A CRITIQUE OF JOHN MAYNARD KEYNES' CONCEPT OF
THE PROPENSITY TO CONSUME

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A CRITIQUE OF JOHN MAYNARD KEYNES' CONCEPT OF
THE PROSPERITY TO CONSUME

THESIS

Presented to the Graduate Council of the North
Texas State College in Partial
Fulfillment of the Requirements

For the Degree of

MASTER OF ARTS

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168290
College Station, Texas
August, 1949
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CHAPTER I

THE SCOPE AND PURPOSE OF THE INVESTIGATION
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THE SCOPE AND PURPOSE OF THE INVESTIGATION

As introduction to the theme of this paper it is necessary to lay down certain limitations upon both the scope and the purpose of the investigation and to point out certain peculiarities in the methodology which have a bearing upon the contents of the paper and upon the conclusion which it draws.

Economic theory as seen by John Maynard Keynes consists of three major fields of investigation. These three are "The Propensity to Consume," "The Inducement to Invest," and "Money-Wages and Prices."¹

It is Keynes' general thesis that what he calls the "classical theory of the subject" applies only to special cases and not to the usual conditions in economic society. Further, he contends that the conditions assumed in the classical theory are not those of the economic system now existent.² Hence, the larger part of economics in the Adam Smith-Alfred Marshall tradition is of no pragmatic value, retaining usefulness only as a series of intellectual exercises for college sophomores.

It will be a part of the thesis of this paper that the General Theory of Keynes may well be subject to that same accusation. It will be a part of the purpose of this paper to show that Keynesian economics treats a closed economy in a static condition while American and British society in actuality exist in open economies in a dynamic condition.

¹John Maynard Keynes, The General Theory of Employment, Interest and Money, p. 31
²Ibid.
In scope this paper is limited to an appraisal of the first of the main concepts of John Maynard Keynes' General Theory. That is, this paper will be concerned only with the "Theory of the Propensity to Consume" and its ramifications.

It is upon this precept that all of Keynes' economic theory must stand or fall and the validity of this "psychological law" must be carefully tested from every standpoint. It is upon the propensity to consume that the quantity of funds devoted to saving and investment depend; hence, it is upon the propensity to consume that income depends, and since the propensity to consume depends upon income, the circular functional relationship relating income to saving-investment to the propensity to consume is the core of Keynes' argument.

The idea which lies at the root of the propensity to consume must be examined as a single unit of thought, as a complete hypothesis in its own right. Briefly stated, that idea is this: (a) as man's money income increases or decreases the quantity of funds which he saves increases or decreases in a measurable proportion. At various levels of income, with the propensity to consume known, saving can be predicted with practicable accuracy. (b) Savings is equal to investment. (c) Investment is the residue from income less consumption and consumption is determined by the propensity to save at any given income level, or inversely, by the propensity to consume. Hence, upon the propensity to consume depends the volume of investment and upon the volume of investment depends the level of employment.

Before we can proceed with an examination of the logic in the basic

\(3\) Ibid., pp. 90 f.  
\(4\) Ibid., p. 90.  
\(5\) Ibid., p. 63.  
\(6\) Ibid., p. 289.
idea, certain definitions of the terms used must be presented, beginning with an examination of Keynes' definition of income. As the term is used in the General Theory, it is synonymous with value of output. The entrepreneur's income is thus defined by Keynes as "... the excess of the value of his finished output sold during the period over his prime cost." Prime cost is the sum of the factor cost—the amount paid to the other factors of production in return for their services, and "user cost," the loss of value of capital or disinvestment during the period.

Savings are defined by Keynes very simply as the residue from income after consumption while in its turn, consumption is said to be the "value of goods sold to consumers during that period." What is meant by the term consumer, or "consumer-purchaser" as Keynes uses it, is a little more complex, although Keynes is quick to point out that any reasonable exposition of the differentia between "consumer-purchaser" and "investor-purchaser" is acceptable so long as it is consistently used. For his own purposes, Keynes chose to define consumption as the aggregate of entrepreneur's sales less the aggregate of sales from one entrepreneur to another. From these definitions of consumption on the one hand and of income on the other, the definition of savings is reaffirmed as the excess of income over consumption. Income being the aggregate of entrepreneur's sales less "user cost" and consumption being the aggregate of entrepreneur's sales less what, for want of a better term, we shall call

7Ibid., p. 53
8Keynes uses the term capital to designate both money and equipment. Here it is presumed he means the latter.
9Ibid., pp. 61 ff.
10Ibid.
11Ibid., p. 62.
the aggregate of entrepreneur's mutual transactions, it follows that savings are entrepreneur's mutual sales less disinvestment (user cost).\textsuperscript{12}

The final term to be defined, investment, is the addition of value to what Keynes calls "capital equipment as the result of the productive activities of the period,"\textsuperscript{13} which is coincidental with saving.\textsuperscript{14}

The question to which these definitions inevitably lead is one of functional relationship—that is, which is the fund and which is the residue? According to Keynes' conception, consumption depends upon the decisions of consumers and entrepreneur's sales depend upon the decision of entrepreneurs, hence income and savings are by definition residues. And therein lies the importance of the psychological law which determines the ratio of consumption and savings, the propensity to consume.

The correctness of these definitions as an interpretation of Keynes' concept is confirmed by numerous critics of Keynes, both sympathetic and severe and by Keynes himself in other writings. Indeed, the importance of these definitions is emphasized by one authority who claims that the most startling concepts of the Keynesian general theory are but matters of definition.\textsuperscript{15}

The logic of Keynes' basic hypothesis as developed above may be questioned at several points. Obviously, the assumption that there is a definite, constant, measurable relationship between income and the rate of saving must be proved and cannot be passed off as a "fundamental

\textsuperscript{12}Ibid., page 63.  \textsuperscript{13}Ibid.

