

The Evolution of J.M. Keynes' Wage and Employment Theory 1920-1946

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Synopsis

This paper traces out a historically-based survey of the development of Keynes' wage and employment theory. While the title includes employment theory, the paper devotes particular attention to Keynes's wage theory. The development of Keynes's wage theory has been given only the most sparing attention in the literature. This glaring omission has usually been attributed to the dearth of material in Keynes's literary works to warrant a major study. Underpinning this, has been the popularly-held view that Keynes said relatively little about wages. This paper attempts to repudiate this interpretation and, in doing so redress this long standing neglect by providing an exegetical account and analysis of Keynes's wage theory.

Introduction

In the *General Theory's* (GT) theoretical framework money wages and labour market analysis in general play a mute role in the process of income determination. Money wages are exogenously given and only in Chapter 19 is there analysis of how changes in wages impinge upon income and employment. The peripheral role assigned to wages in GT summarises, in a way, how the review literature on Keynes has generally regarded his contributions on wage theory. There has, in fact, been a dearth of interpretationist literature recording the historical development of Keynes wage theory as a separate theoretical body of analysis. In attempting to inquire, whether or not, this view is justified, this author undertook a survey of Keynes's collected works. I uncovered, particularly in Keynes's ephemeral writings, a

considerable amount of material pertaining to wages to the extent that the whole area needs re-evaluation.

As we know, Keynes broke rank with his neo-classical colleagues over the decision to restore the Gold Standard given its implications for domestic economic policy. After that juncture Keynes unleashed a flood of correspondence and articles that rejected the concomitant classical medicine of deflation and wage-cutting. By developing a robust critique of classical wage theory Keynes had, by the late twenties, an early but incomplete command of the theoretical arguments that were to appear in Chapter 19 of *GT*. This article will argue that the substance of Keynes's wage theory had been formulated some time before the theoretical framework of *GT* took shape. For that reason alone the wage analysis, as it was, lacked coherence and was founded upon classical dynamic disequilibrium analysis. This asymmetric development in Keynes's theorising explains the detached role wage analysis played in the overall scheme of things in the *GT*. True to their role in the first opening chapter of the *GT*, Keynes's wage analysis, nonetheless, played a crucial part as his battering-ram against the citadel of neo-classical economics particularly its full employment and market-clearing nostrums.

The Twenties

Keynes's first dealings with the issues of employment, output and income distribution had arisen with *The Economic Consequences of the Peace* (1919); it contained a remarkably panoramic, yet succinct account of the nature and dynamics of the 19th century mode of capital accumulation, growth and distribution. Keynes took particular note of the servile working classes that had,

'... accepted from ignorance or powerlessness, or were compelled, persuaded or cajoled by custom, convention, authority, and the well established order of society into accepting, a situation in which they could call their own very little of the cake that they and nature and the capitalists were co-operating to produce'¹.

However, the post-war world was marked by upheaval in the underlying social and psychological climate. There had been a breakdown in the conditions that had underpinned capital accumulation before the war. The working classes were, for one, no longer prepared to meekly surrender the larger portion of the 'cake' to the capitalists without a fight. As Keynes forewarned, 'The labouring classes may no longer be willing to forgo so largely'².

This particular outlook contained the seeds of Keynes's later emphasis upon the relative incomes struggle that arose between the 'capitalist classes' and 'workers' and 'rentiers'. This antagonism would be expressed through the level of money wages; their determination, Keynes inferred, being a politico-economic matter.

The Economic Consequences of the Peace was prescient for its depiction of a mature economy facing the prospect of stagnation due to a savings-investment imbalance³. This arose from the bourgeoisie's diligent practice of setting aside funds for saving whilst profitable investment opportunities shrunk. Keynes questioned not only the purpose of the saving, but by inference, the maldistribution of income that allowed it:

'the duty of 'saving' became nine-tenths of virtue and growth of the cake the object of true religion ... the cake increased; but to what end was not clearly contemplated. Saving was for old age or for your children; but this was only in theory - the virtue of the cake was that it was never to be consumed neither by you nor by your children after you.'

Keynes sensed economic salvation from this conundrum through increasing consumption; the rich may well be persuaded to consume more under the threat of having their wealth expropriated. Therefore, early in his career, Keynes called into question the supposed rationale behind the (mal) distribution of income and effectively presaged the forthcoming conflict over relative income shares. This interest in distributional equity became a marked feature in his literary outpourings.

On the policy front, Keynes was known, during the early twenties, as a 'dear money man'. His advice to the Chancellor of the Exchequer on dealing with the inflationary boom of 1920 revealed an appreciation of the expectational effects created by tight monetary policy; the expectational effects of sharply increased interest rates would counteract the optimistic profit expectations held amongst entrepreneurs. This would impart a reduction in demand for saving funds to finance investment. Interestingly, Keynes did not believe it would cause unemployment because there was a wide margin between firms' solvency and bankruptcy. Underlying this policy advice was Keynes's acute awareness of the effect inflation had upon money contracts - the numeraire on which the capitalist system was based: 'A continuance of inflationism and high prices ... will strike at the whole basis of contract, of security, and of the capitalist system generally.'

Keynes' next work, the *Tract on Monetary Reform* (1923) elaborated upon Hawtrey's hypothesis that price instability generated movements in output and employment. A cleverly-managed monetary policy, Keynes held, operating through the short-term rate of interest, should maintain a stable price level. This view was reflected in his oft-quoted remarks about a preference for inflation rather than deflation indicating his early commitment towards maintaining stable employment levels. Textual evidence corroborating this bias are readily found: 'All of us ... are now primarily interested in preserving the stability of prices, credit and employment' (p. 138) and, 'I regard the stability of prices, credit, and employment as of paramount importance'.

The *Tract's* theoretical allegiance to the quantity theory meant that the business cycle was predicated upon prior movements in the price level; a sudden, unanticipated rise in prices against costs already incurred would produce windfall profits and stimulate production; conversely, an unanticipated fall in prices would, against a backdrop of costs already incurred, deliver the opposite effect. Changes in employment were made dependent upon changes in the price level relative to a firm's cost level. At equilibrium a firm paid out wages and other production expenses in the confident expectation of recouping these outlays when the products were sold. Under a regime of money contracts, the producer was, in effect, a hostage to fortune, forced into a speculative position.

In the *Tract* therefore, Keynes remained faithful to the long-run version of the Quantity Theory but showed dissatisfaction with the theory's lack of realism about the pre-supposed speed and flexibility with which prices and wages returned to equilibrium; his famous phrase about the futility of the long run is apt here. Keynes'

discomfort was further drawn over calls for wage-cutting which orthodox opinion invoked whenever unemployment arose. Keynes had already noted how rigid money wages were despite significant unemployment and concerted calls for wage cuts. Earlier, he had alluded to a post-war institutional development whereby organized groups of workers had succeeded in winning reductions in working hours and secured pay rises equal to, or greater than, the rate of inflation. Factually, one could not, at this stage, ascertain whether this new state of affairs was permanent or just a temporary phase. For Keynes, however, it presaged an era of downward money wage stickiness. Keynes's great mentor, Marshall, had always stressed the value of wage stability in maintaining stable employment levels and had advocated wage indexation to further that end. Keynes carried on this tradition by attaching considerable weight to money wage rigidity from an early stage and of course, used it in *GT*.

In their campaign to hurriedly return Britain to the Gold Standard, neo-classical economists like Cannan, Gregory, Hutt and Rueff argued for wage cuts, achievable through the undeclared, yet deliberate policy of deflation. This brought to the fore Keynes's predilection for domestic price stability (read money-wage stability) over exchange rate stability, first enunciated in the *Tract*. Keynes became increasingly ambivalent about the Gold Standard system where it dictated external balance secured by manipulating domestic prices and costs downwards. While Keynes did not and, in fact, never would disagree with his contemporaries that real wages had to fall to restore their alignment with the exchange rate, he begged to differ on the means to bring this about. As early as 1922, Keynes proposed a policy of price inflation, brought about by demand expansion, instead of deflation as the means by which to rectify the disequilibrating level of real wages. He was, of course, to invoke the same mechanism as the way out of the unemployment trap in the *GT*. In a lecture before the *Institute of Bankers*, Keynes alluded to the difficulties with the classical approach and, in its place, offered his own solution:

The business of forcing down certain levels of wages ... into equilibrium is almost hopeless or it will take a long time' and '... the continuance of unemployment is to an important extent due to the fact that we have got the level of wages of the unskilled, out of gear with everything else. The only way in which they will get into gear will be by an increase in the level of prices'.¹⁰

Underlying these statements were two insights that run thematically through Keynes's work. First, money wage cuts were only ultimately achievable with a severe and sustained round of deflation. This would entail heavy losses in income and employment for most yet generate financial asset gains for rentiers; moreover, real wages would remain undisturbed implying that money wage cuts were 'neutral' in their effect. The second theme relates to the practicality of wage cutting. Trade unionists would stubbornly resist any incursions upon their hard-won money wages. Keynes argued that wage cuts - undertaken in a random, piecemeal fashion - would violate the intuitive notions of fairness the workers held, firstly amongst themselves and, secondly, between themselves and other classes. In short, they would stridently oppose the orthodox, officially sanctioned policy that singled them out to bear the brunt of economic adjustment. Ironically, their very resistance to pressure for wage cuts only attracted an ever sterner policy response from Montagu Norman at the Bank of England.

Another related but early development in Keynes' economic thought was his abhorrence of tolerating the blight of unemployment especially when it apparently formed an integral part of official policy. This reflected his moral and philosophical outlook, itself, a product of his cultural apprenticeship with the Bloomsbury group. He often wrote of unemployment as a 'frightful muddle'¹¹ - an act of stupidity perpetrated by economic policymakers. In the same article, Keynes described the effect the officially-sanctioned policy of deflation had on the economy. In holding expectations of falling prices, entrepreneurs were rightly reluctant to organise production when it entailed a lengthy period between outlay and receipt of takings. These expectations were triggered by movements in the bank rate operating side-by-side with anticipated movements in prices:

'What influences enterprise and employment is not the money rate of interest, but the anticipated real rate of profit over the period of the production process, and this latter is compounded of the bank rate and the anticipated movement of prices.'¹²

This key emphasis upon the expected rate of profit determining a firm's output and accumulation level was carried through to GT. But, for the moment, it had become apparent to Keynes that: 'Individualistic capitalism simply cannot stand a declared policy of deflation'¹³. The persistence of unemployment stemmed from a lack of confidence by entrepreneurs in the stability of the price level. Keynes retained this distaste for 'flexible' wage policy right up to the GT denouncing its destabilizing effect upon business decision-making.

