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John Maynard Keynes
Frontmatter
More information

THE COLLECTED WRITINGS OF

JOHN MAYNARD KEYNES

Managing Editors:
Professor Austin Robinson and Professor Donald Moggridge

John Maynard Keynes (1883–1946) was without doubt one of the most influential thinkers of the twentieth century. His work revolutionised the theory and practice of modern economics. It has had a profound impact on the way economics is taught and written, and on economic policy, around the world. *The Collected Writings of John Maynard Keynes*, published in full in electronic and paperback format for the first time, makes available in thirty volumes all of Keynes's published books and articles. This includes writings from his time in the India Office and Treasury, correspondence in which he developed his ideas in discussion with fellow economists and correspondence relating to public affairs. Arguments about Keynes's work have continued long beyond his lifetime, but his ideas remain central to any understanding of modern economics, and a point of departure from which each new generation of economists draws inspiration.

Once the urgent problems of reparations, which had deeply troubled Keynes at the Peace Conference at Versailles, were on their way towards solution, Keynes turned to the equally grave problems of the currencies of Europe and their adjustment to the post-war world. These issues had been discussed in the series of Reconstruction Supplements of the *Manchester Guardian Commercial* that he had edited during 1922. In the *Tract* Keynes drew heavily on his own contributions to that series. This edition makes available the variations between the texts. The *Tract* remains of interest in three respects. First, it shows the state of Keynes's thinking about monetary problems and the causes of inflation in the early 1920s. Second, it provides one of the clearest expositions ever written of the determination of forward exchange rates. Third, it shows Keynes already favouring flexible exchange rates as a means of allowing independence in national economic policy.

THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES

VOLUME IV

A TRACT ON MONETARY REFORM

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CONTENTS

GENERAL INTRODUCTION

This new standard edition of *The Collected Writings of John Maynard Keynes* forms the memorial to him of the Royal Economic Society. He devoted a very large share of his busy life to the Society. In 1911, at the age of twenty-eight, he became editor of the *Economic Journal* in succession to Edgeworth; two years later he was made secretary as well. He held these offices without intermittence until almost the end of his life. Edgeworth, it is true, returned to help him with the editorship from 1919 to 1925; Macgregor took Edgeworth's place until 1934, when Austin Robinson succeeded him and continued to assist Keynes down to 1945. But through all these years Keynes himself carried the major responsibility and made the principal decisions about the articles that were to appear in the *Economic Journal*, without any break save for one or two issues when he was seriously ill in 1937. It was only a few months before his death at Easter 1946 that he was elected president and handed over his editorship to Roy Harrod and the secretaryship to Austin Robinson.

In his dual capacity of editor and secretary Keynes played a major part in framing the policies of the Royal Economic Society. It was very largely due to him that some of the major publishing activities of the Society—Sraffa's edition of Ricardo, Stark's edition of the economic writings of Bentham, and Guillebaud's edition of Marshall, as well as a number of earlier publications in the 1930s—were initiated.

When Keynes died in 1946 it was natural that the Royal Economic Society should wish to commemorate him. It was perhaps equally natural that the Society chose to commemorate him by producing an edition of his collected works. Keynes himself had always taken a joy in fine printing, and the Society, with the help of Messrs Macmillan as publishers and the Cambridge University Press as printers, has been anxious to give

Keynes's writings a permanent form that is wholly worthy of him.

The present edition will publish as much as is possible of his work in the field of economics. It will not include any private and personal correspondence or publish letters in the possession of his family. The edition is concerned, that is to say, with Keynes as an economist.

Keynes's writings fall into five broad categories. First there are the books which he wrote and published as books. Second there are collections of articles and pamphlets which he himself made during his lifetime (*Essays in Persuasion* and *Essays in Biography*). Third, there is a very considerable volume of published but uncollected writings—articles written for newspapers, letters to newspapers, articles in journals that have not been included in his two volumes of collections, and various pamphlets. Fourth, there are a few hitherto unpublished writings. Fifth, there is correspondence with economists and concerned with economics of public affairs.

