical theory with which we are familiar, as a special case.

The writer of a book such as this, treading along unfamiliar paths, is extremely dependent on criticism and conversation if he is to avoid an undue proportion of mistakes. It is astonishing what foolish things one can temporarily believe if one thinks too long alone, particularly in economics (along with the other moral sciences), where it is often impossible to bring one's ideas to a conclusive test either formal or experimental. In this book, even more perhaps than in writing my *Treatise on Money*, I have depended on the constant advice and constructive criticism of Mr R.F. Kahn. There is a great deal in this book which would not have taken the shape it has except at his suggestion. I have also had much help from Mrs Joan Robinson, Mr R.G. Hawtrey and Mr R.F. Harrod, who have read the whole of the proof-sheets. The index has been compiled by Mr D. M. Bensusan-Butt of King's College, Cambridge.

The composition of this book has been for the author a long struggle of escape, and so must the reading of it be for most readers if the author's assault upon them is to be successful,—a struggle of escape from habitual modes of thought and expression. The ideas which are here expressed so laboriously are extremely simple and should be obvious. The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our minds.

J. M. KEYNES

13 December 1935

PREFACE TO THE GERMAN EDITION

Alfred Marshall, on whose *Principles of Economics* all contemporary English economists have been brought up, was at particular pains to emphasise the continuity of his thought with Ricardo's. His work largely consisted in grafting the marginal principle and the principle of substitution on to the Ricardian tradition; and his theory of output and consumption as a whole, as distinct from his theory of the production and distribution of a *given* output, was never separately expounded. Whether he himself felt the need of such a theory, I am not sure. But his immediate successors and followers have certainly dispensed with it and have not, apparently, felt the lack of it. It was in this atmosphere that I was brought up. I taught these doctrines myself and it is only within the last decade that I have been conscious of their insufficiency. In my own thought and development, therefore, this book represents a reaction, a transition away from the English classical (or orthodox) tradition. My emphasis upon this in the following pages and upon the points of my divergence from received doctrine has been regarded in some quarters in England as unduly controversial. But how can one brought up a Catholic in English economics, indeed a priest of that faith, avoid some controversial emphasis, when he first becomes a Protestant?

But I fancy that all this may impress German readers somewhat differently. The orthodox tradition, which ruled in nineteenth century England, never took so firm a hold of German thought. There have always existed important schools of economists in Germany who have strongly disputed the adequacy of the classical theory for the analysis of contemporary events. The Manchester School and Marxism both derive ultimately from Ricardo,—a conclusion which is only superficially surprising. But in Germany there has always existed a large section of opinion which has adhered neither to the one nor to the other.

It can scarcely be claimed, however, that this school of thought has erected a rival theoretical construction; or has even attempted to do so. It has been sceptical, realistic, content with historical and empirical methods and results, which discard formal analysis. The most important unorthodox discussion on theoretical lines was that of Wicksell. His books were available in German (as they were not, until lately, in English); indeed one of the most important of them was written in German. But his followers were chiefly Swedes and Austrians, the latter of whom combined his ideas with specifically Austrian theory so as to bring them in effect, back again towards the classical tradition. Thus Germany, quite contrary to her habit in most of the sciences, has been content for a whole century to do without any formal theory of economics which was predominant and generally accepted.

Perhaps, therefore, I may expect less resistance from German, than from English, readers in offering a theory of employment and output as a whole, which departs in important respects from the orthodox tradition. But can I hope to overcome Germany's economic agnosticism? Can I persuade German economists that methods of formal analysis have something important to contribute to the interpretation of contemporary events and to the moulding of contemporary policy? After all, it is German to like a theory. How hungry and thirsty German economists must feel after having lived all these years without one! Certainly, it is worth while for me to make the attempt. And if I can contribute some stray morsels towards the preparation by German economists of a full repast of theory designed to meet specifically German conditions, I shall be content. For I confess that much of the following book is illustrated and expounded mainly with reference to the conditions existing in the Anglo-Saxon countries.

