Geoff Tily: ***Keynes's General Theory, the Rate of Interest, and Keynesian Economics: Keynes Betrayed*** Basingstoke: Palgrave Macmillan 2007

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In these dissembling, Harry Potterish, times it is rare to find an ambitious book that reads up to its declared ambition. Geoff Tily's book is just such a work, and its aim is nothing less than to change our view of Keynes. This endeavour, much like unravelling the meaning of Marx's *Capital*, has become one of the great intellectual swamps of economics in which too many able and intelligent academics have lost their way and perished (intellectually, if not physically) in pursuit of phantom solutions to imagined puzzles. Yet we go back to these writers because they are systematic. They therefore go far beyond the incidental insights that keep economics on the level of commonplace observation. Moreover, Keynes defies summary interpretation because of the range of his interests. He toyed wantonly with the presuppositions of his readers, deliberately used ambiguity as a rhetorical device and infused his concepts with special meanings (see below). Any new interpretation therefore requires a huge amount of research, the integration of a mass of seemingly contradictory analysis and opinion and, above all, intellectual stamina and thought.

Geoff Tily's starting point is Keynes as a 'monetary reformer', that is as an economic visionary who, with the *General Theory*, arrived at a way in which monetary reform could change how capitalism works (rather than just securing monetary stability). In Tily's view Keynes appears as an advocate of the reform of capitalism by means of a secular policy of low interest rates, in particular the long-term interest rates that he supposed most influenced investment in the economy. This is to be achieved by keeping Bank Rate (the rate at which central bank's operate in the money markets) low, while engaging in open market operations in the bond market to keep bond prices high. This latter aspect of debt management Tily uncovers in Keynes's Notes to the National Debt Enquiry in 1945, but the argument may be found in his *Treatise on Money*. In Tily's and Keynes's view, such a policy would stimulate investment as a foundation for prosperity and full employment in capitalism.

Where I found myself in disagreement, that disagreement turned out for the most part to be either trivial, or a criticism of Keynes's view: certainly not trivial, but not a charge to be filed against Tily. My critical remarks therefore focus on those details and aspects of the book that I think need most development in order to provide a convincing case for the concerned economist of today.

First, it is necessary to clarify some of our terms. Early on (p. 10), Tily refers to Keynes's use of the term 'neo-classical', and then proceeds throughout the book to use it to refer to the neo-classical synthesis of Keynes, as expounded by Hicks, Samuelson, and Modigliani. This is one of those ambiguities that has misled many readers of Keynes. Everyone knows what Keynes meant by 'the classics'. But some very distinguished Post-Keynesians (and even some of my best students) have been unable to tell me what Keynes meant by the term 'neo-classical'. In the *General Theory* he defined it rather obliquely as follows: 'Unlike the neo-classical school, who believe that saving and investment can be actually unequal, the classical school proper has accepted the view that they are equal' (Keynes 1936, p. 177). In this Keynes was obviously referring to Hobson, Hayek, and of course himself in the *Treatise on Money*. Indeed, Keynes made this clear in his letter to Hawtrey on the 15 April 1936: 'I mean by the classical school, as I have repeatedly explained, not merely Ricardo and Mill, but Marshall and Pigou and Henderson and myself until quite recently, and in fact every teacher of the subject in this country with the exception of yourself and a few recent figures like Hayek, whom I should call "neo-classicals".' (Keynes 1973, p. 24). Unfortunately this was not the sense in which that term was widely used. Hobson, to whom Keynes sent an advance copy of the *General Theory*, wrote on the 10 February to congratulate its author on 'its shattering exposure of the neo-classical theory and policy…' (Keynes 1979, p. 209). But what Hobson meant by 'neo-classical' was the mathematical marginalist school founded by Jevons (Hobson 1926, Part II, chapter II). Keynes too was a marginalist, sought to give his theory mathematical respectability; and could therefore be counted a Hobson-definition neo-classical.

