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RICHARD F. KAHN

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The six *Raffaele Mattioli Lectures* were delivered by Lord Kahn at the Luigi Bocconi University, in Milan, from 5th to 14th June 1978.

## FIRST LECTURE

### Some comments on the earlier economists up to early Keynes

1. *Say's Law: Adam Smith to John Stuart Mill.* – 2. *Say's Law: Alfred Marshall.* – 3. *Dennis H. Robertson in his 'A Study of Industrial Fluctuation'.* – 4. *Dennis H. Robertson in his 'Money'.* – 5. *The impact of young Piero Sraffa on the Cambridge of the Twenties.*

#### 1. *Say's Law: Adam Smith to John Stuart Mill*

The classical doctrine, which used to be expressed categorically in the statement that 'Supply creates its own Demand', requires the underlying assumption that saving promotes the accumulation of national wealth. But expositions by classical economists of the public virtues of thrift often suffered from obscurity. For example, Adam Smith:

Capitals are increased by parsimony, and diminished by prodigality [. . .]

Whatever a person saves from his revenue he adds to his capital, and either employs it himself [. . .] or enables some other person to do so, by lending it to him for an interest, that is, for a share of the profits [. . .]

NOTE: *Lord Kahn introduced his Lectures with the following remarks:*

It is an honour which I deeply appreciate to have been invited to give the second series of Raffaele Mattioli Lectures. It gives me particular pleasure because Dr Mattioli was Piero Sraffa's oldest and greatest friend, whom I met on a number of occasions. He was a wonderful man. At one time he was a Lecturer at the Luigi Bocconi University. Piero Sraffa is both my oldest friend and the first economist with whom I established a close relationship, which has been maintained ever since 1929 until the present day. To Sraffa we all owe the fertile gift of the Italian–Cambridge school of economics, to the great advantage of Cambridge economics – and perhaps I may add of Italian economics. I used to meet Sraffa's father, Angelo, a man of charm and a great commercial lawyer. He was at one time Rector of the Luigi Bocconi University and Professor of Commercial Law.

Soon after the end of the First World War Sraffa visited England. He had been given an introduction to Keynes, on whom he made a very favourable impression. Keynes invited him to write a contribution on 'Italian Banking To-day' for the *Manchester Guardian*, Reconstruction Supplement, of which Keynes was the General

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## I – COMMENTS ON THE EARLIER ECONOMISTS

What is annually saved is as regularly consumed as what is annually spent, and nearly in the same time too; but it is consumed by a different set of people.<sup>1</sup>

The first half of the final sentence called for an apologetic editorial note by Cannan, Adam Smith's editor:

This paradox is arrived at through a confusion between the remuneration of the labourers who produce the additions to the capital and the additions themselves. What is really saved is the additions to the capital, and these are not consumed.<sup>2</sup>

Malthus was, of course, the great heretic of the classical age. But the extent of his heresy is, I suggest, less than Keynes attributed to him.

Editor. It was published in English on 7 December 1922. It was also published in Italian. Sraffa described how "the industrial crisis of 1921 had a grave repercussion on the ordinary [commercial] banks, all of which [. . .] found themselves loaded with doubtful credits and worthless securities, and at the same time compelled to agree to fresh advances to save what could be saved. [. . .] through the Consortium [of commercial banks] the banks of issue have been gradually extending their credit operations [. . .] in part taking the place of the ordinary banks and fulfilling functions properly theirs. [. . .] It will be interesting to follow the later developments in these tendencies" (PIERO SRAFFA, 'Italian Banking To-Day' *Manchester Guardian*, Supplement 'Reconstruction in Europe', 7 December 1922, pp. 675-6).

Mussolini was angry. Piero Sraffa was urged by his father to leave the country – at least temporarily. Keynes arranged for him to stay in Cambridge, England. But Sraffa was in no sense an exile. He paid frequent visits to Italy to maintain his connections and meet his friends.

At the end of the First Lecture I shall be discussing Sraffa's famous article 'On the Relations between Cost and Quantity Produced', published by this University in *Annali di Economia* in 1926 (PIERO SRAFFA, 'Sulle relazioni fra costo e quantità prodotta', *Annali di Economia*, vol. II, 1925-1926. Milano: Università Bocconi Editrice, 1926, pp. 277-328). On the strength of this article Keynes persuaded our Faculty to appoint Sraffa to a post. He has been with us ever since – a most important influence in our Faculty and much beloved.

