
Students Brief

JOHN MAYNARD KEYNES, 1883 - 1946 - THE MAN BEHIND THE NAME

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On the 5th June this year there falls the hundredth anniversary of the birth of John Maynard Keynes - Lord Keynes of Tilton - the greatest and most influential economist of this century. His is one of the few names of economists familiar to the general public. That this is so, nearly forty years after his death, is an indication of the enormous impact which his ideas have had on economic theory and policy. Since the publication in 1936 of his **General Theory of Employment, Interest and Money** a great part of the intellectual effort of the economics profession has been devoted to explaining, extending or attempting to escape from the interpretation of the working of the economic system presented in that work. In academic and in popular discussion of unemployment and inflation the epithet "Keynesian" is bandied about by theorists, journalists and politicians - applied sometimes as a term of commendation, sometimes as a term of abuse. The purpose of the present piece is to convey some impression - as it may be gleaned from his writings and from the memoirs of those who knew him - of the man behind the name. It is opportune to give thought to Keynes and to the nature of his contribution not simply because this happens to be his centenary year, but particularly because the social disaster of mass unemployment, to the elimination of which his energies were passionately committed, has again befallen the world economy.

The Family Background

Maynard Keynes, as a Cambridge don and economist, was in his own career to follow a path taken before him by his father, John Neville Keynes. J N Keynes (1852-1949), born in Salisbury of a middle-class nonconformist family, attained academic distinction at Cambridge as a philosopher and an economist. His **Formal Logic** and **The Scope and Method of Political Economy** are minor classics. Subsequently he was for many years, as the capable occupant of the post of Registrar, responsible for the administration of the University's affairs.

J N Keynes married in 1881 an early Newnham graduate, Florence Brown, who had been his pupil. Mrs Keynes (1862-1958) was a daughter of Dr John Brown, Congregationalist minister of the Bunyan Meeting House in Bedford, a distinguished preacher and scholar (author of what is still the best and most readable **Life of Bunyan**). Maynard, it is recorded, held his grandfather in "immense respect". There is a Scottish link in that Dr Brown, although born and brought up in Bolton-le-Moors, Lancashire, was of Ayrshire descent. Mrs Keynes was to be in her own right a Cambridge notable: she was active in social work, became an alderman of the borough, a Justice of the Peace, and mayor.

The Keynes children - Maynard, the eldest, Margaret (pioneer of modern methods of care of the elderly and wife of A V Hill, physiologist and Nobel prizeman) and Geoffrey (Sir Geoffrey Keynes, eminent as a surgeon and as a man of letters) were born into a secure and happy professional home, into a family tradition, one feels, of high thinking, of ideals of social responsibility and service. It was a home to which eminent Cambridge personalities - the philosophers Henry Sidgwick and W E Johnson in particular - were familiar visitors. Sir Geoffrey, looking back more than eighty years, gives us a sense of the family's life at Harvey Road. He writes that home provided "an ideal atmosphere for a highly individual intelligence like my brother's to develop, unfettered by parental dominance or prejudice. Our parents, as I now look back on them, had a lovable aura of perfect integrity and goodness without stuffiness or pomposity; they were affectionate without sentimentality, and were careful not to interfere with the personalities of their children, while always ready to foster any worthwhile interests as soon as they discerned them". Throughout his life Maynard's relations with parents remained very close.

Eton and King's

The young Maynard Keynes proceeded by the customary educational stages; local preparatory school, public school (Eton on a scholarship) and University (in his case, of course, Cambridge). The Eton years brought outstanding success, and as is evident from his letters, great enjoyment. Innumerable prizes in Mathematics and Classics fell to him. He revelled in the Eton life. He debated and wrote papers on such subjects as mediaeval Latin poetry, the characters of the Stuart monarchs, the difference between East and West. He acted, he rowed (though not with conspicuous success) and he performed valiantly at the notorious wall game. He displayed natural qualities of leadership and achieved "the greatest triumph open to an Etonian", election to the society known as Pop. It was a sophisticated and confident young man, well aware that he was the possessor of remarkable talents, who went up in October 1902 on an Open Scholarship to King's College, Cambridge.

He read for a degree in Mathematics, but certainly did not confine himself to that field. Philosophy was a particular enthusiasm. His interests were wide and the range of his activities extensive. He was elected President of the Liberal Club. He became President of the Union. A letter to an Eton friend at Oxford, written incidentally in his first term at Cambridge, vividly conjures up an extremely energetic undergraduate life:

"I have never enjoyed myself so much before. I have very much increased my knowledge of the affairs of this world and even more of the next.

I know nice people. I have bought over fifty books this term. I row hard every afternoon without exception, and I never go to bed. What more can heaven offer me?

Take my programme last Sunday evening. Immediately after hall I went to a Trinity Essay Society and heard a most brilliant satire on Christianity. From there I went to an informal philosophical debating society of interesting people where I stayed till nearly twelve; then I went to see Monty James where I stayed till one; from there I went on to another man with whom I talked till half past four. At half past seven I got up and read the lesson in Chapel. I had four hours' work that morning, and rowed half a course in the afternoon. In the evening I went as a visitor to

the Political Society to hear a paper on the Jesuits.... and so on."