The mid-twenties deflation had, in part, been brought about by the Cunliffe Committee that had recommended the immediate restoration of the Gold Standard with the pound set at its old pre-war parity value. The Committee recognized the consequential adjustment problems but advised nonetheless, a deflation of domestic costs and prices to restore internal and external balance at the old parity. The deflation of the price level was necessary because of the dualistic nature of British industry. The 'unsheltered' industries had to reduce their prices after the revaluation to keep competitive, yet had to purchase inputs from the 'sheltered' industries at unchanged prices. Obviously, some price adjustment was necessary to restore the balance between the two sectors. The Cunliffe Committee approach ultimately entailed reducing the prices of the sheltered industry's output in the midst of falling output levels¹⁴. Keynes attacked the realism of the theoretical nostrums underpinning the Committee's findings especially their tunnel-vision attitude on internal price adjustments. Neo-classical orthodoxy held that the recommended policy could, by and large, engineer a decline in prices and incomes without disturbing output and economic activity.

In *The Committee on the Currency* (1925) Keynes challenged the orthodox view that a fall in the price level was neutral¹⁵. He criticized the report for showing little appreciation of the relationship between exchange management and economic instability and for dogmatically dismissing devaluation as an option. A devaluation, Keynes reasoned, would have reduced Britain's level of 'gold wages' and avoid plunging the country into an incomes deflation to achieve the same result. A revaluation, as the Committee proposed in effect, would enable workers to enjoy a real wage gain without any commensurate lift in productivity. On that score, Keynes obediently subscribed to the neo-classical view of employment being determined by

the real wage-marginal productivity nexus. Eventually, one way or another, the economy would gravitate towards full employment with lower real wages prevailing.

Throughout the twenties, Keynes laced his ephemeral writings with such subjects as the growing problems of immobility of labour, wage rigidity and the 'inelasticity' of the industrial system. All these broadly combined to deny the efficacy of market forces with respect to ridding Britain of unemployment. These elements were woven together in his damning indictment of the Cunliffe Committee's findings:

I suspect that their conclusions may be based on theories, developed fifty years ago, which assumed a mobility of labour and a competitive wage level which no longer exist; and that they have not thought the problem through over again in the light of the deplorably inelastic conditions of our industrial organism today.¹⁶

Another of Keynes's observations in this regard, alluded to earlier, had been the growing power of trade unions to maintain real wages in the face of unemployment, even within the exporting industries.

In a piece entitled 'Does Employment need a Drastic Remedy?' (1924),¹⁷ Keynes wrote on the exemplar of a high wage prosperous economy. This optimal state could only come to fruition by monetary reform - in the form of a managed currency - and the diversion of national savings into public works. Admittedly the public works were presented as purely temporary expedients for reducing unemployment but it was much better than a drastic, near impractical, cut in wages. The funds for the latter could be made available by diverting them away from 'barren' foreign investment. This marked something of a volte-face in Keynes's thinking. Now Keynes held that only foreign investment could be crowded-out. Beforehand and even in concurrent drafts of the *TOM* Keynes had subscribed to the fully-fledged Treasury view' that capital expenditure financed by public borrowing, could not exert any positive economic stimulus and might do actual harm.¹⁸ This new proposal reflected Keynes's growing disenchantment with orthodox opinion and was prompted by his patriotic concern that too much capital was being invested abroad while substantial unemployment persisted at home.¹⁹ Fundamentally, under a fixed exchange rate, foreign lending threw the balance of payments into disequilibrium and necessitated an offsetting adjustment of either increased exports or reduced imports brought about by a depreciating exchange rate. However, workers in the sheltered industries would resist the concomitant real-wage reduction and thereby impede this cycle of adjustment.

During the twenties Keynes also focused brief attention upon population growth and the portent it held for wages and employment. He feared that population growth was outstripping capital accumulation and threatening living standards. Keynes had first raised the Malthusian spectre in his *Economic Consequences of the Peace*. In a later article, Keynes held that while unemployment was partly attributable to the low level of purchasing power, it could, also be in league with excessive population growth, and the power of organized labour to maintain real wages above what underlying economic conditions were able to support.²⁰

Further evidence of Keynes unswerving loyalty to the marginal productivity theory of wages is sampled on his view on protectionism. Here he upheld the

classical tradition by deriding the idea that it could cure unemployment, terming it a 'fallacy in its grossest and crudest form'²¹. Keynes was later to recant on this admittedly during the despair of economic depression.

At the *Balfour Committee on Industry and Trade* (1925), Keynes discussed the means by which a gold standard imposed general reduction of wages could peacefully take place in all industries. The orthodox approach, entailed a tight credit policy that fell heavily upon the barely profitable unsheltered industries with subsequent losses in employment and output²². Keynes termed this policy as one of 'intensifying unemployment'. Ideally a wage-cutting program, to be acceptable, had to be achieved across-the-board. As Keynes put it,

'If all wages could be reduced simultaneously the cost of living would fall too, and real wages would very likely be very little lower than they had been before, and the working classes would not have suffered; so that if there was any machinery by which you could reduce wages simultaneously the objections to the policy that I have been outlining would not be very serious.'²³ Furthermore, 'The difficulty I see is that those workers who are first asked to accept a reduction have a legitimate grievance because if you ask workers in a particular trade to accept a reduction they have no guarantee that the cost of living will fall and you are in the first instance, until it has fallen, throwing on them a reduction of their real wage against which they can legitimately protest.'²⁴

These passages suggest that Keynes, from an early stage supported a money-wage cost pricing theory which was later employed in the *GT*. More importantly, Keynes believed that workers adhered to a relative wage conditioning which effectively governed their behaviour towards money wage cuts; workers were well aware of the real wage/money wage dichotomy. The truly significant element in Keynes's thought at this stage was his apparent disavowal of the classical proposition that money wage negotiation between labour and employers determined the real wage. Usually the secondary literature on Keynes dates this development from the *Treatise*. However, this paper's interpretation is supported by Keynes' evidence before the Balfour Committee and his numerous public writings during the mid-twenties*.

During this period Keynes also alluded to the new but growing problem of structural unemployment - a product of the decline of the 'staple' industries. Keynes's advice on dealing with problems was, in terms of his later works, rather prescient. He urged the government to 'create a condition of demand for labour in the other industries'²⁵. This advice was consistent with his allegiance to the expansionist cause. Here Keynes found some support from the *Federation of British Industry* which echoed his catch-cry that 'prosperity is cumulative'. This group of industrialists pushed for imaginative economic measures that would stimulate production and, through the increase in output, allow some reduction in unit costs.

In his *Economic Consequences of Mr Churchill* (1925), Keynes raised the tenor of his attack upon the internal adjustment policies being orchestrated by the Bank of England²⁶. Elaborating upon the theme of workers' resistance to wage cuts, Keynes propounded the concept of a 'National Treaty' whereby all money incomes would be uniformly cut to bring the price level into alignment with the appreciated exchange rate. Reiterating the industrial disputation and social disruption that would ensue from a wage-cutting campaign, Keynes underscored the more effusive

aspects of Churchill's strategy. Keynes claimed that: 'The problem, how to bring about this reduction is as much a political as an economic problem'²⁷. This marked an important break in Keynes's thinking on money-wage determination. He had already gone some way in highlighting the deficiencies of the neo-classical approach towards understanding wage behaviour in a capitalist economy. Now Keynes was hinting that money-wage determination was an imponderable, not altogether responsive to market forces of demand and supply. However Keynes never really focussed much attention towards developing a rigorous, systematic theory of money wage determination. This was demonstrated when he made an almost identical statement in 1943 when discussing the control, if any, upon rising money wages in a full employment economy.

What Keynes did do in this period, however, was contrast the two alternatives available towards conducting a wages policy in a capitalist society; one imbued with considerations of equity and justice, the other subordinated to the 'hard facts' of market pressures. Keynes rejected the latter policy as morally distasteful and, more importantly, inoperable because of institutional constraints. Even in the midst of deflation money wages were recalcitrant yet the dislocation and unemployment were immediate²⁸. Keynes also objected to the deflationist 'internal adjustment' policies on distributional equity grounds. As he wrote, 'Intensifying unemployment is a policy ... from which any humane or judicious person must shrink'²⁹.

For the moment Keynes was duty bound as a classical economist to regard money wage cuts as theoretically justifiable in the circumstances. However, his intuition and moral dictates led him to suggest more acceptable expedients towards resolving the economic crisis. These policy recommendations were advanced without any underlying theoretical support. This was a trademark of Keynes' work; bold and loosely-argued policy proposals embodied within his polemical writings always far outstripped, in terms of development, the formal theoretical supports. Keynes' outpouring of articles on the return to the Gold Standard reflected his innately-held optimism that Bank of England and Treasury officials would rethink their policies and, like public opinion, see good sense and vouch for price stability before exchange stability³⁰.

Yet, Keynes was still years away from presenting a theoretical tour de force that would categorically announce his departure from the classicists by providing a theoretical basis for his iconoclastic views.

During the long gestation in which the *Treatise* took shape Keynes produced several polemical essays that were to provide the philosophical backdrop for the GT central message. Keynes' search for 'a new set of convictions'³¹ began with his essays 'The End of Laissez-Faire' (1924) and 'Am I a Liberal' (1925)³¹. In the former, Keynes asserted that private interests do not necessarily concur with the public interest. Moreover, he perceived that the public were beginning to demand economic stability through state regulation of the levels of saving and investment³². In the latter essay Keynes devoted attention to the emerging juggernaut roles of trade unions and employer groups within the economy; Keynes voiced concern about the growing influence of the former, in particular, their ability to defy market forces in determining wages. Trade unions were, 'once the oppressed, now the tyrants whose selfish and sectional pretensions need to be bravely opposed'³³. Interestingly, as Kahn notes, Keynes did not develop this apparently isolated view of trade union irrespon-

sibility in later writings but he had, to be sure, taken note of the power of organized labour in negotiating money wages³⁴.

