

KEYNES'S GENERAL THEORY: A SOLUTION IN SEARCH OF A PROBLEM

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ABSTRACT: This article is an evaluation of the *General Theory* largely on its own terms. Extensive quotations from *The General Theory of Employment, Interest, and Money* are used in order to allow Keynes himself to expound the theory. The goal of this article is to show that even on its own terms the *General Theory* must be considered a failure, for the problem it purports to solve, involuntary unemployment, does not exist. Many of the individual points made here have been made before, but no references are provided. Benjamin Anderson (1980), for example, remarks on the counter-intuitive (indeed, worthless) nature of Keynes's "volume of employment," and Henry Hazlitt ([1959] 2007) points out that one part with liquidity whenever one buys anything. I think at least two points here have not been made before: 1) that deficit-spending plays an insignificant or non-existent role in the *General Theory*, and 2) that involuntary unemployment (used in the manner in which Keynes uses the phrase) is incapable of being known to exist—which removes any justification for the assertion that full employment does not exist.

THE PROBLEM

Keynes's *General Theory* purports to provide a solution to a problem. That problem is not generic unemployment but rather a species of it that Keynes calls involuntary unemployment. What is involuntary unemployment?

Men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the

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aggregate demand for it at that wage would be greater than the existing volume of employment. (Keynes 1965, 15)

What is the criterion by means of which we detect the presence of involuntary unemployment? The effect that something has had on the volume of employment. What does Keynes mean by the phrase “volume of employment”? The

quantity of employment can be sufficiently defined for our purpose by taking an hour's employment of ordinary labour as our unit and weighting an hour's employment of special labour in proportion to its remuneration; *i.e.* an hour of special labour remunerated at double ordinary rates will count as two units. (Keynes 1965, 41)

Calling Keynes's measure of employment dubious (at the very least, curious) seems warranted. Consider a community with four adults, Tom, Dick, Richard, and Harry. On Tuesday Tom was unemployed; Dick and Richard both worked for eight hours and were paid \$20 per hour; and Harry worked for eight hours and was paid \$600 per hour. On Wednesday Tom was still unemployed; so, alas, was Dick, who was fired; Richard worked for eight hours and was paid \$20 per hour; and Harry worked for eight hours and was paid \$650 per hour (he received a raise). Tom and Dick, fortunately, were not disgruntled, for the quantity of employment had increased.

But wait—there is more. Not only did the quantity of employment increase, so, too, did the quantity of output. For the measure of output as a whole—a vague concept as Keynes himself admits (1965, 43) —is nothing other than the quantity of employment:

It follows that we shall measure changes in current output by reference to the number of hours of labour paid for (whether to satisfy consumers or to produce fresh capital equipment) on the existing capital equipment, hours of skilled labour being weighted in proportion to their remuneration. (Keynes 1965, 44)

This is fun. Not only did Harry's raise produce an increase in employment, it also produced an increase in output. Want to increase employment and output? Raise the wages of the well-paid!

Now let us return to the test that we use to detect the existence of involuntary unemployment. The mere fact that people are unemployed does not mean that involuntary unemployment exists, for Keynes expressly allows for the existence of voluntary

unemployment and excludes from involuntary unemployment “the withdrawal of their labour by a body of workers because they do not choose to work for less than a certain real reward.” (Keynes 1965, 15) It should be obvious that Keynes’s volume of employment tells us nothing about the level of unemployment (the volume of employment can increase when the number of workers employed and the number of hours worked both decrease). Can it tell us something about the level of involuntary unemployment?

It certainly cannot tell us what the level of involuntary unemployment *is*—or even if there is *any* involuntary unemployment—for the test for the existence of involuntary unemployment is what the effect on the volume of employment *would be* if the price of wage-goods rose relatively to the money-wage. Can we use the volume of employment to detect the *previous* existence of involuntary unemployment? Let us construct a case favorable to Keynes’s position.

On Tuesday Tom is unemployed; Dick, Richard, and Harry each work for eight hours and are paid \$20 per hour. On Wednesday the price of wage-goods has risen relatively to the money-wage, which we will assume has remained the same. Tom, Dick, Richard, and Harry all have jobs: each works for eight hours and is paid \$20 per hour. The volume of employment has increased. We may not know if there is still any involuntary unemployment on Wednesday, but surely we know that there was involuntary unemployment on Tuesday? Unfortunately, we do not. Tom’s unemployment on Tuesday may have been the result of his decision not to “work for less than a certain real reward.” His employment on Wednesday may stem from his decision to accept a lower real reward on Wednesday than he was willing to accept on Tuesday. Nothing in the facts of the case—the increase in the volume of employment that has occurred after a rise in the price of wage-goods relative to the money-wage—permits us to infer that there was any involuntary unemployment on Tuesday.

