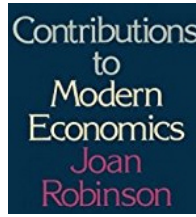
in Joan Robinson, *Contributions to Modern Economics*, 1978



6

KALECKI AND KEYNES

1

It is difficult now to recapture the state of orthodox opinion in the capitalist world in the early years of the great depression.

There was heavy unemployment in England even before the world slump set in. In 1929 Lloyd George was campaigning for a programme of public works. In reply, British officials propounded the 'Treasury View' that if the Government borrowed, say, a hundred million pounds to set men to work on road building and so forth, foreign investment would be reduced by an equal sum and no overall increase in employment would occur.

In 1931 the British Labour Government was led to destruction through the belief that it was necessary to balance the budget in order to save the exchange value of sterling.

Academic opinion was serenely oblivious to the problems of reality. Professor Robbins, surrounded by unemployed labour and idle plant, defined economics as 'the science which studies human behaviour as a relation between ends and scarce means which have alternative uses'.[1]

According to accepted theory the price level was determined by the quantity of money. But the suggestion that the depression might therefore be relieved by increasing the quantity of money was confined to cranks. In the orthodox view it would create a dangerous inflation.

The Marxists abused the academics, but they shared their belief in the principles of sound finance.

In this fog Keynes was groping for a theory of employment. He had backed up Lloyd George with a rather vague and half-baked argument that an increase in investment would generate an increase in saving (so that borrowing in one form need not be subtracted from borrowing in another)[2] and a young pupil of his, R. F. Kahn, worked it out properly. During the

[1] *Essay on the Nature and Significance of Economic Science*. 1932.
[2] J. M. Keynes and H. D. Henderson, *Can Lloyd George Do It?*

From *Essays in Honour of Michał Kalecki*, 1964.

sessions of the Macmillan Committee on currency and banking Keynes was coming to the view that there was a fallacy in the accepted argument that a cut in money wage rates would restore profitability to enterprise, by lowering costs relatively to prices, because prices would come down more or less in proportion. But in his great theoretical *Treatise* his mind was working in a different plane, and it failed to produce a theory of employment, though it contained the highly significant conception that an increase of investment without (as we should now put it) a corresponding increase in propensity to save raises profits, while an increase in propensity to save without a corresponding increase in investment reduces them.

Over the continent, no doubt including Poland, the fog of orthodoxy was even thicker than in England. Only in Sweden Wicksell's pupils were puzzling out a new line. In *Monetary Equilibrium* published in Swedish in 1931, Gunnar Myrdal twitted Keynes upon his 'attractive Anglo-Saxon kind of unnecessary originality', but he was not altogether clear of the fog himself.

The *Treatise on Money* was passed for the last time to the printers in September 1930, and Kahn's article appeared in the *Economic Journal* of June 1931, setting out the analysis of the multiplier – the relation of an increase in employment in investment to the total increase in employment that it generates – and showing how the rise in incomes that accompanies an increase in investment brings about a rise in savings of an equal amount.

There followed a great bout of argument that churned over these ideas for three years.

In 1933 I published a kind of interim report, which clears the ground for the new theory but does not supply it.[3] It was not till the summer of 1934 that Keynes succeeded in getting his theory of money, his theory of wages and Kahn's multiplier into a coherent system.

In January 1935 he wrote to Bernard Shaw: '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.'[4]

The General Theory of Employment, Interest and Money was published in January, 1936.

Meanwhile, without any contact either way, Michał Kalecki had found the same solution.

His book, *Essays in the Theory of Business Cycles*, published in Polish in 1933, clearly states the principle of effective demand in mathematical form.

[3] See above, 'The theory of money and analysis of output'.

[4] R. F. Harrod, *Life of Keynes*, p. 462.

At the same time he was already exploring the implications of the analysis for the problem of a country's balance of trade, along the same lines that I followed in drawing riders from the *General Theory* in essays published in 1937.

The version of his theory set out in prose (published in 'Polska Gospodarcza', No. 43, X, 1935) could very well be used today as an introduction to the theory of employment.

He opens by attacking the orthodox theory at the most vital point – the view that unemployment could be reduced by cutting money wage rates. And he shows (a point that the Keynesians came to much later, and under his influence) that, if monopolistic influences prevent prices from falling when wage costs are lowered, the situation is still worse, because reduced purchasing power causes a fall in sales of consumption goods, so that higher profit margins do not result in higher profits.

Having demolished the case for the orthodox remedy for a depression, he shows how an increase of investment, coming about, for instance, as the result of a great new invention, would increase employment, and then points out that if a spontaneous increase in investment is possible, it must be possible also by deliberate government policy to carry out schemes of investment that would not otherwise be undertaken and so relieve unemployment and increase consumption as well.