In the latter essay, Keynes again pleaded for greater co-ordination between saving and investment flows so that the fundamental economic forces could be led towards economic stability and social justice³⁵. To bring this about meant inventing a 'new wisdom for a new age' that would be a radical break with the prevailing economic theory. For Keynes it meant adopting an intellectual predisposition that was, 'unorthodox, troublesome, dangerous and disobedient to them that begat us'³⁶. Certainly, after years of disquietude, Keynes had gone some way towards challenging the fundamental postulates underlying the neo-classical edifice. On the issue of unemployment Keynes found that neo-classical '... theory starts off by assuming the non-existence of the very phenomenon which is under investigation'.³⁷ A blithely-held faith in the market clearing axiom assumed away the problem at the outset and relieved the classicists of any doubt of their theory's worth.

The 1929 pamphlet *Can Lloyd George do it?* co-authored with Hubert Henderson, marked another milestone in Keynes's thinking for it confidently postulated a positive relationship between employment and expenditure. This concept had been first alluded to by Keynes in 1924³⁸. The notion of a multiplier was, of course, quite alien to the neo-classicals since, in their world, full employment was always proximate with a consequent zero elasticity of total output³⁹. There was, however, no coherent theoretical conviction behind the multiplier concept, its early appearance forming part of a populist electoral campaign policy for the Liberal party. Largely based on 'common sense', the essay conveyed some simple logic. An economy like Britain, which had an excessive savings problem could deal with it in two different ways. The first approach, a non-interventionist one, effectively meant part of the excess savings being expended, via taxation, upon dole payments, while the rest was 'spilled on the ground', in the form of business losses.

Alternatively, the State could harness the savings funds and re-engage them as expenditure upon public works. This would generate an increase in income, output and employment⁴⁰. Employment would be created directly in the area of expenditure and indirectly in the linkage industries. Furthermore, the employment increase would generate an increase in 'purchasing power' thereby imparting a 'secondary' stimulus to activity, thus 'the forces of prosperity, like those of depression work with a cumulative effect'⁴¹. The public works program would also stimulate the economic system into a higher level of efficiency, reducing somewhat the pressure to cut wage costs. With plentiful credit, brighter expectations and higher prices, unemployment would tumble⁴². In the same essay, Keynes made reference to a new 'transfer problem'. Here the term was used to describe structural unemployment which many commentators believed to be an intractable problem. Keynes rejected both diagnosis and prognosis. It was the general lack of demand, or 'purchasing power' in the economy and the refusal by officialdom to consider fiscal action that lay at the root of the problem. The failure of labour migration to iron out differences in unemployment among different trades was essentially due to the prevailing low level of aggregate demand. Keynes reiterated that rising prices rather than cutting wages was a better means of diverting resources from one kind of employment to another.

The rest of this pamphlet was, like his other essays, given over to polemics. Nevertheless one can still capture from his essays, a broad outline and indication of

Keynes' theoretical development and his interventionist policy orientation. Another essay, *Liberalism and Industry* (1927) is replete with policy suggestions relating to industrial re-organisation⁴³. It contained criticism of the technical inefficiency of small-scale industry and the waste of cut-throat competition, and urged moves towards full-scale rationalisation. Also advocated was greater state influence over the allocation of capital. Citing the failure of private enterprise to address the problem, Keynes also suggested state-sponsored training for workers to facilitate labour mobility. Interestingly, Keynes went further and proposed that the State should have some input into money wage bargaining, insofar as it promoted the 'betterment of the economic welfare of the workers'⁴⁴. It was apparent that, in his mind, Keynes held to a wage policy of sorts - one that stipulated a fair and justifiable share of the 'cake' to the working classes. Embodied within this was the key emphasis upon keeping money wages stable.

The Thirties

The *Treatise on Money* (*Treatise*) (1930) contains some material, albeit brief, pertaining to wages and employment. Before considering the *Treatise's* contribution in this regard one is mindful of Keynes' disclaimer that, 'this is a *Treatise* on money and not on the wage system'⁴⁵. The *Treatise* was intended to provide a systematic theoretical framework to support the views and assertions contained in his public writings; however his prodigious work-rate and continual revision of his theorising meant that the *Treatise*, at the time of publication, did not fully represent the content of his contemporaneous writings.

While still beholden to the quantity theory, the *Treatise* presented a more elaborate version with the Fisherine identity $MV=PT$, replaced by a savings equals investment equilibrium condition. Assumptions of neutrality of money and constant output were retained. The centre piece of the *Treatise's* analysis - the fundamental equations - purported to explain the cyclical instability of the price level generated by changes in 'monetary' and 'investment' factors. Consequently the *Treatise's* theoretical model regarded unemployment as ensuing from short-term market imperfections; unemployment was not considered a viable equilibrium state.

A perusal of the causal dynamics of the model illustrates the relatively minor role wages played in the analysis. Once again, the level of profits was deemed the locomotive force within the economy. An increase in the money supply would lower interest rates, propel investment ahead of savings thereby pushing the actual price level beyond their expected level. Windfall profits would ensue encouraging enterprises to expand operations and employ more labour. The subsequent increase in the demand for money for 'industrial circulation' purposes pushed up interest rates and brought investment back into line with savings. The new equilibrium would have a higher price level, corresponding to the original increase in the quantity of money⁴⁶.

Conversely, a high interest rate policy would choke off investment spending. With falling prices, entrepreneurs would record losses and respond by reducing employment. Inevitably there would stem pressures for wage cuts as entrepreneurs sought to realign their costs with lower prices. The longer workers impeded this equilibrating adjustment, the longer unemployment would persist. Theoretically

Keynes dismissed wage-cutting as the answer to this oversaving economy since it merely reduced the spending power of the workers by as much as the costs of production⁴⁷. With this argument, part of which was to reappear in Chapter 19 of the *GT*, Keynes was effectively assuming a marginal propensity to consume of unity for wage income. The true equilibrating factor in the scenario was the fall in the interest rate engendered by the reduction in the demand for funds as the costs of production fell. Mehta rightly identifies this as the prototype of the 'Keynes Effect'⁴⁸. Using this coherent model in the *Treatise* Keynes could detail the modus operandi of how the Treasury's deflationist policy of a high bank rate actually took hold. Officialdom's view of the matter was that if they prosecuted the deflation of prices the deflation of costs would look after itself⁴⁹. Keynes chided their naivete and believed them 'apt to contemplate a deflation too lightheartedly'⁵⁰.

With wages, the fundamental equations enabled Keynes to differentiate between cost inflation and profit inflation. Cost inflation could occur whenever there was a 'spontaneous' rise in the rate of efficiency wages⁵¹. Keynes regarded the occurrence of this type of inflation as being dependent upon the 'character' of the wages system, including the behaviour of trade unions. A victim of the circumstances in which he wrote, Keynes believed this type of inflation was unlikely to occur. Yet in the last pages of *Treatise* he seemed well aware of the effect trade union power could have upon the price level;

'If there are strong social or political forces causing spontaneous changes in the money rates of efficiency wages, the control of the price level may pass beyond the power of the banking system'⁵²

Confronting this type of inflationary problem would be difficult, for monetary policy was 'singularly ill-adapted' towards achieving money wage restraint from trade unionists⁵³. In the *GT*, Keynes continued this theme with his comment that trade union control of money wage setting would result in monetary policy being effectively governed by them.

The other type of inflation, namely profit inflation, stemmed from the level of purchasing power pushing prices above costs per unit of output. Workers might achieve higher money wages due to the upswing in activity and the corresponding strengthening in their bargaining power⁵⁴. Nonetheless some erosion of real wages was initially likely since money wages usually lagged behind the rise in prices.

The *Treatise* focussed prime attention upon the perennial external economic problem facing Britain which was itself founded upon the relationship between the interest rate and domestic wage costs.⁵⁵ Britain's fundamental problem was that her volume of aggregate savings vastly exceeded her total investments. The parlous state of her foreign balance not only limited British foreign investment but also curtailed domestic investment because of the high interest rates required to maintain external balance. On a theoretical plane, wage cuts could improve the situation by generating a more favourable foreign balance and thereby permit lower interest rates. But with money-wages rigid, interest rate manipulation was the only means to maintain external balance. However, manipulation of interest rates might induce a haemorrhage of capital abroad⁵⁶. Should this occur, Keynes advised that: 'there remains in reserve a weapon by which a country can partially rescue itself when its international disequilibrium is involving it in severe unemployment'⁵⁷. The 'weapon' was public works. In his public writings Keynes' advocacy of public works

to counter unemployment had become legendary. Now even passages in the *Treatise* mirrored Keynes' uneasiness about accepting a body of thought that did not allow for persistent unemployment, nor entertain any long period analysis other than that befitting the quantity theory*. Indeed his throwaway line at the end of the *Treatise* harbours an element of dissatisfaction with the quantity theory's explanatory power and monetary policy generally: 'Monetary theory, when all is said and done, is little more than a vast elaboration of the truth that "it all comes out in the wash"',⁵⁸

Keynes admitted to being disappointed with the *Treatise* sometime before its publication saying that it needed a 'somewhat drastic rewriting'. It did not reflect the state of his mind on matters of economic policy, particularly his preference for public works rather than fiddling with the Bank Rate.⁵⁹ Keynes was also in some state of confusion about what determined the price level. In one part of *Treatise* the price level is apparently governed by the costs of production, in another, prices seem determined by the quantity of money.⁶⁰ In his ephemeral writings Keynes confided, as shown, in a money-wage driven theory of prices. Despite his expressed doubts about the *Treatise*, Keynes' advice to the *Macmillan Committee* and the *Economic Advisory Council's Committee of Economists* still largely drew from its theoretical schema.

The *Macmillan Committee of Inquiry into Finance and Industry* was charged with inquiring into measures that would promote the employment of labour and, more fundamentally, rectify Britain's excess savings conundrum. It reported against a backdrop of increasing real wages due to falling prices and favourable movements in the terms of trade. Keynes was to prove a key contributor to the Committee in three ways; in the questioning of witnesses, in his own private policy submission, and, in the formulation of its findings. He used the Committee as a sounding board for testing the policy advice stemming both from the *Treatise* and his more controversial writings. All was to little avail however since the majority report of the Committee embraced the fiscal orthodoxy of the 'Treasury View'.

