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Source: *Nebraska Journal of Economics and Business*, Autumn, 1963, Vol. 2, No. 2 (Autumn, 1963), pp. 11-15

Published by: Creighton University

Stable URL: https://www.jstor.org/stable/40472252

A SELF-ADJUSTING ECONOMIC SYSTEM*

JOHN MAYNARD KEYNES

I was asked recently to take part in a discussion among English economists on the problem of poverty in the midst of potential plenty, which none of us can deny is the outstanding conundrum of today. We all agreed that, whatever the best remedy may be, we must reject all those alleged remedies that consist, in effect, in getting, rid of the plenty. It may be true, for various reasons, that as the potential plenty increases, the problem of getting the fruits of it distributed to the great body of consumers will present increasing difficulties. But it is to the analysis and solution of these difficulties that we must direct our minds. To seek an escape by making the productive machine less productive must be wrong. I often find myself in favor of measures to restrict output as a temporary palliative or to meet an emergency. But the temper of mind that turns too easily to restriction is dangerous, for it has nothing useful to contribute to the permanent solution. But this is another way of saying that we must not regard the conditions of supply—that is to say, our facilities to produce—as being the fundamental source of our troubles. And, if this is agreed, it seems to follow that it is the conditions of demand that our diagnosis must search and probe for the explanation.

Up to this point of the argument, as I have said, we were all in substantial agreement. Each one of us was ready to find the major part of our explanation in some factor that relates to the conditions of demand. But, though we all started out in the same direction, we soon parted company into two main groups. What made the cleavage that thus divided us?

On the one side were those who believed that the existing economic system is in the long run self-adjusting, though with creaks and groans and jerks, and interrupted by time-lags, outside interference and mistakes. One adherent of this school of thought laid stress on the increasing difficulty of rapid self-adjustment to change in an environment where population and markets are no longer expanding rapidly, Another stressed the growing tendency for out-

*Reprinted from *The New Republic,* February 20, 1935, pp. 35–37. The Editorial Board of the *Nebraska Journal of Economics and Business* wishes to express its appreciation to the Editors of *The New Republic* for their kind permission to reprint the above article by John Maynard Keynes.

side interference to hinder the processes of self-adjustment, while a third stressed the effect of business mistakes under the influence of the uncertainty and the false expectations caused by the faults of post-war monetary systems. These economists did not, of course, believe that the system is automatic or immediately self-adjusting, but they did maintain that it has an inherent tendency towards self-adjustment, if it is not interfered with, and if the action of change and chance is not too rapid.

Those on the other side of the gulf, however, rejected the idea that the existing economic system is, in any significant sense, self-adjusting. They believed that the failure of effective demand to reach the full potentialities of supply, in spite of human psychological demand being immensely far from satisfied for the vast majority of individuals, is due to much more fundamental causes. One of them stressed the great inequality of incomes, which causes a separation between the power to consume and the desire to consume. Another believed that the great resources at the disposal of the entrepreneur are a chronic cause of his setting up plant capable of producing more than the limited resources of the consumer can absorb. A third, not disagreeing with these two, demanded some method of increasing consumer power so as to overcome the difficulties they pointed out.

The gulf between these two schools of thought is deeper, I believe, than most of those on either side of it realize. On which side does the essential truth lie?

The strength of the self-adjusting school depends on its having behind it almost the whole body of organized economic thinking and doctrine of the last hundred years. This is a formidable power. It is the product of acute minds and has persuaded and convinced the great majority of the intelligent and disinterested persons who have studied it. It has vast prestige and a more far-reaching influence than is obvious. For it lies behind the education and the habitual modes of thought, not only of economists but of bankers and business men and civil servants and politicians of all parties. The essential elements in it are fervently accepted by Marxists. Indeed, Marxism is a highly plausible inference from Ricardian economics that capitalistic individualism cannot possibly work in practice. So much so, that, if Ricardian economics were to fall, an essential prop to the intellectual foundations of Marxism would fall with it.

Thus, if the heretics on the other side of the gulf are to demolish the forces of nineteenth-century orthodoxy—and I include Marxism in orthodoxy equally with laissez-faire, these two being the nineteenth-century twins of Say and Ricardo—they must attack them in their citadel. No successful attack has yet been made. The heretics of today are the descendants of a long line of heretics who, overwhelmed but never extinguished, have survived as isolated groups of cranks. They are deeply dissatisfied. They believe that common observation is enough to show that facts do not conform to the orthodox reasoning. They propose remedies prompted by instinct, by flair, by practical good sense, by experience of the world—half-right, most of them, and half-wrong. Contemporary discontents have given them a volume of popular support and an opportunity for propagating their ideas such as they have not had for several generations. But they have made no impression on the citadel. Indeed, many of them themselves accept the orthodox premises; and it is only because their flair is stronger than their logic that they do not accept its conclusions.