\textsuperscript{14}Here again Keynes uses capital funds and capital equipment interchangeably, presumably assuming the automatic metamorphosis from one form to the other.

psychological law upon which we are entitled to depend with great confidence both a priori from our knowledge of human nature and from the detailed facts of experience . . . . The "a priori knowledge" and what "detailed facts of experience" does Keynes refer to? At least this part of the hypothesis is open to question.

That savings are equal to investment in the Keynesian concept cannot be questioned since it is true by his definition. However, this equation does not necessarily stand the test of altered definition. According to Keynes, "income can only be generated by producing goods," but if the findings of the Brookings Institute are true, that is, if "it is possible to increase the supply of capital goods without an antecedent or concurrent restriction of consumption" through the use of bank credit then there must be investment from a source other than income, as Keynes defines the term. Consequently, savings which must stem from income, are not necessarily equal to investment, nor is investment necessarily in a functional relationship with consumption, which certainly must be limited by the quantity of goods produced. The illusion arises from what C. E. Ayres calls the ability of economists to cross their eyes and see two entities as one. The quantity of capital goods available is confined to the quantity of capital goods produced in the past less capital goods used up, but investment, in the sense often used by Keynes, is ownership values measured by capital funds, money, the production of which is limited in

16 J. M. Keynes, General Theory, p. 96.
the American economic system only by a few ineffectual regulations which
give the effect of an infinite range of variation in the supply of money
with the level being determined by the attitude of the banking fraternity.

As to the "fundamental psychological law," which will be treated more
fully in a later chapter, perhaps a writer in another field has summed
up the criticism which this paper will levy. Ruth Benedict says

... custom has not been commonly regarded as a subject of any great
moment. The inner workings of our own brains we feel to be uniquely
worthy of investigation, but custom we have a way of thinking, is
behavior at its most commonplace. As a matter of fact, it is the
other way around. Traditional custom, taken the world over, is a
mass of detailed behavior more astonishing than what any one person
can ever evolve in individual actions no matter how aberrant. Yet
that is a rather trivial aspect of the matter. The fact of first
rate importance is the predominant role that custom plays in experi-
ence and in belief, and the very great varieties it may manifest.

... The life history of the Individual is first and foremost an
accommodation to the patterns and standards traditionally handed
down in his community.20

There are known, provable truths about the sciences of psychology,
sociology and anthropology to which economics, a science traditionally
based on deduction, must bow. As Stuart Chase remarks, "Classical economics
... became a kind of theology...",21 and this paper maintains that
John Maynard Keynes is not the dissenter from that theology that he
believed himself to be. On the other hand, a system of beliefs which may
explain the propensity to consume in an acceptable manner is highly
desirable. Some of those whom Keynes calls heretics, notably J. A. Hobson
and J. M. Clark, have made strides in this direction, and J. S. Gamse has
summed up the institutional viewpoint with

Institutionalists have taken economics out of the realm of
pseudo-physical science, which is where standard theory seems to
want to put it, and have placed it squarely into the biological

20 Ruth Benedict, Patterns of Culture, p. 2.
21 Stuart Chase, "Word Trouble Among the Economists," Harper's
sciences. They have made it—or, at least, valiantly tried to
make—its doctrines conformable with those of anthropology, ethnology,
psychology, genetics, disciplines that have bothered standard
theorists less. 22

It is from this positive viewpoint that this paper will approach the
Keynes concept of the propensity to consume.

Another test to which the Keynes concept must be put is that of
empirics. Two questions must be brought forward and the propensity to
consume examined in their light. First, do or can the conditions implied
in the concept actually exist and second, is there existent historical
evidence in support or refutation of the concept?

Although they will be developed more fully as the paper progresses,
mention must be made at this point of the preconceptions which Keynes
brings with him into the general theory. First, and most important
from the standpoint of this study is the adherence of Keynes to marginal
utility theories. 23

Commenting upon this preoccupation of the great heretic with one
of the classic precepts, J. M. Clark says, "Utility theorizing . . . still
contains the major psychological elements which were successfully attacked
as bad psychology . . . thirty years ago." 24 And again,

... the major psychological assumption common to the utility approach,
the individual demand schedule approach, and the indifference curve
approach, is the assumption that each individual possesses a scale of
preferences exact and stable, and that his allocation of his resources—
his budgeting of his income between different goods and services as a
consistent expression of this scale of preferences. They assume a
static equilibrium within human nature which is obviously non-existent. 25

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22 John S. Gambs, Beyond Supply and Demand, p. 10.
23 Keynes, General Theory, p. 135. This is concerned only with the
marginal efficiency of capital, but it is typical of Keynes' arguments.
24 J. M. Clark, "Realism and Relevance In the Theory of Demand,"
25 Ibid., p. 348.
Another preconception, that of the rational behavior of an economic man, is brought to light and destroyed at the same time. That Keynes held this notion of a philosophy of pleasure and pain is evidenced by several of the points that are brought forth in the *General Theory*. The first of these points could well be the "Psychological and Business Incentives to Liquidity." This discussion of the justification of capital return is basically a restatement of the classical theories of sacrifice and reward, of hedonistic pain and pleasure.

Beside a rational man in a marginal utility society, the general theory presupposes that each member of that society have some working knowledge of economic measurements since a great portion of their action is based upon real wages rather than money wages and the worker must be careful that he estimates his real wage in terms of wage-goods instead of production goods, since it is this portion of the total product which will determine income.

Since Keynes' concept of the propensity to consume concerns the social actions of what Veblen called "the underlyng masses" this paper will take the position that an investigation of Keynes' authority to speak for or of this group is not out of order.

