Keynes' Investments:

Their Relation to the General Theory

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ABSTRACT. It is well known that in *The General Theory,* Keynes is very critical of the *stock exchange* market, an institution, he says, that "cannot be claimed as one of the outstanding triumphs of *laissez-faire* capitalism." At the same time much of his income was derived from *speculation* in *commodities, stocks* and *foreign exchange.* Some questions raised by Keynes' way of making a living are addressed. When did his market activities begin? Did he, as some detractors allege, take advantage of *insider information?* What principles of behavior did he follow in his buying and selling? What was his attitude toward his way of making a living? And, above all, do the views expressed in *The General Theory* reflect the influence of Keynes' market experience? It is suggested that there is, in fact, a close relation between Keynes' financial experiences and some of his distinctive economic theories. His experiences, interpreted in the light of his Apostolic-Moorean *beliefs,* caused the deeply critical attitude toward the whole financial system that one finds in *The General Theory's* chapter 12.

I

KEYNES' ACTIVITIES as an investor were of two types: those dealing with his own account and those he performed as chairman or director of companies managing other people's money. Data on the first type of activities leave no doubt that Keynes' income from investment and speculation soon dwarfed his income from academic activities, including royalties from books and articles. Already in 1916–17, about three fourths of his income was from investment sources. Academic income surged in 1919–20 because of the substantial royalties earned by *The Economic Consequences of the Peace,* but by 1924–25, speculative income again represented seventy-five per cent of the total. Thereafter, the relation between the two portions of income was affected by the impact of the various depressions, but in the last seven years of his life investment income averaged around eighty per cent of the total. At his death in 1946 his gross security assets were about 436,000 pounds[1] or approximately 9 million pounds (13.5 million dollars) in today's prices.

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This paper is part of a larger study to be published by Macmillan.

American Journal of Economics and Sociology, Vol. 54, No. 1 (January, 1995).

Skidelsky has already disposed of the myth, propagated by Harrod, that Keynes' involvement in the stock market before 1919, when he was attached to the Treasury, was minimal.[2] His security holdings of £539 in 1910 had by 1919 grown to £14,453,[3] a not inconsiderable amount when one considers that a King's fellowship in 1909 paid £120 a year.[4] After leaving the Treasury in 1919, Keynes' investment activity certainly broadened. He entered into a partnership with an old Treasury war associate, Mr. O.T. Falk, investing not only his savings but those of some of his friends, of his parents and of his brother. The resulting syndicate began with a capital of £30,000 and invested its funds mainly in foreign exchange. Months of concentrated thinking and learning about the European financial situation resulted not only in *The Economic Consequences* but also in his going bearish on European currencies and bullish on the dollar. But, in what turned out to be the first shock of his life as an investor, it was the dollar that depreciated, the ten per cent margin on the basis of which he had speculated providing insufficient cover, so that by April 1920, the whole position had to be liquidated at a loss of £22,575.[5]

In the aftermath of the debacle, we find Keynes appealing to a millionaire banker in Cologne, Sir Ernest Cassel, for a loan of £5,000. Presenting himself as one who "knows the ropes" (a claim that makes sense only if we grant that he had been an investor for many years prior to 1920), Keynes noted that the European currencies bore no relation to their "real value." The forthcoming Brussels and Spa Conferences, he added, do not justify these values and talk of an international loan is "pure deception." Anyone "prepared to stand the racket" for a couple of months would make substantial profits.[6]

Keynes' 1919–20 foreign exchange dealings were the result of an invitation he received in October 1919 to meet other influential people at Amsterdam in a gathering that was "entirely private, confidential and unofficial," as he wrote.[7] *The Economic Consequences of the Peace* had not yet appeared but his views on European problems and reconstruction were so well known to influential people that he was asked to join an unofficial body formed to lobby the United States and other neutral countries to come forth with an international loan to rescue Europe from the coming catastrophe. Dr. Visserling (Governor of the Bank of the Netherlands), Fred Kent (once head of the foreign exchange department of the Federal Reserve and U.S. representative at Versailles), Paul Warburg (the influential banker), all took "an exceedingly pessimistic view" of the European situation following the Treaty of Versailles.

