Mr. Keynes' Treatise on Money

Author(s): J. C. Stamp

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MR. KEYNES' TREATISE ON MONEY

A Treatise on Money. By J. M. KEYNES, Fellow of King's College, Cambridge. In two volumes. Vol. I. The Pure Theory of Money, pp. 363. Vol. II. The Applied Theory of Money, pp. 424. 15*s*. each.

AFTER an interval of several months from publication, a review of a long-anticipated and much-discussed book like this tends to be a review also of readers and receptions. The merit of the work itself in this case becomes for a time much involved with individual reactions to the challenging personality of the author, and all the different complexes which his public record has created. Frankly, so far, the book seems to have baffled the bankers, who, quite unused to inner economic analysis beyond a very static type, find in this new masterpiece of dynamic economics, headaches of the most formidable kind. And small wonder: for the chapters on definitions and fundamental equations are absolutely essential to anyone who would follow through the *proof* of the argument, and they are exceedingly concentrated reading. Indeed, they are not reading at all, in the ordinary sense, but concentrated study, such as the average business and professional man has not needed to employ since he left college and examinations. Some of these pages certainly demand a half-hour each of close application before the reader is entitled to proceed. But to anyone who is concerned, not with proofs but results and doctrine, it is by no means so essential to master these sections provided that their general drift is understood and for the time being accepted. But the average banker is not disposed to put his hand trustfully in that of Mr. Keynes, and be led forth through devious and unknown ways. He is, indeed, afraid of being " taken for a ride," in the Chicago sense. In fact he is nervous of being " had," and certainly even if he is ready to be a disciple, he is afraid of his colleagues, and of having himself to " explain why." It will probably be a good many years before the full implications of this work will be a part of the mental machinery of the head offices of central and deposit banks, and there are many good reasons why it is not of much use in some of them singly, for it needs *general* comprehension and readiness of acceptance before its full practical values can really accrue.

The academic world is not always without its camps and its jealousies, and its reluctances to make admissions of a large and generous order. Nevertheless, private recognitions are now rapidly accruing, and no work of this remarkable force can, in an environment of reasonably disinterested intellectuality, and love of truth, fail to strike its mark fairly soon. Indeed, the more brilliant of the undergraduate world are, I find, quicker to realise its potentialities than the cautious and conservative professors. It is to them, going out into the active professional world, that we must look for the widespread infiltration of practical affairs by the central ideas of the book.

Professor Pigou has already described this treatise as " important and ambitious." Certainly, hardly anything in the Theory of Money can ever be quite the same again, and I doubt if anyone can now go over any of his past work in this field without wishing to modify some of his expressions and without wanting to touch up even the most finished of his products with the new tools he has obtained.

In many respects I regard Mr. Keynes' work as the most penetrating and epoch-making since Ricardo, and in saying that I do not under-estimate the immense value of the synthesising work of Mill, Marshall and Pigou, and the general new incisive analysis of Jevons and the Austrians. For, this method of attack may lead us into quite new fields, and the author himself has not explored them all by any means, though he has mapped out a programme and given some provisional rules.

I do not suggest for a moment that the work is perfect in form. In some places it is unnecessarily difficult—by which I mean it can be made easier on a second approach. Mr. Keynes had to " get it born " somehow, and he tells us the story of his labouring in the preface : " I could do it better and much shorter if I were to start over again." The marvel is that it is so satisfactory architecturally as we find it, and it would be most ungrateful to cavil at some of the effects of the mode and challenging, changing time of writing. We must all feel that recent events have completely bankrupted the old monetary analysis both as a means of explanation and also as a practical guide. It would have been a less service to delay it several years in order to give it greater perfection. But I agree with Professor Pigou that the author might now well write a short work embodying his chief conclusions for the general reader, and to the banker and student of affairs such a book would form an introduction to the larger work. The author calls this " forcing his way through a confused jungle "—a collection of material rather than a finished work, but in this he does himself much less than justice.