The unavoidable conclusion is that Keynes’s test for the existence of involuntary unemployment cannot be used to detect the existence of involuntary unemployment. Keynes himself seems to have realized that the existence of involuntary unemployment is problematic, for he informs us that “if the classical theory is only applicable to the case of full employment, it is fallacious to apply it to the problems of involuntary unemployment—if there

be such a thing (and who will deny it?)." (Keynes 1965, 16) I do not profess to be able to decipher the meaning of his remark with complete assurance, but I do not see how it can be taken not to include an admission that there may be no such thing as involuntary unemployment.

Full employment is "the absence of 'involuntary' unemployment." (Keynes 1965, 15) The problem associated with the concept of full employment is therefore the problem associated with the concept of involuntary unemployment. Because we can never know that involuntary unemployment exists, we can never know that full employment does not exist. At the risk of pointing out what should be obvious, a remedy for a problem which is not known to exist—indeed, which *cannot* be known to exist—might not be much of a remedy.

KEYNES'S SYSTEM

Keynes's system contains given factors, independent variables, and dependent variables. (Keynes 1965, 245) We may ignore the given factors because they are the "factors in which the changes seem to be so slow or so little relevant as to have only a small and comparatively negligible short-term influence on our *quaesitum*...." (Keynes 1965, 247)

The "independent variables are, in the first instance, the propensity to consume, the schedule of the marginal efficiency of capital and the rate of interest...." (Keynes 1965, 245) We soon learn that "the rate of interest depends partly on the state of liquidity-preference (*i.e.* on the liquidity function) and partly on the quantity of money measured in terms of wage-units." (Keynes 1965, 246) For that reason we need to include liquidity-preference and the quantity of money among the independent variables. (Keynes 1965, 246–47) The remaining independent variable that Keynes identifies is the wage-unit, (Keynes 1965, 246–47) which he defines as "the money-wage of a labour-unit." (Keynes 1965, 41) The dependent variables are "the volume of employment and the national income (or national dividend) measured in wage-units." (Keynes 1965, 245)

What is the propensity to consume? Keynes defines the propensity to consume as "the functional relationship... between Y_w , a given level of income in terms of wage-units, and C_w the expenditure on consumption out of that level of income." (Keynes 1965, 90)

Keynes's definition suffers from at least one defect: it suggests that the decision to consume depends only on current income and not on other factors such as assets that one owns. Keynes seems to recognize the defect, for he tells us later that the people who take an active interest in their Stock Exchange investments "are, perhaps, even more influenced in their readiness to spend by rises and falls in the value of their investments than by the state of their income." (Keynes 1965, 319)

What is the marginal efficiency of capital? Although Keynes defines the marginal efficiency of capital in a manner that connects it exclusively with the continued ownership of a capital-asset, (Keynes 1965, 135) I think the concept needs to be expanded. Keynes seems to think so too, for in other places it is the gap between the price at which a good sells and the cost of producing it which has causal significance.¹ I think we are justified in using the phrase "marginal efficiency of capital" to refer to the expected return (excess of price received over costs incurred) from production.

The rate of interest is determined by liquidity-preference and the quantity of money. What is liquidity-preference? I see no reason not to call it the desire to acquire or retain the ownership of money,² a desire often called the demand for money.³ What effect does it have on the rate of interest? Keynes tells us that

the mere definition of the rate of interest tells us in so many words that the rate of interest is the reward for parting with liquidity for a specified

¹ "We can then define the *income* of the entrepreneur as being the excess of the value of his finished output sold during the period over his prime cost. The entrepreneur's income, that is to say, is taken as being equal to the quantity, depending on his scale of production, which he endeavours to maximise, *i.e.* to his gross profit in the ordinary sense of this term...." (Keynes 1965, 53–54)

"As I now think, the volume of employment (and consequently of output and real income) is fixed by the entrepreneur under the motive of seeking to maximise his present and prospective profits...." (p. 77)

² "In other words, what is the degree of his *liquidity-preference*—where an individual's liquidity-preference is given by a schedule of the amounts of his resources, valued in terms of money or of wage-units, which he will wish to retain in the form of money in different sets of circumstances?" (Keynes 1965, 166)

³ "We must now develop in more detail the analysis of the motives to liquidity-preference which were introduced in a preliminary way in Chapter 13. The subject is substantially the same as that which has been sometimes discussed under the heading of the Demand for Money." (Keynes 1965, 194)

period.... Thus the rate of interest... is a measure of the unwillingness of those who possess money to part with their liquid control over it. (Keynes 1965, 167)

In Keynes's terminology, when one lends money to someone else, one has parted with liquidity. The smaller the supply of liquidity (money) offered for sale, the higher its price will be.