The man sometimes called "Baron Keynes of Tilton" was a product of an upper class, wealthy family and can by no stretch of the imagination be considered a man with the knowledge of the people in the same sense as Veblen, for example, or John R. Commons. But perhaps Keynes himself

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27 Ibid., pp. 15 ff.  
answers this question better than any observer could when he says in answer to a question about another matter:

Ought I then to join the Labour party? Superficially that is more attractive. But looked at closer, there are great difficulties. To begin with, it is a class party, and the class is not my class. If I am going to pursue sectional interests at all, I shall pursue my own. When it comes to the class struggle as such, my local and personal patriotism, like those of everyone else, except certain zealous ones, are attached to my own surroundings. I can be influenced by what seems to me justice and good sense; but the class war will find me on the side of the educated bourgeoisie.

Of course, no one could deny Keynes the right to join whichever side he chose to take in any class war, but his avowed attitude would seem to allow question of his objectivity in appraising the activities of the uneducated proletariat.

So far as the second question of empirics is concerned, let it suffice to say that there is no historical background for Keynes' assumptions. In the intervening years, economic theory has advanced sorrowfully little for Keynes bases his theory on the same sort of haphazard, random personal observations which were the forte of Adam Smith and Ricardo. Indeed, it is actually retrogression since Marshall did use something approaching objective method in building his appendices.

Since the propensity to consume is admittedly concerned with human behavior, both the psychological and sociological aspects of the concept must be examined.

If the propensity to consume is approached with the traditional behavioristic psychology in mind, there arises the question of the nature of the stimuli which move men to save. The stimulus must be overt, inceptive, or subvocal. 32 Without anticipating the more detailed examination

31 J. M. Keynes, an address at Oxford University, cited by A. L. Rowse, "Why Mr. Keynes is Not a Socialist," The Nineteenth Century and After, Vol. 112, (Sept, 1938) p. 338.

of what Keynes calls the "subjective factors"\(^{33}\) of the propensity to consume, some conjectures about these motives for saving can be made.

If the process of thinking which leads to saving is overt, or if it stems from an overt act, then the act and the stimulus must be readily apparent to any and to every alert observer. Moreover, if the process is to be of any use to Keynes, this act must be universal in time and space, or at least must occur to all members of a certain economic group with predictable regularity. While there may be such an act or group of acts, it is difficult to conceive of one.

If the thought process leading to saving is inceptive, or if the thought process leading to saving is subvocal, the problem is roughly the same. Is there some faint race memory which makes mankind desire to hoard a portion of his goods in the same manner as squirrels and other rodents, and has man transferred this notion from goods to money? Or is this propensity to save the result of conditioning in each man's early years? If so, then there again must be apparent actions on the part of someone—the child, his parents, his teachers, or the society generally—which does this conditioning. If these actions do exist, then they can be discovered. So far, none which meet the test of universality are evident.

Keynes might have argued that this was not the sort of psychological law which he meant, that what he meant was simply that a portion of the group's income must always be residual, since man's capacity to consume is limited by the size of his stomach and the number of hours in his lifetime, and since income is poorly distributed. This possibility will be discussed in some detail below, since Keynes does mention

\(^{33}\text{J. M. Keynes, General Theory, p. 107.}\)
institutional factors which tend to encourage accumulation and retard the growth of consumption when incomes increase.\textsuperscript{34}

Approached from the standpoint of configurative or gestalt psychology the propensity to consume not only presents much the same problem of stimuli, but also brings forth an additional question about the nature of saving and man.

If the act of saving has universal psychological implications, then in the gestalt school of thought the act must be inseparably tied to all or most of man's other actions and impulses. Man, as he squirrels his money, must be acting in response to a myriad of unifized stimuli; hence, the problem of developing a recognizable and understandable motive is complicated by a whole system of psychological laws.

Perhaps the answer to the motive for saving problem lies not in individual motivation but rather in societal motivation, and it is to the relationship between the propensity to consume and social behavior that the search now turns.

The importance of the sociological approach to economics is pointed out by J. A. Hobson.

Only by considering the organic nature of man and of human society can we trace an intelligible order in the evolution of industry. The wants of man, and therefore the economic operations serving them must be treated as organic processes. This term borrowed from biology, must be extended so as to cover the entire physical and spiritual structure of human society, for no other term is so well fitted to describe the nature of the federal unity which society presents. The standard of values thus set up is the current estimate of 'organic welfare'.\textsuperscript{35}

In a study of this sort, the prime difficulty is not one of determining the limits of the factor under investigation, but rather is one of


\textsuperscript{35} J. A. Hobson, Work and Wealth, A Human Valuation, preface, p. VI.
determining the extent of the factor to which that factor under investigation is to be compared. In this case, the factor under investigation is the propensity to consume and the factors to which it must be correlated are the customs, traditions, institutions, mores, manes, and taboos of the social group in which the investigation is to take place.

And therein lies the difficulty since the psychologists, the social psychologists, and the sociologists are in no sort of agreement as to the exact cultural accoutrements of mankind nor is there even widespread agreement about the exact definition of these terms.

John Dewey says,

It is folly psychologically and historically to identify the structure of the individual simply with the elements of human nature that make for variation and that mark one person off from another. The force of habit that leads individuals to cling to that which has been established is a genuine part of the constitution of individuals. In the main, it is a stronger and deeper part of human nature than is desire for change. When tradition and social custom are incorporated in the working constitution of an individual, they have authority as a matter of course over his beliefs and his activities. The forces that exert and exercise this authority are so much and so deep a part of individuals that there is no thought or feeling of their being external and apprehensive.36

But, of course, they are external to the extent that an individual can have entity apart from the community, which makes up his greater nature.

The question regarding this thesis that Dewey’s statement leaves to be answered is whether or not among these established institutional forces which control men, there is that which impels them to save a part of each day’s bread, or if, and this will be the thesis of this monograph, saving is purely and wholly an involuntary act, engaged in because certain members of this society receive as their share of the nation’s product a larger portion, or, more exactly, the right to a larger portion, than

they can consume. That this condition seems to exist is evident, for as Ayres says, "... if anything in the field of economics is definitely and positively known, it is that nearly all saving is involuntary," and again speaking of the accumulation of the Ford fortune, "it would be stretching common sense a bit to ascribe a billion dollars to unfamiliarity with the arts of spending."  