In a complete treatise, Mr. Keynes necessarily had to deal with aspects ancillary to his main thesis, and there are, therefore, various chapters which do not contain the same note of originality as the others. But, even in these, his touch and treatment are fresh and distinctive—nowhere is he merely summarising and recording existing material, for he brightens, retests, criticises and adorns. So, combined with his broad treatment are a " number of discussions which might have been the subject of separate monographs." Book I opens with classifications of money and bank money, where appears a discussion of the controversy, partly verbal, as to how and by whom bank deposits are " created," and also a definition, destined later to be of much importance, of *savings deposits*, the criterion of which is that they are not required for current payments and can, without inconvenience, be dispensed with, if some other form of investment is seen to be preferable. Such savings deposits are here somewhat in excess of one-half of the whole. Book II deals with the Value of Money—purchasing power tested in different ways—the plurality of secondary price levels, the diffusion of price levels, and the theory of comparisons of purchasing power. At one point he says very justly, " I do not believe that Great Britain would have returned in 1925 to the gold standard at the pre-war parity if it had not been for the habit of regarding the wholesale standard as a satisfactory indication of general purchasing power." In his study of index-numbers I think he inclines to do less than justice to the Chain Method, for while it may not be the best to adopt when a full equipment is available, its practical value for " running repairs " when away from home and help is very great.

In Book III, " The Fundamental Equations," we reach the heart of Mr. Keynes' new theory and the most difficult and original passages of the two volumes. It is especially important that " profits " are particularly and closely defined in the residual sense of windfalls or differentials, all normal remunerations and interest and regular monopoly gains having gone into " income "; such profits are, of course, often negative. " If an entrepreneur spends part of his profits on current consumption, then this is equivalent to negative savings, and if he restricts his normal consumption because he is suffering windfall losses, this, on the other hand, is equivalent to positive saving." If these special definitions are not kept in mind, in reading the later chapters, all is lost. Mr. Keynes then restates the Quantity Theory identities, but with the important aim of separating out those factors, through which, under a dynamic system, the causal process actually operates during a period of change, and arrives at his first statement, now so obvious, but so far-reaching:

> "I propose, therefore, to break away from the traditional method of setting out from the total quantity of money irrespective of the purposes on which it is employed, and to start instead—for reasons which will become clear as we proceed—with the flow of the community's earnings or money-income, and with its two-fold division (1) into the parts which have been *earned* by the production of consumption-goods and of investment-goods respectively, and (2) into the parts which are *expended* on consumption-goods and on savings respectively.
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> "We shall find that, if the first of these divisions of the community's income is in the same proportion as the second, *i.e.* if the output measured in cost of production is divided between consumption-goods and investment-goods in the same proportion as expenditure is divided between current consumption and savings, then the price level of consumption-goods will be in equilibrium with their cost of production. But if the proportionate divisions are not the same in the two cases, then the price-level of consumption-goods will differ from their cost of production.
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> "The price level of investment-goods, on the other hand, depends on a different set of considerations, which we shall come to later."

He finds that profits and losses are first an effect rather than a cause, but having come into existence are then the mainspring of change. It is vital to his argument that the actual price level of investment is the resultant of the sentiment of the public and the behaviour of the banking system. It used to be sufficient to say that savings—purchasing power put into the money machine—were really spending, on a different class of goods, *i.e.* productive goods. But the essence of Mr. Keynes' theory is that the decision to save instead of spending on consumption-goods is made by a different set of minds and on different principles (in the way it divides purchasing power) from the decision to spend on production-goods (*i.e.* to invest) by those waiting and working at the practical investment outlet of the money machine, and there is nothing immediately to compel investment to be equal to savings. The whole of the theory is bound up with the results of these disequilibria. "The performance of the act of saving is in itself no guarantee that the stock of capital goods will be correspondingly increased."

At first blush, and through a condensed description, it may be thought that we have here little more than an elaborate way of putting old theories of "over-saving" or "under-consumption."