Keynes began his seven days of evidence before the Committee by first diagnosing the key problem with the official Bank rate policy - it had become 'jammed' owing to the rigidity of wages and could not by its own accord clear the disequilibrium between prices and costs. He went on to put up seven policy options for consideration. All were committed towards reducing the real wage and thereby lead to greater entrepreneurial profits. Moreover, six of the seven expedients would engineer a balance of payment surplus thereby allowing greater export of capital without resorting to high interest rates.⁶¹

As it turned out, Addendum I of the Macmillan Report, written under Keynes' editorship eventually put forward three of his alternative recommendations; a reduction of wages and salaries; a tariff-bounty mix of industry support; and a program of public works and subsidized private investment.⁶² Although recognition was given to the theoretic option of cutting all money incomes under some National Treaty arrangement, Keynes deprecated the practical value of this proposal since no machinery existed to expedite the policy. Britain was, said Keynes, 'extremely ill-adapted to violent upward changes in the value of money'.⁶³

Nonetheless scientific integrity still compelled Keynes to admit, in the *Treatise*, that this option was 'theoretically conceivable' as a means of correcting disequilibrium; wage cuts would generate larger profit expectations, induce investment, and

help improve the foreign balance, provided export and import elasticities were favourable. But wage-cutting was a 'dangerous enterprise' and Keynes drew attention to the marked reluctance of businessmen and employer associations towards sanctioning that policy.⁶⁴ Even the supposedly high priest of classical economics, Pigou, failed to commit himself wholeheartedly to this expedient.⁶⁵ In a letter to the Prime Minister, Keynes reported that there was: 'a very set and deliberate determination in almost all quarters of the community not to go back on this as a general policy ... except as an absolutely last resort'.⁶⁶

Keynes had already questioned the magnitude of the employment-creating benefits of a wage cut; proponents of the price deflation policy tended to overstate the employment gains as they overlooked the commensurate effect the wage cuts had upon expenditure.⁶⁷ This point had, of course, been previously elucidated in Keynes's journalistic writings but it now re-appeared more formally presented than hitherto. While he accepted that wage cuts would benefit the export trades his pragmatic bent put forward for consideration the alternative expedient of a tariff-bounty scheme. The Macmillan Committee were apparently convinced of Keynes' stricture that an outbreak of competitive wage-cutting would ensue if Britain began to cut wages in export industries.

Before the Committee, Keynes had also paraded the domestic expansion option as a first-best means of bringing domestic prices and incomes into alignment with the exchange rate. Contrasted against the money-wage cut option, the expansion in the price level, following domestic expansion, carried several inherent advantages; first, it would fall equitably upon all money incomes; second, it entailed an acceptable fall in real wages; third, it would provoke less resistance; and, fourth, it would sidestep the problem of aggravating the monetary debt.⁶⁸ Finally, the domestic expansion expedient would help the labour 'transference' process.

The most notorious of Keynes' expedients put to the Committee was his espousal of trade protection. Underlying this proposal was Keynes's insistence that the conditions for the success of *laissez-faire* had banished.⁶⁹ Protection obviated the need for wage cutting, and possessed all the advantages of the domestic expansion option. It enhanced profitability in the unsheltered industries and would power investment ahead of saving stimulating output and employment.⁷⁰ Some pondered whether the trade unions might seek out higher money wages from this exercise; Keynes was optimistic in this regard believing that money wages, were, for the most part, quite stable.⁷¹

Despite this Keynes still subscribed to classical economic principles and regarded protection as an unsound long-term policy, but, for the interim, a necessary evil. In pragmatically backing protection, Keynes had been particularly fearful that international wage-cutting would emerge in the absence of protectionist measures.⁷² However, when Britain escaped the 'tyranny' of the gold standard Keynes abandoned both his tariff and public works proposals because they were overly inconsistent with the *Treatise's* theoretical schema. He did however remain somewhat opposed to the idea of bowing to the dictates of comparative advantage especially where it threatened a loss of economic stability.⁷³ In this regard, Keynes was uniquely aware of the usually unaccounted for adjustment costs borne by society when resources needed redeployment.⁷⁴

In his private evidence before the Macmillan Committee, Keynes had also canvassed three other policy options that could help generate an economic recovery.

One expedient, industrial rationalization, had been developed as part of the classicist policy response to the economic crisis. In light of the international dimension of the depression, Keynes spoke of a grand scheme where the leading central banks launched a concerted policy of international reflation to restore world price levels to parity with world levels of costs of production. A more local and achievable expedient was the idea of placing bounties upon exports. This way the whole community subsidized the high wages prevalent in the export industries. Interestingly, Keynes's advocacy of this option mirrored his predilection towards raising working class standards through the welfare system (i.e. the social wage) rather than directly pursuing a high wage economy.⁷⁴

In promoting this expedient, Keynes was aware of the ability of capital to undermine a country's independent wage policy, especially in Britain where the perennial capital outflow necessitated a tight money policy that suppressed domestic economic activity. He conveyed this to the Macmillan Committee: 'I believe that *laissez-faire* in foreign lending is utterly incompatible with our existing wage policy'.⁷⁵ Unfettered foreign lending could indefinitely 'put off the day' when workers could claim their entitlement to the enlarged income cake resulting from generations of capital accumulation.⁷⁶ Capital, in fact, could conspire to reduce labour's share of the 'cake' by provoking a balance of payments crisis. These views were contained in Keynes's article *The Question of High Wages* (1930). Again recorded was Keynes's acceptance of the view that money wages were, in fact, the product of historical and social forces rather than being strictly based on any productivity nexus.⁷⁷ It followed that, were the working classes to secure greater political-cum-bargaining power, they would, under the rules of the game, appropriate a larger share of the product of industry.

Another critical development in Keynes's thinking on wages at this time relates to worker psychology; Keynes believed industrial harmony would be enhanced only if workers received the rewards of increased productivity in the form of higher wages rather than lower prices.⁷⁸ Conversely, a real wage fall was best expedited by prices rising and wages remaining steady. This asymmetry in expediting real wage adjustment translated into the policy lesson that money wages should be regarded as rather sticky.

A key development, evident in Keynes' submissions before the *Macmillan Committee* and the *Economic Advisory Council*, was that, while still beholden to classical persuasion that the maladjustment of real wages was the root cause for all unemployment, he was now of the opinion that the level of real wages was determined and affected by other forces in the economic system. In answering a questionnaire Keynes himself had circulated to the Committee of Economists in September 1930 he began to question where real wages actually came in when tackling unemployment. As he put it, 'Real wages seem to me to come in as a by-product of the remedies which we adopt to restore equilibrium. They came in at the end of the argument rather than at the beginning',⁷⁹ and, 'Employment is not a function or real wages in the sense that a given degree of employment requires a determinate level of real wages irrespective of how the employment is brought about'.⁸⁰

This marked a watershed in Keynes theorising on the wages-employment nexus - namely the essential irrelevance of the former in determining the latter. Real wages, for that matter, are seen to 'fall out' from the tempo of economic activity.* The

essential contention of this article is that Keynes already, at this early stage, albeit incoherently, commanded the rudiments of the wage theory that was to appear in the *GT*. For instance, the famous line in the *GT* relating how there may exist no expedient by which labour can reduce its real wage was hardly a new insight; as argued, Keynes had grasped that fundamental insight as early as 1922 and intermittently incorporated it in his subsequent writings. However, Keynes had yet to develop a theoretic framework that would add rigour to his then iconoclastic views on wages.

Privately, he began to do so in the same questionnaire invoking Kahn's multiplier analysis in writing of 'primary employment' brought about by an increase in investment spending and 'secondary employment from the consequent increase in consumption'.⁸¹ Real wages would be reduced by the accompanying lift in prices. Meanwhile the public Keynes's opposition to the *MacMillan Committee* espousal of wage cuts was still solely based upon the impracticality of doing so. He was at one with his Committee colleagues that real wage cuts would increase employment. Yet privately, as argued, Keynes was becoming uneasy about sharing with Pigou the conviction that only labour market rigidities allowed unemployment to persist.

In his Harris lecture entitled '*An Economic Analysis of Unemployment*' (1931), Keynes modified his *Treatise*-based analysis by referring to a 'spurious equilibrium' at some low level of output where investment was dragged down to equality with savings.⁸² But this merely represented a transitory point at the trough of the business cycle before replacement of stock and the pressure of capacity-constraints again pushed investment ahead of savings. Nonetheless, Keynes had begun to associate equilibrium with positions other than at full employment further signifying a break with neoclassical thought.

In the same lecture, Keynes reiterated that the wage-cutting option would only succeed in dragging down the price level and accentuate the burden of monetary indebtedness.⁸³ Keynes cited examples of the British cotton and coal industries where wage rates had fallen up to 40 per cent without any discernible output gains since producers had merely cut prices. It would neither solve an economy's excess savings predicament nor lift its profit ratio. As he put it, 'an all-round diminution in entrepreneur's variable costs per unit of output may actually aggravate, rather than remedy a subnormal level of profit which is reacting unfavourably on output'.⁸⁴ The road to recovery, Keynes contended, was by raising the level of investment, achieved by restoring business confidence, reducing the rate of interest or by undertaking public works.

In a commentary entitled '*Report of the Australian Experts*' (1932) Keynes considered how far a program of actual wage-cutting could go in reducing unemployment in a small open economy. Australia had just undergone a uniformly applied cut in money incomes - along the lines of Keynes' National Treaty proposal - and now Australian economists pondered whether another round of wage and salary cuts would be beneficial. Keynes, pointed out that high real wages were a result of the slump and felt that the exercise would have little value apart perhaps from a minor improvement on the trade balance.⁸⁵ Australia would remain locked-in to a state of unemployment until it took stimulatory measures to alleviate the problem. This would comprise a depreciation of the exchange rate and public works.

Meanwhile, at Cambridge, the first rudiments of what was to become the *GT* was

taking shape. Abandoning the constant output assumption, Keynes, with the help of the Cambridge Circus, transformed the *Treatise's* fundamental equations into a system that determined output and employment. Savings-Investment disequilibria were now brought into balance by changes in output. With Kahn's seminal multiplier analysis at his fingertips Keynes could examine the economy's ability to supply different output levels. By 1932 Keynes could profess what was to become the fundamental theoretic import of the *GT*: 'There is no reason to suppose that positions of long period equilibrium have ... to be positions of optimum output'⁸⁶.

