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The Heresies of John Maynard Keynes

A few years before his death, Thorstein Veblen had done something oddly out of character—he had taken a plunge in the stock market. A friend had recommended an oil stock, and Veblen, thinking of the financial problems of old age, had risked a part of his savings. He made a little money on the venture at first, but his inseparable bad luck plagued him—no sooner had the stock gone up than it was cited in the current oil scandals. His investment eventually became worthless.

The incident is unimportant in itself except insofar as it reveals one more tiny chink in Veblen's armor. And yet, in another context, this pathetic misadventure is curiously revealing. For Veblen himself had fallen victim to the same dazzling lure that blinded America: when the most disenchanted of its observers could be tempted to swallow a draught, is there any wonder that the country was drunk with the elixir of prosperity?

Certainly the signs of prosperity were visible at every hand. America in the late 1920s had found jobs for 45 million of its citizens to whom it paid some $77 billion in wages, rents, profits, and interest—a flood of income comparable to nothing the world had ever seen. When Herbert Hoover said with earnest simplicity, "We shall soon with the help of God be within sight of the day when poverty will be banished from the nation," he might have been shortsighted—as who was not?—but he rested his case on the incontrovertible fact that the average American family lived better, ate better, dressed better, and enjoyed more of the amenities of life than any average family thitherto in the history of the world.

The nation was possessed of a new self-image, one a great deal more uplifting than the buccaneering ideals of the robber barons. John J. Raskob, chairman of the Democratic party, gave it precise expression in the title of an article he wrote for the *Ladies' Home Journal:* "Everybody Ought to Be Rich." "If a man saves $15 a week," Raskob wrote, "and invests in good common stocks, at the end of twenty years he will have at least $80,000 and an income from investments of around $400 a month. He will be rich."

That bit of arithmetic merely presupposed that such a man would keep reinvesting his dividends, figured at about 6 percent a year. But there was an even more alluring road to riches. Had a devotee of Raskob's formula *spent* his dividends and merely allowed his money to increase with the trend of stock prices, he would have achieved his goal of wealth just as rapidly and a good deal less painfully. Suppose he had bought stock in 1921 with the $780 he would have saved at $15 a week. By 1922 his money would be worth $1,092. If he then added another $780 yearly he would have found himself worth $4,800 in 1925, $6,900 a year later, $8,800 in 1927, and an incredible $16,000 in 1928. Incredible? By May 1929 he would have figured his worldly wealth at over $21,000—worth ten times that in 1980s values. And when the Great Bull Market had gone on for nearly half a generation in an almost uninterrupted rise, who could be blamed for thinking this the royal road to riches? Barber or bootblack, banker or businessman, everyone gambled and everyone won, and the only question in most people's minds was why they had never thought of it before.

It is hardly necessary to dwell upon the sequel. In the awful last week of October 1929, the market collapsed. To the brokers on the floor of the Stock Exchange it must have been as if Niagara had

suddenly burst through the windows, for a cataract of unmanageable selling converged on the marketplace. In sheer exhaustion brokers wept and tore their collars; they watched stupefied as immense fortunes melted like spun sugar; they shouted themselves hoarse trying to attract the attention of a buyer. The grim jokes of the period speak for themselves: it was said that with every share of Goldman Sachs you got a complimentary revolver, and that when you booked a hotel room the clerk inquired, "For sleeping or jumping?"

When the debris was swept away the wreckage was fearful to behold. In two insane months the market lost all the ground it had gained in two manic years; $40 billion of values simply disappeared. By the end of three years our investor's paper fortune of $21,000 had diminished by 80 percent; his original $7,000 of savings was worth barely $4,000. The vision of Every Man a Wealthy Man had been shown up as a hallucination.

In retrospect it was inevitable. The stock market had been built on a honeycomb of loans that could bear just so much strain and no more. And more than that, there were shaky timbers and rotten wood in the foundation which propped up the magnificent show of prosperity. Chairman Raskob's formula for retirement was arithmetically accurate enough, all right, but it never raised the question of how a man was to save $15 out of an average pay envelope that came to only $30.

The national flood of income was indubitably imposing in its bulk, but when one followed its course into its millions of terminal rivulets, it was apparent that the nation as a whole benefited very unevenly from its flow. Some 24,000 families at the apex of the social pyramid received a stream of income three times as large as 6 million families squashed at the bottom—the average income of the fortunate families at the peak was *630 times* the average income of the families at the base. Nor was this the only shortcoming. Disregarded in the hullabaloo of limitless prosperity were two million citizens out of work, and ignored behind their façade of classical marble, banks had been failing at the rate of two a day for *six years* before the crash. And then there was the fact that the average American had used his prosperity in a suicidal way; he had mortgaged himself up to his neck, had extended his resources dangerously under the temptation of installment buying, and then had ensured his fate by eagerly buying fantastic quantities of stock—some 300 million shares, it is estimated—not outright, but on margin, that is, on borrowed money.

Inevitable or not, it was far from visible at the time. It was a rare day that did not carry the news of some typical figure assuring the nation of its basic health. Even so eminent an economist as Irving Fisher of Yale was lulled by the superficial evidences of prosperity into announcing that we were marching along a "permanently high plateau"—a figure of speech given a macabre humor by the fact that stocks fell off the brink of that plateau one week to the day after he made his statement.

Dramatic as it was, it was not the wild decline of the stock market which most damaged the faith of a generation firmly wedded to the conviction of never-ending prosperity. It was what happened at home. A few items from those dreary years may serve to illustrate. In Muncie, Indiana—the city made famous by its selection as "Middletown"—every fourth factory worker lost his job by the end of 1930. In Chicago the majority of working women were earning less than twenty-five cents an hour, and a quarter of them made less than ten cents. In New York's Bowery alone, two thousand jobless crowded into bread lines every day. In the nation as a whole, residential construction fell by 95 percent. Nine million savings accounts were lost. Eighty-five thousand businesses failed. The national volume of salaries dwindled 40 percent; dividends 56 percent; wages 60 percent.

And the worst of it, the most depressing aspect of the Great Depression, was that there seemed to be no end to it, no turning point, no relief. In 1930, the nation manfully whistled "Happy Days Are Here Again," but the national income precipitously fell from $87 billion to $75 billion. In 1931 the

country sang “I’ve Got Five Dollars”; meanwhile its income plummeted to $59 billion. In 1932 the song was grimmer: “Brother, Can You Spare a Dime?”—national income had dwindled to a miserable $42 billion.

By 1933 the nation was virtually prostrate. The income of the country was down to $39 billion. Over half the prosperity of only four years back had vanished without a trace; the average standard of living was back where it had been twenty years before. On street corners, in homes, in Hoovervilles, 14 million unemployed sat, haunting the land. It seemed as if the proud spirit of hope had been permanently crushed out of America.

It was the unemployment that was hardest to bear. The jobless millions were like an embolism in the nation’s vital circulation; and while their indisputable existence argued more forcibly than any text that something was wrong with the system, the economists wrung their hands and racked their brains and called upon the spirit of Adam Smith, but could offer neither diagnosis nor remedy. Unemployment—this kind of unemployment—was simply not listed among the possible ills of the system; it was absurd, unreasonable, and therefore impossible. But it was there.

It would seem logical that the man who would seek to solve this paradox of not enough production existing side by side with men fruitlessly seeking work would be a Left-Winger, an economist with strong sympathies for the proletariat, an angry man. Nothing could be further from the fact. The man who tackled it was almost a dilettante with nothing like a chip on his shoulder. The simple truth was that his talents inclined in every direction. He had, for example, written a most recondite book on mathematical probability, a book that Bertrand Russell had declared “impossible to praise too highly”; then he had gone on to match his skill in abstruse logic with a flair for making money—he accumulated a fortune of £500,000 by way of the most treacherous of all roads to riches: dealing in international currencies and commodities. More impressive yet, he had written much of his mathematics treatise on the side, as it were, while engaged in government service, and he piled up his private wealth by applying himself for only half an hour a day while still abed.