A significant event of Keynes' undergraduate days was his introduction, after vetting by Lytton Strachey and Leonard Woolf, to the select and secret discussion society which went by the name of "The Apostles". The spirit and fellowship of the Society proved very congenial. The Apostles saw themselves as seekers after truth - truth at all costs, without regard to tradition or convention. It must be said that a certain intellectual arrogance characterised the Society, a sense of being an elite, possessed of exceptional understanding and wisdom. Many years later (1938), with mature appreciation of the naivety of the Apostles' philosophy, Keynes was to write: "We had no respect for traditional wisdom or the restraints of custom. We lacked reverence ... for everything and everyone. It did not occur to us to respect the ordinary accomplishment of our predecessors in the ordering of life (as it now seems to me to have been) or the elaborate framework which they had devised to protect this order". Despite the moderation of attitude implied by that appraisal an iconoclastic element remained strong in Keynes, as did a confident belief in his superiority of vision. The gusto with which in the **General Theory** (1936) he demolished traditional economic doctrines recalls the radical enthusiasm of the Society.

Membership of the Society brought Keynes not only intellectual excitement, it brought him also lasting friendships. The group of close friends around Lytton Strachey which included Keynes, together with the Stephen sisters, Virginia and Vanessa, and the painter Duncan Grant, subsequently formed the nucleus of "Bloomsbury", that famous, or notorious, coterie of intellectuals and artists. The values of Bloomsbury were those of the Society. Until his marriage Keynes' social life was centred on this group and there he found affection and love. Later, although relations were less close, friendship remained.

In one aspect Keynes was quite untypical of Bloomsbury. The characteristic Bloomsbury attitude to the outside world was one of ironic detachment - Bloomsbury preferred to concentrate on the attainment of good states of mind, on the contemplation of personal relationships and in aesthetic appreciation of objects of beauty. But Keynes cared, passionately, about the world and its problems. We find him throughout his adult life directing his attention to the discovery of rational and humane solutions to economic problems and applying his powers of polemic and persuasion to the task of getting these solutions adopted. Is it not reasonable to suppose that, despite the Society, despite Bloomsbury, the ethos of the family in which he was brought up - a moral inheritance from his parents - counted for a great deal in shaping Maynard Keynes' outlook on the world, in creating his urgent, activist spirit? Bertrand Russell, who knew Keynes and his background well, suggests as much.

To return to Keynes' Cambridge career: in 1905 he took a First in Mathematics. He was undecided as to the future. The Bar was suggested but he eventually determined to prepare for the Civil Service examination. This plan involved him for the first time, in formal study of economics. He remarked in correspondence: "I find Economics increasingly satisfactory, and I think I am rather good at it. I want to manage a railway or organize a Trust... It is so easy and fascinating to master the principles of these things." He came second in the Civil Service examination in 1906 and entered the India Office. Keynes appears not to have found life in

Whitehall sufficiently fulfilling. When after two years, he received an offer of a Lectureship he threw up his post at the India Office and returned to Cambridge.

Fellow of King's

During the years 1906-1911 Keynes' main intellectual efforts were devoted not to economics but to philosophy. In the India Office period his spare time was occupied in the preparation of a dissertation, on the theory of probability, by which he hoped to win a Fellowship at King's. After he gained his Fellowship in 1909 he continued work on the subject, developing the dissertation into a **Treatise on Probability**. Before the book was completed other activities intervened and it did not appear until 1921.

Any portrayal of Keynes which neglected the **Probability** would be seriously incomplete. The **Probability** was concerned with the theory of knowledge, and suggested, against the scepticism of Hume, a justification of inductive reasoning, and offered a notion of probability (as an attribute of a conclusion in relation to its premises.) of wider relevance than the numerical concept of the frequency theory. It was a work of wide scope and erudition and made an original and important contribution and it gives Keynes a claim to distinction in the field of philosophy. Keynes did not claim to present a final and definitive treatment of probability and induction. "There is much here" he said in his Preface "which is novel, and, being novel, unsifted, inaccurate, or deficient. I propound my systematic conception of this subject for criticism and enlargement at the hand of others..." Perhaps it is fair to say that the place of the **Probability** in the history of ideas is in accordance with the tenor of these remarks: it may be described as an important and influential contribution to a debate which continues. It may be noticed that, years later in the **General Theory**, Keynes analysing business decision making in respect of production, investment and asset choice, drew on the ideas of the **Probability**, on his understanding of thought processes in a world of uncertainty. The roots of 'liquidity preference' lie in the **Probability**.

At Cambridge before the First World War Keynes was performing the duties of the economist, exactly as described (1921) in his famous introduction to the Cambridge Economic Handbooks: "The main task of the professional economist now consists, either in obtaining a wide knowledge of **relevant** facts and exercising skill in the application of economic principles to them, or in expounding the elements of his method ... so that, through his instruction, the number of those who can think for themselves may be increased." The "apparatus of thought" which was to hand seemed adequate; Keynes applied this apparatus to monetary affairs, specifically to issues of Indian currency and finance. He became an authority on these matters: they formed the subject of his first book (1913) and he sat on a Royal Commission (1913-1914) which deliberated on this question.

Shortly after the outbreak of the 1914-1918 war, Keynes was taken into the Treasury. He was to play an important executive role in the management of war finance. Treasury colleagues later recalled: "Once there, his quick mind and inexhaustible capacity for work rapidly marked out a kingdom for itself, and before long he was a leading authority on all questions of external, and particularly inter-allied, finance. "....it was Keynes who developed and applied the system of allied war loans, largely from the angle

of control over the use of these borrowings and its relation to our own needs and orders for material.... Equally absorbing was his interest in the provision of foreign exchange resources for UK expenditure abroad." Official business took him to Paris and to New York. He had a close escape in June 1916: but for a last moment change of plan he would have sailed with Lord Kitchener for Russia aboard the ill-fated HMS Hampshire.