The first time that I visited Italy after the war was in 1948 when Joan Robinson, Sraffa and I stayed on the Passo Sella in the Dolomites. It was early in the summer and there was too much snow. Our rock climbing was restricted. Roy Harrod's book *Towards a Dynamic Economics* was in page proof and Harrod lent me a proof, which we read when we were not walking or climbing. So far as Cambridge is concerned this was the origin of the economics of growth.

1. ADAM SMITH, *The Wealth of Nations*, Edited by Edwin Cannan. Fourth Edition. London: Methuen, 1925, vol. I, p. 320.

2. *Ibid.*, p. 320 note.

SAY'S LAW: ADAM SMITH TO J. S. MILL

In the Introduction to the *Principles*, Malthus wrote:

Adam Smith has stated, that capitals are increased by parsimony, that every frugal man is a public benefactor, and that the increase of wealth depends upon the balance of produce above consumption. That these propositions are true to a great extent is perfectly unquestionable [...] but it is quite obvious that they are not true to an indefinite extent, and that the principle of saving, pushed to excess, would destroy the motive to production [...] The two extremes are obvious; and it follows that there must be some intermediate point, though the resources of political economy may not be able to ascertain it, where, taking into consideration both the power to produce and the will to consume, the encouragement to the increase of wealth is the greatest.<sup>1</sup>

Ricardo felt obliged to concede qualified agreement:

But the argument is not about the motive to production, in that every body is agreed – the accumulation of capital may go on so much faster, than labourers can be increased, that productions must cease increasing in the same proportion as capital, from want of hands [...].<sup>2</sup>

In a letter to Ricardo, Malthus wrote:

an attempt to accumulate very rapidly which necessarily implies a considerable diminution of unproductive consumption, by greatly impairing the usual motives to production must prematurely check the progress of wealth.<sup>3</sup>

In his reply Ricardo protested against Malthus' view that 'an increase of consumption' was a 'remedy' for 'stagnation of trade, in a want of employment for our labourers, &c. &c.'<sup>4</sup>

1. THOMAS R. MALTHUS, *Principles of Political Economy*. First Edition. London: John Murray, 1820, Introduction, pp. 8-9; quoted by KEYNES, vol. x, p. 102 and vol. vii, p. 363.

2. DAVID RICARDO, *Works and Correspondence*, vol. II, *Notes on Malthus's Principles of Political Economy*. Edited by PIERO SRAFFA with the collaboration of M. H. Dobb. Cambridge: Cambridge University Press, 1951, p. 8.

3. DAVID RICARDO, *Works and Correspondence*, vol. IX, *Letters July 1821-1823*. Cambridge: Cambridge University Press, 1952, p. 10, from a letter dated 7 July 1821; quoted by KEYNES, vol. vii, pp. 362-3.

4. DAVID RICARDO, *Works and Correspondence*, vol. IX, p. 16, from Ricardo's letter to Malthus, 9 July 1821.

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Ricardo was confused. Keynes wrote that he 'was stone-deaf to what Malthus was saying'.<sup>1</sup>

Ricardo took refuge in two quite separate lines of defence. One I have already indicated – if 'accumulation of capital may go on so much faster, than labourers can be increased, that productions must cease increasing in the same proportion as capital, from want of hands'.<sup>2</sup>

The other line of defence is indicated in the following passage:

With very low profits the motives for saving would cease, and therefore the motives for increased production would also cease. Do you not then say that increased production is often attended with evil consequences to mankind, because it destroys the motives to industry, and to the keeping up of the increased production? Now in much of this I cannot agree with you. I indeed allow that the case is possible to conceive of saving being so universal that no profit will arise from the employment of capital, but then I contend that the specific reason is, because all that fund which should, and in ordinary cases does, constitute profit, goes to wages, and immoderately swells that fund which is destined to the support of labour. The labourers are immoderately paid for their labour, and they necessarily become the unproductive consumers of the country. I agree too that the capitalists being in such a case without a sufficient motive for saving from revenue, to add to capital, will cease doing so – will, if you please, even expend a part of their capital; but I ask what evil will result from this? none to the capitalist, you will allow, for his enjoyments and his profits will be thereby increased, or he would continue to save. None to the labourers, for which we should repine; because their situation was so exceedingly favourable that they could bear a deduction from their wages and yet be in a most prosperous condition. Here it is where we most differ. You think that the capitalist could not cease saving, on account of the lowness of his profits, without a cessation, in some degree, of employment to the people. I on the contrary think that with all the abatements from the fund destined to the payment of labour, which I acknowledge would be the consequence of the new course of capitalists, enough would remain to employ all the labour that could be obtained, and to pay it liberally, so that in fact there would be little diminution in the quantity of