Nevertheless the theory of output as a whole, which is what the following book purports to provide, is much more easily adapted to the conditions of a totalitarian state, than is the theory of the production and distribution of a given output produced under conditions of free competition and a large measure of *laissez-faire*. The theory of the psychological laws relating consumption and saving, the influence of loan expenditure on prices and real wages, the part played by the rate of interest—these remain as necessary ingredients in our scheme of thought.

I take this opportunity to acknowledge my indebtedness to the excellent work of my translator Herr Waeger (I hope his vocabulary at the end of this volume may prove useful beyond its immediate purpose) and to my publishers, Messrs Duncker and Humblot, whose enterprise, from the days now sixteen years ago when they published my *Economic Consequences of the Peace*, has enabled me to maintain contact with German readers.

J. M. KEYNES

7 September 1936

PREFACE TO THE JAPANESE EDITION

Alfred Marshall, on whose *Principles of Economics* all contemporary English economists have been brought up, was at particular pains to emphasise the continuity of his thought with Ricardo's. His work largely consisted in grafting the marginal principle and the principle of substitution on to the Ricardian tradition; and his theory of output and consumption as a whole, as distinct from his theory of the production and distribution of a *given* output, was never separately expounded. Whether he himself felt the need of such a theory, I am not sure. But his immediate successors and followers have certainly dispensed with it and have not, apparently, felt the lack of it. It was in this atmosphere that I was brought up. I taught these doctrines myself and it is only within the last decade that I have been conscious of their insufficiency. In my own thought and development, therefore, this book represents a reaction, a transition away from the English classical (or orthodox) tradition. My emphasis upon this in the following pages and upon the points of my divergence from received doctrine has been regarded in some quarters in England as unduly controversial. But how can one brought up in English economic orthodoxy, indeed a priest of that faith at one time, avoid some controversial emphasis, when he first becomes a Protestant?

Perhaps Japanese readers, however, will neither require nor resist my assaults against the English tradition. We are well aware of the large scale on which English economic writings are read in Japan, but we are not so well informed as to how Japanese opinions regard them. The recent praiseworthy enterprise on the part of the International Economic Circle of Tokyo in reprinting Malthus's '*Principles of Political Economy*' as the first volume in the Tokyo Series of Reprints encourages me to think that a book which traces its descent from Malthus rather than Ricardo may be received with sympathy in some quarters at least.

At any rate I am grateful to the *Oriental Economist* for making it possible for me to approach Japanese readers without the extra handicap of a foreign language.

J. M. KEYNES

4 December 1936

PREFACE TO THE FRENCH EDITION

For a hundred years or longer, English Political Economy has been dominated by an orthodoxy. That is not to say that an unchanging doctrine has prevailed. On the contrary. There has been a progressive evolution of the doctrine. But its presuppositions, its atmosphere, its method have remained surprisingly the same, and a remarkable continuity has been observable through all the changes. In that orthodoxy, in that continuous transition, I was brought up. I learnt it, I taught it, I wrote it. To those looking from outside I probably still belong to it. Subsequent historians of doctrine will regard this book as in essentially the same tradition. But I myself in writing it, and in other recent work which has led up to it, have felt myself to be breaking away from this orthodoxy, to be in strong reaction against it, to be escaping from something, to be gaining an emancipation. And this state of mind on my part is the explanation of certain faults in the book, in particular its controversial note in some passages, and its air of being addressed too much to the holders of a particular point of view and too little *ad urbem et orbem*. I was wanting to convince my own environment and did not address myself with sufficient directness to outside opinion. Now three years later, having grown accustomed to my new skin and having almost forgotten the smell of my old one, I should, if I were writing afresh, endeavour to free myself from this fault and state my own position in a more clear-cut manner.