Keynes attended the Peace Conference in Paris as the Treasury's chief representative, with power to speak for the Chancellor. At Paris he was engaged with immediate matters of economic management - the provisioning of Germany, the control of inter-allied finance and the allocation of food, materials and shipping - rather than with the actual making of the Treaty. When the terms to be demanded of Germany became known Keynes (and not only Keynes) was appalled. He made urgent efforts to modify the reparation terms and to provide for an international loan to Germany: Lloyd George was receptive, but Wilson was not. To Keynes the folly and hypocrisy of the Treaty, as he saw it, was a matter of intense personal concern. In a state of frustration and despair he wrote (to his mother): "..the Peace is outrageous and impossible and can bring nothing but misfortune behind it." To the Chancellor: "..The Prime Minister is leading us all into a morass of destruction. The settlement which he is proposing for Europe disrupts it economically and must depopulate it by millions of persons. The new states we are setting up cannot survive in such surroundings. How can peace be kept or the League of Nations live. How do you expect me to assist in this tragic farce any longer, seeking to lay the foundation, as a Frenchman puts it, 'd'une guerre juste et durable'." He resigned and left Paris in June 1919 before the Treaty was signed at Versailles.

The Radical Critic : "The Economic Consequences...."

Keynes' sense of outrage found expression in the immediate composition of **The Economic Consequences of the Peace**, a masterpiece of polemic which reached the public before the end of 1919. His purpose was to lay bare the reality of the "Carthaginian Peace". He charged the peacemakers - Clemenceau, Lloyd George and Wilson - with disregard of undertakings made to Germany by the terms of the Armistice and with the imposition of an unprecedentedly vindictive and humiliating settlement which threatened to destroy her industry and reduce her "to servitude for a generation". The peacemakers had failed in their task. "It was the task of the Peace Conference to honour engagements and to satisfy justice; but not less to re-establish life and to heal wounds. These tasks were dictated as much by prudence as by the magnanimity which the wisdom of antiquity approved in victors."

Keynes may have underestimated the resilience of the European economic system, and it may have been naive to suppose that the politicians really intended to extract from Germany the tribute they were ostensibly demanding, but there can be no doubt that reason and magnanimity would have made a better Peace. It was in the five years following Versailles, while attempts were being made to force reparations out of Germany, that unrestrained resort to the printing press by the Reichsbank destroyed the value of the mark on the exchanges, thereby accelerating the pace of domestic inflation. As to the consequences of run-away inflation Keynes had spoken in no uncertain terms: "Lenin is said to have declared that the best way to destroy the capitalist system is to debauch the currency... Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages

all the hidden forces of economic law on the side of destruction..." Keynes was wise in recognising that the peacemakers were playing with fire. With a moderate and constructive settlement the collapse of the mark might not have occurred; without that disastrous inflation would Hitler have come to power? **The Economic Consequences** put Keynes in the public eye. The book was published in American, Belgian, Chinese, Danish, Dutch, Italian, Japanese, Roumanian, Russian, Spanish, Swedish and German editions. It had a profound effect on opinion.

Keynes decided not to return to full-time academic life. He wished to influence events more directly, to play an active part in shaping public opinion. He had great confidence in his own powers; he believed that in his own field of expertise he possessed particular insight. He would continue in the part of the author of the **Economic Consequences**, a free-lance campaigner "setting in motion those forces of instruction and imagination which change opinion." "The assertion of truth, the unveiling of illusion" would be his objective. What was required, he believed, for the attainment of reasonable solutions was "clear analysis of the real facts": want of proper understanding, not self-interest or lack of goodwill, was generally the obstacle. In the years from 1919 he operated on opinion at all levels - through the quality and the popular press, through direct contact with those in high authority and through his academic writings. He became Chairman of and contributed regularly to the Liberal weekly **The Nation**. He required financial independence. That he successfully achieved (after an early reverse) by operations in foreign exchange, commodities and stocks and shares. Keynes operated not only on his own account: he was for many years Chairman of the National Mutual Life Insurance Company and a member of the board of the Provincial Insurance Company. He was also Bursar of King's. His personal capital and that of the institutions whose investments he guided grew with remarkable success. In the inter-war years Keynes was in effect conducting three careers - as an academic, as a free-lance journalist and as a financier. Financial business is said to have taken about half an hour (in bed) each morning. Weekends in term were spent in Cambridge, the rest of the week in London.

In the immediate post-war period Keynes' attention was concentrated on monetary questions, both domestic and international. The reparations problem remained unsettled, although the **Economic Consequences** had had an important moderating effect on opinion. As the value of the mark collapsed on the foreign exchanges and inflation raged destructively in Germany Keynes continued to work for a practicable solution. He proposed that Britain should forego all claims to reparations; during the Ruhr crisis he was himself in touch with the Chancellor in an effort to achieve agreement between Germany and the Allies, but it was not until 1924 that a workable arrangement was found.

In Europe the stable monetary order of the pre-war gold standard had been destroyed by war and inflation. The £ was floating; its value in terms of gold (or in terms of the dollar which had maintained its pre-war relationship to gold) was well below the pre-war parity £1 = \$4.86. Keynes had very definite ideas on practical policy; he called conventional presumptions into question and invited fundamental reconsideration of traditional beliefs. He propounded his views in academic articles, in articles in the press (placed world-wide), in his contributions to the authoritative **Manchester Guardian** supplements on "Reconstruction in Europe" (which he edited) and in his **Tract on Monetary Reform**.

Keynes' practical recommendation was consistently that "the objective of the authorities, pursued with such means as are at their command, should be the stability of prices". Inflation and deflation were both damaging and should be avoided. "...inflation is unjust and deflation is inexpedient. Of the two perhaps deflation is, if we rule out exaggerated inflations such as that of Germany, the worse; because it is worse, in an impoverished world, to provoke unemployment than to disappoint the **rentier**. But it is not necessary to weigh one evil against the other. It is easier to agree that both are evils to be shunned."