But actually, although, as Mr. Keynes says, they have some affinity, they are based on quite a different point. Messrs. J. A. Hobson, and Foster and Catchings, have stressed an appropriate equilibrium between the devotion of human effort to consumption and production goods respectively—according to them there is an ideal, unspecified proportion between the two efforts, and when this proportion is departed from, trouble ensues. The kind of trouble they see at the bottom of our social disturbance is "too much saving," that is, too much put into instrumental goods, so that the consequent production finds too little consumption demand to meet it. Mr. Hobson at any rate traces the actual potentiality of over-saving in a maldistribution of income—too much income in the hands of a few whose consumption wants are few. But Mr. Keynes does not stress this ideal proportion. He would say, whatever proportion you *actually* have between the two, you must be consistent on both sides of the account. He does not say it should be 80 per cent. and 20 per cent. rather than 90 per cent. or 10 per cent., but whichever it is, it must apply to both the total production divided between the two classes, and total purchasing power divided between consumption spending and investment spending, and if the proportions differ—if the rate of investment lags behind the rate of savings—then trouble must result. He remarks, with complete justice, it seems to me : "They—Messrs. Hobson, etc.—are occupying an entirely different *terrain* from my theory, inasmuch as, on my theory, it is a large volume of saving which does *not* lead to a correspondingly large volume of investment (not one which *does*) which is the root of the trouble." But he acknowledges that they deserve recognition for trying to analyse the influence of saving and investment on the price level and credit cycle when the majority neglected this aspect—although they stopped short of the true link with the theory of money. Mr. Keynes finds that the writer coming nearest to the centre of his position is Mr. N. Johannsen (*A Neglected Point in Connection with Crises*, 1908, and pamphlets 1925, 1926 and 1928). "His doctrine of 'Impair Savings,' *i.e.* of savings withheld from consumption expenditure, but not embodied in capital expenditure, and so causing entrepreneurs who have produced goods for consumption to sell them at a loss, seems to me to come very near the truth." But this writer does not go to the point of temporary disequilibrium, adjustable by a changed rate of interest, as a chronic state of affairs in society—he does not envisage it as a banking machine defect of transmission.

Mr. Keynes finds that Tugan-Baranovski assumes that savings " accumulate " during depression to be used up in booms, and also has the maldistribution of wealth complex. He puts the credit for the pioneer work upon Mr. Dennis Robertson, where we shall all be glad to leave it, presuming that Mr. Robertson will give Mr. Keynes credit for hatching out the fertile egg laid so unobtrusively in " Banking Policy and the Price Level " which Mr. Robertson himself, after a well justified crow, left to its fate.

In the *modus operandi* of the bank rate, some important new distinctions are made—the discouragement of investment relatively to saving, in its effect on prices, being brought to the front as a causal element. " There has been no more harmful confusion within the field of monetary practice than the belief that bank rate has done its work when it has produced a fall in the price level, irrespective of whether this is due to selling at a loss or to a decline in the costs of production, *i.e.* irrespective of whether the deflation which it has produced is a Profit Deflation or an Income Deflation."

In Book IV we have the " Dynamics of the Price Level," in which the author does skilful manipulations of the creatures he has made, and savings and investment gyrate in what, on first reading, is a giddy maze, but which on a closer acquaintance is a brilliant and profound analysis—a perfect orgy of symbolic and difficult reasoning, which will defeat all but the most practised and persevering.

In the second volume on Applied Theory we are soon back into savings deposits and velocities, backed by a use of all available statistical material, which, to say the least, is courageous, though I am bound to say rarely foolhardy. By the analysis of deposits into two sections, it is shown that an apparent stability of monetary factors may really be covering up important changes in the relative velocity of the two parts, which have far-reaching consequences. Mr. Keynes gets results of great value by dividing price level conceptions hitherto taken in one, and produces a completely new picture. He does the same with deposits, and indeed with like fundamental importance. One wonders whether, lurking behind other single conceptions, there may not be other double and diverse influences. For example, Mr. Keynes tends to treat " savings " as subject to a single influence of rate. He does not take the separate component psychologies of savings, made familiar by Professor Gonner—those sections in which the response to a higher rate is to make it necessary to save *less*, instead of more—but probably on balance this is insignificant. More important, I suspect, is a further analysis of " Profits " looked at as an aggregate—first an aggregate made up of slight tendencies all in one direction, and second an aggregate of a large mass of profits in certain sections rather outbalancing an aggregate of losses. I imagine that *dispersion* is just as important as aggregation, and that the behaviour of the Keynesian analysis could not be identical for two similar total effects made up of widely different types. Again, " business losses " are financed by excess saving—but such losses can be broken up into a diverse classification. Some businesses definitely finance a " loss position " by borrowing, others by letting stocks run down, others by not renewing, or delaying making revenue provision for renewal of, machinery (involving no borrowing). Is the effect of borrowing, disinvestment, and restriction identical? Nor is it always clear whether the business loss is brought about more easily by the fact that finance is available through over-saving, or under-investment, or whether it is the over-saving which causally compels the business loss, *viâ* price change. For not all losses requiring financing are due to price changes—some follow miscalculation and competition and individual trouble and backwardness. The dynamics are clear, but not always the *direction* of causation.