The ground work supporting this finding first made its appearance in early drafts of the *GT*. In these drafts, all trace of which were strangely omitted from the final version, Keynes distinguished between a monetary production economy and a real exchange economy. Using the Marxian schema M-C-M, Keynes outlined a monetary economy founded upon nominal contracts where entrepreneurs hired labour, organized production and sought the recoupment of costs incurred by selling the output to the very people they employed. In this money-contract based economy, employment was determined by aggregate demand in conjunction with entrepreneurial expectations. Entrepreneurs sought to maximise profits by enlarging the margin between sale proceeds and variable cost.⁸⁷ Keynes's other construct, the co-operative economy, on the other hand, depicted an idyllic, equilibrium-orientated economy where trade and exchange were conducted on a barter basis with money rendered neutral. Full employment was reached at the point at which the value of the expected output did not exceed the cost of production with labour assured a fixed share of output.⁸⁸

In the entrepreneurial economy profitability of entrepreneurs expenditure was the key dynamic; consequently, employment was primarily dependent upon the relation between aggregate expenditure and aggregate costs. Whenever aggregate costs exceeded aggregate receipts firms could not mitigate the loss by adjusting money wages since this effectively constituted the bulk of demand for the firm's output. Keynes emphasized that this was the great stumbling block for the classicists; they assumed unemployment could be removed by workers bargaining for lower real wages.⁸⁹ They transposed the (micro) economics of the firm to the economy at large. In contrast, Keynes outlined three expedients, should need arise, that would ensure equality between aggregate expenditure and aggregate costs, namely loan-financed expenditure by government, redistribution of income measures and, not least, manipulating interest rates.⁹⁰

One preface in an early draft of the *GT* forewarned of the intellectual resistance the theory would arouse. Keynes intended to 'raise some dust' with his theoretical assault on neo-classical economics for he feared that the classicists would expurgate his work or, at best, only partly understand this theory. His criticism of their theory would, he believed, be easily set aside, 'like water off a duck's back'.⁹¹

Although Keynes ultimately lowered the tenor of criticism in the preface to the *GT* he was somewhat guilty, in his habitual self-promotion, of over simplifying accepted neo-classical theory. In this vein, Keynes' selective onslaught upon Pigou's *Theory of Unemployment* (1933) as the sole representation of classical economic theory relating to wages and employment was somewhat unfair*. Only Robbins, Cannan and Rueff actually advocated money wage cuts during the early thirties. Many classical economists, including Pigou, were more flexible than Keynes would have

one believe, especially on matters of employment creation and wage policy. Pigou, for instance, acknowledged not only that the unemployment occurring in the early thirties was involuntary but also expressed doubt - before the Macmillan Committee - that a direct assault on money wages would impart any lasting beneficial effect. Like Keynes, Pigou felt that unemployment arose because the level of real wages was out of kilter with the 'existing state of demand'.⁹²

Revisionist research undertaken by Schlesinger, Hutchison and more lately, Bleaney also supports the contention that Keynes was guilty of attributing to his predecessors a general position that was only, in truth, partly held.⁹³ Nevertheless there still remained, before the publication of the *GT*, a strong literary tradition within the economics profession, but more especially, within Whitehall and the City in favour of wage reductions whenever unemployment arose. The credibility of the Pigouvian theory of employment had obviously suffered in that it provided no theoretical justification for the demand stimulating policies Pigou now recommended. Certainly Keynes was utterly correct in identifying the classical model's theoretical presuppositions, as only, 'applicable to a society which is in equilibrium, with all its productive resources already employed'.⁹⁴ In short, the classicist economists had no conception of an effective demand constraint at the macroeconomic level.

As the *GT* took shape Keynes characteristically pre-empted some of its content by producing the pamphlet *The Means to Prosperity* (1933).⁹⁵ In it, Keynes put forward two major policy initiatives. The first proposal was for the State to engage in public works projects using loan-financed expenditure to induce an expansion in local economic activity. Invoking multiplier analysis, Keynes now quantified the actual employment gains. Importantly, he noted that as employment crept up, the potency of the employment multiplier diminished. The second proposal pushed for the restoration of global prosperity by way of a multi-lateral staged program of demand expansion. In sum, the article could be considered within the early *GT* framework although Keynes had yet to fully flesh out the accompanying theoretical system that would provide a convincing theory of unemployment.

This, of course, came to fruition in the *GT* (1936) which marked the pinnacle of Keynes's academic career. In contrast to the *Treatise*, the *GT*'s quaesitum was output and employment. A completely new theoretical edifice was therefore needed to justify the bold policies Keynes had been arguing for, on and off, for the past several years. The revolutionary import of the *GT*, of course, was that the economy could equilibrate at levels of output below the full-employment level of output. Moreover, the *GT* indicted the market capitalist system for its arbitrary and inequitable distribution of income and for having involuntary unemployment as the general state of affairs in the economy. Employment was determined by aggregate demand, comprising consumption and investment spending, the latter variable being the powerhouse of the economic system. In that sense, Keynes' theory of employment was somewhat demand biased - aggregate supply simply assumed to be an aggregation of Marshallian short-run supply functions. Similarly, the other half of the employment equation, wage rates, played a rather subsidiary role. The wage theory, albeit effusive, was hardly new; Keynes having brought together all the disparate elements of wage theory he had put forth over the years and merged them into a synthesis.

In the *GT* Keynes confessed to some difficulty in defining just what the classical

theory of employment was before concentrating his assault upon Pigou's *Theory of Unemployment*. As argued, he had not been so hesitant in asserting the fundamental dissimilarities between his theory and the neo-classicals: 'My difference from this theory is primarily a difference of analysis'⁹⁶. Keynes consigned the classical theory as a special case, applicable only at full employment, whereas his theory held general applicability, whether money wages were fixed or flexible. Theoretically, the classicists were reduced to arguing that only a rigidity of money wages prevented a return to full employment since they held dearly to the axiom that wage bargains between entrepreneurs and workers determined the real wage. As Keynes put it: 'The Classical Theory has been accustomed to rest the supposedly self-adjusting character of the economic system on an assumed fluidity of money wages; and when there is rigidity, to lay on this rigidity the blame of maladjustment'⁹⁷.

In Chapter Three of the *GT* the theory of employment determination was clearly and succinctly put;

The propensity to consume and the rate of new investment determine between them the volume of employment, and the volume of employment is uniquely related to a given level of real wages - not the other way round. If the propensity to consume and the rate of new investment result in a deficient effective demand, the actual level of employment will fall short of the supply of labour potentially available at the existing real wage; and the equilibrium real wage will be greater than the marginal disutility of the equilibrium level of employment'.⁹⁸

In his exposition, Keynes included remnants of the classical theoretical edifice. However, his advised use of the two classical postulates led to much confusion and ultimately, served to obscure and sidetrack the true meaning of the *GT* as far as employment determination was concerned¹⁰⁰. This was particularly ironic as the postulates had, at Harrod's behest, been included to appeal to the classicists 'on their own ground'. The first postulate sets out the inverse relationship between real wages and employment. This Keynes readily accepted as it was consistent with the Marshallian tradition of diminishing marginal returns and marginal cost pricing. Keynes however, took issue with the second classical postulate on two grounds*. The first reservation concerned the actual attitude workers held towards real wages and money wages respectively though Keynes judged it not 'theoretically fundamental'¹⁰¹. It did, however, negate the classical labour supply relationship with labour supply now being more dependent upon relative real wages than upon real wages per se.

By framing this reservation Keynes had simply incorporated workers' resistance to money wage-cuts that he had observed, over the preceding years into a condition underlying a hypothetical labour supply function. The second, more fundamental, objection related to the received wisdom that labour in a monetary economy had the ability to decide their real wage via money wage bargaining; labour had little say in their real wage outcome unless they could somehow influence the overall level of aggregate demand. As argued, Keynes' past writings had shown, ad nauseam, that there was no direct link between the forces that determines money wage remuneration and those that determined real wages. This culminated in his oft-quoted dictum that: 'There may exist no expedient by which labour as a whole can reduce its real wage to a given figure by making revised money wage bargains with the entrepreneurs'¹⁰².

The classicists were reproached for not perceiving that a wage cut would reduce prices, more or less proportionately, under atomistic competition¹⁰³. Since money wage cuts neither altered the real wage, nor the level of employment, workers' resistance to wage cuts could be exalted as sound economics since it preserved monetary stability. Although Keynes concurred with the classicists that a decline in real wages was the *sine qua non* for increasing employment the classicists felt this could be only expedited by money-wage cuts. Keynes, of course, did not share faith in this view; workers would accept a minor erosion of their real wage only as a side-effect of some upswing in activity and output. This amounted to a violation of the classical labour market behavioural relationship between real wage compensation and the disutility of labour; the existing real wage was no longer an accurate reflection of the marginal disutility of employment. Keynes's formal, but cumbersome definition¹⁰⁴ of involuntary unemployment incorporated this element of real wage elasticity.

'Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment'.

This contrasted with the classical view of things where: 'any rise in the cost of living, however moderate, relatively to the money-wage will cause the withdrawal from the labour market of a number of workers ...'¹⁰⁵. The nexus between real wages, determined by the level of aggregate demand, and marginal disutility of employment was broken; it was only at full-employment that they were equal.

Keynes's renunciation of the second classical postulate upset traditional labour market analysis. Consistent with this, Keynes attacked the legitimacy of an aggregate demand curve for labour, founded as it was on a fallacy of composition argument - unless one held aggregate demand constant¹⁰⁶. Given this interdependence, one could not say whether cutting money wages would, in fact, generate employment increases until one considered the effect upon aggregate demand. In that light, Keynes's convenient acceptance of the first classical postulate certainly did not signify that he held the marginal product curve for labour to constitute the aggregate demand curve for labour. Rather the labour demand curve constituted points of effective demand themselves derived from the intersections of the aggregate demand and supply functions¹⁰⁷. The aggregate demand function, in turn, represented the entrepreneur's expected proceeds from the community's spending on investment and consumption.

This expectational element in Keynes' thought on labour hiring was fully incorporated into the GT's analytical system. There had, of course, been some antecedents in this regard with *The Tract* and the *Treatise*, both of which placed entrepreneurial expectations at the centre-piece in determining output levels within a monetary economy. In the GT, the amount of labour businessmen employed was made dependent upon their estimation of the expected proceeds arising from consumption and investment expenditure matched against corresponding projections of supply costs of output at that level.

In sum, the equilibrium level of employment was determined by the intersection of the aggregate demand schedule with the aggregate supply function. This point of intersection represented effective demand and marked the point of profit maxi-

misation for entrepreneurs. Only a peripheral role was assigned to money wages in the schema, except to underpin the aggregate supply curve which denoted labour costs associated with differing levels of output. As effective demand increased, employment would rise till a point is reached where there is no more supply of labour at the existing real wage. Before reaching full employment, the economy would run into a succession of semi-critical points or bottlenecks where money wage rates would rise disproportionately with the increase in effective demand. This reflected not only the problem of diminishing supplies of labour but also the growing bargaining power of labour in the circumstances.