This series will attempt to publish a complete record of Keynes's serious writing as an economist. It is the intention to publish almost completely the whole of the first four categories listed above. The only exceptions are a few syndicated articles where Keynes wrote almost the same material for publication in different newspapers or in different countries, with minor and unimportant variations. In these cases, this series will publish one only of the variations, choosing the most interesting.

The publication of Keynes's economic correspondence must inevitably be selective. In the day of the typewriter and the filing cabinet and particularly in the case of so active and busy a man, to publish every scrap of paper that he may have dictated about some unimportant or ephemeral matter is impossible. We are aiming to collect and publish as much as possible, however, of the correspondence in which Keynes developed his own ideas in argument with his fellow economists, as well as the more significant correspondence at times when Keynes was in the middle of public affairs.

GENERAL INTRODUCTION

Apart from his published books, the main sources available to those preparing this series have been two. First, Keynes in his will made Richard Kahn his executor and responsible for his economic papers. They have been placed in the Marshall Library of the University of Cambridge and have been available for this edition. Until 1914 Keynes did not have a secretary and his earliest papers are in the main limited to drafts of important letters that he made in his own handwriting and retained. At that stage most of the correspondence that we possess is represented by what he received rather than by what he wrote. During the war years of 1914–18 Keynes was serving in the Treasury. With the recent opening of Public Records under a thirty year rule, many of the papers that he wrote then and in later years have become available. From 1919 onwards, throughout the rest of his life, Keynes had the help of a secretary—for many years Mrs Stevens. Thus for the last twenty-five years of his working life we have in most cases the carbon copies of his own letters as well as the originals of the letters that he received.

There were, of course, occasions during this period on which Keynes wrote himself in his own handwriting. In some of these cases, with the help of his correspondents, we have been able to collect the whole of both sides of some important interchange and we have been anxious, in justice to both correspondents, to see that both sides of the correspondence are published in full.

The second main source of information has been a group of scrapbooks kept over a very long period of years by Keynes's mother, Florence Keynes, wife of Neville Keynes. From 1919 onwards these scrapbooks contain almost the whole of Maynard Keynes's more ephemeral writing, his letters to newspapers and a great deal of material which enables one to see not only what he wrote, but the reaction of others to his writing. Without these very carefully kept scrapbooks the task of the editor or biographer of Keynes would have been immensely more difficult.

The plan of the edition, as at present intended, is this. It will total twenty-four volumes. Of these, the first eight will be Keynes's published books from *Indian Currency and Finance*, in 1913, to the *General Theory* in 1936, with the addition of his *Treatise on Probability*. There will next follow, as vols. IX and X, *Essays in Persuasion* and *Essays in Biography*, representing Keynes's own collections of articles. *Essays in Persuasion* will differ from the original printing in two respects; it will contain the full texts of the articles or pamphlets included in it and not (as in the original printing) abbreviated versions of these articles, and it will have added one or two later articles which are of exactly the same character as those included by Keynes in his original collection. In the case of *Essays in Biography*, we shall add various other biographical studies that Keynes wrote throughout his work.

There will follow three volumes, XI to XIV, of economic articles and correspondence, and one volume of social, political and literary writings. We shall include in these volumes such part of Keynes's economic correspondence as is closely associated with the articles that are printed in them.

The further nine volumes, as we estimate at present, will deal with Keynes's *Activities* during the years from the beginning of his public life in 1905 until his death. In each of the periods into which we propose to divide this material, the volume concerned will publish his more ephemeral writings, all of it hitherto uncollected, his correspondence relating to these activities, and such other material and correspondence as is necessary to the understanding of Keynes's activities. The first four of these volumes are being edited by Elizabeth Johnson; the later volumes will be the responsibility of Donald Moggridge. It is their task to trace and interpret Keynes's activities sufficiently to make the material fully intelligible to a later generation. Until this work has progressed further, it is not possible to say with exactitude whether this material will be distributed, as we now think, over nine volumes, or whether it will need to be spread over a further volume or volumes. There will be a final volume of bibliography and index.