The link that Keynes draws between the demand for money and the rate of interest is unwarranted. To start with, it is too narrow. The demand for money clearly has an effect on all transactions, not merely on transactions in the loan-market. If the demand for money rises, the prices of other goods will fall. After all, one parts with liquidity whenever one buys anything. In addition, Keynes tells us that the demand for money has an effect on the rate of interest within the context of the psychological time-preferences of an individual. (Keynes 1965, 166) If those preferences are sufficient to account for the rate of interest, nothing is gained by the introduction of the demand for money. I will not pursue the subject, however, because I am principally concerned with an evaluation of the *General Theory* on its own terms.

What effect does the quantity of money have on the rate of interest? According to Keynes, "As a rule, we can suppose that the schedule of liquidity-preference relating the quantity of money to the rate of interest is given by a smooth curve which shows the rate of interest falling as the quantity of money is increased." (Keynes 1965, 171) Expanding on the point when discussing open-market operations, Keynes explains that "in normal circumstances the banking system is in fact always able to purchase (or sell) bonds in exchange for cash by bidding the price of bonds up (or down) in the market by a modest amount; and the larger the quantity of cash which they seek to create (or cancel) by purchasing (or selling) bonds and debts, the greater must be the fall (or rise) in the rate of interest." (Keynes 1965, 197)

When the central bank⁴ buys a bond, the price of bonds rises, and the rate of interest thereby falls. On that point Keynes is, of course, correct, but he is correct about there being a connection between the quantity of money and the rate of interest only if the increase in the quantity of money is "pointed" at the price of bonds. Suppose that no central bank existed. Suppose that money consisted exclusively

⁴ Keynes tells us that it is the central bank that determines the quantity of money. (Keynes 1965, 247)

of gold coins. If all newly-minted coins were spent on the purchase of bonds, the rate of interest would fall. But what reason is there to think that all the newly-minted coins would be spent (i.e., offered for sale in the loan-market) on the purchase of bonds? There is not. Keynes is able to establish a connection between the quantity of money and the rate of interest only because his system permits—indeed, requires—a central bank that not only controls the quantity of money but also creates new money in a manner which has to lower the rate of interest. *Q.E.D.*

Keynes has one remaining independent variable, the wage-unit, which is the money-wage of a labor-unit. The wage-unit allows us to convert special labor into ordinary labor by dividing the wage paid to special labor by the wage-unit—and so arrive in due course at the volume of employment.

The dependent variables are income and employment. How is income connected to the independent variables? “The decisions to consume and the decisions to invest between them determine incomes.” (Keynes 1965, 64) Decisions to consume may be called the propensity to consume made flesh. And decisions to invest? “The amount of current investment will depend, in turn, on what we shall call the inducement to invest; and the inducement to invest will be found to depend on the relation between the schedule of the marginal efficiency of capital and the complex of rates of interest on loans of various maturities and risks.” (Keynes 1965, 27–28) Indeed, “the actual rate of current investment will be pushed to the point where there is no longer any class of capital-asset of which the marginal efficiency exceeds the current rate of interest.” (Keynes 1965, 136) Income therefore depends on the propensity to consume, the marginal efficiency of capital, and the rate of interest, which itself is shorthand for liquidity-preference and the quantity of money.

And employment? “The amount of labour N which the entrepreneurs decide to employ depends on the sum (D) of *two* quantities, namely D_1 , the amount which the community is expected to spend on consumption, and D_2 , the amount which it is expected to devote to new investment.” (Keynes 1965, 29) Income depends on consumption and investment; employment depends on expected consumption and expected investment.

The elements of Keynes’s system are now in place. What makes the actual operation of the system so complicated?