But this is only a sample of his many-sidedness. He was an economist, of course—a Cambridge don with all the dignity and erudition that go with such an appointment; but when it came to choosing a wife he eschewed the ladies of learning and picked the leading ballerina from Diaghilev’s famous company. He managed to be simultaneously the darling of the Bloomsbury set, the cluster of Britain’s most avant-garde intellectual brilliants, and also the chairman of a life insurance company, a niche in life rarely noted for its intellectual abandon. He was a pillar of stability in delicate matters of international diplomacy, but his official correctness did not prevent him from acquiring a knowledge of other European politicians that included their mistresses, neuroses, and financial prejudices. He collected modern art before it was fashionable to do so, but at the same time he was a classicist with the finest private collection of Newton’s writings in the world. He ran a theater, and he came to be a Director of the Bank of England. He knew Roosevelt and Churchill and also Bernard Shaw and Pablo Picasso. He played bridge like a speculator, preferring a spectacular play to a sound contract, and solitaire like a statistician, noting how long it took for the game to come out twice running. And he once claimed that he had but one regret in life—he wished he had drunk more champagne.

His name was John Maynard Keynes, an old British name (pronounced to rhyme with “rains”) that could be traced back to one William de Cahagnes and 1066. Keynes was a traditionalist; he liked to think that greatness ran in families, and it is true that his own father was John Neville Keynes, a well-known economist in his own right. But it took more than the ordinary gifts of heritage to account for the son; it was as if the talents that would have sufficed half a dozen men were by happy accident

crowded into one person.

He was born in 1883, in the very year that Karl Marx died. But the two economists who thus touched each other in time, and who were each to exert the profoundest influence on the philosophy of the capitalist system, could hardly have differed more. Marx was bitter, at bay, heavy and disappointed; as we know, he was the draftsman of Capitalism Doomed. Keynes loved life and sailed through it buoyant, at ease, and consummately successful, to become the architect of Capitalism Viable. Perhaps we can trace Marx's passionate prophecy of collapse to the thread of neurotic failure that marked his practical life; if so, we can surely credit Keynes's persuasive salesmanship of reconstruction to the exhilaration and achievement that marked his.

His boyhood was Victorian, Old School, and premonitory of brilliance. At age four and a half he was already puzzling out for himself the economic meaning of interest; at six he was wondering about how his brain worked; at seven his father found him a "thoroughly delightful companion." He went to a Mr. Goodchild's preparatory school, where he gave evidence of his flair for handling his fellows: he had a "slave" who obediently trailed him with his schoolbooks, a service rendered in exchange for assistance with the knottier problems of homework, and a "commercial treaty" with another boy whom he disliked: Keynes agreed to get the boy one book a week out of the library in exchange for which the party of the second part agreed never to approach within fifteen yards of the party of the first.

At fourteen he applied for and won a scholarship to Eton. Horror stories on English public schools to the contrary, he was neither sadistically abused nor intellectually quashed. He bloomed; his marks were superlative; he won prizes by the score; bought himself a lavender waistcoat; acquired a taste for champagne; grew tall and rather stooped and cultivated a mustache; rowed; became a formidable debater; and without turning into a snob became an Eton enthusiast. Yet a letter to his father when he was only seventeen shows a discernment unusual for that age. The Boer War had come to a climax and the headmaster made a speech; Keynes described it perfectly in five phrases: "It was the usual stuff. Ought to show our thankfulness; remember dignity of school; if anything done must be of best; as always before."

Eton was a vast success; King's College at Cambridge was to be a triumph. Alfred Marshall begged him to become a fulltime economist; Professor Pigou—Marshall's heir-to-be—had him to breakfast once a week. He was elected Secretary of the Union, a post automatically carrying an eventual presidency of one of the most famous nongovernmental debating societies in the world; he was sought out by Leonard Woolf and Lytton Strachey (whose lover he became), and the nucleus of what was to be known as the Bloomsbury group came into being; he climbed mountains (Strachey complained at the "multitudes of imbecile mountains") ; bought books; stayed up in the small hours arguing; shone. He was a phenomenon.

But even phenomena must eat and there came the question of what to do. He had very little money, and the prospect of an academic career offered less. And he had larger visions: "I want to manage a railway or organize a Trust or at least swindle the investing public," he wrote to Strachey; "it is so easy and fascinating to master the principles of these things."

No one offered him a railway or a trust, and the "swindling" showed only an impious side to Keynes's imagination. He chose instead to try the public route to success. He took the civil service examinations with an apparent indifference that made Strachey's sister ask if his insouciance was a pose. No, he had it all figured out and so what was the use of fretting; he was sure to land in the top ten. Of course he did; he was second, and his lowest mark was in the economics section of the examination. "I evidently knew more about Economy than my examiners," he explained later, a

remark that would be unforgivably presumptuous if it were not, in this case, entirely true.

Hence, in 1907 to the India Office. Keynes hated it. He was spending his freshest energies at home on an early draft of his mathematical treatise, and he found the post of a minor official in public office a far cry from running a railway. After two years he had had enough. His efforts, he declared, consisted in having one pedigreed bull shipped to Bombay, and all that he had found in government work was that an ill-considered remark might result in your being "snubbed." He resigned and went back to Cambridge. But his years could not have been so utterly useless. From what he had learned of Indian affairs he wrote a book in 1913 on *Indian Currency and Finance*, which everyone admitted to be a small masterpiece, and when a Royal Commission was formed that same year to look into the Indian currency problem Keynes at twenty-nine was asked to be a member—a remarkable honor.

Cambridge was more to his liking. He was an immediate success, and as a mark of the esteem in which he was held, he was given the editorship of the *Economic Journal*, Britain's most influential economic publication—a post he was to hold for thirty-three years.

Even more pleasant than Cambridge was Bloomsbury. Bloomsbury was both a place and a state of mind; the little group of intellectuals to whom Keynes had belonged as an undergraduate had now acquired a home, a philosophy, and a reputation. Perhaps not more than twenty or thirty people ever belonged to that charmed circle, but their opinions set the artistic standards of England—after all, it included Leonard and Virginia Woolf, E. M. Forster, Clive Bell, Roger Fry, Lytton Strachey. If Bloomsbury smiled, a poet's name was made; if it frowned, he was dropped. It is said that the Bloomsbury group could use the word "really" in a dozen different intonations, of which sophisticated boredom was by no means the least. It was a group at once idealistic and cynical, courageous and fragile. And slightly mad; there was the incident known as the Dreadnought Hoax in which Virginia Woolf (then Stephen) and a few co-conspirators dressed up as the Emperor of Abyssinia and entourage, and were escorted with honors aboard one of His Majesty's most closely guarded battleships.

In all of this, Keynes was a central figure—adviser, councillor, referee. He could talk about anything with complete assurance: William Walton the composer, Frederick Ashton the choreographer, and many another artist or professional was used to Keynes's "No, no, you're absolutely wrong about that...." His nickname, it might be added, was Pozzo, a sobriquet pinned on him after a Corsican diplomat known for his multifarious interests and his scheming mind.

It was a rather dilettantish beginning for one who was to set the capitalist world on its ears.

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The war years somewhat disrupted Bloomsbury. Keynes was called to the Treasury and assigned to work on Britain's overseas finances. He must have been something of a phenomenon there, too. An anecdote in point was later recounted by an old associate: "There was an urgent need for Spanish *pesetas*. With difficulty a smallish sum was raked up. Keynes duly reported this to a relieved Secretary to the Treasury, who remarked that at any rate for a short time we had a supply *of pesetas*. 'Oh no!' said Keynes. 'What!' said his horrified chief. 'I've sold them all; I'm going to break the market.' And he did."