GENERAL INTRODUCTION

Those responsible for this edition have been: Lord Kahn, both as Lord Keynes's executor and as a long and intimate friend of Lord Keynes, able to help in the interpreting of much that would otherwise be misunderstood; Sir Roy Harrod as the author of his biography; Austin Robinson as Keynes's co-editor on the *Economic Journal* and successor as secretary of the Royal Economic Society. The initial editorial tasks were carried by Elizabeth Johnson. More recently she has been joined in this responsibility by Donald Moggridge. They have been assisted at different times by Jane Thistlethwaite; Mrs McDonald, who was originally responsible for the systematic ordering of the files of the Keynes papers; Judith Masterman, who for many years worked with Mrs Johnson on the papers; and more recently by Susan Wilsher and Margaret Butler.

NOTE TO THE READER

A Tract on Monetary Reform was first published in England on 11 December 1923. It was reprinted in 1924, 1929 and 1932. There were also American, French, German, Italian, Danish and Japanese editions. Of these, only the French edition had a preface differing from the English.[1]

At the bottom of the final page of the table of contents of the original English edition, Keynes wrote

> 'I have utilised, mainly in the first chapter and in parts of the second and third, the material, much revised and re-written, of some articles which were published during 1922 in the Reconstruction Supplements of the *Manchester Guardian Commercial*.'

The articles in question and their dates of publication were: 'The Theory of the Exchanges and "Purchasing Power Parity"', 20 April 1922; 'The Forward Market in Foreign Exchanges', 20 April 1922; 'Inflation as a Method of Taxation', 27 July 1922; 'The Consequences to Society of Changes in the Value of Money', 27 July 1922.

The existence of these articles posed a problem for the editors. If we had reproduced the articles separately, it would have meant considerable duplication in so far as they also appear in the *Tract*. In one case, moreover, given the reprinting of much of chapter 1 of the *Tract* in *Essays in Persuasion* (volume IX), it would have implied triplication. If, on the other hand, we had reproduced the *Tract* as originally printed but made reference to the changes that occurred since the publication of the relevant articles over a year before, we would have run the risk of distracting the readers with a large number of footnotes. This method, however, had the added advantage that we could have provided an example of how Keynes moved material between

[1] The Italian edition, translated by Mr Piero Sraffa, left out the last sentence of the English preface in translation.

media and audiences and also indicate how his views evolved over time. Given this advantage, after experimenting with this approach, we have decided to adopt it.

The text reproduced here is basically that of the first printing of the *Tract*. However, we have removed the excessive capitalisation favoured by his original printers, made the minor corrections indicated in Keynes's working copy of the volume,[1] added the French preface and introduced into chapter 1 some contemporary cartoons which Keynes chose to accompany the version printed in the *Manchester Guardian Commercial*. In footnotes we indicate all changes from the articles of the previous year other than those resulting from the updating of tables on the correction of figures. Keynes's footnotes in the *Tract* are set off in square brackets in the sections where the articles and the final text are compared.

[1] These are noted in Appendix III.

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PREFACE

We leave saving to the private investor, and we encourage him to place his savings mainly in titles to money. We leave the responsibility for setting production in motion to the business man, who is mainly influenced by the profits which he expects to accrue to himself in terms of money. Those who are not in favour of drastic changes in the existing organisation of society believe that these arrangements, being in accord with human nature, have great advantages. But they cannot work properly if the money, which they assume as a stable measuring-rod, is undependable. Unemployment, the precarious life of the worker, the disappointment of expectation, the sudden loss of savings, the excessive windfalls to individuals, the speculator, the profiteer—all proceed, in large measure, from the instability of the standard of value.

It is often supposed that the costs of production are threefold, corresponding to the rewards of labour, enterprise, and accumulation. But there is a fourth cost, namely risk; and the reward of risk-bearing is one of the heaviest, and perhaps the most avoidable, burden on production. This element of risk is greatly aggravated by the instability of the standard of value. Currency reforms, which led to the adoption by this country and the world at large of sound monetary principles, would diminish the wastes of *risk*, which consume at present too much of our estate.