All this goes to show how difficult it is in such discussions to avoid the worst, most futile excesses of Keynesian exegesis. But there is a serious point to these considerations that Tily, who appears to adopt Hobson's definition of what constitutes 'neo-classical' theory, nicely highlights. Pre-eminent among the Keynes-definition 'neo-classicals' was of course Knut Wicksell. Wicksell's ideas were the ones to which Keynes was groping in his *Treatise on Money*. Tily's main policy conclusions, namely the maintenance of a high level of private sector economic activity by stimulating investment through cheap money and the manipulation of long term interest rates by central bank bond purchases, may all be found in Treatise. On Tily's reading, the main innovation in the *General Theory* follows from Keynes's realisation that, in a closed economy with no government, saving is determined by investment (chapter 6 in Tily's book). It follows that saving equals investment at all rates of interest. If the rate of interest does not bring saving into equilibrium with investment, then it becomes necessary to have some other explanation of how the rate of interest is determined. Keynes therefore advanced the 'liquidity preference' theory of interest, whereby interest is determined in the financial markets by the demand for liquidity in the market for long-term securities. But even a perfectly regulated long-term rate of interest is not, according to Keynes, an infallible instrument for regulating the level of investment because the latter is also affected by uncertainty and volatile expectations. In this way Keynes broke the link between the rate of interest and the marginal productivity of capital that was the central feature of the neo-classical (Keynes-definition) credit cycle, as expounded by Wicksell, Hayek and in the *Treatise on Money*. As Schumpeter put it, the result was a 'pure monetary' theory of interest.

In this reviewer's opinion, Wicksell deserves more attention, because of his contribution to credit cycle theory, and his prior enunciation of a 'monetary' theory of interest, determined in the money markets of the banking system, as opposed to what he called the 'natural' rate determined by capital productivity. Tily rejects the existence of a credit cycle, arguing that the symptoms associated with it, fluctuations in the financial markets and coincident variations in output and employment, result from high interest rates and/or volatile expectations. This takes the discussion beyond Tily's book to a consideration of the nature and scope of business cycle in the contemporary capitalist economy, and macroeconomic stability in general. Tily's book may be viewed as a contribution to just such a consideration. Implicitly, if not explicitly, the question of macroeconomic stability lies at the heart of Tily's analysis and its relation to current macroeconomic theory and policy.

Current theory and policy are concentrated around the New Consensus on Monetary Policy, according to which central bank interest rates should regulate inflation and, in some versions such as the Taylor Rule, employment. This may look like a Keynesian policy, and has indeed been welcomed by some Post-Keynesians. But in fact the New Consensus owes more to the thinking of Keynes's rivals, Ralph Hawtrey and Denis Robertson, if only because of the presumption in the New

Consensus of the efficacy of short-term interest rates. Tily would reject this, because it would involve raising interest rates when prices and employment exceed some target level.

Let us suppose that interest rates are set permanently at low rates, as advocated by Keynes and Tily. Tily argues in his Conclusion that this would stabilise capitalism and open way for prosperity. However, this depends crucially on the scope and nature of the business cycle. If the business cycle is the result of variations in long-term interest rates, then Tily & Keynes are right. But already in Keynes's time, Hawtrey had responded to Keynes's policy analysis in his 1937 Marshall Lectures, published as *A Century of Bank Rate* (Hawtrey 1938) and Kalecki in his 1941 paper in the *Review of Economic Statistics* (Kalecki 1943). Both showed that long-term interest rates were much more stable by comparison with short-term interest rates, even during the economically turbulent inter-War period. Kalecki concluded that the long-term rate could not be responsible for the business cycle (Kalecki 1943). The significance of this for Keynes's analysis was obvious to his contemporaries. Hicks, later to be vilified by Post-Keynesians for his 'neo-classical' interpretation of Keynes, was, in 1937 trying to raise money for a systematic investigation of the role of long-term interest rates. Curiously, neither Hawtrey's, nor Kalecki's refutation of Keynes's central policy recommendation find their way into either Donald Moggridge's edition of the *Collected Writings of John Maynard Keynes*, or the monetarist reconstruction of Keynes in David Laidler's *Fabricating the Keynesian Revolution* (Laidler 1999). Tily has indeed broken new ground in focussing attention on the role of long-term interest rates in Keynes's analysis.