He was soon a key figure in the Treasury. His first biographer and fellow economist, Roy Harrod, tells us that men of ripe judgment have declared that Keynes contributed more to winning the war than any other person in civil life. Be that as it may, he managed to find time for other things. On a financial mission to France he was seized with the idea that it would help balance the French accounts with the British if they sold some of their pictures to the National Gallery. He thus casually

acquired a hundred thousand dollars' worth of Corot, Delacroix, Forain, Gauguin, Ingres, and Manet for the British, and managed to get a Cezanne for himself: Big Bertha was shelling Paris and prices were pleasantly depressed. Back in London he attended the ballet; Lydia Lopokova was dancing the part of the beauty in "The Good-Humored Ladies," and she was the rage. The Sitwells had her to a party, where she and Keynes met. One can imagine Keynes with his classic English and Lydia with her classic struggles with English—"I dislike being in the country in August," she said, "because my legs get so bitten by barristers."

But all this was tangential to the main thing—the settlement of Europe after the war. Keynes was now an important personage—one of those unidentified men one sees standing behind the chair of a head of state ready to whisper a guiding word. He went to Paris as Deputy for the Chancellor of the Exchequer on the Supreme Economic Council with full power to make decisions and as representative of the Treasury at the Peace Conference itself. But he was only second echelon; he had a grandstand seat but no power to interfere directly in the game. It must have been an agony of frustration and impotence, for at close quarters he watched while Wilson was outmaneuvered by Clemenceau and the ambition of a humane peace replaced by the achievement of a vindictive one.

"It must be weeks since I've written anyone," he wrote to his mother in 1919, "but I've been utterly worn out, partly by work, partly by depression at the evil around me. I've never been so miserable as for the last two or three weeks; the Peace is outrageous and impossible and can bring nothing but misfortune behind it."

He dragged himself from the sickbed to protest against what he called the "murder of Vienna," but he could not stop the tide. The peace was to be a Carthaginian one, and Germany was to pay a sum of reparations so huge that it would force her into the most vicious practices of international trade in order to earn the pounds and francs and dollars. This was not the popular opinion, of course, but Keynes saw that in the Versailles Treaty lay the unwitting goad for an even more formidable resurgence of German autarchy and militarism.

He resigned in despair; then three days before the treaty was signed he began his polemic against it. He called it *The Economic Consequences of the Peace;* when it appeared that December (he wrote it at top speed and fury), it made his name.

It was brilliantly written and crushing. Keynes had seen the protagonists at work, and his descriptions of them combined the skill of a novelist with the cutting insight of a Bloomsbury critic. He wrote of Clemenceau that "He had only one illusion—France, and one disillusion—mankind, including his own colleagues not least"; and of Wilson, "... like Odysseus, he looked wiser when seated." But while his portraits sparkled, it was his analysis of the harm that had been done that was unforgettable. For Keynes saw the Conference as a reckless settlement of political grudge in utter disregard of the pressing problem of the moment—the resuscitation of Europe into an integrating and functioning whole:

The Council of Four paid no attention to these issues, being preoccupied with others,—Clemenceau to crush the economic life of his enemy, Lloyd George to do a deal and bring home something that would pass muster for a week, the President to do nothing that was not just and right. It is an extraordinary fact that the fundamental problems of a Europe starving and disintegrating before their eyes, was the one question in which it was impossible to arouse the interest of the Four. Reparation was their main excursion into the economic field, and they settled it as a problem of theology, of politics, of electoral chicane, from every point of view except that of the economic future of the States whose destiny they were handling.

And he went on to deliver this solemn warning:

The danger confronting us, therefore, is the rapid depression of the standard of life of the European populations to a point which will mean actual starvation for some (a point already reached in Russia and approximately reached in Austria). Men will not always die quietly. For starvation, which brings to some lethargy and a helpless despair, drives other temperaments to the nervous instability of hysteria and to a mad despair. And these in their distress may overturn the remnants of organization, and submerge civilization itself in their attempts to satisfy desperately the overwhelming needs of the individual. This is the danger against which all our resources and courage and idealism must now cooperate.

The book was an immense success. The unworkability of the treaty was manifest almost from the moment of its signing, but Keynes was the first to see it, to say it, and to suggest an outright revision. He became known as an economist of extraordinary foresight, and when the Dawes Plan in 1924 began the long process of undoing the impasse of 1919, his gift for prophecy was confirmed.

He was famous now, but there remained the question of what to do. He chose business, the riskiest possible business, and with a capital of a few thousand pounds he began to speculate in the international markets. He nearly lost it all, was helped with a loan from a banker who had never met him but who was impressed by his work during the war, recouped, and went on to roll up a fortune worth then $2 million. It was all done in the most casual way. Keynes disdained inside information—in fact, he once declared that Wall Street traders could make huge fortunes if only they would disregard their "inside" information—and his own oracles were nothing but his minute scrutiny of balance sheets, his encyclopedic knowledge of finance, his intuition into personalities, and a certain flair for trading. Abed in the morning he would study his items of financial intelligence, make his decisions, phone his orders, and that was that; the day was now free for more important things, like economic theory. He would have gotten along famously with David Ricardo.

He made money, by the way, not only for himself. He became the Bursar of King's College and turned a fund of £30,000 into one of £380,000. He managed an investment trust and guided the finances of a life insurance company.

Meanwhile—there was always more than one thing going on at a time with Keynes—he wrote for the *Manchester Guardian*, gave regular classes in Cambridge, in which he spiced dry theory with an intimate account of the goings-on and personalities of the international commodity marts, bought more pictures, acquired more books, and, after a tumultuous love life with Lytton Strachey, Duncan Grant, and a score of other male lovers, married Lydia Lopokova. The ballerina became the wife of the Cambridge don, a new role, which somewhat to the surprise (and relief) of Keynes's friends she filled to perfection. She gave up her professional career, of course, but a visiting friend later reported hearing alarming thumps and crashes from above: Lydia was still practicing her art.

She was extremely beautiful; he was altogether the proper admirer, not handsome but tall and dignified. His large, somewhat gawky frame provided a suitable pedestal for a longish, triangular, inquisitive face: a straight nose, a clipped mustache held over from Eton days, full, mobile lips, and a rather disappointing chin. The eyes were most revealing; under arching brows they could be grave, icy, sparkling, or "soft as bees' bottoms in blue flowers," as one editor wrote, depending, perhaps, on whether he was acting as government emissary, speculator, Bloomsbury brilliant, or balletomane.

There was one odd mannerism: Keynes liked to sit like an English variant of a Chinese mandarin, with his hands tucked out of sight in the opposing sleeves of his coat. It was a gesture of concealment

made all the more curious because of his inordinate interest in other people's hands and his pride in his own. Indeed, he even went to the extent of having casts made of his and his wife's hands and talked of making a collection of casts of his friends'; and when he met a man the first thing he noticed was the character of his palms and fingers and nails. Later, when he first talked with Franklin Roosevelt, he noted down this description of the President:

... But at first, of course, I did not look closely at these things. For naturally my concentrated attention was on his hands. Firm and fairly strong, but not clever or with finesse, shortish round nails like those at the end of a business man's fingers. I cannot draw them right, yet while not distinguished (to my eye) they are not of a common type. All the same, they were oddly familiar. Where had I seen them before? I spent ten minutes at least searching my memory as for a forgotten name, hardly knowing what I was saying about silver and balanced budgets and public works. At last it came to me. Sir Edward Grey. A more solid and Americanized Sir Edward Grey.

It is doubtful whether Roosevelt would have written as he did to Felix Frankfurter—"I had a grand talk with K. and liked him immensely"—had he known that he was being summed up in the eyes of the other as a businessman's version of an English Foreign Secretary.

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By 1935 it was already a brilliantly established career. The book on *Indian Currency and Finance* had been a tour de force, albeit a small one; *The Economic Consequences of the Peace* had made an éclat; and the *Treatise on Probability* was an equal triumph, although far more specialized. An amusing incident in regard to this last book: Keynes was having dinner with Max Planck, the mathematical genius who was responsible for the development of quantum mechanics, one of the more bewildering achievements of the human mind. Planck turned to Keynes and told him that he had once considered going into economics himself. But he had decided against it—it was too hard. Keynes repeated the story with relish to a friend back at Cambridge. "Why, that's odd," said the friend. "Bertrand Russell was telling me just the other day that he'd also thought about going into economics. But he decided it was too easy."