[W]hilst an increase in the quantity of money may be expected, *cet. par.*, to reduce the rate of interest, this will not happen if the liquidity-preferences of the public are increasing more than the quantity of money; and whilst a decline in the rate of interest may be expected, *cet. par.*, to increase the volume of investment, this will not happen if the schedule of the marginal efficiency of capital is falling more rapidly than the rate of interest; and whilst an increase in the volume of investment may be expected, *cet. par.*, to increase employment, this may not happen if the propensity to consume is falling off. (Keynes 1965, 173)

In other words, there are times when *ceteris* is not *paribus*. Suppose that consumers stop consuming. Suppose that the marginal efficiency of capital heads south. Suppose that the rate of interest rises. The system might need a lube-job: better get some grease.

THE SOLUTION

Increase in consumption and investment = good. Investment depends on the marginal efficiency of capital and the rate of interest. Increase in marginal efficiency of capital = good. Increase in rate of interest = bad. The rate of interest depends on liquidity-preference and the quantity of money. Increase in liquidity-preference = bad. Increase in quantity of money = good. Where do we go from here? "Our final task might be to select those variables which can be deliberately controlled or managed by central authority in the kind of system in which we actually live." (Keynes 1965, 247) Let us start with the marginal efficiency of capital.

Keynes informs us that "[t]he Trade Cycle is best regarded, I think, as being occasioned by a cyclical change in the marginal efficiency of capital...." (Keynes 1965, 313) During the slump the principal obstacle to recovery is that "it is not so easy to revive the marginal efficiency of capital, determined, as it is, by the uncontrollable and disobedient psychology of the business world." (Keynes 1965, 317) The suggestion that the business world is a naughty six-year old is almost amusing—only "almost" because the question of who gets to play mommy or daddy is far from benign—but the important word is "uncontrollable." The marginal efficiency of capital cannot be deliberately controlled or managed by central authority. Let us turn to the rate of interest.

The rate of interest depends on the quantity of money and liquidity-preference. We already know that the quantity of money is controlled by the central bank. We also know that an increase in the quantity of money will, *ceteris paribus*, produce a decline in the

rate of interest. One obvious question is, will prices rise if you print more money? Keynes provides an answer:

When full employment is reached, any attempt to increase investment still further will set up a tendency in money-prices to rise without limit, irrespective of the marginal propensity to consume; *i.e.* we shall have reached a state of true inflation. Up to this point, however, rising prices will be associated with an increasing aggregate real income. (Keynes 1965, 118–19)

Thus, prices will rise, but—short of full employment—that will not be a problem.

What about liquidity-preference? Subject to control or management by central authority? One would not think so, yet in a passage that has to have embarrassed his fans (assuming that they were capable of being embarrassed by anything), Keynes toys with the idea of issuing money that comes with an expiration date. What Keynes does is to endorse—with reservations—Gesell’s proposal that currency-notes should expire at the end of a month unless they are stamped with stamps purchased at a post-office. (Keynes 1965, 357) Keynes seems to have only two objections. In the first place, Gesell’s proposal does not go far enough: “it would clearly need to apply as well to some forms at least of bank-money....” (Keynes 1965, 357) In the second place, Gesell was “unaware that money was not unique in having a liquidity-premium attached to it....” (Keynes 1965, 357) We do not need to pursue the subject of liquidity-premiums attached to items other than money; suffice it to say, Keynes does not think that liquidity-preference is subject to control or management by central authority—at least not yet.⁵

If investment depends on the marginal efficiency of capital, liquidity-preference, and the quantity of money, and if the quantity of money is the only variable which is subject to control or management by central authority, the system might even need a new transmission:

the schedule of the marginal efficiency of capital may fall so low that it can scarcely be corrected, so as to secure a satisfactory rate of new investment, by any practicable reduction in the rate of interest. Thus with markets organised and influenced as they are at present, the market estimation of the marginal efficiency of capital may suffer such enormously wide

⁵ “The idea behind stamped money is sound. It is, indeed, possible that means might be found to apply it in practice on a modest scale.” (Keynes 1965, 357)

fluctuations that it cannot be sufficiently offset by corresponding fluctuations in the rate of interest. Moreover, the corresponding movements in the stock-market may, as we have seen above, depress the propensity to consume just when it is most needed. In conditions of *laissez-faire* the avoidance of wide fluctuations in employment may, therefore, prove impossible without a far-reaching change in the psychology of investment markets such as there is no reason to expect. I conclude that the duty of ordering the current volume of investment cannot safely be left in private hands. (Keynes 1965, 319–20)

How will the state order (and can the state order investment without ordering investors to stop being naughty and to eat their vegetables?) the current volume of investment? Keynes informs us that

[i]t is not the ownership of the instruments of production which it is important for the State to assume. If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary. (Keynes 1965, 378)

One assumes that ownership of the means of production will remain—nominally—in private hands but that decisions about the volume of production will not. What will this mean in practice? One cannot subject a proposal that is never made to scrutiny. The only safe conclusion is that the state may have to order production—in more ways than one.

