

DID KEYNES MEAN ANYTHING? REJOINDER TO YEAGER

Axel Leijonhufvud

Professor Yeager may be justified in his complaint that I have defended my interpretation of Keynes of 20 years ago merely by “emphatic reassertion.” I have tried consistently to refrain from rearguing my case, when I have had nothing much to add to it, in response to the various commentaries and criticisms that have been raised against it. Repetition of that sort has seldom proved productive. At some point, one must simply leave it to readers to make their own judgments without boring them with one’s insistence on having been right. When Yeager alluded to the matter in his recent paper, I wished merely to signal that I do not concede to his critique (or very much to Grossman’s). But this time, there also was something to add, namely, the previously unknown evidence from Keynes’ *Collected Writings*, vol. XXIX, which has appeared in the interim. Yeager’s “Reply” makes clear, however, that mere reassertion plus that reference will not do. I owe him an explanation of how it fits in.

I do not want to argue that Keynes “was right all along.” So that is not the issue. What is at issue is the theme of my 1968 book which maintained that the *General Theory* contained a novel and important theoretical idea, that this idea was central to Keynes’ conception, and that this idea was not developed, or even preserved, in the later development of Keynesian economics. This “promise which the Keynesian tradition has not fulfilled” (p. 386) inheres in the idea of “effective demand failures.”

In his 1973 “Keynesian Diversion” article, Professor Yeager declared that, on his reading of Keynes, while much in the *General Theory* strikingly resembles “the supposedly vulgar Keynesianism of the income-expenditure theory,” Keynes “falls short of articulating any-

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The author is Professor of Economics at University of California, Los Angeles.

thing resembling . . . the Clower-Leijonhufvud story.” Similarly, Professor Grossman’s 1972 review article, “Was Keynes a Keynesian?”, concludes that “the most plausible answer” to the question of its title “is that Keynes did not have in mind anything resembling Clower’s interpretation of the consumption function . . . and that he had no vision of the sort attributed to him by Leijonhufvud.” And Yeager now quotes the late Alan Coddington (in his 1976 article) as finding our interpretation to be the result of “reading not so much between the lines as off the edge of the page.”¹ This line is so witty, it is rather a pity that it misses the whole book!

At the time I was writing, the established interpretation of Keynes was that he had explained unemployment by postulating rigid wages. (Today this is also the re-established interpretation—one sees this old canard repeated almost wherever Keynesian economics still rates a mention.) The rigid wages hypothesis was *not* a novel idea in Keynes’ day. That the explanation of why labor fails to sell must start from the presumption that wages are too high and won’t come down is a notion that is in all probability older than is economics as a discipline. The idea that Keynes sought to differentiate himself from the “Classics” and start a “revolution” by reasserting this old platitude is not necessarily the “most plausible” reading of the *General Theory*—particularly since it is definitely to be found only “off the edge of the page.”

In 1968, I tried to show that there was a theoretically far more interesting, alternative reading of the *General Theory* and therefore—and this was really the point—that there had existed in 1936 an “alternative future” for Keynesian economics to the one realized. I did confess (rather too readily and too often, I now think) that this alternative reading was “speculative” rather than literal on some points. But I also maintained that it made more sense. In particular, it allowed a coherent interpretation of how Keynes did differentiate himself from the “Classics,” where no such coherent interpretation was previously available.

Mass unemployment is a symptom of coordination failure. “Wrong” prices that won’t budge is one possible explanation of such failures. Another possibility, the one that Clower and I explored, is that freely competitive, flexible prices might fail to move in such a manner as to generate the price signals required to coordinate activities. The “market forces” governing the adjustment of prices (and of rates of output, employment, and consumption) will not always drive prices

¹This was said about Clower, but it was undoubtedly intended that I should feel guilt by association.

toward the equilibrium configuration where the desired transactions of all parties are consistent. Although there are no obstacles to price movements, the price system may thus fail to communicate all the information required to enable agents to exhaust potential gains from trade.²

In an imaginary economy so organized that the offer of any particular good would constitute an “effective” demand for any other good desired by the supplier, such effective demand failures would not occur. They occur in systems where money appears on one side of all transactions and thus is the only good traded in all markets. For an individual agent in a money economy, the sale of labor and purchase of wage-goods, for instance, must then be separated by the acquisition and disposal of money; whether the agent’s desire to acquire wage-goods is communicated as an effective demand thus becomes conditional on the realization of the sale of labor. To capture the theoretical possibility of this kind of coordination problem, therefore, it is vital to think in terms of a model in which money is *the* means of exchange. “Barter” models will not do.