But mathematics was only a sideline, as we know; in 1923 a *Tract on Monetary Reform* again raised the eyebrows of the world. Now Keynes was inveighing against the fetishism of gold, against the peculiar passivity evidenced by men's abdication of conscious control of their own currencies and their transfer of this responsibility to the impersonal mechanism of an international gold standard. It was a technical book, of course, but like all of Keynes's works, lit up with telling phrases. One thrust will surely be added to the stock of English aphorisms: talking of the "long run" consequences of some venerable economic axiom, Keynes dryly wrote: "In the long run we are all dead."

Then to top it off, in 1930 he published a *Treatise on Money*—a long, difficult, uneven, sometimes brilliant and sometimes baffling attempt to account for the behavior of the whole economy. The *Treatise* was a fascinating book, for it took as its central problem the question of what made the economy operate so unevenly—now bustling with prosperity, now sluggish with depression.

The question, of course, had absorbed the attention of economists for decades. Great speculative crashes aside—like the 1929 bust and its predecessors in history (we saw one such in eighteenth-century France when the Mississippi Company collapsed)—the normal course of trade seemed to evidence a wavelike succession of expansions and contractions, not unlike a kind of economic breathing. In England, for example, business had been bad in 1801, good in 1802, bad in 1808, good

in 1810, bad in 1815, and so on for over a hundred years; in America the pattern was the same, although the dates were slightly different.

What lay behind this alternation of prosperity and depression? At first the cycles of business were thought to be a sort of mass nervous disorder: “These periodic collapses are really mental in their nature, depending on variations of despondency, hopefulness, excitement, disappointment, and panic,” wrote an observer in 1867. But although such a statement was undoubtedly a good description of the state of mind in Wall Street or Lombard Street, Lancaster or New England, it left unanswered the basic question: What causes such a widespread nervous hysteria?

Some early explanations looked *outside* the economic process for an answer. W. Stanley Jevons, whom we have briefly met before, ventured an explanation that pinned the blame on *sunspots*—not quite so farfetched an idea as it might at first appear. For Jevons was impressed by the fact that business cycles from 1721 to 1878 had had an average duration, from boom to boom, of 10.46 years, and that sunspots (which had been discovered in 1801 by Sir William Herschel) showed a periodicity of 10.45 years. The correlation, Jevons was convinced, was too close to be purely accidental. Sunspots, he thought, caused weather cycles, which caused rainfall cycles, which caused crop cycles, which caused business cycles.

It was not a bad theory—except for one thing. A more careful calculation of the sunspot cycles lengthened their periodicity to eleven years and the neat correspondence between celestial mechanics and the vagaries of business broke down. Sunspots went the way of astronomy, and the quest for the motivating factors of business cycles returned to more earthbound considerations.

It returned, in fact, to an area first bumblingly but intuitively pointed out by Malthus a century before—the area of saving. Perhaps we remember Mathus’s doubts—his ill-articulated feeling that saving could somehow result in a “general glut.” Ricardo had scoffed; Mill had pooh-poohed; and the idea had become part of the disreputable and dangerous nonsense of the underworld. To say that saving might be a source of trouble—why, that was impugning thrift itself! It was almost immoral: had not Adam Smith written, “What is prudence in the conduct of every private family can scarce be folly in that of a great nation?”

But when the early economists refused to consider that saving might be a stumbling block for an economy, they were not indulging in moral proselytizing; they were only observing the facts of the real world.

For in the early 1800s, by and large those who saved were the very same people as those who put savings to use. In the hard-pressed world of Ricardo or Mill, virtually the only people who could afford to save were wealthy landlords and capitalists, and any sums they put together were usually employed in productive investments of one kind or another. Hence saving was rightly called “accumulation,” for it represented a two-sided coin; on the one hand the amassing of a sum of money, and on the other hand its immediate employment in purchasing the tools or buildings or land to make still more money.

But toward the middle of the nineteenth century, the structure of the economy changed. The distribution of wealth improved, and along with it the possibility of saving became open to more and more members of society. And at the same time, business became larger and more institutionalized; increasingly it looked for new capital not just in the pockets of its individual manager-owners but also in the anonymous pocketbooks of savers all over the country. Hence saving and investing became divorced from one another—they became separate operations carried out by separate groups of people.

And this did introduce trouble into the economy. Malthus was right after all, although for reasons

he had never foreseen.

The trouble is so important—so central to the problem of depression—that we must take a moment to make it clear.

We must start out by understanding how we measure the prosperity of a nation. It is not by its gold—poverty-stricken Africa for years was rich in gold. Nor is it by its physical assets—buildings, mines, factories, and forests did not evaporate in 1932. Prosperity and depression are not so much matters of past glories but of present accomplishments; therefore they are measured by the *incomes* that we earn. When most of us individually (and therefore all of us collectively) enjoy high incomes, the nation is well off; when our total individual (or national) income drops, we are in depression.

But income—national income—is not a static concept. Indeed the central characteristic of an economy is *the flow* of incomes from hand to hand. With every purchase that we make, we transfer a part of our incomes into someone else's pocket. Similarly every penny of our own incomes, be it wages, salaries, rents, profits, or interest, ultimately derives from money that someone else has spent. Consider any portion of the income that you enjoy and it will be clear that it has originated from someone else's pocket: when he or she engaged your services, or patronized your store, or bought the output of the corporation in which you own bonds or stock.

It is by this process of handing money around—taking in each other's wash, it has been described—that the economy is constantly revitalized.

Now to a large extent this process of handing income around takes place quite naturally and without hindrance. All of us spend the bulk of our incomes on goods for our own use and enjoyment—on consumption goods, so-called—and since we go on buying consumption goods with fairly consistent regularity, the handing around of a large portion of our national income is assured. The fact that we must eat and clothe ourselves, and that we crave enjoyment, ensures a regular and steady spending on the part of all of us.

So far everything is quite simple and direct. But there is one portion of our incomes which does *not* go directly out onto the marketplace to become another's income: that is the money we save. If we tucked these savings into mattresses or hoarded them in cash, we should obviously break the circular flow of income. For then we should be returning to society less than it gave to us. If such a freezing process were widespread and continued, there would soon be a cumulative fall in everybody's money income, as less and less was handed around at each turn. We should be suffering from a depression.

But this dangerous break in the income flow does not normally take place. For we do not freeze our savings. We put them into stocks or bonds or banks and in this way make it possible for them to be used again. Thus, if we buy new stock we give our savings directly to business; if we put our savings in a bank, they can be used on loan by businessmen who seek capital. Whether we bank our savings or use them to buy insurance or securities, the channels exist for those savings to go back into circulation via the activities of business. For when our savings are taken and spent by business, they again turn up as someone's wages, someone's salary, or someone's profit.

But—and notice this vital fact—there is nothing *automatic* about this savings-investment channel. Business does not need savings to carry on its everyday operations; it pays its expenses from the proceeds of its sales. Business needs savings only if it is *expanding* its operation, for its regular receipts will not usually provide it with enough capital to build a new factory or to add substantially to its equipment.

And here is where the trouble enters. A thrifty community will always attempt to save some part of its income. But business is not always in a position to expand its operations. When the business outlook is poor, whether because of "gluts" in particular markets, or because the international situation is alarming, or because businessmen are nervous about inflation, or for any other reason, the impetus to invest will wane. Why should businessmen expand their facilities when they look to the future with trepidation?

And therein lies the possibility of depression. *If our savings do not become invested by expanding business firms, our incomes must decline*. We should be in the same spiral of contraction as if we had frozen our savings by hoarding them.