What about the propensity to consume? Any prospect of control or management by central authority? One might not think so, but

[t]he only radical cure for the crises of confidence which afflict the economic life of the modern world would be to allow the individual no choice between consuming his income and ordering the production of the specific capital asset which, even though it be on precarious evidence, impresses him as the most promising investment available to him. (Keynes 1965, 161)

Unless you spend all your income on something, you will be arrested? Shot? And how do you establish that you have spent all your income on something? When you buy a soft drink from a vending machine, do you need to ask it for a receipt? Assume that you get lucky and that the State passes a Paperwork Reduction Act. You no longer need receipts, but your mattress will be examined monthly to ensure that there is no currency hiding in the horse-hair?

Let us take a different tack. Is it possible to use taxation as an instrument that will give the propensity to consume a jump-start? Keynes asserts that “it is ... obvious that a higher absolute level of income will tend, as a rule, to widen the gap between income and consumption.... These reasons will lead, as a rule, to a greater *proportion* of income being saved as real income increases.” (Keynes 1965, 97) Perhaps taxes should be levied on those with high incomes and the proceeds given to those with low incomes or no income?

There is a problem. “Provided it is agreed that income is equal to the value of current output, that current investment is equal to the value of that part of current output which is not consumed, and that saving is equal to the excess of income over consumption—all of which is conformable both to common sense and to the traditional usage of the great majority of economists—the equality of saving and investment necessarily follows.” (Keynes 1965, 63) That portion of income which is not spent on consumption is saved, and that which is saved is invested. Aggregate demand is derived from consumption and investment.⁶ Using taxation to transfer income from those who save to those who consume may increase consumption, but it can do nothing to increase aggregate demand because of the effect that it will have on investment.

Does the conclusion change if saving can exceed investment? Keynes tells us elsewhere that “a relatively weak propensity to consume helps to cause unemployment by requiring and *not* receiving the accompaniment of a compensating volume of new investment....” (Keynes 1965, 370) In fact, “there has been a chronic tendency throughout human history for the propensity to save to be stronger than the inducement to invest.” (Keynes 1965, 347) If aggregate demand is derived from consumption and investment, is money that is not spent either on consumption or on investment hoarded? If so, levying a tax on hoarders and distributing the proceeds to spenders should increase aggregate demand.

The problem with that suggestion is that it is by no means clear that hoarding—in any meaningful sense—exists, for Keynes admits that

⁶ “Opportunities for employment are necessarily limited by the extent of aggregate demand. Aggregate demand can be derived only from present consumption or from present provision for future consumption.” (Keynes 1965, 104)

it is impossible for the actual amount of hoarding to change as a result of decisions on the part of the public, so long as we mean by 'hoarding' the actual holding of cash. For the amount of hoarding must be equal to the quantity of money (or—on some definitions—to the quantity of money *minus* what is required to satisfy the transactions-motive); and the quantity of money is not determined by the public. (Keynes 1965, 174)

If all money, in the nature of the case, is hoarded, we will never be in a position where we can "unhoard" it: if you take money that Peter is hoarding and give it to Paul, the only thing you have changed is the name of the hoarder.

Perhaps "hoarding" is really a synonym for "liquidity-preference"⁷ and interest "is the reward of not-hoarding." (Keynes 1965, 174) If so, hoarding is really a refusal to lend money in the loan-market. Nowhere in the *General Theory*, however, does Keynes argue that the propensity to hoard will increase as income increases, and it is difficult to understand why it should be so: one would expect one's willingness to make loans to increase with the size of one's bank account (or stash in the mattress), not to decrease. Where does all this leave us? Keynes never provides a plausible argument that "appropriate" taxation will increase aggregate demand.⁸

Perhaps deficit-spending will come to the rescue? One curious feature of Keynes's *General Theory* is that it contains so little material dealing with deficit-spending, the very feature most often associated with the work. Keynes's only extended discussion of deficit-spending occurs in a footnote:

It is often convenient to use the term "loan expenditure" to include the public investment financed by borrowing from individuals and also any other current public expenditure which is so financed. Strictly speaking, the latter should be reckoned as negative saving, but official action of this kind is not influenced by the same sort of psychological motives as those which govern private saving. Thus, "loan expenditure" is a convenient expression for the net borrowings of public authorities on all accounts,

⁷ "The concept of *Hoarding* may be regarded as a first approximation to the concept of *Liquidity-preference*. Indeed, if we were to substitute 'propensity to hoard' for 'hoarding,' it would come to substantially the same thing." (Keynes 1965, 174)

⁸ Keynes (1965) argues in at least two places that fiscal policy can be used to increase the propensity to consume. The reasoning, however, is fallacious, and the appropriate criterion should be the effect of fiscal policy on aggregate demand, not merely its effect on the propensity to consume. See pp. 94–95 and pp. 372–73.

whether on capital account or to meet a budgetary deficit. The one form of loan expenditure operates by increasing investment and the other by increasing the propensity to consume. (Keynes 1965, 128–29)

Two significant points in the preceding passage that ought to be noted are that borrowing by public authorities on “capital account” does not qualify as deficit-spending and that the money for the “loan expenditures” is borrowed from individuals, not printed by the central bank.

One obvious question is, will borrowing by the government have an adverse effect on the rate of interest? Keynes provides an answer when discussing the effect of borrowing for public works (i.e., on “capital account”), but his conclusion clearly applies to all borrowing by the government: “[t]he method of financing the policy ... may have the effect of increasing the rate of interest and so retarding investment in other directions, unless the monetary authority takes steps to the contrary....” (Keynes 1965, 119)

If the demand to borrow money increases, so will its price. The only possible escape from that conclusion is an increase in the supply of money offered for sale. Because the central bank is precluded from buying the government’s bonds by Keynes’s statement that the money for “loan expenditures” is borrowed from individuals, the central bank must purchase other debt in open-market operations. Only in that manner can it counter the adverse effect that borrowing by the government would otherwise have on the rate of interest.

Does that mean that deficit-spending can increase aggregate demand? Even if aggregate demand does increase, the motor is the printing-press, not the “loan expenditure,” and there is no reason to think that the “loan expenditure” played an indispensable role: if the government balances its budget and the central bank buys debt in open market operations, the rate of interest will fall, and the inducement to invest will rise. The protagonist of the *General Theory* is the printing-press; deficit-spending is just a walk-on.

Once again, the obvious question is, what will happen to prices? Keynes’s answer is the *General Theory* in a nutshell:

We have shown that when effective demand is deficient there is under-employment of labour in the sense that there are men unemployed who would be willing to work at less than the existing real wage. Consequently, as effective demand increases, employment increases,

though at a real wage equal to or less than the existing one, until a point comes at which there is no surplus of labour available at the then existing real wage; *i.e.* no more men (or hours of labour) available unless money-wages rise (from this point onwards) *faster* than prices. (Keynes 1965, 289)

In sum, prices will rise, but money-wages (assuming the existence of involuntary unemployment) will not rise as quickly as the prices of wage-goods, and those who are willing to work for less than the previously existing real wage will accept the jobs that are thereby made available.

The obvious question then becomes, why tinker with the printing press (paper and ink may not be expensive, but no one ever said that they were free) if there are people who are willing to work for less than the existing real wage? Why do not those who are willing to work for less than the existing real wage simply accept jobs at less than the existing real wage (*i.e.*, for a lower money-wage) *before* any paper is printed? Keynes answers that question:

Let us assume, for the moment, that labour is not prepared to work for a lower money-wage.... although a reduction in the existing money-wage would lead to a withdrawal of labour, it does not follow that a fall in the value of the existing money-wage in terms of wage-goods would do so, if it were due to a rise in the price of the latter. In other words, it may be the case that within a certain range the demand of labour is for a minimum money-wage and not for a minimum real wage. (Keynes 1965, 8)

In other words, labor will not accept a reduction in its real wage effected by a lower money-wage. Why not? It does not want to. I am glad that problem has been cleared up.

In Keynes's system, the only arrow in the quiver is the printing press. Provided that involuntary unemployment exists, the ultimate result will be more employment at a lower real wage—so runs the argument. Bullseye?