It was consistent with that position that Keynes advocated dear money - which, in the circumstances, he did not expect seriously to affect employment - to break the inflationary post-war boom in Britain. But he was strongly opposed to the application of deflationary measures for the purpose, not of controlling inflation, but of pushing down domestic prices for external reasons. He considered it foolish for a country to attempt to raise the external value of its currency by domestic deflation. (The mechanism supposed was that a reduction in wages and prices would affect exports and imports and thereby lead to appreciation of the domestic currency on the foreign exchange markets.) He cited the case of Czechoslovakia as an example of the unhappy consequences of pursuing an irrational objective - that of improving the exchange value of the Czech crown. "...it has cost her an industrial crisis and serious unemployment. To what purpose? I do not know.... Her finances were in equilibrium, her credit good, her foreign resources adequate, and no one could have blamed her for devaluing the crown, ruined by no fault of hers and inherited from the Hapsburg Empire. Pursuing a misguided policy in a spirit of stern virtue, she preferred the stagnation of her industries...."

Keynes raised the question - an extremely radical question in the 1920's - of the desirability of return to the rigidly fixed exchange rates of the gold standard. He was very conscious of the extreme difficulty and slowness of balance of payments adjustment via deflation which adherence to the gold standard would require. He charged conventional economic wisdom with giving insufficient attention to problems of adjustment, of thinking too much in terms of long run equilibrium. "But this **long run** is a misleading guide to current affairs. **In the long run** we are all dead. Economists set themselves too easy, too useless a task, if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." He took the view that stability of internal prices should be preferred to rigidity of the exchange rate. If realignment of domestic with international values should be required, he recommended devaluation rather than deflation. A regime of **adjustable** exchange rates was indicated. Not only should Britain not seek to re-establish the pre-war parity of the £, she should not seek to fix any **permanent** value of sterling in relation to gold.

Despite Keynes' warnings, faith in the gold standard remained strong in the City and at Westminster. Speculation took the value of the £ to an artificially high level and in April 1925 the Chancellor of the Exchequer, Mr Winston Churchill, announced Britain's return to gold at the pre-war parity of \$4.86 to the £. At this parity the £ was overvalued, on Keynes' estimate, by about 10%; for balance of payments equilibrium, domestic prices would have to be brought down by two shillings in the pound.

He launched a scathing attack. Did the Government, he asked in **The Economic Consequences of Mr Churchill**, not understand the implications? In taking

this "silly" decision, Mr Churchill had been "grossly misled by his experts". "I think the minds of his advisers still dwell in the imaginary academic world... where the necessary adjustments follow 'automatically' from a 'sound' policy by the Bank of England." Keynes spelled out the reality of suffering glossed over by soothing official phrases. Credit restriction would do its work of bringing down prices by the required 10% **"in no other way than by the deliberate intensification of unemployment....** It is a policy from which any humane or judicious person must shrink... No section of labour will readily accept lower wages merely in response to sentimental speeches, however genuine, by Mr Baldwin. We are depending for the reduction of wages on the pressure of unemployment and of strikes and lockouts..." Because of the weak position of the coal industry, the miners above all others, would suffer. "They are the victims of the Economic Juggernaut. They represent in the flesh the 'fundamental adjustments' engineered by the Treasury and the Bank of England to satisfy the impatience of the City fathers to bridge the 'moderate' gap between \$4.40 and \$4.86.... The gold standard, with its dependence upon pure chance, its faith in 'automatic adjustments', and its general regardlessness of social detail, is an essential emblem and idol of those who sit in the top tier of the machine. I think they are immensely rash in their regardlessness, in their vague optimism, and comfortable belief that nothing really serious ever happens..."

We feel in these phrases Keynes' fierce indignation that ignorance in high places should impose suffering - avoidable suffering. We feel his determination to force to public attention, to the attention of those responsible for policy, the reality of the situation. Characteristically also, he offered a plan. If the value of the £ was to remain as it was, might not an alternative to the "hateful and disastrous" method of forced deflation be tried? He suggested a form of incomes policy. "The other way is to effect a **uniform** reduction of wages by **agreement** (between the Government and labour)... a uniform initial reduction of money wages throughout the whole range of employment, of (say) 5%, which reduction shall not hold good unless, after an interval, it has been compensated by a fall in the cost of living."

But the Government did not act on Keynes' plan; his predictions of industrial strife and the difficulty of price adjustment were fully borne out by events. The imposition of wage cuts by the mine owners resulted in the General Strike of 1926. The 'automatic adjustment' of wages and prices was not generally achieved, and the British economy limped through the rest of the twenties, an era of prosperity elsewhere, with dear money, uncompetitive prices and high unemployment.

The similarity, **mutatis mutandis**, of British problems and policies of the twenties to those of the eighties is remarkable. As a means of price management, deflation by force may be deemed no less crude and brutal when the object is to moderate a rate of price increase than when it is to achieve an absolute reduction of money wages and prices.

The Creative Theorist : The General Theory

Up to the mid-twenties, however unorthodox Keynes' practical prescriptions might be, the analytical tools he employed were essentially those he had inherited from Marshall. It began to be evident to him that the theoretical

apparatus was not adequate for his purposes. The precise mechanism by which monetary policy affected activity and prices was not fully understood; public works might have an intuitive appeal to common sense as a remedy for unemployment, but theory did not make clear their impact on the economy. Keynes became involved in a long effort of theoretical construction. It was to take more than ten years to develop his new vision embodied in the **General Theory**.