The very rich save most of their incomes, not because they are more abstentious than other people but because, with all their ingenuity and determination, and with the practiced help of expert advisers they are still unable to stand the strain of spending more than a small part of their millions.  

For proof, however, the cultural pattern must be reviewed to find if by chance or design there is some order of God or nature which reduces men to the status of squirrels by planting in their psyche a compulsion to save a portion of all that they accumulate.  

The institutions under which men live are varied. A partial list of those given by one student of culture includes the structures of law, religion, and family; the corporate structure; nationalism and racial superiority; private property rights and many others. The systems of permissions and restrictions, the traditions and the conventions, the cultural natures of man as a social animal are partly known; others are suspected by students of culture, but doubtless there are still others which have not yet been brought to light. Thus it is that our study is handicapped to the point that the propensity can only be related to known psychological and cultural factors, leaving a possibility that there

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37 C. E. Ayres, The Divine Right of Capital, p. 25  
38 C. E. Ayres, The Problem of Economic Order, p. 35  
39 C. E. Ayres, The Divine Right of Capital, p. 25  
40 R. I. Ashley, Our Contemporary Civilization, pp. 7 f.
is an unknown proof lost in the limbo of mind. The complete analysis of human behavior is yet to be made.

On the other hand, if it can be shown that the institution determining the propensity to consume in a major part is the distribution of income and that "the flow of income is determined by the basic institutional patterns of society," then the "psychological law" can be dispensed with and the economic ills of mankind treated with changes in the institutional pattern rather than with vague manipulations of the interest rate. Ayres adds a cautionary note which must not be forgotten.

However income flows it is symptomatic of that underlying condition and is determined by it. Consequently, in seeking to superimpose upon the underlying pattern some device or devices for rectifying the flow of income as it has already been determined by the basic institutions of society, we are proposing to treat the symptoms of what we ourselves regard as a deep-seated, chronic, constitutional disease.

In later chapters it is proposed to show the truth of Ayres' contentions as to the nature of saving and to show that since Keynes' concept is wrong, by his own admission, the rest of the general theory will not stand. "This psychological law was of the utmost importance in the development of my own thought, and it is, I think also fundamental to the theory of effective demand as set forth in my book."

Although, doubt has already been cast upon the concept of the "nature of the beast" as a reason for saving, there is another division of knowledge concerning man which should be investigated before passing on to the more detailed determination of the factors controlling the propensity to consume. That general branch of knowledge to which

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12 Ibid., p. 173.  
reference is made is that of the natural sciences, biology particularly. For, after all, man is but an animal no matter how highly developed he may be or how greatly he desires to disavow his more earthly relations. The exact balance in man is difficult to ascertain.

Man’s opinion of his own position in relation to the rest of the animals has swung pendulumwise between too great or too little a conceit of himself, fixing now too large a gap between himself and the animals, now too small. The gap, of course, can be diminished or increased at either the animal or the human end. One can, like Descartes, make animals too mechanical, or, like most unsophisticated people, humanize them too much. Or one can work at the human end of the gap and then either dehumanize one’s own kind into an animal species like any other, or superhumanize it into being a little lower than the angels.\textsuperscript{14}

Exactly where man belongs in this social scale Huxley is unwilling to state definitively, but he does agree with his late grandfather that

\textit{It is only exceptionally that men have dared to uphold their uniqueness and to be proud of their human superiority to the impersonality and irrationality of the rest of the universe. It is time now, in the light of our knowledge to be brave and face the fact and the consequences of our uniqueness . . . Man has now become the sole representative of life in [the] progressive aspect and its sole trustee for any progress in the future.}\textsuperscript{15}

Certainly this great biologist sees the need for some sort of concrete planning as a means for man to fulfill his apparent promise of further progress, and this planning must be of a fundamental nature, dealing not with the superficials of interest and price but with the basic foundation of the institutional structures. How, though, about the biologic nature of the biped, placental mammal man? What exists inbred, instinctive in him which would return him to the ordained paths of nature from wherever he may have been forced to deviate.

Turning again for guidance to Huxley it is found that a kind of crude and basic technological and cultural behavior is beyond doubt

\textsuperscript{15} \textit{Ibid.}
instinctive among certain animals and birds. He cites, for example, birds from eggs hatched in captivity and brought up by hand in artificial nests bearing no resemblance to the natural nest for that species, which upon mating build the natural nest for the species, not attempting to reproduce their own early homes.\footnote{Huxley, "The Intelligence of Birds," \textit{Man in the Modern World}, pp. 101 f.}

Is there a similar nature in humankind? Ruth Benedict thinks not. She cites the cases of exposed children who manage to survive and who live as animals bearing no human aspects or knowledge and who actually hardly recognize themselves as a strange or superior species as evidence that most of man's accomplishments are of an acquired rather than an intrinsic nature.\footnote{\textit{Ibid}.} Of course, Huxley actually comes to this same conclusion, pointing out first the biologic uniqueness of man. Only man, he claims, has a capacity for conceptual thought, factalization, reproductive variability, and constant ability to mate and, finally, only man has had such plastic cerebral development. Man's progress in evolution is due to his ability to avoid rigid instinctive behavior.\footnote{\textit{Ibid}.} Had man possessed an instinct to hoard or to save goods, he probably would not have developed into the dominant animal of his age; instead, his evolutionary advancement would have stopped at some point, and he would have specialized in accumulation, perhaps in somewhat the same manner that some of the rodents have devoted their existence and their evolutionary progress to the accumulation of food or other attractive objects.

Clearly, man's propensity to consume and save must lies beyond the

\footnote{Huxley, "Uniqueness of Man," \textit{Man in the Modern World}, pp. 7 f.}
realm of biology and among the acquired, cultural habits already mentioned. The thesis of this paper, that the propensity to consume follows no psychological or biological law but is a result of certain over-privileged groups in society being unable to consume all their allotted income, will stand or fall upon this hypothesis.

