Preface to the French Edition

For a hundred years or longer English Political Economy has been dominated by an orthodoxy. That is not to say that an unchanging doctrine has prevailed. On the contrary. There has been a progressive evolution of the doctrine. But its presuppositions, its atmosphere, its method have remained surprisingly the same, and a remarkable continuity has been observable through all the changes. In that orthodoxy, in that continuous transition, I was brought up. I learnt it, I taught it, I wrote it. To those looking from outside I probably still belong to it. Subsequent historians of doctrine will regard this book as in essentially the same tradition. But I myself in writing it, and in other recent work which has led up to it, have felt myself to be breaking away from this orthodoxy, to be in strong reaction against it, to be escaping from something, to be gaining an emancipation. And this state of mind on my part is the explanation of certain faults in the book, in particular its controversial note in some passages, and its air of being addressed too much to the holders of a particular point of view and too little *ad urbem et orbem*. I was wanting to convince my own environment and did not address myself with sufficient directness to outside opinion. Now three years later, having grown accustomed to my new skin and having almost forgotten the smell of my old one, I should, if I were writing afresh, endeavour to free myself from this fault and state my own position in a more clear-cut manner.

I say all this, partly to explain and partly to excuse, myself to French readers. For in France there has been no orthodox tradition with the same authority over contemporary opinion as in my own country. In the United States the position has been much the same as in England. But in France, as in the rest of Europe, there has been no such dominant school since the expiry of the school of French Liberal economists who were in their prime twenty years ago (though they lived to so great an age, long after their influence had passed away, that it fell to my duty, when I first became a youthful editor of the *Economic Journal* to write the obituaries of many of them—Levasseur, Molinari, Leroy-Beaulieu). If Charles Gide had attained to the same influence and authority as Alfred Marshall, your position would have borne more resemblance to ours. As it is, your economists are eclectic, too much (we sometimes think) without deep roots in systematic thought. Perhaps this may make them more easily accessible to what I have to say. But it may also have the result that my readers will sometimes wonder what I am talking about when I speak, with what some of my English critics consider a misuse of language, of the 'classical' school of thought and 'classical' economists. It may,

https://doi.org/10.1017/UPO9781139524278.006 Published online by Cambridge University Press

therefore, be helpful to my French readers if I attempt to indicate very briefly what I regard as the main *differentiae* of my approach.

I have called my theory a *general* theory. I mean by this that I am chiefly concerned with the behaviour of the economic system as a whole,—with aggregate incomes, aggregate profits, aggregate output, aggregate employment, aggregate investment, aggregate saving rather than with the incomes, profits, output, employment, investment and saving of particular industries, firms or individuals. And I argue that important mistakes have been made through extending to the system as a whole conclusions which have been correctly arrived at in respect of a part of it taken in isolation.

Let me give examples of what I mean. My contention that for the system as a whole the amount of income which is saved, in the sense that it is not spent on current consumption, is and must necessarily be exactly equal to the amount of net new investment has been considered a paradox and has been the occasion of widespread controversy. The explanation of this is undoubtedly to be found in the fact that this relationship of equality between saving and investment, which necessarily holds good for the system as a whole, does not hold good at all for a particular individual. There is no reason whatever why the new investment for which I am responsible should bear any relation whatever to the amount of my own savings. Quite legitimately we regard an individual's income as independent of what he himself consumes and invests. But this, I have to point out, should not have led us to overlook the fact that the demand arising out of the consumption and investment of one individual is the source of the incomes of other individuals, so that incomes in general are not independent, quite the contrary, of the disposition of individuals to spend and invest; and since in turn the readiness of individuals to spend and invest depends on their incomes, a relationship is set up between aggregate savings and aggregate investment which can be very easily shown, beyond any possibility of reasonable dispute, to be one of exact and necessary equality. Rightly regarded this is a banale conclusion. But it sets in motion a train of thought from which more substantial matters follow. It is shown that, generally speaking, the actual level of output and employment depends, not on the capacity to produce or on the pre-existing level of incomes, but on the current decisions to produce which depend in turn on current decisions to invest and on present expectations of current and prospective consumption. Moreover, as soon as we know the propensity to consume and to save (as I call it), that is to say the result for the community as a whole of the individual psychological inclinations as to how to dispose of given incomes, we can calculate what level of incomes, and therefore what level of output and employment, is in profit-equilibrium with a given level of new investment; out of which develops the doctrine of the Multiplier. Or again, it becomes evident that an increased propensity to save will *ceteris paribus* contract incomes and