In another way also a new phase was beginning in Keynes' life. In 1925 he married Lydia Lopokova, a prima ballerina of the Diaghilev company. Lydia (1892-1981) was born in St Petersburg and trained at the Imperial School of Ballet; curiously enough, she too, through her mother, had a Scottish connection. Of Lydia as an artist, it has recently been stated that "beyond question, she was one of the greatest dancers of our time". We have the impression of a charming and lovable person. Sir Geoffrey writes: "Lydia was the most enchanting friend, always bubbling over with high spirits and delightful nonsense. There are many anecdotes of her (sometimes outrageous) remarks and eccentric behaviour. She brought joy to us all, especially Maynard. They were a completely devoted couple." Mrs Alfred Marshall said that marrying Lydia was "the best thing Maynard ever did". But Lydia and Bloomsbury did not mix well: Harrod speaks of "oil and water". The Bloomsbury friends slipped into the background of Keynes' life. At the time of his marriage Keynes leased, as a country home the farm of Tilton, under the South Downs near Lewes in Sussex. The lands of Tilton, he later learned, had once been in the possession of the Keynes family. Farming became an enjoyable hobby.

The **Treatise on Money** - a substantial two volume work, the fruit of five years' efforts - appeared in 1930. It was intended as a definitive exposition of the working of a monetary economy but, although containing much of value, turned out to mark only an interim stage in the development of Keynes' thought. Intensive examination by Cambridge colleagues and criticism from other quarters revealed certain deficiencies. Whilst the analysis of the **Treatise** was evidently intended to comprehend fluctuations of activity and employment in response to changes in demand, Keynes' formal theoretical model seemed to require the assumption of constancy of output; an adequate theory of unemployment was still wanting. We may note Professor Austin Robinson's comment on Keynes' reaction to the critical response the **Treatise** received.

At no moment in his life, I think, did Keynes' greatness of character appear more strongly than at this time. He had just completed what he might reasonably have regarded as his **magnum opus**. There are few authors who would not have been sorely tempted to take up a position and to use their authority and reputation to maintain it until dislodged by sheer weight of opposition. Keynes never even appeared to hesitate. He was off with the rest of us in pursuit of truth with as enthusiastic a zest as if he were demolishing the work of his worst enemy.

An important catalyst to his thought process was the development of the "multiplier" by Richard Khan. Keynes again taking the lead integrated this concept into his evolving theoretical formulation. Through many drafts the constituent elements began to fall into place. He himself indicated the steps by which his understanding advanced.

.... the most extraordinary thing regarded historically, is the complete disappearance of the theory of the demand and supply for output as a whole, i.e. the theory of employment, **after** it had been for a quarter of a century the most discussed thing in economics. One of the most important transitions for me, after my **Treatise on Money** had been published, was suddenly realising this. It only came after I had enunciated to myself the psychological law that, when income increases, the gap between income and consumption will increase, - a conclusion of vast importance to my own thinking but not apparently, expressed just like this, to anyone else's. Then, appreciably later, came the notion of interest as being the meaning of liquidity preference, which became quite clear in my mind the moment I thought of it. And last fall, after an immense lot of muddling and many drafts, the proper definition of the marginal efficiency of capital linked up one thing with another.

Keynes had no doubts about the fundamental importance of his new conception. As the book embodying the new theory - **The General Theory** - neared completion, he described to George Bernard Shaw the effect he expected it to have:

To understand my state of mind.... you have to know that I believe myself to be writing a book on economic theory which will largely revolutionize - not, I suppose, at once but in the course of the next ten years - the way the world thinks about economic problems. When my new theory has been assimilated and mixed with politics and feeling and passions, I can't predict what the final upshot will be in its effect on action and affairs. But there will be a great change.....

I can't expect you, or anyone else, to believe this at the present stage. But for myself I don't merely hope what I say, in my own mind I am quite sure.

Keynes' presentation of his new theory was intentionally provocative - stressing that orthodox thinking on employment was entangled in confusion and error. He deliberately sought "to raise a dust" to force the economics profession to attend to his message and to reconsider deeply ingrained ideas.

During these years, despite being engaged with economics, finance and journalism, Keynes was able to give time to activities relating to the arts. Marriage to Lydia brought him into close touch with the world of ballet. He became treasurer of the Camargo Society which kept ballet alive in England between the death of Diaghilev and the emergence of the Vic-Wells company. He was a principal organiser of the London Artists Association which provided security of income to member artists. The Cambridge Arts Theatre was his creation. The idea was his, he supplied finance and brought the project to completion. Once it was established as a financially viable operation Keynes made over the theatre as a gift to a trust formed of representative of town and university. He continued to be closely involved in the management. The Arts Theatre opened with a gala performance by the

Vic-Wells ballet on 3 February 1937. **The General Theory of Employment, Interest and Money** was published the next day.

The General Theory was a contribution of the first importance. It provided a conceptual framework in terms of which the nature and cause of the principal socio-economic problem of the time - mass unemployment - could, for the first time, be clearly understood. It was Keynes' contention that conventional thinking had completely failed to understand the phenomenon of unemployment, and that the solution commonly recommended was hopelessly irrelevant. According to the conventional wisdom (or as Keynes put it, according to the "classical theory") unemployment could occur in two forms. The two categories which the theory identified were considered comprehensive.