However, there is another phase of the natural sciences which will gravely affect the thesis of this paper if another contention which will be made concerning Keynes' General Theory can be proved. This secondary hypothesis is that, although Keynes in a few places very nearly saw the true appearance of man's relation to his economic environment in the end he missed the significance of ownership and the significance of technological development.

After reviewing Keynes' accomplishments in a most complimentary manner, Ayres, who after all has a great deal in common with Keynes in ends if not in means, concludes that at heart Keynes is still little more than an apologist for the traditional mode of economic thought. Most of the things Keynes has to say have been said already by the more progressive members of the classical and neo-classical school. About his stand on saving and consumption, Ayres concludes, "Keynes still attributes the growth of industry to the accumulation of funds," and this is a belief long ago refuted by progressive economists.

That Keynes was actually aware of the true extent of his switch from classical to "heretical" economics is evidenced by his now famous preface remark that other classicists would fluctuate between a belief

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that he was wrong and one that he was saying nothing new. What Keynes overlooked was the obvious third alternative; a good many people believe that he is both wrong and has nothing new to say.

At any rate, with technological culture advancing in geometric progression due to the efforts of natural science, economics and the rest of social science do not have the time to develop equilibrium through monetary manipulations and through high sounding mathematical expressions of the old classical mumbo-jumbo. Keynes' concept of both the nature and use of the propensity to consume must give way to a concept which will allow the intelligent and efficient use of the society's resources. It is for this reason that Keynesian economics can never be more than a transitional phase between the economics of superstition and the economics of fact. Saving is hardly a measurable factor when production is increasing, or could increase, at an almost infinite rate.

Any idea put forth in the realm of science, both social and natural, must be considered not only as an independent unit of thought but also as a part of a larger scheme of thought. What, for example, must be the effect of the concept of the propensity to consume upon all of the rest of the structure of economic theory, of sociological theory, of psychological theory, and upon all of the rest of either accepted or provisional scientific belief?

Very few, if any, students of progressive economics will deny the validity of Keynes' implied arguments that income should be more equitably distributed in order to assure society as a whole more prosperous times,

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50 J. M. Keynes, General Theory, p. V.
51 J. M. Keynes, General Theory, pp. 372 f.
and upon this end there can be general agreement. Keynes, however, gives evidences of two major weaknesses in his theory on this point: first, he lacks the courage of his convictions and attempts to belittle his own findings with "For my own part, I believe that there is social and psychological justification for significant inequalities of incomes and wealth." 52 Second, Keynes missed the significance of why the propensity to consume is of importance. At full employment, he believes saving is necessary to increase growth of capital 53 thus failing to see that so long as there is saving there can be no full employment. Destroyed buying power destroys employment at full employment as surely as at any other point of equilibrium. Buying power at any given moment is the command over goods exercised by the consumers, both the so-called ultimate consumer and the industrial consumer, that is, both the individual and the enterpriser, of a society. Buying power over a given period of time is the aggregate of command over goods exercised by the consumers during that period. The determinate of buying power consequently is the command over goods. In turn, the command over goods is determined by the sum of the quantity of money and the extent of credit available to the consumer. Credit is obviously a matter of cultural behavior. Installment buying, open book retail credit, lay-away, and so forth are matters of custom and occasionally of law. For the industrial consumer bond issues, long term loans, stock issues, and other forms of high finance are likewise determined by custom and are regulated or limited by law.

Money, too, is the product of culture and custom. In the United States, as in England, it consists of currency, coin and paper, issued by the state under constitutional or other legal restrictions, various

\begin{align*}
52\text{Ibid., p. 374.} & \quad 53\text{Ibid., p. 373.}
\end{align*}
grades of bank notes, currency with all the properties of the state money except those of origin and sanction, and most important, bank deposits, bookkeeping or checkbook money originating in the credit institution with which banks are invested. In the United States in 1916, for example, of $167,100,000,000 in circulation only $28,245,000,000, about 17%, was currency of all sorts, both state and bank. The balance, $138,855,000,000 was bank deposits. Bank deposits, bookkeeping money, are the result of loan activity. The banking industry has the power to create what constitutes the major part of money by making loans and conversely to destroy that major portion of money by calling loans or by allowing loans to be paid off. Saving results in the accumulation of surplus funds which are used in retiring loans, thus destroying buying power. At the same time, funds not used directly to pay off loans come into competition for investment with bookkeeping money prohibiting the making of loans and so the creation of buying power. The significance of the General Theory to economic theory in general lies not in the interest theories as Keynes believes but in its development of a reason, albeit an erroneous one, for the redistribution of income and wealth.

But to take a new approach, let it be assumed that there can be no valid criticism of Keynes' concept of the propensity to consume. What then is its importance?

Social science is important only to the extent to which it can be used to better the lot of mankind, or as John Dewey puts it, when it "becomes the means of control of occurrence of experienced things".

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54 Information Please Almanac, John Kiernan, editor, p. 341.
55 J. M. Keynes, General Theory, p. 375.
having a richer and more secure equipment of values and qualities .... Scientific operations ... are such as disclose relationships.\textsuperscript{56}

It will be the argument put forth in this paper that the Keynesian effort to establish the propensity to consume upon a foundation of truth and logic is wasted even if the concept could be proven because it is a part of a larger scheme of thought which does not fulfill the requirements of a science as laid down by John Dewey. It is obvious that the General Theory adheres to the classical theory in that it is a study of price and price relationships rather than one of man's efforts to carve out an existence for himself.

Alfred Marshall defines economics as

\ldots a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well being.

Thus it is on the one side a study of wealth; and on the other, and more important side, a part of the study of man.\textsuperscript{57}

Price is not wealth nor yet is it any part of man. A study of price is not a study in science. Whatever it may be, it is of little pragmatic value.