The information gained at the Amsterdam meeting led Keynes to write four aides de memoir which formed the basis for a lecture delivered three months later at Manchester on "The Present State of the Foreign Exchange," in which he noted the "extraordinary" speculative purchases of marks and expressed foreboding at the possible negative impact of this speculation: what would "the vast army of speculators" do in the future? How would they take their gains and when?[8] The debacle in the spring of 1920 represented an early shock to his belief in the rational possibilities of assessing the economic behavior of the market crowd. Quite possibly the experience affected his revision of *The Treatise on Probability.*[9]

The 1919–20 experience raises another point, namely the extent to which Keynes had sources of information not available to the public. Apparently, rumors to that effect had been common enough for Roy Harrod to go to some length to scotch them in his 1954 biography.[10] He denies, of course, that Keynes was guilty of using inside information in his speculative dealings, alleging, among other things, that between June 1919 and July 1940 Keynes had no official government position. This may well have been so, but it does not mean that the economist was cut off from centers of private economic and political knowledge and power. On the contrary, after 1919, Keynes was at the center of evolving European financial history. Most of the *Activities* volumes of *The Collected Writings* testify to this. Let us only note that in February 1925 Keynes wrote to his wife Lydia, "I heard today the important news that the Governor [of the Bank of England] is going to put up the bank-rate."[11]

Keynes was an educator. His classroom was England and the world, and his tools were the newspaper article, the pamphlet, the letter to *The Times,* the radio broadcast, the committee testimony and, occasionally, the technical books and journal articles addressed to economists. In pursuit of this mission, he gained knowledge by participating in economic committees, by questioning those in authority, by partying and conferring with statesmen, bankers, politicians and those "in the know." How was it humanly possible for Keynes to shut out of his mind information gained from these sources when deciding on his speculative ventures? Keynes himself believed that the truth is often found at the confluence of psychology, history, politics, mathematics, ethics and everyday experience. Thus, what he learned by associating with influential men proved useful in the markets; and what he learned in the markets affected his economics. To suggest that Keynes' speculative activities depended on knowledge gained by reading the newspaper in bed half an hour each morning, as Harrod says, is to believe in an inhuman split of the mind.

II

THE STATISTICAL MATERIAL in Vol. XII of *The Collected Writings* also disposes of another myth about Keynes: that he was exceptionally gifted as an investor. We already saw how in 1920 he suffered a brush with bankruptcy, but even after

1923 he outperformed the market only 14 out of 23 years, about sixty per cent of the time.[12] His investments were not immune from any of the main market downturns. Indeed, in 1937–9 "the value of his net assets was to fall by almost two-thirds and he was to suffer large losses on commodities and currencies."[13] His brokers asked him to increase his cover to fifty percent.[14] Only the economic stability of the war years restored Keynes to affluence as the value of his security holdings rose from £188,353 in 1940 to over £436,000 five years later.[15] From 1919 to 1945 the value of his stock holdings rose at the average rate of about 14 percent, which of course includes new investments, capital gains, etc.

In addition to his own portfolio, Keynes managed (with others) a few investment companies. One of them was the P.R. Finance Company (whose initials come from a greek phrase meaning "everything is in flux"), founded in 1923 and whose shareholders included distinguished Bloomsberries. Starting out with a capital of £115,000, it originally did well, but in 1929–31 it ran into losses totalling over £98,000.[16] Keynes retrieved the position in the next four years. Eventually, the company was liquidated, and each shareholder, having invested one pound in 1923, ultimately received £1 7s 7.68d in 1935.[17]

Another company set up for the benefit of individuals who had been associated with Keynes while he was at the Treasury in 1915–19 (the A.D. Investment Trust) did not survive the 1929-32 slump.[18] As for the Independent Investment Company, founded in 1924, its fortunes were such that only by the time of Keynes' death "the funds underlying the ordinary shares had almost returned to their original issue price."[19]

The more conservative investments for King's College also suffered from general downturns. In the short period of four months after August 1937 the College's investments in United Kingdom and United States shares depreciated a full 20 per cent, losing the paper appreciation of the previous two years.[20] About the same slump Keynes wrote to a colleague at the National Mutual Society that "it would have required abnormal foresight" to anticipate it.[21]

III

WHAT WAS KEYNES' INVESTMENT PHILOSOPHY? At the beginning of his career he was the typical speculator trying to anticipate and exploit changes in market sentiment. Even in his college investments he was "extremely active," as the editor of *The Collected Writings* says. Almost 30 per cent of the shares were held for three months or less and only 15 per cent were held for over three years.[22] In the first long phase of his career he bought for the short term, attempting to sell his shares on the eve of a falling market, and to buy them on a rising market. This implied confidence in his ability to foresee shifts in market sentiment. By the 1930s, though, we find Keynes confessing that the chief lesson to be drawn from his experiences was "the opposite of what I set out to show when, what is now nearly twenty years ago, I first persuaded the College to invest in ordinary shares."[23] The new lesson taught by "time and experience" was that it took "abnormal foresight" and "super human skill" to buy and sell at the correct time. By degrees Keynes concluded that it was preferable to choose a small group of carefully selected securities ("pets"[24]) and hold them "through thick and thin," perhaps for several years, until they fulfilled their promise or proved to be a mistake.[25] "Time and opportunity" did not allow one to have adequate knowledge of more that a very limited number of investment; "continuous and anxious work on the telephone" (not half an hour in bed) was "none too good for health." Indeed, one was liable to lose one's "sense of proportion" when absorbed in market quotations.[26]