Nowhere do conservative notions consider themselves more in place than in currency; yet nowhere is the need of innovation more urgent. One is often warned that a scientific treatment of currency questions is impossible because the banking world is intellectually incapable of understanding its own problems. If this is true, the order of society, which they stand for, will decay. But I do not believe it. What we have lacked is a clear analysis of the real facts, rather than ability to understand an analysis already given. If the new ideas, now developing in many quarters, are sound and right, I do not doubt that sooner or later they will prevail. I dedicate this book, humbly and without permission, to the Governors and Court of the Bank of England, who now and for the future have a much more difficult and anxious task entrusted to them than in former days.

J. M. KEYNES

October 1923

PREFACE TO THE FRENCH EDITION

Events in the world of money move fast; but it does not follow that principles shift as quickly. In addressing this edition to the French public, I may be excused, therefore, if I seek to apply, in a few words, the principles of this book to the changes which have come over the financial situation of France during the past six months.

I have maintained for a long time that a substantial fall in the value of the franc was inevitable unless there was to be a more drastic change in the policy of the French Treasury than was likely to be politically feasible. This fall has now taken place. The effect of the fall on the mind of the public is to engender increased distrust and fear, and the atmosphere is pessimistic. Nevertheless the establishment of financial equilibrium is easier now than it was before the fall took place.

Let me first clear out of the way certain opinions and arguments, which appear in the past to have influenced opinion, yet are altogether contrary to good sense:

1. It has never been officially admitted that the value of the franc can ever be fixed at any other value, either in gold or in commodities, than its pre-war gold parity. This is absurd. A restoration of the pre-war gold parity, apart from other intolerable consequences, would increase fourfold the present burden of the French National Debt. It is easy to calculate that the holders of the debt would have a claim in that event practically equal to the entire wealth of France. No Finance Minister there ever was could balance such a budget. Unless, therefore, the franc is *never* to be stabilised, in terms either of gold or of commodities, this figment of an ultimate return to a pre-war parity must be discarded.

2. Whenever the franc falls in value, the Minister of Finance is convinced that this is due to anything except economic causes and attributes it to the presence of a foreigner in the neighbour-

hood of the Bourse or to the mysterious and malignant influences of 'speculation'. This is not far removed, intellectually, from an African witch doctor's ascription of cattle disease to the 'evil eye' of a bystander or of bad weather to the unsatisfied appetites of an idol.

In the first place the volume of speculation, properly so called, is always extremely small in proportion to the volume of normal business. In the second place the successful speculator makes his profit by anticipating, not by modifying, existing economic tendencies. In the third place, most speculation, especially 'bear' speculation, is for very short periods of time, so that the closing of the transaction soon exerts an influence equal and opposite to its initial effect. Moreover there has probably been on balance, since the date of the Armistice, more speculation in favour of the franc than against it. At least I can testify that many Englishmen, and even more Americans, have lost large sums by purchasing francs or franc investments in the hope of profiting from an improvement in the value of the franc.

I beg the attention of French readers to the arguments of chapters 2 and 3 of this book, because superstitions about speculation can only exist in an atmosphere of ignorance concerning the veritable influences which fix the level of the exchanges. In estimating lightly the influence of speculation, I do not include, however, the effects of a general distrust of the future prospects of a currency, to which I refer later.

3. It is often argued that the franc cannot fall in value because France is a wealthy, thrifty and industrious country, or because her balance of trade is *prima facie* satisfactory. This again springs from confusion as to the causes which ultimately govern the value of money. A very rich country can have a very bad currency, and a very poor country a very good one. The wealth of France and her balance of trade may render it easier for her authorities to pursue a sound monetary policy. But they are not the same thing. The value of a country's monetary unit is not a function of its wealth or even of its trade balance.