Keynes' relative wage hypothesis became relevant for explaining the intensified wage struggle that would ensue between groups of workers as full employment was approached. Thus,

'... The struggle about money-wages primarily affects the distribution of the aggregate real wage between different labour groups, ... The effect of combination on the part of a group of workers is to protect their relative real wage'¹⁰⁸.

However, the relationship between labour's bargaining power and the inflation rate, itself a product of an increase in effective demand, was a 'discontinuous' one, dependent upon the, 'psychology of the workers and by the policies of employers and trade unions' and therefore, 'did not lend itself to theoretical generalization'¹⁰⁹. While Keynes left the matter of money wage determination open-ended, the possibility of an inflation, fuelled by a relative wage struggle, was pre-conditional upon an earlier lift in effective demand. Also alluded to in the *GT* was that cost-push inflation can occur given the statement that the cost unit (i.e.; money wages) can change independently of monetary expansion¹¹⁰. There was continuity with the *Treatise* where this possibility had been first aired.

At full employment, a state of 'true inflation' was reached where increases in effective demand resulted in equiproportionate price rises and the quantity theory was restored to its former relevancy. Keynes noted an asymmetric relationship between money wages and aggregate demand; while money wages and aggregate demand rose in tandem upwards, money wages would lag behind whenever aggregate demand turned downwards¹¹¹.

In the overall development of Keynes' wage theory, Chapter 19 of the *GT* represents the crowning piece in his long intellectual struggle with orthodoxy over appropriate wage policy¹¹². After detailing the *GT*'s theoretical framework in the first eighteen chapters, Keynes mounted a rigorous, systematic rebuttal of the classical view that flexible money wages would ultimately guarantee full employment. To repudiate this particular nostrum effectively amounted to denying once and for all the self-adjusting character of the economic system.

On a general plane, Keynes criticised the neo-classical approach for slipping into partial equilibrium analysis when examining the effect of money wage changes¹¹³. As discussed, Keynes had already alluded to the 'disharmony of general and particular interest' for some time when considering the wage-cut option¹¹⁴. This focus on partial equilibrium precluded neo-classical economists from considering the effects of changes in wages upon the aggregate level of demand. As Keynes summed it, 'the precise question at issue is whether the reduction in money wages will or will not be accompanied by the same aggregate effective demand as before...'¹¹⁴.

Since classical theory ignored this approach, Keynes substituted in his own method of analysis. He examined whether a cut in money wages would stimulate employment either by increasing consumption expenditure, or increasing investment expenditure. The possibilities of success with the first were poor because the redistribution of income from the wage cuts would deliver a net effect more likely to be adverse than favourable¹¹⁵. Similarly, the odds were against investment responding favourably to a round of wage cuts, unless it was widely held that money wages levels had reached their nadir.¹¹⁶ This left the interest rate effect to consider: 'It is ... the effect of a falling wage ... on (the rate of interest) that those who believe in the self-adjusting quality of the economic system must rest the weight of their argument'¹¹⁷.

Should the quantity of money contract in step with the reduction in money wages, the interest rate would hardly fall but otherwise the interest rate would fall in the face of a lower demand for money balances. This might stimulate investment spending. However, Keynes poured scepticism over this possibility insisting that there was likely to be a highly interest-elastic demand for money and, in any case, investment expenditure plans were likely to display, given the circumstances, a low interest elasticity. If this is what the classicists were really about with their wage-cutting proposals, Keynes reasoned, surely an easier expedient would be expansionary policy. Keynes administered the coup de grace for classical theory and its corollary, flexible wage policy: 'There is, therefore, no ground for the belief that a flexible wage policy is capable of maintaining a state of continuous full employment ... The economic system cannot be made self-adjusting along those lines' (*GT* pg. 267). Keynes decreed that it was only in authoritarian societies that a flexible wage policy in a closed economic system would have any chance of success. In contrast, it was too much to expect a market based system to exhibit a comparable degree of control over the money supply and the level of investment that would ensure full employment.

In the many reviews of the *GT*, it was apparent that many of the leading neo-classicals (i.e. Viner, Pigou, Haberler) failed to grasp the import of Keynes' wage theory or, less charitably, scandalously misinterpreted it. Many reviewers, sceptical from the outset of Keynes's claims of having overthrown classical theory singularly, interpreted the *GT* as showing unemployment being the natural order of things whenever sticky wages prevailed. Keynes inadvertently helped foster such misconceptions by presenting the first 18 chapters of the *GT* under fixed wages mode. Ironically this had to be done to 'facilitate the exposition'. He added to the confusion by giving reasons why money wages would be sticky and why this would be beneficial for the economy's monetary stability. The few readers that studied Chapter 19 would have noted Keynes's essential point that having a regime of flexible wages made no difference to the analysis set out in the previous eighteen chapters. Keynes apparently was not too perturbed by these types of misunderstandings provided the major elements of the aggregative analysis and policy implications of the *GT* were properly grasped and disseminated. He was not interested in abstract theory per se, but in reasoning that led to clear thinking on practical economic problems.

However, there was one isolated instance where Keynes took exception to Haberler's claim that there was little separating his wage theory from that of the

classicals. It concerned the differing causal mechanisms that Keynes and the classicals held with regard to money wage cuts. Keynes addressed the matter thus:

'If classical economists here always meant that a sufficient increase of money in terms of wage units would be a compensatory element, well and good. I am not aware of any passage written before the publication of my book, in which anyone in the classical tradition has said this, or anything remotely resembling it. I have always understood that they favoured a reduction in money wages because they believed that this would have a direct effect on profits, and not one which operated indirectly through the rate of interest.'¹¹⁸

It was a telling remark; the classical economists had no pre-conception of the possible stimulus wage-cuts could impart by engineering a fall in the interest rate. Subsequently dubbed the 'Keynes effect' it became for some harsh reviewers of the *GT* one of the few, significant, theoretical contributions from that work. (The fact that Keynes had first written of it in the *Treatise* largely escaped notice.) What was critically overlooked by many reviewers in this regard was the failure of the rate of interest to balance the supply and demand for funds. As argued, if the rate of interest did not equilibrate planned investment with full employment savings, wage flexibility would not, in any circumstance, guarantee a full employment equilibrium; the question whether, money wages were rigid or not, was reduced to an irrelevancy.

After the *GT*, Keynes' literary activities centred upon contributing advice on economic policy. In his pamphlet *'How to Avoid the Slump'* (1937) Keynes focussed attention upon formulating a regionally tailored demand management policy. Facing a 12% unemployment rate, Keynes pressed for a 'rightly distributed demand' to direct most of the stimulus to the distressed regions with less emphasis upon a general stimulus.¹¹⁹ This switch in demand management was predicated upon advancing the general interest; the 'special' areas - marked by pools of idle resources - would allow rearmament without inflation. Hitherto, the rigidity of Britain's industrial structure had prevented broad-based expansionary measures from registering any impact in cutting unemployment in the depressed regions.¹²⁰ At this stage, Keynes was overly pessimistic about the threshold rate of unemployment whereupon any further fiscal stimulus beyond that would generate inflation instead of increased output.

As the dissemination of the *GT* took hold the review by Ohlin was of particular note since it led to Keynes eventually modifying his theory of wages. Ohlin had been critical of Keynes for not freeing his analysis from the first classical postulate. In contrast, Ohlin confidently speculated upon the likelihood of increasing returns to scale upon an upturn in activity. At first, Keynes was unrepentant about discarding the postulate and decreed that decreasing physical returns in the short period was an 'uncontrovertible proposition'; the inverse relationship between real wages and employment was one of the 'best established statistical conclusions.'¹²¹ The associated relationship, raised by Keynes, namely, the movement in real wages always being opposite in direction to changes in money wages was based upon his a priori assumption that marginal cost increases in the short run with an increase in output was synonymous with an increase in the marginal wage cost. The empirically-based studies of Tarshis and Dunlop which refuted this relationship were acknowledged by Keynes but he did not accept them as sufficiently compelling to completely abandon the classical hypotheses. Keynes was aware that retention of the first

classical postulate was incongruous with his interpretation of the real wage-employment nexus referred to repeatedly in the *GT*. This was, of course, that the real wage fell only as a consequence of the rise in employment not the other way around. Keynes was equally aware of the postulate's distracting role when he wrote that its retention within the *GT* framework; '... had a tendency to offset the influence of the main forces which I am discussing'¹²².

In his 1939 *Economic Journal* article, Keynes pondered modifying his view of the relationship between employment and output in the short run. An increase in output could possibly be achieved without the marginal product of labour falling; a fall in the real wage was no longer necessary for an increase in employment provided there was an increase in aggregate demand. Keynes attempted to reconcile the empirical findings of Tarshis and Dunlop with the contra-cyclical real wages behaviour in the *GT* by conjecturing that it was due to 'our modern quasi-competitive system' where producers operated under increasing returns to scale. Acceptance of procyclical real wage movements allowed Keynes to simplify his 'fundamental explanation' expounded in the *GT*. Indeed, the simplifications gave his conclusions added force.¹²³ Keynes was also more than happy to accept the findings since it dispensed with allegations of money illusion in the labour supply function and hence any superficial similarity with Pigou's theory of employment.

On that very matter Keynes rejected the claim that his theory of employment rested upon workers being susceptible to a money illusion. Workers were fully aware of their real wage, respective to their marginal disutility of labour. They accepted incursions into their real wage during an upswing provided it did not drive it below the marginal disutility of labour. Keynes' later admission of a real wage resistance phenomenon among workers removed any trace of money illusion from his theory of employment but did not invalidate, in any way, that theory's overall force. It was the classicists who invoked a money illusion mechanism in reconciling Keynes' theory of employment¹²⁴ with their own. This had long been part of the classicist theoretical baggage.

In his next major essay '*How to Pay for the War*' (1940) Keynes sought to integrate distribution policy with employment and wage theory. The pamphlet set out to devise a 'means of adopting the distributive system of a free community to the limitations of war'¹²⁵. With the 'size of the cake' fixed, Keynes pondered over the means by which the State could marshal resources for the war effort. In the last war, the resources had been appropriated by the State employing 'nature's remedy' - inflation operating in tandem with the tax system. Besides bearing heavily upon the working classes, this policy had generated excessive post-war gains for rentiers in the form of national debt dividends¹²⁶. This violated Keynes' deeply-held notion of economic justice. The inflationary solution to war financing was no longer operable because workers would no longer tolerate incursions into their real wage levels. Trade Unionists had become real-wage conscious; the lag between price rises and compensating money wage rises had shrunk. As Keynes noted, 'Wages will pursue prices with not so lame a foot'¹²⁷.