I say all this, partly to explain and partly to excuse, myself to French readers. For in France there has been no orthodox tradition with the same authority over contemporary opinion as in my own country. In the United States the position has been much the same as in England. But in France, as in the rest of Europe, there has been no such dominant school since the expiry of the school of French Liberal economists who were in their prime twenty years ago (though they lived to so great an age, long after their influence had passed away, that it fell to my duty, when I first became a youthful editor of the *Economic Journal* to write the obituaries of many of them—Lévy, Lefèvre, Molinari, Leroy-Beaulieu). If Charles Gide had attained to the same influence and authority as Alfred Marshall, your position would have borne more resemblance to ours. As it is, your economists are eclectic, too much (we sometimes think) without deep roots in systematic thought. Perhaps this may make them more easily accessible to what I have to say. But it may also have the result that my readers will sometimes wonder what I am talking about when I speak, with what some of my English critics consider a misuse of language, of the 'classical' school of thought and 'classical' economists. It may, therefore, be helpful to my French readers if I attempt to indicate very briefly what I regard as the main *differentiae* of my approach.

I have called my theory a *general* theory. I mean by this that I am chiefly concerned with the behaviour of the economic system as a whole,—with aggregate incomes, aggregate profits, aggregate output, aggregate employment, aggregate investment, aggregate saving rather than with the incomes, profits, output, employment, investment and saving of particular industries, firms or individuals. And I argue that important mistakes have been made through extending to the system as a whole conclusions which have been correctly arrived at in respect of a part of it taken in isolation.

Let me give examples of what I mean. My contention that for the system as a whole the amount of income which is saved, in the sense that it is not spent on current consumption, is and must necessarily be exactly equal to the amount of net new investment has been considered a paradox and has been the occasion of widespread controversy. The explanation of this is undoubtedly to be

found in the fact that this relationship of equality between saving and investment, which necessarily holds good for the system as a whole, does not hold good at all for a particular individual. There is no reason whatever why the new investment for which I am responsible should bear any relation whatever to the amount of my own savings. Quite legitimately we regard an individual's income as independent of what he himself consumes and invests. But this, I have to point out, should not have led us to overlook the fact that the demand arising out of the consumption and investment of one individual is the source of the incomes of other individuals, so that incomes in general are not independent, quite the contrary, of the disposition of individuals to spend and invest; and since in turn the readiness of individuals to spend and invest depends on their incomes, a relationship is set up between aggregate savings and aggregate investment which can be very easily shown, beyond any possibility of reasonable dispute, to be one of exact and necessary equality. Rightly regarded this is a banale conclusion. But it sets in motion a train of thought from which more substantial matters follow. It is shown that, generally speaking, the actual level of output and employment depends, not on the capacity to produce or on the pre-existing level of incomes, but on the current decisions to produce which depend in turn on current decisions to invest and on present expectations of current and prospective consumption. Moreover, as soon as we know the propensity to consume and to save (as I call it), that is to say the result for the community as a whole of the individual psychological inclinations as to how to dispose of given incomes, we can calculate what level of incomes, and therefore what level of output and employment, is in profit-equilibrium with a given level of new investment; out of which develops the doctrine of the Multiplier. Or again, it becomes evident that an increased propensity to save will *ceteris paribus* contract incomes and output; whilst an increased inducement to invest will expand them. We are thus able to analyse the factors which determine the income and output of the system as a whole;—we have, in the most exact sense, a theory of employment. Conclusions emerge from this reasoning which are particularly relevant to the problems of public finance and public policy generally and of the trade cycle.

Another feature, specially characteristic of this book, is the theory of the rate of interest. In recent times it has been held by many economists that the rate of current saving determined the supply of free capital, that the rate of current investment governed the demand for it, and that the rate of interest was, so to speak, the equilibrating price-factor determined by the point of intersection of the supply curve of savings and the demand curve of investment. But if aggregate saving is necessarily and in all circumstances exactly equal to aggregate investment, it is evident that this explanation collapses. We have to search elsewhere for the solution. I find it in the idea that it is the function of the rate of interest to preserve equilibrium, not between the demand and the supply of new capital goods, but between the demand and the supply of money, that is to say between the demand for liquidity and the means of satisfying this demand. I am here returning to the doctrine of the older, pre-nineteenth century economists. Montesquieu, for example, saw this truth with considerable clarity,—Montesquieu who was the real French equivalent of Adam Smith, the greatest of your economists, head and shoulders above the physiocrats in penetration, clear-headedness and good sense (which are the qualities an economist should have). But I must leave it to the text of this book to show how in detail all this works out.