"Frictional" unemployment was seen as the natural accompaniment of change within the economy. Unemployment of that sort was understood to be a reflection of the fact that adjustment to a disturbance (such as a change in the pattern of demand, or a change in the money supply) does not occur instantaneously, but takes place over time. Secondly, any unemployment over and above that which could be described as frictional was considered to be of a kind which might be termed 'voluntary' - voluntary in the sense that those in this category had only themselves to blame: the cause of their being out of work was that they were demanding unrealistic terms of employment - asking for higher real wages than employers could afford to pay. The level of unemployment experienced in the twenties and thirties, abnormally high by historical standards, was explained on that basis as the inevitable consequence of the "wage policy" which the trade unions had adopted. From that orthodox viewpoint the remedy was thought to be obvious - acceptance of lower wages would mean more employment.

In the **General Theory** Keynes advanced the thesis that the unemployment of the time (beyond the unavoidable element of frictional unemployment) was of a character not recognised by the classical theory: the problem as he saw it was essentially one, not of "voluntary" unemployment, but of **involuntary** unemployment. A condition of involuntary unemployment could be said to exist when people willing to work on perfectly realistic terms, terms compatible with their employment, are unable to find work because not enough jobs are offered by employers. Why should employers not wish to take on all the labour available to them? The amount of employment they offer depends on their expectations as to the amount of output they will be able to sell. If demand for output falls off, demand for the services of labour will be correspondingly reduced.

Keynes' damning charge against the classical theory was that it entirely overlooked the possibility of involuntary unemployment: it failed to allow that on occasion total demand for output could be less than would induce employers to take on the whole of the available workforce. That failure of vision was symptomatic of a great gap in the classical analysis: what was missing, Keynes argued, was an adequate theory of how total demand for output is determined. Reliance had instead been placed on the woolly assumption that - somehow - "supply creates its own demand", implying that the market will always take up whatever volume of output entrepreneurs produce and offer for sale.

Having demonstrated the nature of the unemployment problem to be quite different from what had been supposed, and having revealed the deficiency of

received doctrines, Keynes proceeded in the **General Theory** to develop the required analysis of aggregate real demand. Aggregate demand for output emerged as an independently determined key variable, not an automatic reflection of the value of aggregate supply. The theory of effective demand explained, by reference to the behaviour of individuals operating in real world conditions of uncertainty, the determination of consumption, investment and total demand for output within the economy. The analysis demonstrated that aggregate demand could vary according to circumstances with consequent effects on activity and employment. Keynes made it clear that, when demand was for less than the full capacity output of the productive system, the economy could get "stuck" in a situation of unemployment equilibrium, with no effective adjustment forces operating to push it towards full employment. A case for governmental management of aggregate demand was indicated. It was evident from Keynes' analysis that the slump conditions of the 1930's required not wage-cutting but stimulation of demand for the output of industry.

The general theory was intellectually convincing; its "psychological and institutional reality" appealed to common sense, and it offered an analytical apparatus of evident practical utility. Many of the economics profession came to accept Keynes' vision. But what, it might be asked today, of the 'monetarist' challenge to the ascendancy of Keynesian theory? The monetarist school reasserts the 'classical' thesis that unemployment can only be frictional or voluntary. Their underlying theory is essentially pre-Keynesian. We find a theory of **monetary** (not **real**) expenditure together with a theory which purports to explain employment by reference to conditions of productivity and labour supply;

deviation of employment from its 'natural' level is said to be due to a change in monetary spending causing a change in labour **supply**. This contemporary version of classical theory is still vulnerable to Keynes' critique: they proceed in **neglect** of Keynes' theory.

The Statesman : War and Post-War Reconstruction

As the international situation worsened Keynes spoke out against appeasement. "We are suffering to-day from the worst of all diseases, the paralysis of will. Nothing can be more dangerous than that. We have become incapable of constructive policy or decisive action. We are without conviction, without foresight, without a resolute will to protect what we care for. We just rearm a little more, grovel a little more, and wait to see what happens" (March 1938). "The Christian civilisation and fundamental basis of conduct which our predecessors established in a savage world" were in danger. He urged a policy of "positive pacifism", a policy of firm collective resistance, by whatever means might be appropriate, to fascist aggression. Arrangements to permit the emigration of Jews should be made with Germany.

Keynes applied his mind to questions of war finance. Articles appeared in **The Times** (and, stolen, in the **Frankfurter Zeitung**). The economic problem which threatened was now one of too much rather than too little demand: the total of civil and military expenditure would have to be accommodated to the supplies which could be made available. Keynes applied the conceptual apparatus of the **General Theory** to the new problem. **How to Pay for the War** (February 1940) demonstrated that taxation and compulsory savings (Keynes' "deferred pay" scheme) could be used to constrain private sector demand and so release resources for the war effort.

When Winston Churchill took charge in May 1940, Keynes was brought back into Whitehall. His position was not that of a salaried official; it was as an (unpaid) expert consultant - though he was to become much more than that - that he was given a desk in the Treasury. His influence was quickly felt in domestic economic management. Treatment of government expenditures and revenues as elements of the total macroeconomic balance replaced previous concentration on the government's own accounts as the basis of formulation of fiscal policy. The 1941 Budget was for the first time cast in "Keynesian" terms, recognising the implications of the government's budgetary position for the state of the economy as a whole. A fundamental advance had taken place. The 1944 White Paper on Employment Policy expressed a transformation of official attitudes. The message of the **General Theory** had been absorbed - and in less than Keynes' ten years. Unemployment was recognised as an avoidable evil, an evil against which preventive or corrective action should, and could, be taken. The 1946 Employment Protection Act marked a similar conversion of United States opinion.