CONCLUSION

Keynes's *General Theory* purports to be a theory of employment, interest, and money, yet it contains no useful (from Keynes's point of view) theory of employment. What it does contain is a definition of the term "volume of employment" which is fully consistent with an increase in the volume of employment even when the number of workers and the number of hours worked both decrease. Was that the *quaesitum* that Keynes was looking for? And that same

“volume of employment” is of no avail when searching for the involuntarily unemployed.

Keynes’s theory of interest is defective, for Keynes makes the rate of interest depend on the demand for money, or liquidity-preference, and the quantity of money. The demand for money has an effect on all transactions, not merely (if at all) on transactions in the loan-market, and a convincing link between the quantity of money and the rate of interest exists only in so far as new money is offered for sale in the loan-market.

We discussed some of what Keynes had to say on the subject of money in the preceding paragraph. One thing that needs to be made clear is that Keynes did not present a general theory of money in his *General Theory*. Instead, he presented a special theory of money, aptly called The Green Cheese Theory of Money,⁹ which only applies to money made of green cheese (well, to money newly manufactured by a central bank and used to purchase debt in the loan-market).

The significant independent variables in Keynes’s system are the propensity to consume, the marginal efficiency of capital, the rate of interest (which is itself determined by the demand for, and the quantity of, money), and the wage-unit, which is “determined by the bargains reached between employers and employed.” (Keynes 1965, 247) Keynes hopes to be able to identify those variables “which can be deliberately controlled or managed by central authority in the kind of system in which we actually live.” The overarching goal is the solution to a problem called involuntary unemployment and the achievement of its absence, full employment. How successful is the *General Theory* on its own terms?

If saving equals investment, no justification exists for talk about allowing the individual “no choice between consuming his income and ordering the production of a specific capital-asset” nor for talk about the need for the state to assume “the duty of ordering the current volume of investment.” Nor is it possible to justify

⁹ “Unemployment develops, that is to say, because people want the moon;—men cannot be employed when the object of desire (*i.e.* money) is something which cannot be produced and the demand for which cannot be readily choked off. There is no remedy but to persuade the public that green cheese is practically the same thing and to have a green cheese factory (*i.e.* a central bank) under public control.” (Keynes 1965, 235)

taxation that falls disproportionately on those with high incomes. Do matters change if saving can exceed investment? If saving can exceed investment, Keynes's General Theory is self-contradictory, and we no longer need to concern ourselves with any of its features.

"Central authority" has no control over the marginal efficiency of capital, liquidity preference (at least not yet), nor the wage-unit, and deficit-spending can have no effect on aggregate demand without a printing-press in the foreground. When all is said and done, Keynes's system contains only one treatment, more money, for the ill that ails us, for the quantity of money is the one thing that central authority does control—provided, of course, that there is a central bank.

And what is the ill that ails us? Involuntary unemployment. We saw earlier that we can never know that involuntary unemployment exists (not even that it *did* exist), but why should that deter our efforts to eradicate it? If printing a little bit of paper does not do the trick, print some more. That will teach them a lesson they will never forget. Who is the "them"? Labor—do you really think that all the naughty six-year olds are entrepreneurs and investors? If labor will not agree to a reduction in real money-wages, you print more paper and hope that some of them will change their minds. And if a child will not eat his vegetables, you double the size of his portion and hope that he will eat half. It almost makes sense.

It does not. Someone who "withdraws his labor" because he will not accept a lower real-wage is, by Keynes's own admission, voluntarily unemployed, yet it is precisely those who are voluntarily unemployed who form the body of what one might call Keynes's army of the involuntarily unemployed in training. For—and here is the kicker—if they change their minds after the printing press has done its magic (after, that is to say, the central bank has debased the currency) and agree to accept employment at a lower real wage, they receive a promotion: it turns out that those who were once voluntarily unemployed were actually involuntarily unemployed. It almost makes sense.

It does not. When someone is voluntarily unemployed on Tuesday because he "does not choose to work for less than a certain real reward," then changes his mind on Wednesday and agrees to work for a lower real wage than he was willing to accept on Tuesday, that does not change his status on Tuesday to someone who was involuntary unemployed. Rather, it changes his

status on Wednesday to someone who is voluntarily employed. Keynes's *General Theory* is a solution to a problem that does not exist, and Keynes himself clearly was a crank, which makes the praise which the *General Theory* has received in the corridors of power—though hardly unexpected—appalling, and the praise in academia, scandalous.

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