To meet the physical demands placed on the economy by the prosecution of war, Keynes proposed a deferred consumption scheme:

Thus, quite apart from its primary purpose to finance the war, it would be worthwhile to introduce deferred pay at a time of scarce resources such as the

present, if only with the object of releasing it subsequently at a time of surplus resources and so preventing ... unemployment. I think of it as a first instalment of a comprehensive social policy to regulate the general rate of spending so as to avoid the disastrous alternatives of boom and slump ...¹²⁸

Keynes's perennial emphasis on the mal-distribution of income, now acting as an agent behind unemployment, prompted the deferred-consumption scheme as an equitable way of redressing the problem. It was also consistent with Keynes' life-long concern over distributional equity and ensuring that the economy afforded the working classes a reasonable standard of living. His deferred consumption plan, expedited via regressive taxation, avoided direct adjustment of wages yet met the long run interest of wage earners.

Earlier, Keynes dismissed the idea of a wages standstill as a means to alleviate excess demand pressures. This long-held reluctance to directly tamper with wages was repeated in Keynes' advice on budgetary policy. The right to negotiate wages was sacrosanct: 'the freedom of the wage bargain is the ark of the covenant for trade unions'.¹²⁹ The trade unions insisted upon exercising this right and dismissed Keynes's proposal as 'pie in the sky'. Keynes seemed a trifle naive in expected union compliance with the plan but, as Joan Robinson remarked, he sometimes over-estimated the power of reason to persuade.

During the war years Keynes was largely uninvolved in the domestic policy committees but did play a considerable part in the 1941 budget preparations. Nor did he assume a key role in the drafting of the 1944 *White Paper on Employment* but monitored its progress by reviewing drafts put out by Meade.¹³⁰ Meade, in fact, was left to do most of the running on devising 'Keynesian' policy ideas on employment but Keynes did offer some further ideas for the post-war full employment world.¹³¹ The White Paper, of course, carried the whole thrust of Keynes's lifetime work with its commitment towards full employment and the objective of price stability (read wage stability). Wilson records that the White Paper had elements of caution within it, suggesting that Keynes' earlier bolder proposals, like automatic fiscal stimulus in times of slump, were now shelved. This, Wilson argues, merely reflected Keynes's continuing state of mind on matters of economic policy.¹³²

Another area where Keynes remained cautious was in estimating the actual full-employment rate. In the GT full employment had been defined as the maximum level of employment obtainable by lifting aggregate demand before 'true inflation' sets in. Over the past few years Keynes had been progressively lowering his percentage estimate, usually at the behest of some colleague; by 1943 Keynes had settled on 5% of the work force as the acceptable limit.¹³³ When Beveridge suggested 3%, Keynes was sceptical but urged an experimental attempt at it. Of course, Beveridge's experiment was to do better than expected, and without antagonising the inflation bogey.

Keynes, in fact, spent most of the later war years devising the groundwork for the new post-war international trading and financial system - these new arrangements held some implications for Britain's wage and employment policy in the international context. Keynes' proposed International Clearing Union would permit countries to retain some sovereignty over the level of their 'efficiency wages' by adjusting exchange rates where necessary. In a speech to the House of Lords, a key thread of Keynes' lifetime work, especially his disillusionment with unyielding

exchange rates like the Gold Standard came to the fore with his declaration that, '... we will not accept deflation at the dictate of influences from outside ... We abjure the instruments of bank rate and credit contraction operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors'.¹³⁴

Despite external pressures operating on wages Keynes attached key importance to having wages 'being seen' to be determined largely by domestic economic considerations. He was appalled however when Hubert Henderson and the parliamentary Budgetary Committee sanctioned deflation to maintain the value of sterling; the persistence of old ways of thought was not to be under-rated.¹³⁵

It had also been during war-time that Keynes first pondered over the behaviour of money wages in a full-employment economy. As the economy neared full employment the bargaining power of labour was bound to strengthen, relative to capital, and money wages were bound to give. As argued, Keynes had given only scant attention in his works to the problem of rising money wages. Logically he would be equally concerned with the problem as he was with wage cuts; both directly affected the price level and thereby endangered the whole exchange basis on which the economy was built.

The classical medicine of deflation was still one option that could be invoked to suppress wage inflation. However Keynes believed less punitive means could be devised to keep trade unions in check if only economists turned their minds to the problem. In a way, Keynes absolved himself of that responsibility because his theoretical writings always modelled money wages as exogenously-given and beyond direct policy control. To him the dilemma was primarily a political problem rather than an economic one; scientific analysis could only go so far. In a later comment, Keynes fudged the issue: 'One is also, simply because one knows no solution, inclined to turn a blind eye to the wages problem in a full employment economy'.¹³⁶

Although trade unions had practised co-operation and wage restraint during the war years, Keynes discounted the reoccurrence of this in the post-war era and predicted money wages inevitably creeping upwards.¹³⁷ Despite this, Keynes was optimistic about receiving trade union support towards realizing the goal of full employment. This support was expected on two counts. First, that unions would not impose barriers to full employment by engaging in restrictive practices. Second, and more importantly, that trade unions would not prove 'irresponsible' or 'masochistic' enough to sterilize expansionary economic policy.¹³⁸ To reaffirm this, Keynes impressed upon the union leaders the awesome responsibility they held with respect to wage levels and economic stability generally. Keynes confidently held that the more unions were told of their social obligations, the more they would be willing to live by them.

The same was expected from economic policy makers. The maintenance of full employment, required that they too not just be 'good' but 'clever' also*. Keynes's comments on the White Paper on Employment policy were marked by an optimistic, almost paternalistic air. Lingering doubts about the wisdom of pursuing full employment were quickly dispelled by the power of reason and the 'elitist presuppositions' of Harvey road.¹³⁹

It is a rather pointless exercise to speculate what Keynes 'might have said' about reconciling full employment with rising money wages had he lived longer. Extrapolating about how his views might have crystallized is a dubious practice since he had a disconcerting tendency towards changing his mind, especially on policy matters, and having little allegiance to yesterday's outlook. In that light, Keynes's last article, published posthumously, where he warned against, 'modernist stuff, gone wrong and turned sour and silly, is circulating', can be seen as a reaction against the policies being propagated by Keynesian zealots.¹⁴⁰ In that article, Keynes reaffirmed that the market was still, except in times of marked unemployment, the optimal means of allocating resources. Keynes' long exposure to orthodox teaching had made him beholden to certain fundamental shibboleths embodied in classical economics including the marginal productivity theorem and not least, the role of relative prices in guiding resource allocation.* This was not inconsistent with his earlier call for the socialization of investment when satiation of consumption was reached. Rather he sought to improve the efficacy of markets or as he put it, 'not to defeat but to implement the wisdom of Adam Smith'.¹⁴¹ Nonetheless, his moral imperative, of ordering full employment of resources before allocative efficiency, remained unchanged.

Conclusion

This article has presented material in a manner that emphasises the essential continuity and systematic progression embodied within Keynes' work on wage theory. There was one or two conceptual breakthroughs along the path but otherwise it was a slow, tentative progression. In reading the literature one is struck by the repetitive and remorseless way in which Keynes developed and refined his critique of classical wage theory. Underlying this were central interests that run thematically through Keynes' works, all of which relate to his social and philosophical bearings. Among the more prevalent were the scourge of unemployment, distributional equity and social justice, the need for wage and price stability, the imponderability of money wage setting together with the expectational element in labour hiring decisions and, not least, the futility of wage cuts.

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Notes

- 1 J.M. Keynes, *The Collected Writings* VOL 2 (London, MacMillan, 1971) pp. 11-12.
- 2 *Ibid.* Pg 22
- 3 J.A. Schumpeter 'John Maynard Keynes 1883-1946' in J. Wood (ed.) *John Maynard Keynes: Critical Assessments* (Croom Helm, 1983) VOL 1 pp. 55-56
- 4 C.W. Vol. 2 pp. 11-12
- 5 S. Howson 'A Dear Money Man?': Keynes on Monetary Policy, 1920' *Economic Journal* June 1973
- 6 C.W. Vol. XVII pp. 183-4
- 7 C.W. Vol. IV pg 140
- 8 D. Winch, *Economics and Policy: A Historical Study* (London 1972) Chapters 1-3
- 9 J.F. Wright, 'Real Wage Resistance: Eighty years of the British Cost of Living' in D. Collard & P. Helm (eds) *et al. Economic Theory and Hicksian Themes* (O.U.P. 1985) Pg. 156.
- * That is not to say, of course, that Keynes sanctioned inflation. His writing detail an acute awareness of the havoc inflation can inflict on an economy based upon nominal contracts. What Keynes was in favour of was restoring the price level to its previous level.
- 10 C.W. Vol. XIX pg. 66
- 11 C.W. Vol. XIX pg. 113
- 12 C.W. Vol. XXIX pg. 337
- 13 C.W. Vol. XXIX pg. 117
- 14 M. Milgate 'Keynes and Pigou on the Gold Standard and Monetary Theory' in *Contributions to Political Economy* (1983) 2, Pg. 41.
- 15 C.W. Vol. XIX pg. 371
- 16 Quoted from S.E. Harris, *John Maynard Keynes* (New York, 1955) Pg. 166.
- 17 C.W. Vol. XIX pp. 219-30
- 18 C.W. Vol. XIII pg. 23
- 19 C.W. Vol. XIX pg. 149
- 20 C.W. Vol. XIX pp. 120-124
- 21 C.W. Vol. XIX pg. 152
- 22 C.W. Vol. XIX pg. 393
- 23 *Ibid.* pg. 393
- 24 *Ibid.* pg. 393 and C.W. Vol. V pg. 271
- 25 C.W. Vol. XIX pp. 409-410
- * Recent intellectual support for this view has come from Paul Wells in his article 'Mr Churchill and the General Theory' in J. Cohen & G.C. Harcourt (eds) *International Monetary Problems and Supply side Economics* (St Martin's Press 1986).
- 26 C.W. Vol. IX pgs. 212, 218, 224
- 27 C.W. Vol. XIX pg. 435
- 28 C.W. Vol. XIX pp. 553-4 and Vol IX pp. 223-4
- 29 C.W. Vol. IX pg. 218
- 30 C.W. Vol. XIX pg. 348
- 31 C.W. Vol. IX pp. 272-284 and pp. 295-306
- 32 C.W. Vol. IX pg. 292
- 33 *Ibid.* pg. 309
- 34 R. Kahn, *On Reading Keynes* (British Academy 1974) pg. 24
- 35 C.W. Vol. IX pp. 295-306
- 36 *Ibid.* pg. 306
- 37 C.W. Vol. XIX pg. 811
- 38 C.W. Vol. XIX pp. 219-223.
- 39 C.W. Vol. XIV pg. 58.
- 40 C.W. Vol. IX pp. 116-117

