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Keynes as an Interpreter of Classical Economics

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Keynes, John Maynard, as an Interpreter of the Classical Economists

J.M. Keynes characterized the classical school of economics as those '*followers* of Ricardo' who 'perfected the theory of Ricardian economics' and included J.S. Mill, Marshall, Edgeworth and Pigou as its principal representatives. Keynes believed that he was extending Marx's characterization of the classical school as including Ricardo, James Mill and their predecessors whose work had culminated in Ricardian economics. He was aware that he was 'perhaps perpetuating a solecism' in his extension of the term, but thought it still appropriate, because in his view the '*classical* theory of the subject' dominated the economic thinking 'of the governing and academic classes of this generation, as it has for a hundred years past' (Keynes, *CW*, I. 3). Given our current understanding of the differences between classical and neoclassical economics (e.g., Garegnani, 1978/1979), it is probably correct to say that Keynes did indeed misuse the term. Certainly he was less concerned with what have come to be regarded as the characteristic doctrines of classical political economy than with neoclassical views of his own time.

Keynes's purpose in treating Mill, Marshall, Edgeworth and Pigou as classical economists and proponents of Ricardian economics was to set off their work together with most of past economics (Malthus was an important exception) as a special case to be contrasted with his own general theory of the economy. Ricardo, he allowed, correctly assessed his own theory as excluding any consideration of the nature and causes of wealth, and repudiated 'any interest in the *amount* of the national dividend, as distinct from its distribution'. Classical or Ricardian economics was thus the 'theory of Value and Production ... concerned with the distribution of a *given* volume of employed resources between different uses and with the conditions which, assuming the employment of a quantity of resources, determine their relative rewards and the relative values of their products'. In contrast, Keynes's own general theory explained 'what determines the *actual employment* of the available resources' (*CW*, I, 4). He thus saw classical theory not as flawed, but rather as limited in its application to the actual world, because its requirements were rarely satisfied. Indeed, were 'our central controls [to] succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own again from this point onwards' (ibid.: 378). In his view, then, the forces determining the volume of output were outside the ambit of classical thinking.

Keynes was aware that classical economists had described and informally investigated fluctuations in employment and output, but saw himself as contributing to the pure theory of the subject. To this end, he first set out what he believed to be the two fundamental postulates upon which the classical theory of employment implicitly relied: first, that the wage is equal to the marginal product of labour (the demand schedule for employment) and, second, that the utility of the real wage is equal to the marginal disutility of the employment involved (the supply schedule for employment). Putting aside imperfect competition, he believed the first postulate was typically fulfilled, but that the second generally did not obtain. Moreover, while the second postulate was compatible with there being frictional and voluntary unemployment, it did not allow for a third form of unemployment central to his own argument, namely, involuntary unemployment. Here he took Pigou's *Theory of Unemployment*, published in 1933, as the best account of the classical theory of employment.

Pigou had recognized that there was unemployed labour at existing money wages, but had argued that money wages could not fall to increase employment because of open or tacit agreement between workers not to accept lower money wages. Such unemployment was thus really voluntary in his view. But Keynes argued that, even were it true that labour was unwilling to work for lower money wages (contrary to what he observed had happened in the United States in 1932), this did not imply that the existing level of real wages accurately measured the marginal disutility of labour, since experience showed that a rise in the price of wage goods could reduce the value of the money wage without leading to a withdrawal of labour. Moreover, experience also showed that wide fluctuations in the volume of employment had occurred without much variation in real wages. It was consequently more reasonable to suppose that labour sought a minimum money wage, not a minimum real wage, and from this it followed that the 'classical school' was mistaken in assuming that the supply of labour is solely a function. of the real wage, and that the real wage accurately measures the marginal disutility of labour.

But Keynes thought there was an even more fundamental objection to the second postulate in its requirement that bargaining between entrepreneurs and labour determine the real wage, and so enable labour to bring the real wage into line with the marginal disutility of labour by accepting or rejecting money wage offers from entrepreneurs: 'There may exist no expedient by which labour as a whole can reduce its *real* wage to a given figure by making revised *money* bargains with entrepreneurs.' Thus the real wage could exceed the marginal disutility of employment, and labour could be involuntarily unemployed: 'In assuming that the wage bargain determines the real wage the classical school have slipt in an illicit assumption.' This, Keynes asserted, was one of his 'main themes' and one he intended to address at length in *The General Theory* by providing an alternative account of the forces determining the real wage, specifically, in his explanation of the income determination process (*CW*, I. 13).