The relation between development projects and " unused capital " in times when savings exceed investment is obviously one of great importance, and different readers have apparently found support for different views from these pages. Strictly the lack of equivalence does not result in a potential fund in existence for any length of time. For the enhanced savings, according to some, may hold the *old* objective investments at higher values, a form of security inflation, and support is found for this in the absence of any statistical evidence of a fund awaiting investment. But, in Mr. Keynes' analysis, the purchasing power withheld from consumption-goods lowers the demand and the price, and produces business losses which, put crudely here, are " financed " by that very excess of purchasing power transferred to saving. At some subsequent date it may be possible to create an excess of *investment* over savings, and reverse the process, but this is mere equivalence, and not an absorption of the original error. Dynamically, *at the moment* when private investment is less than savings, the surplus of the latter might be prevented from financing losses by being absorbed in public investment which creates a demand for the right commodities and prevents a deflation of their price on the supply existing.

Another brilliant passage restores a true doctrine of the

Wages Fund—the successors to Mill have not " perceived the truth which lay at the centre of the confusion." Following upon a careful distinction between productive consumption and unproductive consumption, he concludes that " it is the flow of income available for consumption by the factors of production which constitutes the true Wages Fund, and it is the distribution of this fund between relatively productive and relatively unproductive consumption which determines the volume of employment and of output." Most of us have felt, in an unanalysed way, that the ordinary exposure of the " Wages Fund fallacy " left out of account limitations on the *rate* of expansibility of working capital through credit, but Mr. Keynes has made his unerring contribution to this analysis also.

Book VI deals with the Rate of Investment and its fluctuation. Disequilibrium more often arises from such fluctuations than from changes in the volume of savings :—" Whenever the rate of interest changes for reasons other than a change in the demand schedule for the use or enjoyment of fixed capital, it is reasonable to expect a change in the rate of investment." Distinctions between increases in working capital and liquid capital are here very important. The practice of testing net investment by the growth of fixed capital tends to mask the extent of the dependence of the community during a slump upon using up liquid and working capital. " It is precisely this shortage both of available output and of liquid capital which may retard the process of recovery even after the influences which originally caused the slump have long since ceased to operate." It is a common practice to-day to think that a diagnosis of how the slump came about is also the guide to the factors which are to be worked upon to secure recovery.

The chapter on Historical Illustrations contains some very pertinent new criticism of the depression of the eighteen-nineties, but its greatest value perhaps rests in its suggestive treatment of the United States position for the years from 1925 to 1930, while the analysis of the " Gibson paradox " dealing with the high correlation between the rate of gilt-edged interest and the level of prices is of great importance in economic theory.

In Book VII the Management of Money brings us down to the great banking problems of the day, and it is altogether beyond the scope of a review to describe the many contributions to analysis of recent events, and the many practical suggestions which Mr. Keynes makes in this field. For the first time, I think, he gets into reasonable focus the respective potentialities of control by member banks and by central banks, as distinct from what he describes as " supernational control." This portion should be read easily, and its main purport understood, by all interested in current problems. They are extremely far-reaching, for the fundamental assumptions of the gold standard and the difference between its working now and before the war become abundantly clear. A great deal of the critical matter centres round some of our (at present) quite unwarrantable expectations: " Can we afford to allow a disproportionate degree of mobility to a single element in an economic system which we leave extremely rigid in several other respects? . . . To introduce a mobile element highly sensitive to outside influences as a connected part of a machine of which the other parts are much more rigid may invite breakages."

The author deals very acutely with what is sound and unsound respectively in the innumerable proposals of currency cranks with their " self-liquidating " inflations. It is a little surprising, however, that he did not find more room for treatment of " dual systems " of currency, designed to relieve us of most of our internal difficulties by a domestic unit, which would maintain our internal price level conditions at the same time as the present international unit with a varying link of exchange between them—such systems having been put forward by painstaking and thoughtful writers. The treatise winds up with a chapter on Supernational Management, and the Bank for International Settlements, which is suggestive and indicative rather than exhaustive. I do not know that the progenitors in Paris could have done more in the constitution of the Bank if they had had Mr. Keynes' book before them, but at any rate they would have been confirmed in their belief that they were attempting the initial regulation of an overmastering function in the preservation of international social life and civilisation.

Mr. Keynes must take rank in the greatest line of economic development. He has provided material for innumerable analyses of particular questions. Assuredly not all his individual applications will stand. He is young enough to alter and rewrite many of them himself, but as first approximations they are a magnificent contribution to realistic economic thought. In the realm of pure theory and analysis, I am convinced that our sense of indebtedness to him will continually grow. It was not only stout Cortez upon a peak in Darien who had a Pacific to stare at! And the days of path-breakers are clearly not yet ended.

J. C. Stamp