Adding another assumption to the first, that the Keynes concept is valid, what would be the nature of the social changes necessary to use the concept if the economic system of which it is actually a part was not a fantasy but was indeed fitted into the cultural pattern?

Most apparent would be the major modification necessary in the field of banking, since the power to create and destroy money could not be left there. Social science would have to become active as a means of


\textsuperscript{57} Alfred Marshall, Principles of Economics, p. 1.
measuring and determining propensities. Corporate structure would have to be revised and accounting practices modified.

As Keynes suggests, tax structures would have to be revised and most important, widespread measures for relief would have to be undertaken, since the basic causes of maldistribution are ignored by Keynes.

One more factor of some importance and of a positive nature, must be brought out before the next phase of the investigation is undertaken.

Walter B. Pitkin spoke of this factor when he said

"Man the consumer is much more than an economic animal, more than a social constituent, more than an individual mind, more than a prospective buyer of goods. He is an enormously complex individual caught up in the Web of Life. All of his inner complexities interact with all the intricacies of this Web of Life."

J. A. Hobson understands this factor when he mentions the human utility of consumption and C. E. Ayres sees it when he speaks of the importance of consumer buying power and consumer action for this last factor to be considered is the importance of the consumer in a modern industrial structure. The consumer is not important because of the money he saves, or because of his relation to the interest rate, but because he consumes goods in an endless cycle in which "each act of consumption is followed by other acts of a productive character and so by an indefinite series of successive productions and consumptions."

Therefore, it is also with the propensity to consume as a part of the consumer movement that this paper will be concerned, and precisely it is there that whatever importance it may have will lie.

60 C. E. Ayres, The Theory of Economic Progress, p. 274  
61 Ibid., p. 77.
CHAPTER II.

KEYNES' MEANING AND MOTIVE IN THE PROPENSITY TO CONSUME
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As the investigation of the propensity to consume continues, moving now into a detailed phase of the study, it is necessary to determine more fully what was Keynes' attitude toward the subject. In short, exactly what did Keynes mean by the propensity to consume? And specifically what was Keynes' motive in developing the *General Theory*?

It is those questions and their ramifications which will be answered here. In addition various pertinent criticisms will be directed at the theory.

According to Keynes, employment volume can be located at that point where an aggregate supply curve intersects an aggregate demand curve.\(^1\)

The demand curve, the phase of the theory now under consideration, functionalizes the relationship between any given level of employment and the sum of the quantity of money spent on consumption and the quantity spent on investment. In Keynes' eyes the factors controlling these two amounts were separate and distinct, and in his study are treated in such a manner.

Although Keynes believed that for a perfect theory employment should be considered in a direct functional relationship with consumption, for purposes of expediency, he chose to speak in terms of the function relating consumption in wage units to income in terms of wage units.\(^2\)

The wage unit is defined as the money wage of a labor unit which is a unit of measurement intended as a means of comparing labor contribution. It is based upon the proportion between the remuneration per hour that a given occupation receives and the remuneration for an hour's ordinary labor. Keynes assumes homogeneity in the supply of labor and a fixed relationship between the salaries of the various grades of labor. 3

That the relationship which Keynes assumes may possibly be true of England will be admitted. However, in the United States the wage pattern is a product of institutional behavior and wages have no such rational, constant relationship.

For the same tasks in the United States, natives are paid more than immigrants; white workers, at least in the South and West, are paid more than Negro and Mexicans; Mexicans in the South are paid more than Negroes and in the West more than orientals, all for the same grade of labor. To cite examples that reduce the Keynes contention almost to absurdity for this society, married workers are often paid more than single ones for the same job, those with children more than those without, union workers more than non-union, male more than female, light skin Negroes more than dark ones, very dark ones more than medium dark ones, straight haired Negroes more than kinky haired ones and so on. 4

Nevertheless, in order to examine Keynes' arguments fully it is necessary to accept, for the time, this rule and allow the aggregate of labor units times the weighted average wage-unit to be equal to the aggregate of wages and salaries, hereafter used as an aggregate under the term wages.

3Ibid., p. 41.

Consumption has already been defined in Chapter One above, but for clarification it should be noted that Keynes hinged the difference between consumption and investment upon the nature of the entrepreneur. Keynes limited him and his activities by defining consumption as the total sales made in a period less the sales made by one entrepreneur to another. However, he failed to define an entrepreneur, and he chose to decline any attempt to distinguish between consumer purchases and investment purchases in single transactions although maintaining that the distinction could be made for the aggregate.

The pitfall into which he ultimately dropped was that of adopting Adam Smith's concept of the motive of economic activity. "Consumption—to repeat the obvious—is the sole end and object of all economic activity," said Keynes and in the one remark cast the doubt due all such generalities squarely upon his theory.

The functional relationship between any given level of income in terms of wage-units and the expenditure on consumption out of that level of income is defined as the propensity to consume. The propensity of a society depends, according to Keynes, upon three things: the aggregate income, the objective attendant circumstances, and the "subjective needs and the psychological propensities and habits of the individuals composing it and the principles on which the income is divided between them." It is important to note the manner in which Keynes used or implied the term "principles" here several times. What the propensity represents is a group of standard or universal behavior patterns of the community, patterns which are relatively immutable—"we shall in what follows take the subjective factors as given"—and subject to measurement and prediction.

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5 Keynes, General Theory, p. 62.
6 Ibid., p. 104.
7 Ibid., p. 90.
8 Ibid., p. 91.
Circumstances which determine the propensity will be examined below in somewhat greater detail, but they properly should be introduced at this point.