Today, the New Classical Economics has made it utterly commonplace to discuss macroeconomic problems from this information perspective. (This is so even though the New Classics have waved the magic wand of rational expectations over most of the things that Clower and I thought of as information problems—and have thus made them vanish from discussion.) In the mid-1960s, no one wrote about Keynesian unemployment or other macroeconomic issues in those terms. So the contention that Keynes had thought in such sophisticated “modern” terms already 30 years earlier was received with the suspicion to which Yeager, Grossman, and Coddington gave expression.

I came to consider the question whether all this “was in Keynes” quite late in my own work. (Chapter II:3 of my 1968 book was not part of my dissertation.) At that stage, I would not have been averse to claim the originality that Yeager in 1973 sought to accord me! But in revising my manuscript for publication I had to form a judgment on the question. A careful rereading of the *General Theory*, chapter 2, “The Postulates of the Classical Economics,” was more convincing than anticipated. From the standpoint of the theory of effective demand

²The occurrence of “false trading” at the prices of the moment is a link in the chain of argument. But the theoretical emphasis is altogether on whether adjustments of prices have the system heading toward full employment or not. The orientation, therefore, is very different from that of the literature on fix-price general equilibrium rationing models developed by Barro and Grossman, Siven, and the French school of Benassy and Malinvaud.

failures, the chapter made perfect sense. Moreover, all of Keynes' objections to "Classical" theory were part and parcel of the same argument.

It was clear what Keynes' definition of "involuntary unemployment" meant and why he had phrased it in such a seemingly awkward, contrived way. It was clear why he harped on Professor Pigou treating the wage-bargain as if it were a barter bargain when he (Pigou) knew it was a money bargain. It was clear what were Keynes' objections to Say's Law (unemployed labor is not an effective demand for wage goods, and current saving does not constitute effective demand for future consumption). And, finally, it was clear why he claimed that the three "Classical" assumptions, which he argued must be discarded, "all amount to the same thing in the sense that they all stand and fall together, any one of them logically involving the other two" (GT, p. 22).

As far as I am aware, there is to this day no alternative interpretation of Keynes' chapter 2 in the literature which makes *coherent* sense of it. Almost all authors simply ignore Keynes' elaborate definition of involuntary unemployment and substitute their own opinion of what the words might usefully (or, in the case of Lucas, uselessly)³ mean; most of them end up thus labelling some concept of unemployment that Keynes went to the pains of explicitly listing as "voluntary." Some have read his discussion of why Pigou is unjustified in treating wage negotiations as dealing with exchanges of labor for wage-goods as showing that he assumed the labor-supply decision (but not the consumption decision) to be affected by money illusion. And the most common interpretation of his attacks on Say's Law has been that he was attacking Say's Law in the sense (or nonsense⁴) *later* invented by Oskar Lange. This makes Keynes' critique of "Classical" theory, I noted (p. 101), into a "motley assortment of outlandish propositions." Hence,

One must conclude, I believe, that Keynes' theory, although obscurely expressed and doubtlessly not all that clear even in his own mind, was still in substance that to which Clower has recently given a precise statement [p. 102].

This is the conclusion to which Yeager, Grossman, and Coddington take exception. (None of them, however, has tried his own hand at making sense of chapter 2.)

³Lucas (1978) argues the uselessness of the concept of "involuntary unemployment." I have discussed the matter in my 1983 article (pp. 195-99).

⁴For a detailed discussion of Lange's concept and some of the damage it has done to textbook Keynesianism, cf. Robert Clower and Axel Leijonhufvud, "Say's Principle: What It Means and Does Not Mean" (1973).