1. KEYNES, vol. VII, p. 364.

2. DAVID RICARDO, *Works and Correspondence*, vol. II, p. 8.

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commodities produced, – the distribution only would be different; more would go [to] the capitalists, and less to the labourers.

I do not think that stagnation is a proper term to apply to a state of things in which for a time there is no motive to a further increase of production.<sup>1</sup>

Heretic Malthus certainly was. But he was traditionalist in his belief in *laissez-faire*:

if, in reality, saving is a national benefit, or a national disadvantage, according to the circumstances of the period; and, if these circumstances are best declared by the rate of profits, surely it is a case in which individual interest needs no extraneous assistance.

Saving, as I have before said, is, in numerous instances, a most sacred private duty. How far a just sense of this duty, together with the desire of bettering our condition so strongly implanted in the human breast, may sometimes, and in some states of society, occasion a greater tendency to parsimony than is consistent with the most effective encouragement to the growth of public wealth, it is difficult to say; but whether this tendency, if let alone, be ever too great or not, no one could think of interfering with it, even in its caprices. There is no reason, however, for giving an additional sanction to it, by calling it a public duty. [...] [Thus] we shall best conform to that great principle of political economy laid down by Adam Smith, which teaches us a general maxim, liable to very few exceptions, that the wealth of nations is best secured by allowing every person, as long as he adheres to the rules of justice, to pursue his own interest in his own way.<sup>2</sup>

Ricardo's innocent comment on Malthus' final sentence was: 'Who has ever proposed to leave it to any other?' [than the pursuit of individual self-interest].<sup>3</sup>

It was Keynes' belief that, 'The last echo of the controversy [between Ricardo and Malthus] is to be found in John Stuart Mill's discussion of his wages-fund theory'<sup>4</sup> in his *Principles*, published in 1848 (Book I, Chapter v).

1. *Ibid.*, vol. IX, pp. 24-5, from Ricardo's letter to Malthus, 21 July 1821.

2. THOMAS R. MALTHUS, *Principles of Political Economy*, pp. 517-18; DAVID RICARDO, *Works and Correspondence*, vol. II, pp. 449-50.

3. DAVID RICARDO, *Works and Correspondence*, vol. II, p. 450.

4. KEYNES, vol. VII, p. 364. See DON PATINKIN, 'Keynes's Misquotation of Mill: Comment', in *Economic Journal*, June 1978, pp. 341-2, on a learned discussion

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Mill was emphatic:

every increase of capital gives, or is capable of giving, additional employment to industry [...] without creating an impossibility of finding them [the labourers] employment [...]. This proposition [...] is also very much opposed to common doctrines. There is not an opinion more general among mankind than this, that the unproductive expenditure of the rich is necessary to the employment of the poor. Before Adam Smith, the doctrine had hardly been questioned; and even since his time, authors of the highest name and of great merit (for example, Mr. Malthus, Dr. Chalmers, M. de Sismondi) have contended, that if consumers were to save and convert into capital more than a limited portion of their income, and were not to devote to unproductive consumption an amount of means bearing a certain ratio to the capital of the country, the extra accumulation would be merely so much waste, since there would be no market for the commodities which the capital so created would produce. I conceive this to be one of the many errors arising in political economy [...].<sup>1</sup>

In another part of his book Mill included a chapter specifically entitled 'Of Excess of Supply'<sup>2</sup> from which Keynes quoted the following passage at the opening of his *General Theory* as expressly setting forth the doctrine that supply creates its own demand:

meaning by this in some significant, but not clearly defined, sense that the whole of the costs of production must necessarily be spent in the aggregate, directly or indirectly, on purchasing the product.<sup>3</sup>