Kalecki's statement of the theory avoids the problem of the equality of saving and investment, which plagued us so much, by relying simply on the fact that the equivalent of investment outlay is added to profits. He cuts through another passage where Keynes made heavy weather by taking it for granted that the rate of interest is a monetary phenomenon. When investment, income and saving increase, it is necessary for the supply of the medium of exchange to be increased also; otherwise the rate of interest would rise and a drag be set upon investment.

Kalecki did not approach the theory of employment through the multiplier, which makes his version in a way less rich than Keynes', though no less forceful. On the other hand, he went straight to a theory of the trade cycle, on which Keynes was very weak. In this essay there is a clear statement in a few lines of the capital-stock-adjustment mechanism which is now recognized as the basis for all modern trade-cycle models.

Michał Kalecki's claim to priority of publication is indisputable. With proper scholarly dignity (which, however, is unfortunately rather rare among scholars) he never mentioned this fact. And, indeed, except for the authors concerned, it is not particularly interesting to know who first got into print. The interesting thing is that two thinkers, from completely different political and intellectual starting points, should come to the same conclusion. For us in Cambridge it was a great comfort. Surrounded by blank misunderstanding, there were moments when we almost began to wonder if it was we who were mad or the others. In the serious sciences, original work is *discovery* – finding connections that were always there, waiting to be seen. That this could happen in economics was a reassurance that what we had discovered was really there.

I well remember my first meeting with Michał Kalecki – a strange visitor who was not only already familiar with our brand-new theories, but had even invented some of our private jokes. It gave me a kind of Pirandello feeling – was it he who was speaking or I? Reading his article of 1935 (now for the first time available in English)[5] gives me the same feeling. Several times, in those old days, I wrote that very article – though with less concentrated force – trying to explain Keynes' theory in simple words.

Kalecki had one great advantage over Keynes – he had never learned orthodox economics. The preface to the *General Theory* ends thus: 'The ideas which are here expressed so laboriously are extremely simple and should be obvious. The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify for those brought up as most of us have been, into every corner of our minds.'

Kalecki was not brought up so. The only economics he had studied was Marx. Keynes could never make head or tail of Marx. In the letter to Shaw, quoted above, he maintains that his new theory is going to cut the ground from under the feet of the Marxists. But starting from Marx would have saved him a lot of trouble. Kahn, at the 'circus' where we discussed the *Treatise* in 1931, explained the problem of saving and investment by imagining a cordon round the capital-good industries and then studying the trade between them and the consumption-good industries; he was struggling to rediscover Marx's schema. Kalecki began at that point.

2

In his *Essays in the Theory of Economic Fluctuations* published after he had been a little while in England, he filled in several gaps in Keynes' formulation of the theory of employment.

In Keynes' scheme, the concept of *marginal efficiency of capital* means that, at any moment, there is in existence a schedule of possible investment projects, listed in descending order of their prospective profitability (allowing for risk). The schedule is cut off at the point where the

[5] Reprinted in *Essays on the Dynamics of the Capitalist Economy*, Cambridge, 1971.

prospective rate of net profit is equal to the rate of interest to be paid for finance. This determines the total value of investment to be undertaken. Kalecki asked the pertinent question: If there are schemes which promise a rate of profit greater than the rate of interest, would not each individual enterprise be willing and anxious to carry out an indefinitely large amount of investment? It was no use to reply that a faster rate of investment would raise the cost of capital goods and so reduce the prospective rate of profit; for the rise in costs would come about as a result of actual investment, *ex post*, while the marginal efficiency of capital concerns investment plans *ex ante*.

Kalecki supplied an answer, first by making clear the separation between investment decisions and actual investment; and second, by introducing into the argument the obvious fact that no individual enterprise can command an indefinitely large amount of finance at a given rate of interest. He took risk over from the demand side (where it lies rather uneasily in Keynes' scheme) to the supply side, and postulated that the amount of finance that each individual enterprise will commit to investment is in an increasing function of the prospective rate of profit, depending upon the ratio of its borrowing to its own capital. Then, with any given distribution of capital amongst enterprises, there is a particular relation between the total amount of investment plans being drawn up at any moment and the level of prospective profits.

The second difficulty was that, though Keynes himself attached great importance to the idea that the present is always overweighted in forming a view about the future, he treated his schedule of prospective profits as though it was independent of the actual rate of investment. Kalecki shows how a higher level of investment this year than last, means a higher level of current profits, therefore a higher expected rate of profit, therefore enlarged investment plans, therefore a higher rate of investment next year.