The suggestion is sometimes encountered that blame for the inflationary conditions from which the Western world has recently been suffering should be laid at Keynes' door. Post-war governments, it is alleged, were misled by Keynesian ideas to neglect the inflationary implications of the employment objectives they adopted. Although during the war years Keynes' attention was primarily directed to issues other than internal post-war problems, he did give some indication of his thinking on domestic matters. Keynes certainly appreciated that attainment of the objective of full employment would create a problem of wage control. He warned (1943) that stability of prices would require the stabilisation of money wages. "Some countries" he observed "are likely to be more successful than others in preserving stability of internal prices.... A communist country is in a position to be very successful. Some people argue that a capitalist country is doomed to failure because it will be found impossible in conditions of full employment to prevent a progressive increase of wages. According to this view severe slumps and recurrent periods of unemployment have been hitherto the only means of holding efficiency wages within a reasonably stable range. Whether this is so remains to be seen. The more conscious we are of this problem, the likelier we shall be to surmount it."

It was with matters of external finance that Keynes, in the Second, as in the First World War, was principally concerned. He played the major role on the British side in Anglo-American negotiations over war finance and post-war reconstruction. He was not a mere technical adviser. In the formation and conduct of Britain's international economic policy, his part was that of a statesman.

President Roosevelt's announcement of Lend-Lease in January 1941 - allowing Britain to buy "on tick" war materials for which we had no means of paying - relieved for the duration of the war the threat of financial disaster. Even so, there were still financial matters to be settled between Britain and the United States. The scope of Lease-Lend had to be determined in detail, there was the matter of British indebtedness for pre-Lend-Lease supplies and the question of Britain's ability to pay. In May 1941 Keynes (and Lydia) flew to the States; this was the first of six transatlantic visits they were to make between 1941 and 1946. Very full discussions took place with officials of the US Treasury. Keynes gave the Americans a comprehensive picture of the British situation. "From that time forward" Harrod observes, "there was a much more intelligent appraisal of Britain's problems from the American side". Post-war conditions and the question of the ultimate settlement of Lend-Lease obligations came under discussion; it emerged that

American thinking was developing along the lines that Britain's obligations might be cancelled in exchange for an undertaking to co-operate in the elimination of trade restrictions. The discriminatory character of the system of Imperial Preference was a particularly sore point in the United States. Keynes took the American suggestion back to London. It should be understood that during the war years Keynes was far from fit. In 1937 he suffered a serious heart attack. He never fully recovered; thereafter, Harrod says, "his life hung by a thread". He suffered other attacks. Lydia guarded and supported him, accompanying him, despite Admiralty objections, on all his American missions.

Keynes' assessment of the situation was that, while free trade would be in itself a good thing, Britain could move in that direction only in the context of a post-war settlement which took account of the balance of payments problem she would face. He saw, as the pre-requisite of movement towards greater freedom of international trade, the necessity of constructive reorganisation of the international monetary system.

We need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self protection from disruptive outside forces.

He proposed an international "Clearing Union". This "grand and daring" conception was, after much discussion, and with some modification, adopted as the official British plan. The object of the "Keynes Plan" was to create an international system which would permit countries with balance of payments difficulties sufficient freedom of manoeuvre to tackle their problems without resort to damaging crisis measures of deflation or trade restriction.

The Clearing Union which Keynes proposed would act as a bank to its member countries - a central bank for central bankers. A new international money, in the form of deposits with the Clearing Union, would come into being. These deposits would be denominated in units of "bancor", of which the value in relation to gold would be specified. Payments between member countries would be cleared through the Union. Countries with a balance of payments surplus would receive credits to their accounts with the Union; countries with deficits would receive debits. Permitted overdrafts on accounts with the Union would constitute an addition to the stock of international means of payment. Some access to overdraft facilities was to be automatic, but, beyond a certain point further drawing would require the approval of the authorities of the Clearing Union, who could require a deficit country to take corrective action. Pressure would be put on surplus countries, interest would be charged on credit balances above a certain level, and after a certain time, such balances could be cancelled. The credit creating capability of the Union was to be readily adjustable to the needs of trade and the objective of achieving stability of demand and activity. The plan envisaged stable exchange rates, alterable at the request of the Union and, in some degree, also at the discretion of member countries. Keynes had hopes that, if the Clearing Union came into being, its functions might in time be extended - it might for instance operate to stabilize commodity prices; it might ultimately become "the pivot of the future economic government of the world".

Almost at the same time (summer 1942) as the Keynes Plan was revealed to the US authorities, Keynes was informed of an independently devised American scheme - the White Plan (after Harry Dexter White of the US Treasury, its author). The objectives of the White Plan were similar to those of the Keynes Plan. It offered an "International Stabilization Fund with resources and powers adequate to the task of helping to achieve monetary stability and facilitate the restoration and balanced growth of international trade". The proposed scheme was, however, much less ambitious than that of Keynes. The proposal was for a Fund to which members would contribute means of payment and on which, with permission, they could draw; the Fund was not a bank with the power to create a new form of international money. There would be no automatic access to the Fund, pressure on surplus countries would be less than under the rules of the Keynes Plan, and the potential for future development of the Stabilization Fund was far less than that of the Clearing Union. Furthermore, the American plan was on a much smaller scale than the British - it envisaged initial resources of \$8 billion, as against Keynes' figure of \$25 billion.

The two Plans were assessed in London and in Washington. The Americans made a substantial concession to the British by introducing a "scarce currency" clause allowing trade discrimination against a persistent creditor country. It was decided that the authors of the rival plans should confront each other. They met in Washington in September 1943. There was, Harrod reports, "an open clash of will and personality." White would not go beyond what he considered would be acceptable to Congress; by that criterion he could not accept the Keynes Plan - it would appear too generous to debtor countries, too inflationary in potential. It was a question of political realism - half a loaf would be better than none. Keynes had to yield. It was agreed that Keynes should take the White Plan as a basis and make such amendments as he saw fit. The document which was finally agreed could be described as a liberalized version of the White Plan for a Stabilization Fund.