Keynes' abandonment of the credit cycle theory reveals a skepticism in the ability of the mind to attain knowledge in a market prey to human passions. Years of experience now told Keynes that ability to see market trends was the wildest of chimeras. Politics, international diplomatic events, economic and legislative changes in other countries and the general passions and irrationalities of investors all conspire to surprise even the most intelligent. Time is not "homogenous," that is, the events and experiences of the past are not trusty guides for the future. By the 1930s in both politics and economics Keynes became a believer in sudden discontinuities and breaks. Benthamite certainty did not prevail in the financial markets: "there is more temperament than logic" in choosing an investment policy,[27] just as businessmen (in *The General Theory*) only "pretend" to be guided by a statement of their own prospectus while in reality following their "animal spirits," moods, etc.

There probably was another reason for Keynes' shift to a philosophy of holding shares for the long term, namely, the realization that trying to beat the market and holding out for short-term gain was "anti-social." By the late 1930s, he concluded that "the idea that we should all be selling out to the other fellow and should all be finding ourselves with nothing but cash at the bottom of the market is not merely fantastic, but destructive of the whole system."[28] From time to time, it is the "duty" of a serious investor to accept the depreciation of his holdings with equanimity. "Any other policy is anti-social, destructive of confidence, and incompatible with the workings of the economic system." Wholesale flights out of stocks into money are "undesirable" since they aggravate the scale of fluctuations. "Liquidity preference" enhances market errors of pessimism, so that prices end up lower than the underlying situation warrants.[29] Keynes was shaken by the suicide of a Swedish industrialist, Mr. Ivar Krueger, which he attributed to the mad rush to liquidity of American bankers in 1932.[30]

All this, of course, parallels what he will write in both *A Treatise on Money* and in *The General Theory.* Indeed, the very expression "anti-social," the reference to trying "to beat the gun" and to "pass the depreciating crown to the other fellow" all appear in *The General Theory* itself.[31] Popularization of this book have missed Keynes' main concern: the inherent conflict between manufacturing (enterprise) and high finance, making things and manipulating financial symbols, assessing the long-term prospects of an undertaking and assessing changes in the psychology of the crowds. Financiers, by causing and exploiting unjustified and sudden flights into liquidity, create panics which undermine confidence and, thus, production.

One of the few positive proposals of *The General Theory* (more important than countercyclical fiscal policy, which is hardly mentioned) is the severe curbing of high finance. The stock market should be made "comparatively inaccessible" by high transfer taxes and brokerage fees, the goal being to eliminate the speculator and the ignorant and to make investments "permanent and indissoluble, like marriage." "The only radical cure for the crisis of confidence which afflicts the economic life of the modern world would be to allow the individual no choice between consuming his income and ordering the production of the specific capital asset which . . . impresses him as the most promising investment available to him."[32]

IV

KEYNES' VIEWS ON STOCK SPECULATION were clearly affected by moral considerations. Was it moral to take advantage of the less informed crowd, of the "gulls?" On this Keynes had no doubts: "The management of stock exchange investments of any kind is a *low pursuit," he told members of the Estate Committee of King's "having little social value and partaking (at its best) of the nature of a game of skill, from which it is a good thing for most members of our society to be free.'*[33] This belief did not spring suddenly in Keynes' head. In a series of provocative essays in the 1920s, the philosophical Keynes expressed *contempt* for the utilitarian-capitalist values—the desire to accumulate, the power of monetary incentives and the uses of a life absorbed in money making. In *A Short View of Russia* (1925), he hailed Leninism as a "new religion" because it attempted to substitute service to the community for Smithian self-interest.[34] In "The Economic Possibilities for Our Grandchildren"[35] (1928), he wrote that in a mere one hundred years by natural evolution, the advanced countries of the West will recognize that attachment to money as a possession is "detestable," a somewhat "disgusting morbidity," etc. Contempt for capitalist values is also evident in "Clissold"[36] (1927), in a review of a book by H. G. Wells, and is also responsible for many observations by Keynes that have been interpreted as expressions of anti-semitism but are, in fact, attacks on the rentier mentality.[37]

In the already quoted from address to the Estate Committee of King's Keynes notes that there are worthier places to invest a surplus. One of them is Worlaby and Elsham—farm properties acquired by the College. They allow men to "exercise a genuine entrepreneurial function in which many of our body can be reasonably and usefully interested."[38] In a reversal to medieval social thought, the ethical Keynes regarded farming as more noble than finance! Tending crops and raising sheep has *social* value; speculation is "anti-social" and it stimulates some of man's worst instincts.

