Afterword by Robert Skidelsky

As Paul Krugman rightly says in his splendid introduction to this volume, Keynes's *General Theory* is still a largely unread classic. Students of economics get their Keynes from Hicks's two curves, IS and LM. Palgrave's reissue of their 2007 edition is particularly timely. At the end of my biography of Keynes, published in 2000, I wrote: 'Keynes's [ideas] will live so long as the world has need of them'. The economic collapse of 2008–2009, and the feeble recovery from it is conclusive evidence, in my view, that in the long run Keynes remains very much alive.

I contribute the following thoughts as an Afterword because, ideally, I would like the reader to read first Krugman, then the *General Theory*, before coming to me. This is because I disagree with Paul Krugman's interpretation of the GT in a couple of respects, and I would like readers to judge on the evidence of the text itself.

Krugman rightly says that the 'crucial innovation in *The General Theory* … is the demolition of Say's Law' that 'supply creates its own demand'. This is at best a 'useless tautology when individuals have the option of accumulating money rather than purchasing goods and services'. This is of course, true. But it is important to ask why Keynes thought people might exercise this option. Keynes explains why in several places in the GT, but the most important passage is on p. 294 'Money *in*

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its significant attributes [my italics] is, above all, a subtle device for linking the present to the future.' People accumulate money rather than spend it, because they regard the future as uncertain and therefore hoard money as security against uncertainty. This prevents the money rate of interest falling sufficiently to ensure full employment.

But why is money *per se* a security against an uncertain future? Why not buy and store food and clothing? It cannot be because they, unlike money are perishable, because there is nothing imperishable about bits of paper. In Chap. 17, Keynes analyses the peculiar features of money which make it the ultimate source of liquidity, a 'bottomless sink' for purchasing power. These are a 'zero, or at any rate a very small, elasticity of production' (p. 230) and a 'near' zero 'elasticity of substitution' (p. 231). These unique properties of money prevent the interest rate on money from falling in line with returns on all other forms of investment. No one, I suggest, can read the GT with full attention without grasping the crucial role uncertainty, and the role of money as a hedge against uncertainty, play in Keynes's theory of the sub-normal economy. Yet Krugman has written an account of the GT in which the word uncertainty never appears.

We read in Krugman's introduction that one of the key strategic decisions Keynes made 'was to push the whole question of why investment rises and falls into the background'. But this is not true. In Chap. 18, which summarises the GT 'model', the 'marginal efficiency of capital' (or expected yield of investment) is one of the independent variables which determines the volume of employment and national income. Given the quantity of capital equipment, the MEC depends 'on the state of long-term expectations' (p. 246). In fact, given the 'fairly stable character' of Keynes's consumption function (p. 96) and the 'fairly stable long term rate of interest' (p. 204), fluctuations in employment and national income are mainly caused by 'the fickle and highly unstable marginal efficiency of capital'.

So what determines 'the state of long-term expectations'? Keynes has a whole chapter—13—on this. Krugman's account of this chapter is particularly unsatisfactory. For he treats it as a 'witty' discussion of 'irrationality': Keynes, he writes, was a 'behavioural economist before his time'. But it is not a discussion of irrationality at all: it is an extremely subtle discussion of rational (or at least reasonable) behaviour under uncertainty, a

discussion Keynes extends in his QJE article of February 1937, in which he sets out to summarise 'the simple and fundamental ideas which underlie my theory' (CW 14, pp. 114–119).

I draw attention to what I think are these deficiencies in interpretation, because they leave unclear how exactly Keynes refuted Say's Law. To say that 'accumulating money' is an alternative to spending tells one nothing about why people should want to accumulate money in the first place. Without uncertainty Keynes's 'refutation' of Say's Law is a lifeless assertion.

My second quibble is with Krugman's interpretation of Keynes's theory of monetary policy. Krugman writes 'Yet it is fair to say that the *General Theory* is pervaded by scepticism about whether merely adding to the money supply is enough to restore full employment. This was not because Keynes was ignorant of the potential role of monetary policy. Rather, it was an empirical judgment on his part. *The General Theory* was written in an economy with interest rates already so low that there was little an increase in the money supply could do to push them lower'.

This is not so. The attached table shows annualised UK Bank Rate and consumer price index from 1921 to 1939 (Britain returned to the gold standard in 1925; the GT was written between 1932 and 1935).

What this table shows is that real interest rates (the rates which matter for investment, equal to nominal interest rate minus inflation rate), far from being 'close to zero', were strongly positive in the four years leading to the Depression, even more so in the Depression years, and continued positive in the 'cheap money' years till 1937. This was because prices were mainly falling throughout the period, only stabilising in 1934. It is odd then to attribute Keynes's scepticism about monetary policy to interest rates being 'close to zero'. One would have thought that in the circumstances he would have advocated vigorous quantitative easing to push up the price level.

In fact, in the same circumstances in the United States in 1930, he had advocated open-market operations 'to the point of saturation' (TM, 331). But by the early 1930s he thought the excess demand for money had become too entrenched for quantitative easing to work. 'If, however, we are tempted to assert that money is the drink which stimulates the system to activity, we must remind ourselves that there may be several slips between the cup and the lip. For whilst an increase in the quantity of money may be expected, *cet.par.*, to reduce the rate of interest, this will

not happen if the liquidity preferences of the public are increasing more than the quantity of money; and whilst a decline in the rate of interest may be expected, *cet. par*. to increase the volume of investment, this will not happen if the schedule of the marginal efficiency of capital is falling more rapidly than the rate of interest' (GT, 173).

In other words, the 'empirical' judgment Keynes made had nothing to do with the actual level of nominal interest rates in the 1930s. It had to do with his judgment about the psychological attitude to liquidity.

What explains Krugman's particular interpretation of the GT? The answer, I think, is that he is primarily interested in the equilibrium properties of Keynes's 'under-employment' model. This leads him to emphasise Keynes's consumption function as the main condition of stable employment, and stable money-wages as the main condition of stable prices. But this is to present a model without a motor, leaving the student puzzled to know what all the fuss was about.

Appendix

Year	Bank Rate (%): (Average across year to 1 d.p.)	CPI inflation
1921	6	–8.6%
1922	3.6	–14.0%
1923	3.5	–6.0%
1924	4	–0.7%
1925	4.6	0.3%
1926	5	–0.8%
1927	4.6	–2.4%
1928	4.5	–0.3%
1929	5.5	–0.9%
1930	3.4	–2.8%
1931	4.2	–4.3%
1932	2.8	–2.6%
1933	2	–2.1%
1934	2	0.0%
1935	2	0.7%
1936	2	0.7%
1937	2	3.4%
1938	2	1.6%
1939	2	2.8%

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[1] Note: Page numbers followed by 'n' refer to notes.

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