Can such an eventuality come to pass? We shall see. But note meanwhile that this is a strange and passionless tug of war. Here are no greedy landlords, no avaricious capitalists. There are only perfectly virtuous citizens prudently attempting to save some of their incomes, and perfectly virtuous businessmen who are just as prudently making up their minds whether the business situation warrants taking the risk of buying a new machine or building a new plant. And yet, on the outcome of those two sensible decisions the fate of the economy hangs. For if the decisions are out of joint—if the businessmen invest less than the community tries to save, for example—then the economy will have to adjust to the crimp of depression. The vital question of boom or slump depends more than anything else on this.

The vulnerability of our fate to the interplay of savings and investment is, in a sense, the price we pay for economic freedom. There was no such problem in Soviet Russia, nor was there such in the Egypt of the Pharaohs. For in economies of edict both savings and investment are determined from above, and a total control over the nation's entire economic life ensures that the nation's savings will be used to finance its pyramids or power plants. But not so in a capitalist world. For there both the decision to save and the impetus to invest are left to the free decisions of the economic actors themselves. And because those decisions are free, they can be out of joint. There can be too little investment to absorb our savings or too little savings to support our investment. Economic freedom is a highly desirable state—but in bust and boom we must be prepared to face its possible consequences.

We have almost lost sight of John Maynard Keynes and the *Treatise on Money*. But not quite. For the *Treatise* was a sparkling exposition of this seesaw of savings and investment. The idea was not original with Keynes, for a long list of important economists had already pointed to the critical roles of these two factors in the business cycle. But, as with everything that Keynes touched, the bare abstractions of economics took on a new luster in his prose. Thus:

It has been usual to think of the accumulated wealth of the world as having been painfully built up out of that voluntary abstinence of individuals from the immediate enjoyment of consumption, which we call Thrift. But it should be obvious that mere abstinence is not enough by itself to build cities or drain fens.

... It is Enterprise which builds and improves the world's possessions.... If Enterprise is afoot, wealth accumulates whatever may be happening to Thrift; and if Enterprise is asleep, wealth decays whatever Thrift may be doing.

Yet, for all its masterful analysis, no sooner had Keynes written the *Treatise* than, figuratively, he tore it up. For his theory of a seesaw of savings and investment failed at one central point: it did not

explain how an economy could *remain* in a state of prolonged depression. Indeed, as the very analogy of the seesaw indicates, it seemed as if an economy that was weighted down by surplus savings must, in fairly short order, right itself and swing the other way.

For savings and investment—Thrift and Enterprise—were not utterly unconnected economic activities. On the contrary, they were tied together in the market where businessmen "bought" savings, or at least borrowed them: the money market. Savings, like any other commodity, had its price: the rate of interest. Therefore (so it seemed), at the bottom of a slump when there was a flood of savings, its price should decline—exactly as, when there was a glut of shoes, the price of shoes declined. And as the price of savings cheapened—as the rate of interest went down—the *incentive* to invest appeared very likely to increase: if a new factory was too expensive to build when the money for it would cost 10 percent, might it not look much more profitable when the money could be had for a payment of only 5 percent?

Hence the seesaw theory seemed to promise that there would be an automatic safety switch built right into the business cycle itself; that when savings became too abundant, they would become cheaper to borrow, and that thereby business would be encouraged to invest. The economy might contract, said the theory, but it seemed certain to rebound.

But this was exactly what failed to happen in the Great Depression. The rate of interest declined, but nothing happened. The old nostrums were trotted out—a pinch of local relief and a large dose of hopeful waiting—and still the patient failed to improve. For all its logic, something was patently missing from the neat formulation of the rate of interest always hovering over the seesaw of savings and investment to keep it in balance. Something else must be holding the economy back.

Keynes's master book had been brewing for some time. "To understand *my* state of mind," he had written to George Bernard Shaw in 1935—he had just reread Marx and Engels at Shaw's suggestion and found them little to his liking—"... you have to know that I believe myself to be writing a book on economic theory which will largely revolutionize—not, I suppose at once, but in the course of the next ten years—the way the world thinks about economic problems.... I can't expect you or anyone else to believe this at the present stage. But for myself I don't merely hope what I say—in my own mind, I'm quite sure."

He was, as usual, quite right. The book was to be a bombshell. Yet it is very doubtful whether Shaw would have recognized it as such had he attempted to digest it. It had a forbidding title, *The General Theory of Employment, Interest and Money*, and a still more forbidding interior: one can imagine Shaw goggling on page 25 at "Let Z be the aggregate supply price of the output from employing N men, the relationship between Z and N being written $Z = \varphi$ (N), which can be called the Aggregate Supply Function." And if this were not enough to frighten off almost anyone, there was a great dearth of that panorama of social action which the layman had come to expect from a perusal of Smith or Mill or Marx. Here and there were wonderful passages—there is a famous one comparing the choosing of stocks and the picking of beauty contest winners—but the passages came as oases between deserts of algebra and abstract analysis.

And yet the book was revolutionary: no other word will quite do. It stood economics on its head, very much as *The Wealth of Nations* and *Capital* had done.

For *The General Theory* had a startling and dismaying conclusion. There was no automatic safety mechanism after all! Rather than a seesaw that would always right itself, the economy resembled an elevator: it could be going up or down, but it could also be standing perfectly still. And it was just as capable of standing still on the ground floor as at the top of the shaft. A depression, in other words,

might not cure itself at all; the economy could lie stagnant indefinitely, like a ship becalmed.

But how could this be? Would not the flood of savings at the bottom of the slump push down the rate of interest, and would this not in turn induce business to use cheap money to expand its plant?

Keynes found the flaw in this argument in the simplest and most obvious (once it had been pointed out) fact of economic life: *there would be no flood of savings at the bottom of the trough*. For what happened when an economy went into an economic tailspin was that its income contracted, and what happened as its income contracted was that its savings were squeezed out. How could a community be expected to save as much when everyone was hard up as when everyone was prosperous? asked Keynes. Quite obviously, it could not. The result of a depression would not be a glut of savings but a drying-up of savings; not a flood of saving, but a trickle.

And so it was, in fact. In 1929 the American private citizenry put aside $3.7 billion out of its income; by 1932 and 1933 it was saving *nothing*—in fact, it was even drawing down its old savings made in the years before. Corporations, which had tucked away $2.6 billion at the top of the boom *after* paying out taxes and dividends, found themselves losing nearly $6 billion three years later. Quite obviously Keynes was right: saving was a kind of luxury that could not withstand hard times.

But the larger consequence of this decline in saving was of greater significance than even the loss of individual security that the decline brought about. The larger consequence was that the economy found itself in a condition of paralysis just when it most needed to be dynamic. For if there was *no* surplus of saving, there would be *no* pressure on interest rates to encourage businessmen to borrow. And if there were no borrowing and investment spending, there would be *no* impetus for expansion. The economy would not budge an inch: it would remain in a condition of "equilibrium" despite the presence of unemployed men and women and underutilized plant and equipment.

Thus the paradox of poverty amidst plenty and the anomaly of idle men and idle machines. At the bottom of a slump there was a heartless contradiction between a crying need for goods and an insufficiency of production. But the contradiction was purely a moral one. For the economy did not operate to satisfy human *wants*—wants are always as large as dreams. It turned out goods to satisfy *demand*—and demand is as small as a person's pocketbook. Hence the unemployed were little more than economic zeros; they might as well have been on the moon for all the economic influence they exerted on the marketplace.

To be sure, once investment declined and the economy shrank in size, social misery appeared. But not—as Keynes points out—*effective* social misery: the nation's conscience would not do as an effective substitute for enough investment. Rather, since savings declined along with investment, the economic flow turned over evenly, quite unaffected by the fact that it was smaller than it used to be.

A peculiar state of affairs, indeed a tragedy without a villain. No one can blame society for saving, when saving is so apparently a private virtue. It is equally impossible to chastise businessmen for not investing when no one would be so happy to comply as they—if they saw a reasonable chance for success. The difficulty is no longer a moral one—a question of justice, exploitation, or even human foolishness. It is a technical difficulty, almost a mechanical fault. But its price is no less high for all of that. For the price of inactivity is unemployment.