The passage runs as follows:

what [...] constitutes the means of payment for commodities. It is, simply, commodities. Each person's means of paying for the productions

on the question whether Keynes quoted from the original source initiated by J. RONNIE DAVIS and FRANCIS J. CASEY Jr., 'Keynes's Misquotation of Mill', *Economic Journal*, June 1977, pp. 329-30. Don Patinkin agrees that Keynes quoted from Alfred and Mary Marshall's early book (1879), that it does not follow that he had not read Mill, but that his 'carelessness of interpretation' (in the view of Don Patinkin) was not due to a few minor verbal discrepancies.

1. JOHN STUART MILL, *Principles of Political Economy*. First published, London: John W. Parker, 1848. People's Edition, London: Longmans, Green, 1891, Book 1, Chapter v, Section 3, pp. 41-2.

2. *Ibid.*, People's Edition, Book III, Chapter XIV, Section 2, pp. 337-8.

3. KEYNES, vol. VII, p. 18.



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of other commodities consists of those which he himself possesses. All sellers are inevitably, and by the meaning of the word, buyers. Could we suddenly double the productive power of the country, we should double the supply of commodities in every market; but we should, by the same stroke, double the purchasing power. Everybody would bring a double demand as well as supply: everybody would be able to buy twice as much, because every one would have twice as much to offer in exchange.<sup>1</sup>

John Stuart Mill regarded the point as

fundamental; any difference of opinion on it involves radically different conceptions of political economy, especially in its practical aspect. On the one view, we have only to consider how a sufficient production may be combined with the best possible distribution; but on the other there is a third thing to be considered – how a market can be created for produce [. . .] Besides, a theory so essentially self-contradictory cannot intrude itself without carrying confusion into the very heart of the subject [. . .].<sup>2</sup>

The error Mill attributed in the same passage to Malthus, Chalmers and Sismondi

[their] fatal misconception has spread itself like a veil between them and the more difficult portions of the subject, not suffering one ray of light to penetrate [. . .] the merit of having placed this most important point in its true light, belongs principally, on the Continent, to the judicious J. B. Say, and in this country to Mr. Mill [James, John Stuart's father] [. . .].<sup>3</sup>

Even Mill could not fail to notice that there were occasional periods of heavy unemployment and business losses which appeared as 'general over-supply'. This he accounted for as a commercial crisis.

At such times there is really an excess of all commodities above the money demand: in other words, there is an under-supply of money. From the sudden annihilation of a great mass of credit, every one dislikes to part with ready money [. . .] Almost everybody therefore

1. JOHN STUART MILL, *Principles of Political Economy*. People's Edition, Book III, Chapter XIV, Section 3, p. 338.

2. *Ibid.*, Section 4, p. 340.

3. *Ibid.*, Section 4, p. 341.

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is a seller, and there are scarcely any buyers: [. . .] it is a great error to suppose, with Sismondi, that a commercial crisis is the effect of a general excess of production. It is simply the consequence of an excess of speculative purchases [. . .] the remedy is [. . .] the restoration of confidence [. . .] this temporary derangement of markets is an evil only because it is temporary.<sup>1</sup>

Mill then went on to a different theme – the secular fall of profits and interest – a concession similar to, but not identical with, the concession to Malthus made by Ricardo:

Low profits, however, are a different thing from deficiency of demand; and the production and accumulation which merely reduce profits, cannot be called excess of supply or of production.<sup>2</sup>

Keynes wrote:

Mill's successors rejected his wages-fund theory but overlooked the fact that Mill's refutation of Malthus depended on it. Their method was to dismiss the problem from the *corpus* of economics not by solving it but by not mentioning it [. . .] Theories of under-consumption hibernated until the appearance in 1889 of *The Physiology of Industry*, by J. A. Hobson [the economist] and A. F. Mummery [the mountaineer] [. . .].<sup>3</sup>

1. JOHN STUART MILL, *Principles of Political Economy*. People's Edition, Book III, Chapter XIV, earlier in Section 4, pp. 339-40.

2. *Ibid.*, p. 340.

3. KEYNES, vol. VII, p. 364.