I have called this book the *General Theory of Employment, Interest and Money*; and the third feature to which I may call attention is the treatment of money and prices. The following analysis registers my final escape from the confusions of the Quantity Theory, which once entangled me. I regard the price level as a whole as being determined in precisely the same way as individual prices;

that is to say, under the influence of supply and demand. Technical conditions, the level of wages, the extent of unused capacity of plant and labour, and the state of markets and competition determine the supply conditions of individual products and of products as a whole. The decisions of entrepreneurs, which provide the incomes of individual producers and the decisions of those individuals as to the disposition of such incomes determine the demand conditions. And prices—both individual prices and the price-level—emerge as the resultant of these two factors. Money, and the quantity of money, are not direct influences at this stage of the proceedings. They have done their work at an earlier stage of the analysis. The quantity of money determines the supply of liquid resources, and hence the rate of interest, and in conjunction with other factors (particularly that of confidence) the inducement to invest, which in turn fixes the equilibrium level of incomes, output and employment and (at each stage in conjunction with other factors) the price-level as a whole through the influences of supply and demand thus established.

I believe that economics everywhere up to recent times has been dominated, much more than has been understood, by the doctrines associated with the name of J.-B. Say. It is true that his 'law of markets' has been long abandoned by most economists; but they have not extricated themselves from his basic assumptions and particularly from his fallacy that demand is created by supply. Say was implicitly assuming that the economic system was always operating up to its full capacity, so that a new activity was always in substitution for, and never in addition to, some other activity. Nearly all subsequent economic theory has depended on, in the sense that it has required, this same assumption. Yet a theory so based is clearly incompetent to tackle the problems of unemployment and of the trade cycle. Perhaps I can best express to French readers what I claim for this book by saying that in the theory of production it is a final break-away from the doctrines of J.-B. Say and that in the theory of interest it is a return to the doctrines of Montesquieu.

J. M. KEYNES

20 February 1939

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fact that the premium upon thrift is correspondingly diminished'; whilst as for the second alternative, 'it is so far from being our intention to deny that a fall of profit, due to over-supply, will check production, that the admission of the operation of this check forms the very centre of our argument'. Nevertheless, their theory failed of completeness, essentially on account of their having no independent theory of the rate of interest; with the result that Mr Hobson laid too much emphasis (especially in his later books) on under-consumption leading to over-investment, in the sense of unprofitable investment, instead of explaining that a relatively weak propensity to consume helps to cause unemployment by requiring and *not* receiving the accompaniment of a compensating volume of new investment, which, even if it may sometimes occur temporarily through errors of optimism, is in general prevented from happening at all by the prospective profit falling below the standard set by the rate of interest.

Since the war there has been a spate of heretical theories of under-consumption, of which those of Major Douglas are the most famous. The strength of Major Douglas's advocacy has, of course, largely depended on orthodoxy having no valid reply to much of his destructive criticism. On the other hand, the detail of his diagnosis, in particular the so-called $A + B$ theorem, includes much mere mystification. If Major Douglas had limited his B -items to the financial provisions made by entrepreneurs to which no current expenditure on replacements and renewals corresponds, he would be nearer the truth. But even in that case it is necessary to allow for the possibility of these provisions being offset by new investment in other directions as well as by increased expenditure on consumption. Major Douglas is entitled to claim, as against some of his orthodox adversaries, that he at least has not been wholly oblivious of the outstanding problem of our economic system. Yet he has scarcely established an equal claim to rank—a private, perhaps, but not a major in the brave army of heretics—with Mandeville, Malthus, Gesell and Hobson, who, following their intuitions, have preferred to see the truth obscurely and imperfectly rather than to maintain error, reached indeed with clearness and consistency and by easy logic but on hypotheses inappropriate to the facts.