In July 1944 forty-four nations convened at Bretton Woods, New Hampshire, to examine the Anglo-American proposals and to determine the final constitution of the offspring of the Keynes-White negotiations, the International Monetary Fund. The same was to be done for the International Bank for Reconstruction and Development, the establishment of which had also been agreed in the previous months. All amendments proposed by all nations had to be considered. Professor Lord Robbins, who was present as a member of the British delegation, recorded his impression of Keynes in action (actually at a preliminary conference in Atlantic City immediately prior to the Bretton Woods conference proper).

In the late afternoon we had a joint session with the Americans ... Keynes was in his most lucid and persuasive mood; and the effect was irresistible. At such moments, I often find myself thinking that Keynes must be one of the most remarkable men that have ever lived - the quick logic, the birdlike swoop of intuition, the vivid fancy, the wide vision, above all the incomparable sense of the fitness of words, all combine to make something several degrees beyond the limit of ordinary human achievement. It is pure genius.

After three weeks of intensive discussion and drafting at Bretton Woods, the business was complete. As Keynes brought the conference to a close, the delegates rose in a standing ovation. Professor Robbins observed:

In a way, this is one of the greatest triumphs of his life. Scrupulously obedient to his instructions, battling against fatigue

and weakness, he has throughout dominated the Conference.

What had Keynes achieved? The IMF was to be a more limited instrument than that envisaged in his original plan. It may indeed be true that "there can be little doubt, particularly in the light of subsequent events, that on economic grounds the Keynes Plan was superior to its fellow"; but if Keynes, with his great power of persuasion could not get more from the Americans, the Bretton Woods system was very likely the best that in the circumstances could be achieved. It was a beginning. If Britain had not, as under Keynes' guidance she did, adopted an internationalist approach and had not pushed for a dramatic scheme of international monetary reform, not even the Bretton Woods system, perhaps not any rational improvement at all of the international monetary system, would have been achieved.

Even with his demanding wartime responsibilities Keynes managed to find time for the arts. Before the war, he had deplored the fact that, while in other times and other places public patronage of the arts had been taken for granted, in contemporary Britain "we have persuaded ourselves that it is particularly wicked for the state to spend a halfpenny for non-economic purposes". From 1942 he was actually engaged in the disbursement of public money to the arts. In that year he accepted the chairmanship of the Committee for the Encouragement of Music and the Arts. CEMA, as it is generally known, had been set up earlier in the war originally under private auspices later to contribute on the home front by providing, to "hard pressed and often exiled civilians", opportunities for enjoyment of the arts. CEMA brought music, drama and exhibitions to factories, wartime hostels, mining villages. It offered opportunities to artists; a system of subsidies came into being. Keynes wrote: "We seek, increasingly, to aid all those who pursue the highest standard of original composition and executive performance in all branches of the Arts."

From CEMA there developed, as a permanent peacetime institution, the Arts Council, of which Keynes has been described as the architect. In a famous broadcast he spoke of the Council, its policy and its hopes. "At last, the public exchequer has recognised the support and encouragement of the civilising arts of life as part of their duty." He went on to explain: "We want ... to encourage local institutions and societies and local enterprise to take the lead... In Glasgow, in particular, the work of the Citizens Theatre is a perfect model of what we would like to see established everywhere, with their own playwrights, their own company and an ever-growing and more appreciative local public... Certainly in every blitzed town in this country one hopes that the local authority will make provision of a central group of buildings for drama and music and art. There would be no better memorial of a war to save the freedom of the spirit of the individual..." He was to have been the first chairman of the Arts Council.

Keynes was hardly back from Bretton Woods before he returned to Washington as deputy for the Chancellor to negotiate the terms of Lend-Lease for the period (how short it would be was not of course known) of continuing warfare against Japan after victory in Europe. This involved two months of protracted and hard fought negotiations, concerning not only broad principles but as well minutest items of detail. The next year the unexpectedly rapid conclusion of the war in the Far East precipitated a financial crisis for Britain. The Lend-Lease arrangements came abruptly to an end. Britain was in no position to pay her way or pay her debts. It was not conceivably possible to quadruple exports overnight as would have been required to maintain imports of food and materials in the absence of renewed assistance. Keynes was back in Washington with all speed to rescue the situation. It took him three days to present the British case. "Those most sympathetic and those least sympathetic agreed in thinking that this was the finest exposition to which they had ever listened, or were ever

likely to listen." He brought back not the outright gift which he had hoped for, but a loan on generous terms and cancellation of all potential obligations in respect of Lend-Lease. Having fought for the Loan in Washington he had to fight for its acceptance at Westminster. His defence of the terms of the Loan in the House of Lords the day after his return from Washington was a notable triumph.

Early in 1946 Keynes crossed the Atlantic yet again. He was to attend the inaugural meeting at Savannah of the IMF and the World Bank, to both of which he had been appointed British Governor. Unexpected difficulties arose: the conference turned out to be a battle, not the pleasant occasion he had anticipated. To his dismay the Americans, apparently abandoning internationalism for self-interest, were intent on forcing on the conference their own plans for the location and direction of the IMF and the Bank. Keynes feared American political domination of the new institutions. He fought desperately but to no avail for arrangements which would minimise political influence.

En route from Savannah to Washington he collapsed on the train. It was the worst attack he had had. At home in England, at Tilton, early on 21 April - Easter Day 1946 - he suffered another attack. This time there was no recovery.

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