It is what Keynes calls the objective factors that relate the General Theory most closely to the classical theory. It is also these objective factors that Keynes assumes are the sole cause for changes in the propensity to consume since the subjective factors are assumed to remain constant or to change very slowly. 9

The first of these factors to be considered by Keynes is a change in the wage-unit. The wage unit is determined "by the bargains reached between employers and employed" 10 although exactly how these bargains are arrived at under the conditions of involuntary unemployment which Keynes admits is not made clear. Employment increases are the result of optimistic expectation upon the part of the entrepreneur and thus the aggregate labor unit is a result of entrepreneurial will, but in the General Theory there is little expansion upon the origin of the wage unit. 11 However, at another time, Keynes has said, "incomes can be generated only by producing goods." 12 He misses entirely the point made by the institutionalists that "incomes are not effects of production but are allowables of society." 13

Second of the so-called objective factors which affect the propensity to consume is a change in the difference between income and net income. 14

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9 Ibid.
10 Ibid., p. 247.
11 Ibid., p. 9 f.
13 W. C. Tagwell, The Trend of Economics, p. 216
14 Keynes, General Theory, p. 92
Keynes maintained that the amount of consumption "depends upon net income rather than income, since it is, by definition, his net income that a man has in mind when he is deciding his scale of consumption."\(^{15}\)

How does one go about defining what "a man has in mind when deciding his scale of consumption"? If one man makes out a budget including taxes as a part of it and another makes out a budget disregarding taxes, which has considered net income?

And what of the millions of people the world over who live from hand to mouth, whose decision as to their "scale of consumption" consists of feeling to determine the denomination of the coins in their pocket? What is their net income?

The third factor in this series is windfall changes in capital values not allowed for in calculating net income.\(^{16}\) Keynes considered this most important as an agent affecting the propensity to consume especially since the rich, in whose hands most savings originate, are most apt to be recipients of windfall income.

Fourth factor is changes in the rate of time discount. Interest, according to Keynes, is determined by liquidity preference, or as the payment received by money holders in return for sacrificing present liquidity. In the face of the absurdity of the sacrifice theories applied to corporations or to millionaires, a substitute was needed, and Keynes hit upon this happy compromise. Actually it is simply a somewhat watered down version of hedonism, but it does give Keynes a basis for this fourth factor which is not exactly interest but is described as the proportion of appeal between future goods and present goods.\(^{17}\)

\(^{15}\)Ibid. \\
\(^{16}\)Ibid. \\
\(^{17}\)Ibid., p. 93.
"Changes in government fiscal policy, particularly in such matters as income and inheritance taxes," is the fifth of the objective factors while "changes in relation between the present and future levels of income" is sixth. The former is important for the same reasons as windfall income, but the latter, says Keynes, is valuable only because it completes the list of influences.13

Keynes apparently considered this list as somewhat complete, for he remarks, "We are left therefore, with the conclusion that in a given situation the propensity to consume may be considered a fairly stable function,"19 but at least one self- avowed Keynesian disagrees to the extent that he has supplemented the list with one of his own. These objective factors include, in addition to Keynes' group, acquisition of liquid savings, liquidation of consumer debt, population shifts, new products, sales emphasis, deferred demand, and more effective regulation of monopoly.20

But Keynes has concluded that these objective factors and the subjective factors to be discussed later actually have little effect on the propensity. In Keynes' words,

The fact that, given the general economic situation, the expenditure on consumption in terms of the wage-unit depends in the main on the volume of output and employment is the justification for the summing up the other factors in the portmanteau function "propensity to consume." For whilst the other factors are capable of varying (and this must not be forgotten), the aggregate income measured in terms of the wage unit is, as a rule, the principle variable upon which the consumption-constituent of the aggregate demand function will depend.21

16 Ibid., pp. 94 f. 19 Ibid., p. 95.
21 Keynes, General Theory, p. 96.
"Precaution, foresight, calculation, improvement, independence, enterprise, pride and avarice," the consumption motives, weighed against such things as "Enjoyment, short-sightedness, generosity, miscalculation, ostentation, and extravagance" make up the subjective factors influencing the propensity to consume.\(^{23}\)

In detailed description Keynes names as the first of these motives for refraining from spending, that which leads individuals "to build up a reserve against unforeseen contingencies."\(^{24}\) In other words, it is what may be called "rainy day saving."

The second of the eight motives is "to provide for an anticipated future relation between the income and the needs of the individual or his family different from that which exists in the present, as, for example, in relation to old age, family education, or the maintenance of dependents."\(^{25}\) Saving, in other words, in an attempt to offset future poverty.

The third, the calculation motive, is "to enjoy interest and appreciation, i.e., because a larger real consumption at a later date is preferred to a smaller immediate consumption."\(^{26}\) In other words, this is present sacrifice in exchange for the receipt of future pleasures.

There is some saving undergone, says Keynes, in order "to enjoy a gradually increasing expenditure, since it gratifies a common instinct to look forward to a gradually improving standard of life rather than the contrary even though the capacity for enjoyment may be lessened."\(^{27}\) As a rule, there is little to be gained in bickering about semantics, but since Keynes has attached so much importance to the psychological

aspect of the propensity, intellectual integrity requires an investigation of the term instinct.

John Dewey says

... the native stock of instincts is practically the same everywhere. Exaggerate as much as we like, the native differences of Patagonians and Greeks, Sioux Indians, and Hindus, Bushmen and Chinese, their original differences will bear no comparison to the amount of difference found in custom and culture. Such a diversity cannot be attributed to an original identity, the development of native impulse must be stated in terms of acquired habits, not the growth of customs in terms of instincts. 28

But according to Keynes, man has an instinct to desire a gradually increasing standard of life.

Turning to a psychologist, it is found that

... the common man applies the term instinctive to this kind of situation: a person doing the right thing without knowing why and yet feeling that he had to... This popular usage seems... to be founded, to be perfectly compatible with the theory of behavior, 29

and that

Behavior, human and animal, cannot be described or explained without the assumption that the ego is a seat of stresses which require particular kinds of reliefs. Furthermore, it makes no difference whether one uses the more general and neutral term "Stress" or the more specific and controversial one instinct. 30

It is maintained here that Keynes' use of instinct is simply a harkening back to the classical attempt to instill in man control and system from some external force—natural law, natural order.