And here was the most indigestible fact of all. The willingness to invest could not go on indefinitely. Sooner or later, investment was likely to contract.

For, at any time, an industry is limited by the size of the market to which it caters. Let us take the example of the railroads in the 1860s—a time of vast investment in new railroad lines. The early railway magnates were not building for the markets of the 1960s; had they proceeded to lay the trackage the economy would need a hundred years later, they would have been building lines to

nonexistent cities in uninhabited territory. So they built what could be used—and then they stopped. Similarly with the auto industry. Even if Henry Ford had been able to find the capital to build the 1950 River Rouge plant in 1910, he would have gone bankrupt in a hurry; the roads, the gas stations, the *demand* for that many cars were simply lacking. Or to bring the matter a little closer, by the late 1990s American business was spending just over $1 trillion a year for new equipment, but it was not spending $2 trillion. Someday it might well have to, but as the century drew to its end, that day had not yet arrived.

And so investment has its typical pattern: at first eagerness to take advantage of a new opportunity; then, caution lest enthusiasm lead to overbuilding; then inactivity when the market has been satisfied for the time being.

If, as each separate investment project came to a halt, another immediately appeared, there need never be a slump. But such is not likely to be the case. The mere fact that human wants are vast does not mean that *any* investment will pay for itself; the economy is littered with businesses that have died of rash and foolhardy overexpansion. Most investment needs more than the stimulus of sanguine expectations; it needs something more concrete, some new invention, some better way of doing things, some intriguing product to catch the public eye. And such opportunities, as any businessman will tell you, are not always there.

Hence, when one investment project dies, there may not be another ready to step into the breach. If there is—if investment maintains its size, although it changes its composition—the economy will sail smoothly along. But if there is no ready substitute for each investment casualty, contraction will begin.

Looking at this intrinsic vulnerability of the system, Keynes wrote:

Ancient Egypt was doubly fortunate and doubtless owed to this its fabled wealth, in that it possessed *two* activities, namely pyramid-building and the search for the precious metals, the fruits of which, since they could not serve the needs of man by being consumed, did not stale with abundance. The Middle Ages built cathedrals and sang dirges. Two pyramids, two masses for the dead are twice as good as one; but not so two railways from London to York.

Here, then, was the gloomy diagnosis of *The General Theory:*

First, an economy in depression could stay there. There was nothing inherent in the economic mechanism to pull it out. One could have "equilibrium" with unemployment, even massive unemployment.

Second, prosperity depended on investment. If business spending for capital equipment fell, a spiral of contraction would begin. Only if business investment rose would a spiral of expansion follow.

And third, investment was an undependable drive wheel for the economy. Uncertainty, not assurance, lay at the very core of capitalism. Through no fault of the businessman it was constantly threatened with satiety, and satiety spelled economic decline.

Certainly it was an unsettling outlook. But it would have been utterly unlike Keynes to content himself with making a diagnosis of gloom and letting it go at that. With all its prophecy of danger, *The General Theory* was never meant to be a book of doom. On the contrary, it held out a promise and it proposed a cure.

As a matter of fact, the cure had begun before its actual prescription was written; the medicine was being applied before the doctors were precisely sure what it was supposed to do. The Hundred Days of the New Deal had enacted a flood of social legislation that had been backing up for twenty years behind a dam of governmental apathy. These laws were meant to improve the social tone, the morale, of a discontented nation. But it was not social legislation that was designed to revitalize the patient. That tonic was something else: the deliberate undertaking of government spending to stimulate the economy.

It began as makeshift work-relief. Unemployment had reached the point at which some sort of action was dictated by pure political necessity—after all, this was a time when there were riots in Dearborn and a ragged march on Washington, when families huddled for warmth in municipal incinerator buildings and even scrabbled for food in garbage trucks. Relief was essential and began under Hoover; then, under Roosevelt, relief turned into leaf-raking, and leaf-raking turned into constructive enterprise. The government was suddenly a major economic investor: roads, dams, auditoriums, airfields, harbors, and housing projects blossomed forth.

Keynes came to Washington in 1934—this was when he made his notes on the impression of President Roosevelt's hands—and urged that the program be extended further. The statistics showed that the bottom had fallen out of private investment activity: business expansion, which had pumped out $15 billion in wages and salaries and profits in 1929, had fallen to the appalling figure of $886 *million* in 1932—a drop of 94 percent. Something had to start up the investment motor that hoisted the economic car up the shaft, and he hoped that government spending would act as such a stimulus by bolstering the nation's general buying power—"priming the pump," it was called in those days.

Hence when *The General Theory* came out in 1936, what it offered was not so much a new and radical program as a defense of a course of action that was already being applied. A defense and an explanation. For *The General Theory* pointed out that the catastrophe facing America and, indeed, the whole Western world, was only the consequence of a lack of sufficient investment on the part of business. And so the remedy was perfectly logical: if business was not able to expand, the government must take up the slack.

With his tongue only partly in his cheek Keynes had written:

> If the Treasury were to fill old bottles with bank notes, bury them at suitable depths in disused coal mines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well tried principles of *laissez-faire* to dig the notes up again ... there need be no more unemployment and with the help of the repercussions, the real income of the community would probably become a good deal larger than it is. It would, indeed, be more sensible to build houses and the like; but if there are practical difficulties in the way of doing this, the above would be better than nothing.

To some it no doubt appeared that many of the more unorthodox government projects were no more sane than Keynes's whimsical proposal. But now, at least, they had a rationale behind them if private enterprise found itself unable to carry forward with a big enough program of investment, then the government must fill in as best it could—the need for stimulation of some sort was so imperative that almost anything was better than nothing.

And if investment could not be directly stimulated, why then, at least consumption could. While investment was the capricious element in the system, consumption provided the great floor of economic activity; hence public works projects were thought to attack the problem with a two-edged sword: by directly helping to sustain the buying power of the otherwise unemployed, and by leading

the way for a resumption of private business expansion.

Keynes himself in a letter to *The New York Times* in 1934 wrote, "I see the problem of recovery in the following light: How soon will normal business enterprise come to the rescue? On what scale, by which expedients, and for how long is abnormal government expenditure advisable in the meantime?"

Note "abnormal." Keynes did not see the government program as a permanent interference with the course of business. He saw it as lending a helping hand to a system that had slipped and was struggling to regain its balance.

It seemed the essence of common sense; in fact it *was* the essence of common sense. And yet the pump-priming program never brought the results that the planners had hoped for. Total government spending, which had hovered at the $10-billion level from 1929 until 1933, rose to $12 billion, to $13 billion, then to $15 billion by 1936. Private investment picked itself up from the floor and recovered two-thirds of its loss: private firms invested $10 billion by 1936. The national income and national consumption rose by 50 percent after three years of government injections. And yet unemployment lingered on; it was manageable now, but there were still at least 9 million out of work—hardly the mark of a new economic era.

There were two reasons why the cure did not work better. First, the program of government spending was never carried out to the full extent that would have been necessary to bring the economy up to full employment. Later, in the Second World War, government spending rose to the then monumental figure of $103 billion: this brought not only full employment, but inflation. But within the framework of a peacetime economy in the thirties, such all-out spending was quite impossible; indeed, even a modest program of government expenditure soon brought murmurs that federal power was overstepping its traditional bounds. To make matters worse, the Federal Reserve Board was more afraid of inflation (at the bottom of a depression!) than of unemployment, so that policies were established that *discouraged* bank lending.

The second reason was closely allied with the first. Neither Keynes nor the government spenders had taken into account that the beneficiaries of the new medicine might consider it worse than the disease. Government spending was *meant* as a helping hand for business. It was *interpreted* by business as a threatening gesture.