Chapter 24

CONCLUDING NOTES ON THE SOCIAL PHILOSOPHY TOWARDS WHICH THE GENERAL THEORY MIGHT LEAD

I

The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes. The bearing of the foregoing theory on the first of these is obvious. But there are also two important respects in which it is relevant to the second.

Since the end of the nineteenth century significant progress towards the removal of very great disparities of wealth and income has been achieved through the instrument of direct taxation—income tax and surtax and death duties—especially in Great Britain. Many people would wish to see this process carried much further, but they are deterred by two considerations; partly by the fear of making skilful evasions too much worth while and also of diminishing unduly the motive towards risk-taking, but mainly, I think, by the belief that the growth of capital depends upon the strength of the motive towards individual saving and that for a large proportion of this growth we

are dependent on the savings of the rich out of their superfluity. Our argument does not affect the first of these considerations. But it may considerably modify our attitude towards the second. For we have seen that, up to the point where full employment prevails, the growth of capital depends not at all on a low propensity to consume but is, on the contrary, held back by it; and only in conditions of full employment is a low propensity to consume conducive to the growth of capital. Moreover, experience suggests that in existing conditions saving by institutions and through sinking funds is more than adequate, and that measures for the redistribution of incomes in a way likely to raise the propensity to consume may prove positively favourable to the growth of capital.

The existing confusion of the public mind on the matter is well illustrated by the very common belief that the death duties are responsible for a reduction in the capital wealth of the country. Assuming that the State applies the proceeds of these duties to its ordinary outgoings so that taxes on incomes and consumption are correspondingly reduced or avoided, it is, of course, true that a fiscal policy of heavy death duties has the effect of increasing the community's propensity to consume. But inasmuch as an increase in the habitual propensity to consume will in general (i.e. except in conditions of full employment) serve to increase at the same time the inducement to invest, the inference commonly drawn is the exact opposite of the truth.

Thus our argument leads towards the conclusion that in contemporary conditions the growth of wealth, so far from being dependent on the abstinence of the rich, as is commonly supposed, is more likely to be impeded by it. One of the chief social justifications of great inequality of wealth is, therefore, removed. I am not saying that there are no other reasons, unaffected by our theory, capable of justifying some measure of inequality in some circumstances. But it does dispose of the most important of the reasons why hitherto we have thought it prudent to move carefully. This particularly affects our attitude towards death duties: for there are certain justifications for inequality of incomes which do not apply equally to inequality of inheritances.

For my own part, I believe that there is social and psychological justification for significant inequalities of incomes and wealth, but not for such large disparities as exist to-day. There are valuable human activities which require the motive of money-making and the environment of private wealth-ownership for their full fruition. Moreover, dangerous human proclivities can be canalised into comparatively harmless channels by the existence of opportunities for money-making and private wealth, which, if they cannot be satisfied in this way, may find their outlet in cruelty, the reckless pursuit of personal power and authority, and other forms of self-aggrandisement. It is better that a man should tyrannise over his bank balance than over his fellow-citizens; and whilst the former is sometimes denounced as being but a means to the latter, sometimes at least it is an alternative. But it is not necessary for the stimulation of these activities and the satisfaction of these proclivities that the game should be played for such high stakes as at present. Much lower stakes will serve the purpose equally well, as soon as the players are accustomed to them. The task of transmuting human nature must not be confused with the task of managing it. Though in the ideal commonwealth men may have been taught or inspired or bred to take no interest in the stakes, it may still be wise and prudent statesmanship to allow the game to be played, subject to rules and limitations, so long as the average man, or even a significant section of the community, is in fact strongly addicted to the money-making passion.

II

There is, however, a second, much more fundamental inference from our argument which has a bearing on the future of inequalities of wealth; namely, our theory of the rate of interest. The justification for a moderately high rate of interest has been found hitherto in the necessity of providing a sufficient inducement to save. But we have shown that the extent of effective saving is necessarily determined by the scale of investment and that the scale of investment is promoted by a *low* rate of interest, provided that we do not attempt to stimulate it in this way beyond the point which corresponds to full employment. Thus it is to our best advantage to reduce the rate of interest to that point relatively to the schedule of the marginal efficiency of capital at which there is full employment.