A rise in the actual rate of investment cannot go on indefinitely. When the rate of investment ceases to rise, the level of current profit ceases to rise. But the amount of productive capacity competing for sales is steadily growing. The rate of profit is therefore declining, and so the boom will break. Thus prosperity can never last. 'The tragedy of investment is that it causes crisis because it is useful.' He ended the argument with the poignant phrase: 'Doubtless many people will consider this theory paradoxical. But it is not the theory which is paradoxical, but its subject – the capitalist economy.'

The third point at which Kalecki tightened up the slack in the *General Theory* was in connection with the relation of prices to wages rates. Keynes relied upon a rather vague sort of Marshallian concept of competition, with short-period diminishing returns, so that an increase in employment is accompanied by a fall in real wages for workers already employed. Kalecki elaborated his original insight into the relation of monopolistic price policy to employment with the analysis of imperfect competition (then in its heyday) to produce his famous short-period theory of distribution in which the share of wages in the value of output is determined by the degree of monopoly.

This formulation has been attacked as being merely circular, since the degree of monopoly is defined as the ratio of gross margins to the value of output, and so is identically equal (on the stated assumptions) to one minus the share of wages. The apparent circularity lies only in the way the argument is set out. When by degree monopoly we mean, not the *ex-post* level of gross margins, but the price policy of firms, then, in slumpy conditions, when all plants are working under capacity, it is clearly true to say that if firms pursue a competitive policy, cutting prices in an attempt to sell more, real-wage rates will be higher, and the utilization of existing plant greater, than if they pursue a monopolistic policy, maintaining or even raising gross margins.

These amendments have been incorporated into 'Keynesian' thought; few of the present generation of 'Keynesians' stop to inquire how much they owe to Kalecki and how much indeed to Keynes. All the same, as Michał Kalecki is the first to admit, the 'Keynesian Revolution' in Western academic economics is rightly so called. For without Keynes' wide sweep, his brilliant polemic, and, above all, his position within the orthodox citadel in which he was brought up, the walls of obscurantism would have taken much longer to breach.

3

The political interpretation of the new theory for Kalecki was very different from the 'moderately conservative' implications that Keynes saw in it.

Keynes was thoroughly disgusted with latter-day capitalism for moral and aesthetic reasons, but he was by no means a socialist. After proving that building pyramids or digging holes in the ground and filling them up again would maintain effective demand and so prevent a fall in useful production, he adds, 'It is not reasonable, however, that a sensible community should be content to remain dependent on such fortuitous and often wasteful mitigations when once we understand the influences upon which effective demand depends'. He believed, or at least he allowed himself to hope, that once the new theory was understood, capitalism would reform itself. If full employment could be maintained for a generation by useful investment (without much growth of population) poverty would melt away, and the rate of interest would fall so low that unearned income would cease to be a burden upon the economy. Only honest toil and imaginative speculation would be rewarded by society. (We have seen near-full employment maintained in the Western world since the war, not by useful investment, but, less harmlessly foolish than digging holes, by piling up armaments. Keynes' analysis has proved correct, but his pleasant day-dream has turned into a nightmare.)

Kalecki saw a less agreeable vision. In an article written during the War,[6] he predicted that now that the causes of the commercial trade cycle are understood, we shall have instead a political trade cycle. The Government will make a full-employment policy by means of a budget deficit. When full employment prevails, prices will be rising and the bargaining position of workers will be strong.

'In this situation a powerful block is likely to be formed between big business and *rentier* interests, and they would probably find more than one economist to declare that the situation was manifestly unsound.' A return to 'sound finance' will create unemployment again. But as the next election looms up, the Government returns to the vote-getting policy of full employment.

'The regime of the "political business cycle" would be an artificial restoration of the position as it existed in nineteenth-century capitalism. Full employment would be reached only at the top of the boom, but slumps would be relatively mild and short lived.' This is a remarkably exact prediction of life in the Western world since the war. (But now that even a Conservative Government in England admits the need for planning, we may be entering a new phase.)

4

After the war Michał Kalecki was mainly occupied with applications of theory to the diagnosis of current developments in the capitalist world, and to the problems of planning in the socialist world. But in the new wave of theory in Cambridge concerned with long-run growth his influence is still at work.

As well as the short-run theory of distribution connected with the

[6] 'Political aspects of full employment', *Political Quarterly*, October 1943.

'degree of monopoly' his *Essays* contained a long-run theory based on the principle that 'the workers spend what they get and the capitalists get what they spend'. From this is derived the conception that the rate of profit on capital is determined by the rate of accumulation and the propensity to save of capitalists. Kaldor has called this the Keynesian theory of distribution, since it is adumbrated in the *Treatise*, but, like the *General Theory* itself, it has a separate source in Kalecki.