Keynes clearly gave much thought to both the ethical and the psychological implications of stock buying. Stock buying develops "too unsettled and speculative a state of mind;"[39] it requires much more "nerve, patience and fortitude" than any other pursuit;[40] it is bad for one's health, and makes one lose one's sense of proportion. Upon news of the October 1929 Wall Street crash, he noted that he found himself in a "thoroughly financial and disgusting state of mind all day."[41] In 1931, he mused that his speculation against sterling might be "against the national interest."[42] In 1932, in testimony to the Royal Commission on Lotteries and Betting, he compared "betting" in the stock exchange unfavorably with betting on horses.[43] In 1937, after outlining certain decisions, he adds, "How *rightly* to govern one's current investment policy in the light of the above is another matter,"[44] and the "rightly" must refer to the *ethics* of the decisions, since their expediency had already been established.

Keynes was clearly troubled by speculation as a way of making a living. As early as 1923 in *A Tract on Monetary Reform,* after noting that in the 1919–20 inflation it was possible to borrow at seven percent while prices were rising at 50 per cent, he adds that this left "a clear profit of between 30 and 40 per cent per annum, without the exercise of any particular skill, to any person lucky enough to have embarked on this sinful career."[45] The businessman who takes advantage of these windfall profits is a "profiteer" who will lose the respect of society.[46]

Since at least 1600, the individual who borrows at seven per cent and invests at 50 per cent had not been regarded as particularly evil or sinful by economists. These words have no meaning within positive economics. They belong to a different order of discourse.

In John Steinbeck's *East of Eden* (1952), a bankrupted California farmer refuses a gift of money from one of his children on the ground that it had been made by speculating on a rise in the price of beans resulting from America's entry into the First World War: the old man thought that the money was tainted. The philosopher Keynes agreed with these sentiments and was thus at odds with the economist Keynes and, indeed, with his civilization.

V

WHAT CAUSED KEYNES TO BE SO SENSITIVE? Very likely it was his youthful philosophy, Moorism. It did not take any great gifts of self-consciousness on his part to see that speculation did not fit in with the Apostolic-Moorean values of attaining "good states of mind" via the enjoyment of beauty and the pleasures of human intercourse. The Moorean values were inimical to the secular values, "power, politics, wealth, ambition" and also to the "economic motive and the economic criterion for action."[47]

The general vicissitudes of life, the closeness to politics, the blandishment of success, ambition, wealth, "corrupted" Keynes' idealism and Platonism. Early in his career as speculator, he even found himself estimating the cubic capacity of King's Chapel which he intended to use as a possible warehouse of wheat whose delivery he might have to take to fulfill a futures contract.[48] Straying from "The Ideal" nourished the anti-capitalist essays of the 1920s and is responsible for some of the distinctive theories of *The General Theory,* especially for the view of the stock market as a disruptive institution and for the attack on the rentier.

The tension between the ideal and the reality is also at the basis of Keynes' very un-classical, almost socialistic observations about income inequality. Besides the failure to provide full employment, he says, the economic system can be faulted for its "arbitrary and inequitable distribution of wealth and incomes." While there is justification for some inequalities of both, the inequality existing "today" is much too large, he wrote in *The General Theory.* It is not necessary that the economic game be played for such "high stakes as at present."[49]

Even though Keynes worked harder for his money than by reading the papers half an hour in bed each morning, he was Victorian, and certainly Moorean enough to be, at the very least, uneasy about the source of this wealth and the nature and type of effort its accumulation required. He knew that his wealth was not derived from doing anything useful, from *making* anything, but from taking advantage of the ignorant. From here partly stems his respect for those who earned money by working, by acting on raw materials, his acceptance of trade unions and his unwillingness to impose wage cuts on the workers to alleviate depressions.

Some of the main theories of *The General Theory* may well be an attempt to sublimate a sense of guilt born of the compromise between a demanding, ascetic ethics and his wordliness.