There can be no doubt that this criterion will lead to a much lower rate of interest than has ruled hitherto; and, so far as one can guess at the schedules of the marginal efficiency of capital corresponding to increasing amounts of capital, the rate of interest is likely to fall steadily, if it should be practicable to maintain conditions of more or less continuous full employment—unless, indeed, there is an excessive change in the aggregate propensity to consume (including the State).

I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to a point where its marginal efficiency had fallen to a very low figure. This would not mean that the use of capital instruments would cost almost nothing, but only that the return from them would have to cover little more than their exhaustion by wastage and obsolescence together with some margin to cover risk and the exercise of skill and judgment. In short, the aggregate return from durable goods in the course of their life would, as in the case of short-lived goods, just cover their labour-costs of production *plus* an allowance for risk and the costs of skill and supervision.

Now, though this state of affairs would be quite compatible with some measure of individualism, yet it 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. Interest to-day rewards no genuine sacrifice, any more than does the rent of land. The owner of capital can obtain interest because capital is scarce, just as the owner of land can obtain rent because land is scarce. But whilst there may be intrinsic reasons for the scarcity of land, there are no intrinsic reasons for the scarcity of capital. An intrinsic reason for such scarcity, in the sense of a genuine sacrifice which could only be called forth by the offer of a reward in the shape of interest, would not exist, in the long run, except in the event of the individual propensity to consume proving to be of such a character that net saving in conditions of full employment comes to an end before capital has become sufficiently abundant. But even so, it will still be possible for communal saving through the agency of the State to be maintained at a level which will allow the growth of capital up to the point where it ceases to be scarce.

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 be nothing sudden, merely a gradual but prolonged continuance of what we have seen recently in Great Britain, and will need no revolution.

Thus we might aim in practice (there being nothing in this which is unattainable) at an increase in the volume of capital until it ceases to be scarce, so that the functionless investor will no longer receive a bonus; and at a scheme of direct taxation which allows the intelligence and determination and executive skill of the financier, the entrepreneur *et hoc genus omne* (who are certainly so fond of their craft that their labour could be obtained much cheaper than at present), to be harnessed to the service of the community on reasonable terms of reward.

At the same time we must recognise that only experience can show how far the common will, embodied in the policy of the State, ought to be directed to increasing and supplementing the inducement to invest; and how far it is safe to stimulate the average propensity to consume, without foregoing our aim of depriving capital of its scarcity-value within one or two generations. It may turn out that the propensity to consume will be so easily strengthened by the effects of a falling rate of interest, that full employment can be reached with a rate of accumulation little greater than at present. In this event a scheme for the higher taxation of large incomes and inheritances might be open to the objection that it would lead to full employment with a rate of accumulation which was reduced considerably below the current level. I must not be supposed to deny the possibility, or even the probability, of this outcome. For in such matters it is rash to predict how the average man will react to a changed environment. If, however, it should prove easy to secure an approximation to full employment with a rate of accumulation not much greater than at present, an outstanding problem will at least have been solved. And it would remain for separate decision on what scale and by what means it is right and reasonable to call on the living generation to restrict their consumption, so as to establish in course of time, a state of full investment for their successors.

III

In some other respects the foregoing theory is moderately conservative in its implications. 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. 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. But beyond this no obvious case is made out for a system of State Socialism which would embrace most of the economic life of the community. It is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. Moreover, the necessary measures of socialisation can be introduced gradually and without a break in the general traditions of society.

Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world. But if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own again from this point

onwards. If we suppose the volume of output to be given, i.e. to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportions the factors of production will be combined to produce it, and how the value of the final product will be distributed between them. Again, if we have dealt otherwise with the problem of thrift, there is no objection to be raised against the modern classical theory as to the degree of consilience between private and public advantage in conditions of perfect and imperfect competition respectively. Thus, apart from the necessity of central controls to bring about an adjustment between the propensity to consume and the inducement to invest, there is no more reason to socialise economic life than there was before.