In the 'Notes on the Trade Cycle' (Chapter 22 of his *General Theory*) Keynes seems to have supposed that business cycle would continue in some form even with low interest rates, because of volatile expectations. How could one regulate this cycle if interest rates are to remain fixed at a low level in money terms? The obvious 'Keynesian' instrument of counter-cyclical policy is fiscal policy, whether the infrastructure and social expenditure of the Gordon Brown, or the military expenditure and tax cuts by which George W. Bush seems to have galvanised the U.S. economy. Both fiscal policy and interest rate policy suffer similar practical limitations in the face of a sustained failure by business to invest: interest rates cannot be pushed below zero, and additional increases in public debt may become politically more difficult to implement (Kalecki 1944). In any case, such policy is the hallmark of the 'fiscalist' interpretation of Keynes that was part of the 'neo-classical' synthesis that Tily and all Post-Keynesians reject. One might try regulating the business cycle by means of credit controls, such as were implemented after the War. However, those attempts led to monetarism.

This policy dilemma lies at the heart of Tily's attempt to establish the relevance of Keynes today. It needs to be resolved if today's opponents of cheap money are to be convinced that a permanent regime of low interest rates will not just lead to inflation and speculation, and deprive 'the authorities' (with central bank independence, one is not supposed to include monetary policy within the scope of politics) of a presumed effective instrument of counter-cyclical policy.

At various points, as his subtitle indicates, Tily makes much of the moral failure of academic economists in misunderstanding and misrepresenting Keynes. I wonder whether Keynes cared so much what academic economists thought. A few weeks before Keynes died, Hayek reproached him for tolerating in silence the misrepresentations of his theory that were being put about. Keynes's response suggests that he was unconcerned about what academic economists thought of his ideas because his main concern was economic policy (Hayek 1952). Policy then and now continues to be made by 'practical men' except on the Monetary Policy Committee of the Bank of England, where academic economists can be given full discretion, because they can be relied upon to entertain rather than disconcert, as Keynes would have done, the presuppositions of those 'practical men'.

Despite reservations about the implications of Tily's interpretation of Keynes, this serious and thoughtful book is a splendid antidote to today's fashion for interest rate activism. It is also appropriate to acknowledge the influence that this book's author had on the reviewer even as Tily was writing the Ph.D. on which the book is based. His writing up of his thesis coincided with my own writing of the chapters on Keynes in my *Theories of Financial Disturbance*. Geoff and I met on very few occasions. But each of them were marked by very deep discussions on Keynes's analysis. I was genuinely impressed, even a little disturbed, at the degree to which we were both converging on similar conclusions about Keynes. Perhaps this is not really surprising. Geoff's supervisor, Victoria Chick, also introduced me to monetary theory and Post-Keynesian economics, guiding me through my initial steps in these areas, and then arguing with me about them. Geoff writes for both of us in his warm tribute to her supervision. Special thanks are also due to Jennifer Churchill, Ewa Karwowski and Simon Barzilay, who joined me earlier this year in Keynes's Gordon Square Library to discuss Emile Zola's *Money*, elucidating the otherwise incomprehensible reference to 'Gunderman and Saccard' on p. 30 of Tily's book.

In his last book, *Travels with Herodotus* (*Podróże z Herodotem*) Ryszard Kapuściński quotes a passage that T.S. Eliot included in his 1944 essay on Virgil, but which could just as easily have been written about economics today:

‘In our age, when men seem more than ever prone to confuse wisdom with knowledge, and knowledge with information, and to try to solve problems of life in terms of engineering, there is coming into existence a new kind of provincialism which perhaps deserves a new name. It is a provincialism of, not of space but of time; one for which history is merely the chronicle of human devices which have served their turn and been scrapped, one for which the world is the property solely of the living, a property in which the dead hold no shares. The menace of this kind of provincialism is that we can all, all the peoples on our globe, be provincials together; and those who are not content to be provincials, can only become hermits.’

Geoff Tily’s study is notable for the boldness of its escape from the provincialism of economics today, without succumbing to the provincialism of mere history of economic thought. His insight into past ideas and present circumstances will appeal to all intellectuals in the economics profession.

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