What, then, has determined and will determine the value of the franc? First, the quantity, present and prospective, of the francs in circulation. Second, the amount of purchasing power which it suits the public to hold in that shape. (The quantity theory in the form in which I state it in the first section of chapter 3, below, may, I think, be novel to many French readers.) The first of these two elements, namely the quantity of the currency, depends mainly on the loan and budgetary policies of the French Treasury. The second of them depends mainly (in present conditions) on the trust or distrust which the public feel in the prospects of the value of the franc.

With the franc in the neighbourhood of 120 to the £ sterling, the former task does not appear to the outside observer to be unduly difficult. When the internal price level has adjusted itself to the exchanges, the yield of many of the existing taxes in terms of paper francs will naturally be increased. On the other hand, the biggest item of expenditure, namely the service of the internal debt, will remain the same as before. Thus, even apart from additional taxation, the mere movement of the exchange has in itself a tendency to restore the budget towards equilibrium; provided always that public faith is maintained in the prospects of the national currency.

It is in this second factor, therefore, that the crux of the situation lies, namely the attitude of the French public towards their own currency. I emphasise the fact that the matter lies in the hands of Frenchmen themselves, not in those of any foreign persons. For the amount of francs owned by foreigners is probably not very great, not much more than what is still left in their hands as the remnant of disappointed 'bull' operations; and the obstacles are insuperable to 'bear' sales by foreigners of francs, which they do not possess, on a really large scale. On the other hand the volume of franc-notes and franc-bills and other short-dated investments held in France itself is enormous, far beyond the minimum required for the convenient transaction of business. If Frenchmen get it into their heads (as, each in their turn, Russians, Austrians and Germans have done) that their national legal-tender money and titles to legal-tender represent a depreciating asset, then there is no near limit to the fall in the value of the franc. For, in this event, they will diminish their holdings of such assets; they will keep fewer Bank of France notes in their pocket-books and in their safes, will liquidate their *Bons de Trésor* and will sell their *rentes*. No law or regulation will avail to restrain them. Moreover the process will be cumulative; for each successive liquidation of franc assets and their transference into 'real values', by provoking a further fall, will seem to justify the prescience of those who fled first from the franc and will thus prepare the way for a second outburst of distrust.

In this case the fall of the franc will not be prevented even by a reformed budget or a favourable surplus of trade. For it would be necessary for the government to absorb the redundant bank-notes and franc-bonds and -bills, which the public no longer cared to hold, a task unavoidably beyond the government's power. We have the experience of many countries to demonstrate that unbalanced budgets are the initial cause of collapse, but that the real *dégringolade* only comes when the confidence of the general public is so far undermined that they begin to contract their holdings of the legal-tender money.

The central task of the French government at this moment is, therefore, to preserve confidence in the franc in the minds of the widest circles of the French public. For it is the failure of this internal confidence, not speculation by foreigners (though foreigners and Frenchmen too may take advantage of a collapsing currency to win great gains), which would prove their undoing.

Now, if they go the right way about it, there is nothing impossible in the task of restoring and maintaining confidence. The examples of Russia, Austria and Germany are not a just parallel. Those who foresee the future of the franc in the light of such previous experiences may make a big mistake. For in those countries the problem of balancing the budget was, during the earlier phases, a virtual impossibility. The initial impulse towards collapse was, therefore, also a continuing impulse. This is not so in France. There is no impossibility in achieving a fiscal equilibrium, provided that reconstruction expenditure is reasonably postponed. I applaud the efforts of M. Poincaré and the French Treasury in this direction. But this is not enough by itself. It is also necessary to restore public confidence; and in this sphere of action every step taken by M. de Lasteyrie has been away from wisdom.

For upon what foundations does the credit of a currency rest? They are much the same as with a bank. A bank can only attract and retain the deposits of its clients, so long as these clients possess a complete confidence in their freedom to withdraw these deposits for exchange into other assets, if they have a mind to do so. As long as this liberty is beyond doubt, it will not be exercised; the deposits will rest and grow. But if it is once called in question, they will shrink and disappear. So is it with a currency. Men hold a part of their resources in money, because they believe it to be more readily and freely interchangeable than any alternative hoard, into whatsoever object of value they may select hereafter. If this belief proves wrong, they will not hold money and nothing can make them do so.