Still, I had to admit, an argument that rests on coherence of interpretation does not compel assent. If Grossman, Yeager, and others did not accept it, I could not very well force them to do so. My interpretation did involve a fair amount of reading between the lines. Some scholars will object to anything but a literal reading, but I see nothing illegitimate about it—it is, literally, the only “*inter-legent*” thing to do. But why, if this was his message in substance, did not Keynes spell it out more clearly?

Some things he did not need to go into. In trying to understand the relationship between Keynesian macroeconomics and the neo-Walrasian general equilibrium theory of the early 1960s, Clower and I came to delve into such matters as the absence of the Walrasian auctioneer, “false trading,” and the appearance of realized sales-proceeds in the (consumption) demand function. There is no reason why someone, coming to the problem from a Marshallian background in the 1930s, should have trod this tortuous path. Alfred Marshall’s demand function, for instance, was constrained by realized income to begin with.⁵ So there are a number of elements of the 1960s discussion that one should not expect to find paralleled in the *General Theory*.

Nonetheless, before *The Collected Writings* had appeared, the evidence that Keynes had a clear conception of effective demand failures was too a large extent indirect. Keynes could so easily have made the matter indubitable by some simple illustrative example—but had not done so. I put my classroom examples into print to help make the point. The posited context was a state in which, at today’s (fix-)prices, the supply of labor exceeds employment and the supply of wage goods is exceeded by the demand—if in the latter we include what the employed would have bought had they found jobs. Why should we not predict tomorrow’s wage to be set lower *and tomorrow*—

⁵Grossman’s conclusion was, in part, that “[most plausibly] . . . Keynes did not have in mind anything resembling Clower’s interpretation of the consumption function. . . . Keynes surely did not appreciate the essential sense in which it was inconsistent with the classical theory of markets.” It is not easy to appraise it briefly. It is almost certainly true that Keynes had given little or no thought to the various logical inconsistencies that would arise if his consumption function was somehow plunked down in the midst of a Walrasian general equilibrium model. But he certainly knew (and said so) that his theory was inconsistent with Say’s Law of Markets and, of course, that his consumption function was crucial to the thoroughly anti-classical deviation-amplifying multiplier.

Grossman correctly pointed out that my characterization of Keynesian short-run dynamics as “a reversal of Marshall’s ranking of price- and quantity-adjustment speeds” could not be true in general, or Keynes would not have had his labor demand function coincide with the marginal productivity of labor schedule. I stand corrected on this point. But it does not follow from it that Keynes did not have a theory of effective demand failure.

row's wage good prices higher and tomorrow's quantities to be moving smoothly in the directions required to eliminate the "rationing" due to the initial pricing mistakes?

Clearly, because in that [Keynesian] system *all exchanges involve money on one side of the transaction*. The workers looking for jobs ask for *money*, not for commodities. Their notional demand for commodities is *not communicated* to producers. . . . The individual steel-producer cannot pay a newly hired worker by handing over to him his physical product (nor will the worker try to feed his family on a ton-and-a-half of cold-rolled sheet a week). . . .

In an economy of self-employed artisans our problem simply cannot appear. If it does appear in a posited system, say, of big farmers "higgling and haggling" with prospective farm-hands over the room and board and other direct material benefits that are to constitute the real wage, it will be most smoothly solved in a thoroughly Walrasian manner. [1968, pp. 89–91]

I could not find anything that plain in Keynes⁶ and that left a nagging doubt. I have told the rest of the story before but without putting it fully into context (as I have here tried to do). To repeat (1983, p. 198n):

When Volumes XIII and XIV of the *Collected Writings* appeared, I skimmed them solely to see whether my interpolations had been too imaginative. Somewhat to my consternation, I could not find anything that seemed relevant to the problem one way or another! In the Fall of 1974, I visited Cambridge . . . and took the opportunity of a dinner at King's to ask my host, Lord Kahn, and also Lord Kaldor and Professor Robinson whether the Circus had not discussed Chapter 2 of the *General Theory* and why no background material had come to light. They did not recall any such discussions—which left me somewhat mystified.

Some time ago, Mr. C.W.S. Torr brought to my attention that the "Tilton laundry hamper" had contained the answer. Much of Vol. XXIX is devoted to some discarded introductions to the *General Theory* in which 'the contrast between a Co-operative and an Entrepreneur Economy' is treated as fundamental.