To put the point concretely, I see no reason to suppose that the existing system seriously misemploys the factors of production which are in use. There are, of course, errors of foresight; but these would not be avoided by centralising decisions. When 9,000,000 men are employed out of 10,000,000 willing and able to work, there is no evidence that the labour of these 9,000,000 men is misdirected. The complaint against the present system is not that these 9,000,000 men ought to be employed on different tasks, but that tasks should be available for the remaining 1,000,000 men. It is in determining the volume, not the direction, of actual employment that the existing system has broken down.

Thus I agree with Gesell that the result of filling in the gaps in the classical theory is not to dispose of the 'Manchester System', but to indicate the nature of the environment which the free play of economic forces requires if it is to realise the full potentialities of production. The central controls necessary to ensure full employment will, of course, involve a large extension of the traditional functions of government. Furthermore, the modern classical theory has itself called attention to various conditions in which the free play of economic forces may need to be curbed or guided. But there will still remain a wide field for the exercise of private initiative and responsibility. Within this field the traditional advantages of individualism will still hold good.

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, than the nineteenth century supposed; and the reaction against the appeal to self-interest may have 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, which emerges precisely from this extended field of personal choice, and 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 fancy; and, being the handmaid of experiment as well as of tradition and of fancy, it is the most powerful instrument to better the future.

Whilst, therefore, the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest, would seem to a nineteenth-century publicist or to a contemporary American financier to be a terrific encroachment on individualism, I defend it, on the contrary, 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.

For if effective demand is deficient, not only is the public scandal of wasted resources intolerable, but the individual enterpriser who seeks to bring these resources into action is operating with the odds loaded against him. The game of hazard which he plays is furnished with many zeros, so that the players *as a whole* will lose if they have the energy and hope to deal all the cards. Hitherto the increment of the world's wealth has fallen short of the aggregate of positive individual savings; and the difference has been made up by the losses of those whose courage and initiative have not been supplemented by exceptional skill or unusual good fortune. But if effective demand is adequate, average skill and average good fortune will be enough.

The authoritarian state systems of to-day seem to solve the problem of unemployment at the expense of efficiency and of freedom. It is certain that the world 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.

IV

I have mentioned in passing that the new system might be more favourable to peace than the old has been. It is worth while to repeat and emphasise that aspect. War has several causes. Dictators and others such, to whom war offers, in expectation at least, a pleasurable excitement, find it easy to work on the natural bellicosity of their peoples. But, over and above this, facilitating their task of fanning the popular flame, are the economic causes of war, namely, the pressure of population and the competitive struggle for markets. It is the second factor, which probably played a predominant part in the nineteenth century, and might again, that is germane to this discussion.

I have pointed out in the preceding chapter that, under the system of domestic *laissez-faire* and an international gold standard such as was orthodox in the latter half of the nineteenth century, there was no means open to a government whereby to mitigate economic distress at home except through the competitive struggle for markets. For all measures helpful to a state of chronic or intermittent under-employment were ruled out, except measures to improve the balance of trade on income account.

Thus, whilst economists were accustomed to applaud the prevailing international system as furnishing the fruits of the international division of labour and harmonising at the same time the interests of different nations, there lay concealed a less benign influence; and those statesmen were moved by common sense and a correct apprehension of the true course of events, who believed that if a rich, old country were to neglect the struggle for markets its prosperity would droop and fail. 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 neighbours. There would still be room for the international division of labour and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting

the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, 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 goods and services in conditions of mutual advantage.

V

Is the fulfilment of these ideas a visionary hope? Have they insufficient roots in the motives which govern the evolution of political society? Are the interests which they will thwart stronger and more obvious than those which they will serve?

I do not attempt an answer in this place. It would need a volume of a different character from this one to indicate even in outline the practical measures in which they might be gradually clothed. But if the ideas are correct—an hypothesis on which the author himself must necessarily base what he writes—it would be a mistake, I predict, to dispute their potency over a period of time. At the present moment people are unusually expectant of a more fundamental diagnosis; more particularly ready to receive it; eager to try it out, if it should be even plausible. But apart from this contemporary mood, 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 that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil.

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