At the same time, Keynes emphasized that it was important to retain the first postulate of classical theory, once having given up the second, in order to understand properly what changes in employment involved. By the first postulate, the real wage is inversely related to the volume of employment. But, giving up the second postulate, it follows that 'a decline in employment, although necessarily associated with labour's *receiving* a wage equal in value to a larger quantity of wage-goods, is not necessarily due to labour's *demanding* a larger quantity of wage-goods; and a willingness on the part of labour to accept lower money-wages is not necessarily a remedy for unemployment' (ibid.: 18). This was due to labour's being unable to determine the level of real wages in bargaining with entrepreneurs.

Keynes believed that underlying the whole of classical theory was a single proposition, originating in the work of Ricardo and Say, that supply creates its own demand, or 'that the whole of the costs of production must necessarily be spent in the aggregate, directly or indirectly, on purchasing the product' (ibid.: 18). An important corollary of the doctrine, especially as advanced by the early Marshall, was 'that any individual act of abstaining from consumption necessarily leads to, and amounts to the same thing as, causing the labour and commodities thus released from supplying consumption to be invested in the production of capital wealth' (ibid.: 19). Applying these principles to modern economies, Keynes asserted, involved using a false analogy to a non-exchange Robinson Crusoe type of economy. The error was often made in connection with the original proposition of Say and Ricardo, because economists too often failed to distinguish a similar, 'indubitable' proposition, namely, 'that the income derived in the aggregate by all the elements in the community concerned in a productive activity has a value exactly equal to the *value* of the output' (ibid.: 20). The error was typically made in connection with Marshall's corollary, because 'it is indubitable' that the sum of the net increments of the wealth of individuals must be exactly equal to the aggregate net increment of the wealth of the community' (ibid.: 21).

Keynes thought it important to dispel these classical doctrines if the operation of the economy was to be correctly understood. Marshall's saving–investment proposition made 'two essentially different activities appear to be the same', though in fact 'the motives which determine the latter are not linked in any simple way with the motives which determine the former'. From this view, moreover, flowed a number of misleading views regarding 'the social advantages of private and national thrift, the traditional attitude towards the rate of interest, the classical theory of unemployment, the quantity theory of money, the unqualified advantages of *laissez-faire* in respect of foreign trade and much else which we shall have to question' (ibid.).

Not all of the classical economists, of course, came in for criticism from Keynes. Keynes credited Malthus with being 'concerned with what determines the *volume* of output', where Ricardo had only investigated its distribution (*CW*, X. 97). He lamented Malthus's lack of influence on 19th-century economics, and praised Malthus for having argued that inadequate effective demand for output could cause a fall in profits. Keynes noted that Malthus also anticipated the paradox of thrift, and grasped that public works (and expenditure by landlords and the wealthy) could be a remedy to the problem of imbalance between saving and investment. However, Malthus's 'defect lay in his overlooking entirely the part played by the rate of interest' (ibid.: 102). This left the real and monetary sides of the economy separate à la Say, and effectively allowed Marshall to take over Ricardo's view that savings were automatically invested.

Keynes thus essentially identified classical economics with Say's Law, and believed Ricardo principally at fault for economists' subsequent misconceptions. In this he was probably overgenerous to Marshall, and insufficiently generous to Ricardo. Indeed Keynes's friend and colleague at Cambridge, Piero Sraffa, demonstrated after the appearance of *The General Theory* that Keynes was not correct in saying that at full employment the classical theory once again comes into its own, since by this Keynes had meant Marshall's price theory with its unsuccessful treatment of capital. Keynes, however, devoted little time to long period issues, and thus never truly grappled with the classicals' paradigmatic concerns with growth, distribution and accumulation. His critique of classical economics should thus be seen as principally restricted to the rejection of Say's Law.

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See also:
Effective Demand; Say's Law.

Bibliography

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