Keynes's 'Co-operative Economy,' as it turned out, was one in which labor is bartered for goods, so that the supply of labor is always an effective demand for goods. In his 'Entrepreneur Economy' the Clowerian rule applies: labor buys money and money buys goods but labor does not buy goods. In the entrepreneur economy,

⁶ For the *other* effective demand failure (the intertemporal one), Keynes did come up with a homely, to-the-point illustration;

An act of individual saving means—so to speak—a decision not to have dinner today. But it does *not* necessitate a decision to have dinner or buy a pair of boots a week hence or a year hence or to consume any specified thing at any specified date... [GT, p. 210].

therefore, effective demand failures are possible and so, consequently, is 'involuntary unemployment.'

That, I think, should settle the matter. See Keynes (1979), pp. 63–102.

My own reaction to reading the volume XXIX materials was that of at last coming on a piece of the puzzle that I had long conjectured should have existed! The contrasts drawn between the “Cooperative Economy” (in some places also called the “Real-Wage Economy”) and the “Entrepreneurial Economy” involved precisely the simple, straight-forward, unmistakable conceptual experiments that had been missing. Hence my statement in commenting on Yeager: “it so happens that on these particular points we now do know precisely what [Keynes] meant” (1986, p. 415).

Yeager does not think so. His “*Reply*” asks:

[W]hat significance attaches to what Keynes said or supposedly said or supposedly meant in rough drafts that he *discarded*? The fact that he wrote certain ideas down, considered them, and then *discarded* them would suggest that they were *not* what he meant.

Ignoring what did not get into print, Yeager’s conclusion suggests, would “serve the integrity of the history of economic thought and also the very substance of money/macro theory.” Indeed!

Yeager ends on a rhetorical note, “. . . is it not time at last to give up the delusion that Keynes really had his theory right all along?” There are two, somewhat related, delusions that I most definitely would not want to propagate. One is that all the novel theoretical ideas in the *General Theory* were correct and valuable. Keynes’ Liquidity Preference hypothesis of interest rate determination, for instance, I consider to be “theoretically unsound, empirically false, and practically dangerous.”⁷ I also part from Keynes on the scope of the effective demand failure possibilities discussed above.⁸ The other delusion is that, in trying to understand the development of our subject, we should assume that Keynes (or anyone else) had powers of logical closure, i.e., presuppose that he understood fully all the logical implications of a theoretical structure, whether his own or one of those, such as IS-LM, that were proposed by others as interpretations of his thought. But I also regard it as a delusion that Keynes had nothing worthwhile to contribute.

Yeager is simply unwilling to consider Keynes’ understanding of “monetary disequilibrium” as on a par with that of Harry Gunnison Brown, Herbert J. Davenport, or Clark Warburton. Yet, it is hard to

⁷ Leijonhufvud, “The Wicksell Connection” (1981, p. 195).

⁸ See Leijonhufvud (1973).

find anything in the picture Yeager gives of their theories beyond the Quantity Theory with “frictions,” albeit intelligently elaborated. Keynes, too, has written intelligently in this *genre*. His *Tract on Monetary Reform* belongs to it. By the *General Theory*, his theory has become more complicated: a generalized excess demand for money may result not just from a contraction of the money supply but also from an increase in the amount demanded induced by real shocks; in the case of a real intertemporal (saving-investment) disequilibrium, a new relative price vector has to be found for equilibrium to be restored, so simply a balanced deflation will not do; even in the absence of significant “frictions,” the adjustment process may fail to home in on the equilibrium price vector because of effective excess demand failures.

Keynes did not get all this “right all along.” But he was venturing (as we now have every reason to know) into exceedingly difficult territory. The questions that he tackled were not of the sort that would have better been ignored. Monetarism highlights some basic truths that should not be lost from sight—as, admittedly, they tended to be at times during the high tide of Keynesianism. But we also have to be concerned about real shocks, about intertemporal coordination problems, and about effective demand failures. A macroeconomic theory that grapples seriously with these problems is not just a useless diversion.

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