Now *I* range myself with the heretics. I believe their flair and their instinct move them towards the right conclusion. But I was brought up in the citadel and I recognize its power and might. A large part of the established body of economic doctrine I cannot but accept as broadly correct. I do not doubt it. For me, therefore, it is impossible to rest satisfied until I can put my finger on the flaw in the part of the orthodox reasoning that leads to the conclusions that for various reasons seem to me to be inacceptable. I believe that I am on my way to do so. There is, I am concinved, a fatal flaw in that part of the orthodox reasoning that deals with the theory of what determines the level of effective demand and the volume of aggregate employment; the flaw being largely due to the failure of the classical doctrine to develop a satisfactory and realistic theory of the rate of interest.

Put very briefly, the point is something like this. Any individual, if he finds himself with a certain income, will, according to his habits, his tastes and his motives towards prudence, spend a portion of it on consumption and the rest he will save. If his income increases, he will almost certainly consume more than before, but it is highly probable that he will also save more. That is to say, he will not increase his consumption by the full amount of the increase in his income. Thus if a given national income is less equally divided, or if the national income increases so that individual incomes are greater than before, the gap between total incomes and the total expenditure on consumption is likely to widen. But incomes can be generated only by producing goods for consumption or by producing goods for use as capital. Thus the gap between total incomes and expenditure on consumption *cannot* be greater than the amount of new capital that it is thought worth while to produce. Consequently, our habit of withholding from consumption an increasing sum as our incomes increase means that it is impossible for our incomes to increase unless either we change our habits so as to consume more or the business world calculates that it is worth while to produce more capital goods. For, failing both these alternatives, the increased employment and output, by which alone increased incomes can be generated, will prove unprofitable and will not persist.

Now the school that believes in self-adjustment is, in fact, assuming that the rate of interest adjusts itself more or less automatically, so as to encourage just the right amount of production of capital goods to keep our incomes at the maximum level that our energies and our organization and our knowledge of how to produce efficiently are capable of providing. This is, however, pure assumption. There is no theoretical reason for believing it to be true. A very moderate amount of observation of the facts, unclouded by preconceptions, is sufficient to show that they do not bear it out. Those standing on my side of the gulf, whom I have ventured to describe as half-right and half-wrong, have perceived this; and they conclude that the only remedy is for us to change the distribution of wealth and modify our habits in such a way as to increase our propensity to spend our incomes on current consumption. I agree with them in thinking that this would be a remedy. But I disagree with them when they go further and argue that it is the only remedy. For there is an alternative, namely, to increase the output of capital goods by reducing the rate of interest and in other ways.

When the rate of interest has fallen to a very low figure and has remained there sufficiently long to show that there is no further capital consruction worth doing even at that low rate, then I should agree that the facts point to the necessity of drastic social changes directed towards increasing consumption. For it would be clear that we already had as great a stock of capital as we could usefully employ.

Even as things are, there is a strong presumption that a greater equality of incomes would lead to increased employment and greater aggregate income. But hitherto the rate of interest has been too high to allow us to have all the capital goods, particularly houses, that would be useful to us. Thus, at present, it is important to maintain a careful balance between stimulating consumption and stimulating investment. Economic welfare and social well-being will be increased in the long run by a policy that tends to make capital goods so abundant that the reward that can be gained from owning them falls to so modest a figure as to be no longer a serious burden on anyone. The right course is to get rid of the scarcity of capital goods—which will rid us at the same time of most of the evils of capitalism—while also moving in the direction of increasing the share of income falling to those whose economic welfare will gain most by their having the chance to consume more.

None of this, however, will happen by itself or of its own accord. The system is not self-adjusting, and, without purposive direction, it is incapable of translating our actual poverty into our potential plenty.

If the basic system of thought on which the orthodox school relies is in its essentials unassailable, then there is no escape from their broad conclusions, namely, that, while there are increasingly perplexing problems and plenty of opportunities to make disastrous mistakes, yet nevertheless we must keep our heads and depend on the ultimate soundness of the traditional teaching—the proposals of the heretics, however plausible and even advantageous in the short run, being essentially superficial and ultimately dangerous. Only if they are successfully attacked in the citadel can we reasonably ask them to look at the problem in a radically new way.

Meanwhile, I hope we shall await, with what patience we can command, a successful outcome of the great activity of thought among economists today—a fever of activity such as has not been known for a century. We are, in my very confident belief—a belief, I fear, shared by few, either on the right or on the left—at one of those uncommon junctures of human affairs where we can be saved by the solution of an intellectual problem, and in no other way. If we know the whole truth already, we shall not succeed indefinitely in avoiding a clash of human passions seeking an escape from the intolerable. But I have a better hope.