- 41 *Ibid.* pg. 106
- 42 C.W. Vol. XIX pg. 764
- 43 C.W. Vol. XIX pp. 638-648
- 44 C.W. Vol. IX pg. 646
- 45 C.W. Vol. VI pg. 151
- 46 C.W. Vol. 6 pg. 178
- 47 *Ibid.* pp. 159-60
- 48 G. Mehta, *The Structure of the Keynesian Revolution* (London 1977) pg. 207
- 49 P. Clarke, *The Keynesian Revolution in the Making 1924-1936* (O.U.P. 1988) pg. 90, 109
- 50 C.W. Vol. V pg. 244
- 51 C.W. Vol. VI pp. 166-70
- 52 C.W. Vol. VI No. 2 pg. 351
- 53 C.W. Vol. V pp. 243-6
- 54 *Ibid.* pg. 288
- 55 C.W. Vol. VI pp. 165-77
- 56 C.W. Vol. IX pgs. 118, 123-4
- 57 C.W. Vol. IV pg. 337
- 58 C.W. Vol. VI pg. 366
- 59 C.W. Vol. XIII pg. 117-8
- 60 R. Kahn, *The Making of the General Theory* (C.U.P. 1984) pg. 70
- * In his review of the 1890 depression Keynes noted that an interest rate reduction had not been sufficient to prevent deflation and that only loan-financed public works would absorb surplus savings on this occasion (C.W. Vol VI pg. 151).
- 61 Clarke *op. cit.* pp. 114-115
- 62 *Macmillan Committee on Finance and Industry Report* (London, 1931) Addendum I 'A Reduction of Wages and Salaries)
- 63 C.W. Vol. XX pp. 370-1
- 64 C.W. Vol. VI pg. 346
- 65 *Macmillan Committee on Finance and Industry: Minutes of Evidence* (London 1931) Vol 1 pp. 186, 311-3
- 66 C.W. Vol. XX pg. 377
- 67 C.W. Vol. XIII pp. 359-361
- 68 C.W. Vol. XX pp. 429-30
- 69 C.W. Vol. XXI pg. 207
- 70 B. Eichengreen 'Keynes and Protection' *Journal of Economic History* VOL XLIV, No 2, June 1984 pg. 365
- * Devaluation was ruled out because of Britain's financial leadership and the effect it would have on the country's rentier income interests.
- 71 C.W. Vol. XX pg. 120
- 72 C.W. Vol. CC pg. 497
- 73 D. Winch & S. Howson, *The Economic Advisory Council 1930-1939* (CUP 1977) pg. 57
- * In 1933 Keynes brought together the threads of these arguments to mount a radical plea for self-sufficiency. It is difficult to fully reconcile this extremist position - of Little Englandism - with his prior views on trade and protectionism. C.W. Vol. XXI pp. 233-46.
- 74 C.W. Vol. XX pg. 13
- 75 *Ibid.* pg. 147
- 76 C.W. Vol. VI pg. 279
- 77 C.W. Vol. XX pg. 7
- 78 C.W. Vol. XIII pg. 129
- 79 C.W. Vol. XIII pg. 180
- 80 *Ibid.* pg. 180

- * This is not to say Keynes thought high real wages unimportant in determining the level of employment. What it means is that he began to take issue with the Classics over the causation. They confidently claimed that unemployment was caused by labour pushing for and maintaining high (real) wages. While Keynes agreed on the correlation (between high real wages and unemployment) he disagreed that this signified causation. Other economic factors could be responsible for the unemployment and the high real wages.

81 Clarke *op. cit.*, pg. 194; C.W. Vol. XIII pp. 187-8

82 D. Patinkin, *Keynes's Monetary Thought* (Duke University Press 1976) pg. 68.

83 C.W. Vol. XXIII pp. 343-87

84 *Ibid.* pg. 393

85 C.W. Vol. XXI pp. 96-97

86 C.W. Vol. XXIX pg. 55

87 *Ibid.* pgs. 78, 81-3

88 *Ibid.* pg. 67

89 *Ibid.* pp. 97-98

90 *Ibid.* pg. 95

91 C.W. Vol. XIII pg. 548

92 Clarke *op. cit.*, pg. 177

- * Pigou had made some sweeping concessions in the policy field before the Macmillan Committee hearings. This included advancing six reasons why it would be difficult to cut money wages, one of which was the relative wage justice theorem. Nevertheless, the publication of his later work, besides being an accurate summation of classical economic thinking on the matter, marked a return to his long-run equilibrium analysis with the attendant view that the level of real wages lay behind unemployment problems. Unemployment would disappear if only wage-earners did not insist upon a wage rate higher than the equilibrium level set by their productivity. Howson and Winch, *op. cit.*, pg. 183.

93 J.R. Schlesinger 'After Twenty years: The General Theory' in J.C. Wood (ed.) *John Maynard Keynes: Critical Assessments* (Croom Helm 1983). Also M. Bleaney 'Macroeconomic Theory and the Great Depression Revisited' *Scottish Journal of Political Economy* 1987 and T.W. Hutchison 'Demythologizing the Keynesian Revolution: Pigou, Wage Cuts and the General Theory' in *On Revolutions and Economic Progress in Economic Knowledge* (C.U.P. 1978).

94 C.W. Vol. IX pg. 350

95 C.W. Vol. IX pp. 335-66

96 C.W. Vol VII, pg. 257

97 *Ibid.* pg. 257

98 C.W. Vol. IBID pg. 27

99 *Ibid.* pg. 30

100 W. Darity & B. Horn, 'Involuntary Unemployment Independent of the Labor Market' *Journal of Post Keynesian Economics* 1987-88 Vol. X No. 2 pp. 216-224. Ironically, Keynes acceptance of the first classical postulate, taken at face value, helped to reinstate the (neo-classical) nostrum that unemployment was entirely related to real wage levels; unemployment only occurs when the real wage level lies above the marginal product of labour at full employment. (viz J. Brothwell, 'The General Theory after fifty years; Why are we not all Keynesians now' *Journal of Post Keynesian Economics* (1986).)

- * The postulate holds that the Utility of the wage at a given level of employment is equal to the marginal disutility of that amount of employment. (GT pg. 5)

101 C.W. Vol. VII Chap 2

102 *Ibid.* pg. 13

103 *Ibid.* pg. 12

104 *Ibid.* pg. 7

- * GT pg. 15. In chapter 3 of the GT Keynes simplified his definition to state that full employment was reached when the elasticity of employment was zero with respect to an increase in effective demand. See R Kahn, 'Unemployment as seen by the Keynesians' in G.D.N. Worswick (ed.) *The Concept and Measurement of*

Involuntary Unemployment (Allen and Unwin 1976) pg 21 and W. Darity & B. Horn 'Involuntary Unemployment Reconsidered', *Southern Economic Journal* Vol. 49 pp. 717-727.

105 *Ibid.* pg. 277

106 *Ibid.* pg. 259

107 Darity and Horn, *loc. cit.*, pp. 18-19

108 *Ibid.*, pg. 14

109 *Ibid.* pp. 301-2

110 'Comment' by A.P. Thirlwall on Kaldor's paper in D. Worswick, *Keynes and the Modern World* (C.U.P. 1983) Pg. 43.

111 C.W. Vol. VII Pg. 303

* It is particularly ironic that the same chapter has been one of the most overlooked by neoclassical and Keynesian economists alike.

112 *Ibid* pp. 257-8

113 Clarke *op. cit.*, pg. 272

114 *Ibid.* pg. 259

115 *Ibid.* pg. 261

116 *Ibid.* pg. 266

* Keynes qualified this result by stating that a large and sudden cut in money wages might engender a mood of optimism amongst entrepreneurs. However this was unlikely to occur given that it would be difficult to implement a universal wage cut that affected all workers equally without fomenting an increase in industrial friction.

117 *Ibid.* pg. 266

118 C.W. Vol. XXIX pp. 272-3

119 C.W. Vol. XXI pp. 385, 405, 409

120 C.W. Vol. XXIX pp. 384-95

121 C.W. Vol. XIV pg. 196

122 C.W. Vol. VII pg. 400

123 *Ibid.* pp. 400-1

124 *Ibid.* pg. 401

125 C.W. Vol. IX pp. 367-439.

126 C.W. Vol. XXII pp. 58-70

127 *Ibid.* pg. 121

128 *Ibid.* pg. 123

129 C.W. Vol. 22 pg. 288

130 T. Wilson, 'Policy in War and Peace: The Recommendations of J.M. Keynes' in A. Thirlwall (ed.) *Keynes as a Policy Adviser* (1982 Macmillan) pp.48-52.

131 C.W. Vol. XXVII pp. 264-379

132 Wilson, *op. cit.* pp.55-56

133 C.W. Vol. XXI pg. 409 and Vol. XXVII pp. 335-6

134 C.W. Vol. XXVI pg. 16

135 C.W. Vol. XXVII pp. 373-4

136 C.W. Vol. XXVII pg. 385

137 Kahn, *loc. cit.*, pg. 25

138 R. Jones, *Wage and Employment Policy 1936-1985* (Allen and Unwin 1987) pg. 32

* I use these words in the context of Keynes' remark to T.S. Eliot that 'Insufficiency of cleverness, not of goodness is the main trouble'. What Keynes meant here was that to devise a solution to some economic problem one first had to really understand what really lay behind the problem using one's mental resources to the fullest. Only then could one propound a theory to justify the solution to the problem. C.W. VOL XXVII pp. 383-4

139 R. Skidelsky, 'Keynes and the Reconstruction of Liberalism' *Encounter*, June 1977

140 C.W. Vol. 26 pg. 304

* In that light he regarded wage control as arbitrary with an attendant difficulty to discern between wage increases and wage adjustments. See C.W. VOL 27 pg. 358.

141 C.W. Vol. 24 pg. 621

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