Now the prime object of most of M. de Lasteyrie's regulations is to restrict the liberty of holders of francs to exchange them at their discretion into other forms of value. So far, therefore, from protecting the franc and restoring its credit, they are directly calculated to shatter confidence and to destroy its credit. A sufficient number of regulations would destroy the value, precisely because they would destroy the utility, of any currency in the world. As soon as there is a doubt as to whether francs (or *Bons de Trésor*) are a truly liquid asset, these instruments cease to serve the purpose for which they are held, and holders hasten to dispose of them before the doubt is resolved into a certainty and yet further obstacles can have been placed in the way.

An instructive example of the way in which regulations produce the opposite effect to that which they intend is given by those of which the object is to hinder speculative operations. Those who have opened, in one way or another, a 'bear' position against the currency in question are in no way perturbed; for they can reckon with confidence that it will always be possible for them to *buy* the currency which in due course they will require to cover their open position. Those, on the other hand, who have taken up a 'bull' position and will, therefore, require to *sell* the currency at some later date, are thrown into confusion and seek in haste to sell their interest while still they may. It is for this reason that the threat of interference with the freedom of exchange dealings invariably operates to depress the value of the currency which it is sought to regulate. Just as a man draws out his deposits at the bank, whether he needs the money or not, as soon as he has reason to believe that he may not be free to do so later on, so the general public and the financial world alike withdraw their resources from a currency, if they fear a limitation on their subsequent freedom of withdrawal.

What course then should the French Treasury now take in face of the dangers surrounding them? It is soon said. First the government must so strengthen its fiscal position that its power to control the volume of the currency is beyond doubt, the necessity of which is at least accepted. Secondly—and especially during the interval which must needs elapse before the first category of measures can be brought into full operation—the government must restore such complete confidence in the liberty of the franc that no one will think it worth while to enter by way of precaution into sales of francs not immediately urgent—the equal necessity of which seems to be overlooked.

To achieve this latter object nothing more is required than a reversal of the recent policy of restrictions on dealing, of the useless hoarding of gold, of a relatively low bank rate, and of secrecy about the actual position of the Treasury and the Bank of France. The chief measures which are necessary can be summarised under three heads:

PREFACE TO THE FRENCH EDITION

1. All limitations on the use of francs to purchase foreign currencies, foreign bonds, or goods, whether for immediate or for deferred delivery, should be wholly repealed.

2. The discount rate of the Bank of France should be raised to a high figure, probably not less than 10 per cent in present circumstances (though it might not be necessary to maintain such a high rate for any length of time), so as to counteract anticipations, well- or ill-founded, as to the possible depreciation of the franc. In view of the high rate of interest now obtainable on French government securities (let alone the rates on forward exchange) the present rate of discount does not correspond to the facts of the situation and is calculated to stimulate over-borrowing. Possibly some increase of the Bank of France's rate may have been effected by the time these lines are in print.

3. A considerable sum, drawn from the still ample gold reserve of the Bank of France, should be made the basis of a foreign credit, either by outright sale or by borrowing against it, to be available for use without stint in supporting the exchange near the present level and restoring confidence during the interval before fiscal reforms can produce their full effect.

I warrant that these simple well-tried measures, in combination with political moderation and with the drastic economies and taxes, without which no other measures can finally avail, would have a marvellous efficacy. After a few weeks of this medicine and with a benevolent reception by M. Poincaré (or his successor) of the forthcoming Experts' Reports, the franc would be as steady as a rock. But if, on the other hand, distrust in the franc is countered by the methods of the Holy Inquisition, if Frenchmen prefer the concealed capital levy of inflation to other forms of taxation, if France remains the trouble-peace of Europe, then the franc may follow the course of other once-noble tokens.

March 1924 J. M. KEYNES