https://doi.org/10.1017/UPO9781139524278.006 Published online by Cambridge University Press

output; whilst an increased inducement to invest will expand them. We are thus able to analyse the factors which determine the income and output of the system as a whole;—we have, in the most exact sense, a theory of employment. Conclusions emerge from this reasoning which are particularly relevant to the problems of public finance and public policy generally and of the trade cycle.

Another feature, specially characteristic of this book, is the theory of the rate of interest. In recent times it has been held by many economists that the rate of current saving determined the supply of free capital, that the rate of current investment governed the demand for it, and that the rate of interest was, so to speak, the equilibrating price-factor determined by the point of intersection of the supply curve of savings and the demand curve of investment. But if aggregate saving is necessarily and in all circumstances exactly equal to aggregate investment, it is evident that this explanation collapses. We have to search elsewhere for the solution. I find it in the idea that it is the function of the rate of interest to preserve equilibrium, not between the demand and the supply of new capital goods, but between the demand and the supply of money, that is to say between the demand for *liquidity* and the means of satisfying this demand. I am here returning to the doctrine of the older, pre-nineteenth century economists. Montesquieu, for example, saw this truth with considerable clarity, *—Montesquieu who was the real French equivalent of Adam Smith, the greatest of your economists, head and shoulders above the physiocrats in penetration, clear-headedness and good sense (which are the qualities an economist should have). But I must leave it to the text of this book to show how in detail all this works out.

I have called this book the *General Theory of Employment, Interest and Money*; and the third feature to which I may call attention is the treatment of money and prices. The following analysis registers my final escape from the confusions of the Quantity Theory, which once entangled me. I regard the price level as a whole as being determined in precisely the same way as individual prices; that is to say, under the influence of supply and demand. Technical conditions, the level of wages, the extent of unused capacity of plant and labour, and the state of markets and competition determine the supply conditions of individual products and of products as a whole. The decisions of entrepreneurs, which provide the incomes of individual producers and the decisions of those individuals as to the disposition of such incomes determine the conditions. And prices—both individual prices and the price-level—emerge as the resultant of these two factors. Money, and the quantity of money, are not direct influences at this stage of the proceedings. They have

* I have particularly in mind Book XXII, chap. 19 of *L'Esprit des lois*.

https://doi.org/10.1017/UPO9781139524278.006 Published online by Cambridge University Press

done their work at an earlier stage of the analysis. The quantity of money determines the supply of liquid resources, and hence the rate of interest, and in conjunction with other factors (particularly that of confidence) the inducement to invest, which in turn fixes the equilibrium level of incomes, output and employment and (at each stage in conjunction with other factors) the price-level as a whole through the influences of supply and demand thus established.

I believe that economics everywhere up to recent times has been dominated, much more than has been understood, by the doctrines associated with the name of J.-B. Say. It is true that his 'law of markets' has been long abandoned by most economists; but they have not extricated themselves from his basic assumptions and particularly from his fallacy that demand is created by supply. Say was implicitly assuming that the economic system was always operating up to its full capacity, so that a new activity was always in substitution for, and never in addition to, some other activity. Nearly all subsequent economic theory has depended on, in the sense that it has required, this same assumption. Yet a theory so based is clearly incompetent to tackle the problems of unemployment and of the trade cycle. Perhaps I can best express to French readers what I claim for this book by saying that in the theory of production it is a final break-away from the doctrines of J.-B. Say and that in the theory of interest it is a return to the doctrines of Montesquieu.

J. M. KEYNES

20 *February* 1939
King's College
Cambridge

https://doi.org/10.1017/UPO9781139524278.006 Published online by Cambridge University Press