Nor is this surprising. The New Deal had swept in on a wave of antibusiness sentiment; values and standards that had become virtually sacrosanct were suddenly held up to skeptical scrutiny and criticism. The whole conception of "business rights," "property rights," and "the role of government" was rudely shaken; within a few years business was asked to forget its traditions of unquestioned preeminence and to adopt a new philosophy of cooperation with labor unions, acceptance of new rules and regulations, reform of many of its practices. Little wonder that it regarded the government in Washington as inimical, biased, and downright radical. And no wonder, in such an atmosphere, that its eagerness to undertake large-scale investment was dampened by the uneasiness it felt in this unfamiliar climate.

Hence every effort of the government to undertake a program of sufficient magnitude to mop up all the unemployed—probably a program at least twice as large as it did in fact undertake—was assailed as further evidence of Socialist design. And at the same time, the halfway measures the government did employ were just enough to frighten business away from undertaking a full-scale effort by itself. It was a situation not unlike that found in medicine; the medicine cured the patient of one illness, only to weaken him with its side effects. Government spending never truly cured the economy—not because it was economically unsound, but because it was ideologically upsetting.

It was not meant to be upsetting; it was a policy born of desperation rather than design. Had the

government not begun to open the valve of public spending, in all likelihood private business would eventually again have led the way: it always had done so in the past, and despite the severity of the Great Depression, it would in time unquestionably have found new avenues of adventure. But it was impossible to wait. The American people had waited for four long years, and they were in no mood to wait much longer. Economists began to speak of *stagnation* as the chronic condition of capitalism. The voice of Marx rang louder than it ever had rung in the past; many pointed to the unemployed as prima facie evidence that Marx was right. The mumble of Veblen was discernible in the faddish vogue of the technocrats, who wanted to call out not the proletariat but the engineers. And there was the still more chilling voice that never wearied of pointing out that Hitler and Mussolini knew what to do with *their* unemployed. In this welter of remedies and advocacy of desperate action, the message of *The General Theory*, the civilized voice of Keynes, was certainly moderate and reassuring.

For while Keynes espoused a policy of managing capitalism, he was no opponent of private enterprise. "It is better that a man should tyrannize over his bank-balance than over his fellow citizens," he had written in *The General Theory*, and he went on to state that if the government would only concern itself with providing enough public investment, the working of the vast bulk of the economy could and should be left to private initiative. In review, *The General Theory* was not a radical solution; it was, rather, an explanation of why an inescapable remedy should work. If an economy in the doldrums could drift indefinitely, the price of government inaction might be graver by far than the consequences of bold unorthodoxy.

The real question was a moral, not an economic one. During the Second World War, Professor Hayek wrote a book, *The Road to Serfdom*, which, for all its exaggerations, contained a deeply felt and cogent indictment of the over-planned economy. Keynes sympathized with and liked the book. But while praising it, he wrote to Hayek:

I should ... conclude rather differently. I should say that what we want is not no planning, or even less planning, indeed I should say we almost certainly want more. But the planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your own moral position. Moderate planning will be safe enough if those carrying it out are rightly oriented in their own minds and hearts to the moral issue. This is in fact already true of some of them. But the curse is that there is also an important section who could be said to want planning not in order to enjoy its fruits, but because morally they hold ideas exactly the opposite of yours, and wish to serve not God but the devil.

Is this perhaps a naive hope? Can capitalism be managed—in the sense that government planners will turn the faucet of spending on and *off in* such a way as to supplement, but never to displace, private investment? The issue is still with us; still unresolved.

But we will postpone discussion of it to the coming chapter. For here we are dealing with the man Keynes and his beliefs, however misguided we may judge them to be. And it would be a grave error in judgment to place this man, whose aim was to rescue capitalism, in the camp of those who wanted to submerge it. True, he urged the "socialization" of investment, although he was never very clear about what that meant; but if he sacrificed the part; it was to save the whole.

For at heart he was a conservative—long an admirer of Edmund Burke and of the tradition of limited government for which Burke stood. "How can I accept the [Communistic] doctrine" he had written in 1931—when the view was by no means shared by many others—"which sets up as its bible, above and beyond criticism, an obsolete textbook which I know not only to be scientifically

erroneous but without interest or application to the modern world? How can I adopt a creed which, preferring the mud to the fish, exalts the boorish proletariat above the bourgeoisie and the intelligentsia, who with all their faults, are the quality of life and surely carry the seeds of all human achievement?"

One might quibble with Keynes's theories, with his diagnosis, and with his cure—although, in justice, it must be said that no more thoughtful theory, no profounder diagnosis, and no more convincing cure was propounded by those who insisted that Keynes was only a mischievous meddler with a system that worked well enough. But no one could gainsay his aim: the creation of a capitalist economy in which unemployment—the greatest and gravest threat to its continuance—would be largely eliminated.

He was a man incapable of doing only one thing at a time. While he was constructing *The General Theory* in his mind, he was building a theater in Cambridge with his pocketbook. It was a typically Keynesian venture. Starting at a loss, the theater was in the black in two years, and its artistic success was immense. Keynes was everywhere at the same time: financial backer, ticket taker (on one occasion when the clerk failed to materialize), husband of the leading lady (Lydia acted in Shakespeare, with extremely good notices), even concessionaire. He attached a restaurant to the theater and jealously watched its receipts, graphing them against different types of entertainment to ascertain how food consumption varied with the state of one's humor. There was a bar, too, where champagne was sold at a specially low discount to promote its wider consumption. It was probably the most pleasant interlude in his pleasant life.

But it did not go on for long. In 1937 his success story was cut short; he suffered a heart attack and was forced into idleness. Well—comparative idleness. He continued to do an active trading business and to edit the *Economic Journal* and to write a few brilliant articles in defense of *The General Theory*. One academician had said, upon its appearance, "Einstein has actually done for Physics what Mr. Keynes believes himself to have done for Economics," and Keynes was not a man to let someone get away with *that*. When he wanted to, he could wield an acid pen, and he now set to work systematically to demolish his critics, singly and en masse; sometimes with sarcasm, occasionally with brilliance, and not infrequently with petulance: "Mr. X *refuses* to understand me," seemed to rise like a sigh of despair from many of his brief communications.

But the war was approaching; Munich was followed by worse. Keynes watched in indignation the pusillanimous letters of some Left-Wingers to the *New Statesman and Nation*, on whose board he managed to find time to serve. He wrote to its columns: "Surely it is impossible to believe that there can really be such a person as 'A Socialist'! I disbelieve in his existence," and then, "When it comes to a showdown, scarce four weeks have passed before they remember that they are pacifists and write defeatist letters to your columns, leaving the defence of freedom and civilization to Colonel Blimp and the Old School Tie, for whom Three Cheers."

When the war came, Keynes was too ill to be a permanent member of the government. They gave him a room in the Treasury and picked his brains. He had already written another book, *How to Pay for the War*, a daring plan that urged "deferred savings" as the principal means of financing the war. The plan was simple—a portion of every wage earner's pay would automatically be invested in government bonds that would not be available for redemption until after the war. Then, just when consumer buying would again be needed, the savings certificates could be cashed.

Compulsory saving—what a change from his earlier efforts to achieve a kind of compulsory investment! But the change was in the times and not in Keynes's thinking. The old problem had been

too little investment, and its symptom had been unemployment. The new problem was too much investment—an all-out armament effort—and its symptom was inflation. But the framework of *The General Theory* was as useful in understanding inflation as it had been in understanding inflation's opposite—unemployment. Only it was upside down. Now more and more incomes were being handed out with each turn of the wheel, instead of less and less. Accordingly, the cure was the opposite of the depression tonic. Then Keynes had urged that investment be bolstered by every possible means; now he urged that savings must be increased.