Notes

1. John Maynard Keynes, *The Collected Writings of John Maynard Keynes* (henceforth, *C. W.*) Vol. XII, Table 1. Since 1946 British prices have risen roughly by a multiple of twenty. One pound now commands $1.50. Data on Keynes' investment are found in Chapter 1 of Vol XII of the *C. W.* and are mostly the work of Donald Moggridge working from Keynes' notes and records.
2. Robert Skidelsky, *John Maynard Keynes: Hopes Betrayed, 1883–1920* (London: 1983) 286–8.
3. Keynes, C.W., XII 4, Table 2. It should be noted that consumer prices were perhaps 2.5 times higher in 1919 than in 1910.
4. Charles Hession, *John Maynard Keynes* (New York: 1984) 71. King's 1909 fellowship is approximately equal to 4800 pounds today, or $7200.
5. Keynes, C.W., XII, 5–6.
6. ———, 5–6.
7. ———, XVII ("Notes on Financial Conference at Amsterdam, 13–15 Oct. 1919") 129.
8. ———, ("The Present State of the Foreign Exchanges") 175–7.
9. There is evidence to suggest that the later revisions of *A Treatise on Probability* (1921) represent a retreat from the more confident rationalism of the earlier (1914) draft. See Piero V Mini, *John Maynard Keynes: A Study in the Psychology of Original Work* (London: Macmillan forthcoming).
10. Roy Harrod, *The Life of John Maynard Keynes* (London: 1951) 298–9.
11. *Lydia and Maynard: The Letters of John Maynard Keynes and Lydia Lopokova.* Ed. P. Hill and R. Keynes (New York: 1989) 296.
12. Keynes, *C. W.*, XII, *op. cit.*, p. 13, Table 5. It should be noted that when Keynes did out-perform the market he did so by wide margins.
13. ———, 19, editor's notes.
14. ———, 27–8, editor's notes.
15. ———, 11, Table 3.
16. ———, 31, editor's notes.
17. ———, 32. The investors did not withdraw any funds during those eight investment years.
18. ———.
19. ———, 36.
20. ———, ("Post-mortem on Investment Policy," 8 May 1938), 102.
21. ———, (letter to F.N. Curzon, 18 Mar. 1938) 37.
22. Note by D. Moggridge in Keynes *C. W.* XII, 90.
23. ———, ("Post-mortem . . ." *op.cit.*) 106.
24. ———, (letters to F.C. Scott and R.F. Kahn, 10 Apr. 1940 and 5 May 1938, respectively), 78 and 101.
25. ———, 107, 38 and 24, from various letters and post-mortems.
26. ———, (letter to R.F. Kahn, 29 Mar. 1938, and "Post-mortem . . ." *op.cit.*) 29 and 108.
27. ———, (to R.F. Kahn, 5 May 1938) 100.
28. ———, (letter to F.N. Curzon, 18 Mar. 1938) 38–9.
29. ———, ("Post-mortem . . ." *op.cit.*) 106, and letter to F.C. Scott, 4 Sept. 1937, 26.
30. Keynes, *C. W.*, XXI, 84–92 and 93: "There is nothing in the world like the cruel and cold-blooded beastliness of the American bankers."
31. ———, VII (*The General Theory*, 1936) 155.
32. ———, 160–1.
33. ———, ("Post-mortem . . . ," *op. cit.*) 109. Emphasis added.

34. Keynes, *C. W.*, IX (*A Short View of Russia,* 1925) 253–71.
35. ———, ("The Economic Possibilities for Our Grandchildren," 1930) 321–32.
36. ———, ("Clissold," 1927) 315–20.
37. I have examined the anti-Benthamism of J.M. Keynes in an article in this Journal, Vol.50, No.4 (October 1991) and also in *Keynes, Bloomsbury and The General Theory* (Macmillan: 1991).
38. Keynes, *C. W.*, XII, ("Post-mortem . . . ," *op. cit.*) 109.
39. ———, 106.
40. ———, 109.
41. ———, XX (letter to Lydia Keynes, 25 October 1929) 1.
42. ———, XII (letter to O. T. Falk, 18 September 1931) 35.
43. ———, XXVIII ("Royal Commission on Lotteries and Betting," 1932) 399 and 406.
44. ———, XII (letter to F.C. Scott, 4 September 1937) 27.
45. ———, IV (*A Tract on Monetary Reform,* 1923) 18. Emphasis added.
46. ———, 68–9.
47. ———, X, *My Early Beliefs,* 1938.
48. ———, XII, 10–12.
49. ———, VII (*The General Theory,* 1936) 372–4.

Human Development Report 1994

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