The point is important because many have mistakenly judged Keynes as an economist who favored inflation. He did favor "reflation" (a pumping-up of incomes and not prices) from the depths of the depression. But to think that he favored inflation for inflation's sake was to disregard such a passage as this from *The Economic Consequences of the Peace:* Lenin is said to have declared that the best way to destroy the Capitalist System was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate *arbitrarily*.... Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

But despite its logic and its appeal—Keynes made much of the fact that his deferred-savings plan would serve to widen the distribution of wealth by making everyone an owner of government bonds—the plan failed to arouse much support. It was too new; the old methods of taxation and rationing and voluntary-savings drives were tried and trusty weapons of war finance. A deferred-credit scheme was tacked on as an ornamental flourish, but it was never given the central place Keynes had envisaged for it.

But he had no time to lament its cool reception; he was now fully embroiled in the British war effort. In 1941 he flew via Lisbon to the United States. It was to be the first of six such trips; Lydia went with him as his nurse and guardian. Ever since his first heart attack she had assumed the role of timekeeper for her indefatigable husband, and many a dignitary had been politely but firmly ushered out at the expiration of his allotted stay. "Time, gentlemen," said Lydia, and business stopped.

His trips to the United States involved the precarious problems of Britain's war finance and the overhanging question of what was to happen in the terrible postwar interim. Britain was not the only one concerned; the United States, as well, wanted to lay the foundation for a flow of international trade that would avoid the desperate financial warfare that had too often led to actual warfare. An International Bank and an International Monetary Fund were to be established to act as guardians of the international flow of money; in place of the old dog-eat-dog world where each nation sought to undercut everyone else, there would be a new cooperative effort to help out a nation that found itself in monetary difficulties.

The final conference was held at Bretton Woods, New Hampshire. Keynes, despite his illness and fatigue, clearly dominated the conference; not when it came to winning all his points, for the final plan was far closer to the American proposals than to the British, but by virtue of his personality. One of the delegates gives us an insight into the man in this entry in his journal:

This evening, I participated in a particularly *recherché* celebration. Today is the 500th anniversary of the Concordat between King's College, Cambridge, and New College, Oxford, and to commemorate the occasion, Keynes gave a small banquet in his room.... Keynes, who had been looking forward to

the event for weeks as excitedly as a schoolboy, was at his most charming. He delivered an exquisite allocution.... It was an interesting example of the curiously complex nature of this extraordinary man. So radical in outlook in matters purely intellectual, in matters of culture he is a true Burkean conservative. It was all very pianissimo, as befitting the occasion, but his emotion when he spoke of our debt to the past was truly moving.

When Keynes made his final speech at the conclusion of the conference—"If we can continue in a larger task, as we have begun in this limited task, there is hope for the world"—the delegates rose and cheered him.

As always, his major efforts did not preclude a few minor ones. He was made a Director of the Bank of England ("Which will make an honest woman of the other is anyone's guess," he had declared) and chairman of a new government committee that concerned itself with music and the arts. Thus, while he was carrying the weight of presenting Britain's point of view to an international economic council, he was also keeping up a stream of correspondence on music travelers, the Vic-Wells Ballet, poetry reading, and library exhibits. And of course he kept on collecting; he scooped the Folger Library on a rare volume of Spenser and explained a little guiltily to the librarian that he had used the Foreign Office bag to have the catalogue sent over to him.

And the honors started to pour in. He was elevated to the peerage: he was now Lord Keynes, Baron of Tilton, an estate he had bought in middle life only to discover to his delight that one of the branches of the Keynes line had once owned these lands. There were honorary degrees to be accepted at Edinburgh, at the Sorbonne, and from his own university. There was an appointment to the Board of Trustees of the National Gallery. And still there was work: the first loan to Britain had to be negotiated, and Keynes, of course, was given the task of presenting Britain's viewpoint. When he returned from that trip and a reporter asked him if it were true that England was now to be the forty-ninth state, Keynes's reply was succinct: "No such luck."

In 1946 the ordeal was over. He went back to Sussex to read and relax and prepare for a resumption of teaching at Cambridge. One morning there was a fit of coughing; Lydia flew to his side; he was dead.

The services were held in Westminster Abbey. His father, John Neville Keynes, aged ninety-three, and his mother, Florence, walked up the aisle. The country mourned the loss of a great leader, gone just at a time when his acumen and wisdom were most needed; as the *Times* said in a lengthy obituary on April 22, "By his death the country has lost a great Englishman."

He was not an angel by any means. This most sparkling of the great economists was only a human being, albeit a remarkable one, with all the faults and foibles of any person. He could win twenty-two pounds from two countesses and a duke at bridge and crow delightedly; he could also undertip a bootblack in Algiers and refuse to rectify his error, saying, of all things, "I will not be a party to debasing the currency." He could be extraordinarily kind to a slow-thinking student (economists, he said, should be humble, like dentists) and obnoxiously cutting to a businessman or high official to whom he happened to take an intuitive dislike. Sir Harry Goschen, the chairman of the National Provincial Bank, once rubbed Keynes wrong by urging that "we let matters take their natural course." Keynes replied, "Is it more appropriate to smile or rage at these artless sentiments? Best of all, perhaps, just to let Sir Harry take *his* natural course."

Keynes himself gave the clue to his own genius—although he was not at the time writing about himself. Discussing his old teacher Alfred Marshall (whom he both loved and rather lovingly derided as "an absurd old man"), Keynes spelled out the qualifications for an economist:

The study of economics does not seem to require any specialized gifts of an unusually high order. Is it not, intellectually regarded, a very easy subject compared with the higher branches of philosophy or pure science? An easy subject, at which very few excel! The paradox finds its explanation, perhaps, in that the master-economist must possess a rare *combination* of gifts. He must be mathematician, historian, statesman, philosopher—in some degree. He must understand symbols and speak in words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, vet sometimes as near the earth as a politician.

Marshall—as Keynes says—only approximated that ideal, for, Victorian that he was, he lacked the necessary iconoclasm to give his economics deep social penetration. Keynes came closer: the Bloomsbury attitude of "nothing sacred" spilled over into the sacred precincts of economic orthodoxy; once again the world was put into focus by a man not so blind as to fail to see its sickness, and not so emotionally and intellectually dispossessed as to wish not to cure it. If he was an economic sophisticate, he was politically devout, and it is this combination of an engineering mind and a hopeful heart that his vision reveals.

And what of his analysis? There lies a more complex tale. "Keynesian" economics dominated the field in the United States from 1940 until the 1960s. Then began a slipping away, until by 1980, in the words of Alan Blinder, a staunch supporter, "It was hard to find an American economist under the age of forty who professed to be a Keynesian."

What was the cause of this dramatic shift? In part it was a failure to find a satisfactory way of reconciling Keynes's "macro" view of the economy, dominated by massive flows of expenditure often determined by the unpredictable "animal spirits" of investors, with the Marshallian "micro" view that emphasized the centrality of individual markets ruled by the rational considerations of buyers and sellers. From another angle, Keynesianism was weakened by a resurgence of interest in inflation-related questions of money. From yet other quarters came a growing disenchantment with the activist role of government explicit in Keynes, and a return to a belief in individual behavior as a steering as well as driving force that could not be outwitted by Keynesian policies.

Thus Keynesianism withered—but it did not die. Instead, beginning in the 1980s we entered a new period of economic thought in which there was no clear agreement as to how to perceive the economy. The result was—and as of this writing, still is—a crisis of vision, with its inescapable correlate, an absence of any clear-cut analytic prescription. Curiously—perhaps significantly—this hiatus affected the United States, and to some extent Great Britain, much more than Europe. European economists had never been devotees of Marshall and they kept a certain distance from Keynes. Instead there arose in Scandinavia, Germany, the Netherlands, and France a kind of pragmatic fusion of micro and macro. Its vision could perhaps be summed up in the conception of capitalism as the only workable system at hand, but one that could not function satisfactorily without a strong government presence aware of both the needs to compete in an ever more globalized world, and of the necessity to provide generous programs of both welfare and education for those who were casualties of that process. The outcome is a very pragmatic "worldly" philosophy, for which our country has yet to find a workable counterpart. This is a matter to which we will return before we are done.