Fifth of the subjective motives is, "to enjoy a sense of independence and the power to do things, though without a clear idea or definite intention of specific action." 31

30 Ibid., p. 662.
31 Keynes, General Theory, p. 108.
Sixth is, "to secure a maas de manœuvre to carry out speculation or business projects."

Seventh is, "to bequeath a fortune."

And the eighth is, "to satisfy pure miserliness, i.e., unreasonable but insistent inhibitions against acts of expenditure as such."32

These factors, of course, are supposed to influence individuals. To determine what causes corporations to save, four additional reasons must be examined:

(i) The motive of enterprise to secure resources to carry out further capital investment without incurring debt . . .

(ii) The motive of liquidity . . .

(iii) The motive of improvement—to secure a gradually increasing income . . .

(iv) The motive of financial prudence . . .33

The inability of certain groups to consume their income goes unnoticed by Keynes.

Keynes contends that income distribution is the most important part of the propensity since the objective and subjective factors are of little influence in the short run and, as Keynes is reputed to have once said, "... in the long run we'll all be dead."34

In Keynes' own language it is expressed as "the fundamental psychological law, upon which we are entitled to depend with great confidence both a priori from our knowledge of human nature and from the detailed facts of experience, ... that men are disposed, as a

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32 Ibid.
rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income.\textsuperscript{35}

In Keynes' mind, the reason that this "psychological law" exists, is that "... man's habitual standard of life usually has first claim on his income, and he is apt to save the difference which discovers itself between his actual income and the expense of his habitual standard..."\textsuperscript{36}

This means that, if employment and hence aggregate income increases not all the additional employment will be required to satisfy the needs of additional consumption.

While this is but a presentation of the concept, and criticism in detail will follow below, it should be pointed out here that three major weaknesses exist within the concept and it is upon them that the case against the psychological law will be built.

First of these defects in the theory of the psychological law is Keynes' assumption that individual behavior is indicative of group behavior, a mistake that would not have been expected of the man who said at one time,

It is not true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is no 'compact' conferring perpetual rights on those who have or those who acquire. The world is not so governed from above that private and social interests always coincide. It is not a correct deduction from the principles of Economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally is enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does not show that individuals, when they make up a social unit are always less clear sighted than when they act separately.\textsuperscript{37}

\textsuperscript{35}Keynes, \textit{General Theory}, p. 96.

\textsuperscript{36}Ibid.

\textsuperscript{37}Ibid., \textit{The Nineteenth Century and After}, Vol. 112, p. 325
It is to be seen clearly here how Keynes valiantly attacks the superstructure of classic belief but leaves the fundamental premise untouched. While agreeing that individual ends and social ends may not coincide, he misses entirely the point that a mass of conglomerate individual behavior does not necessarily equal a unit of social behavior.

The second of the innate fallacies in Keynes' psychological law is that he assumes the universality of the action. "We take it as a fundamental psychological rule of any modern community that, when its real income is increased, it will not increase its consumption by an equal absolute amount, so that a greater absolute amount must be saved unless a large and unusual change is occurring at the same time in other factors." 38

This means, of course, that the psychological law in our society must apply to all groups, sects, sexes, climates and climes, at any and all times and under any and all circumstances. Experience will not confirm this belief, and a minimum investigation of a proven economic precept, Engels' law, will lead to the conclusion that is the basis of this paper’s criticism of the psychological law. The effect of increased employment or increased real wage or increased money wage would not be evident if that increase took place in certain income brackets but would be more than usually effective if it occurred in others. The principle involved is the motive for saving, and it is not a psychological one. It simply is a matter of a surplus of income over consumption due to maldistribution of income and physical inability to spend it. Moreover, there is never a time when an industrial society is so static that new avenues of culturally acceptable expenditures are not being opened for every social level of the group.

38 Keynes, General Theory, p. 97.
Third of the misconceptions has to do with the source of income. Keynes believed that income is the result of production and is a limit upon it. He believed, as has been pointed out, that production depends upon accumulated funds. What he overlooked or ignored is the development of a machine technology under conditions of something less than free competition. Coupled with a system of checkbook money this means that investment or production is not dependent upon accumulated funds and that income is dependent upon neither past nor present nor future investment, as that term is used in reference to capital funds, or in any other pecuniary sense.

Concerning the subject matter of economics, John R. Commons has said, "The subject matter with which an economist deals is not a mechanism or organism whose notions the investigator cannot understand—it is human beings whose activities he can fairly well understand by putting himself "in their place" and thus constructing the "reasons," in the sense of motives, or purposes, or values, of their activity under all the variable conditions of time and place."[39]

"Keynes" attempt to put himself in the place of the common man took the form of the average propensity to consume and the marginal propensity to consume.

The average propensity to consume may be considered to be the average midpoint of a collection of propensities taken at various levels of income or conversely at various levels of consumption. Actually the average propensity should properly be called the average of propensities since a real average propensity to consume would be determined by the relationship

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between average consumption and average income weighted in a manner proportionate to the distribution of income at the various levels of society.

The marginal propensity on the other hand, is the relation between the last increment of income and the consumption resulting from it. Its importance, as Keynes sees it, lies in telling how the next increment of output will be distributed between income and investment.

The marginal propensity to consume depends upon the validity of Keynes' assumption that the ratio of consumption to income as expressed in the propensity is always less than one. What this concept overlooks is coincidental with one of the oversights already mentioned, that is, that an increase in consumption can, under certain circumstances, equal an increase in income and under certain conceivable conditions an increase in income may be followed by an increase in consumption greater than the increase in income, apart from the disinvestment, or use of capital for consumptive purposes, which Keynes foresaw.

Assume for the moment an economic society existent at a certain level of income but with the addition of an institution with which Keynes did not work, installment buying. For most goods, installment buying requires a down payment of ten per cent and the balance to be paid over a given period of time.

Now allow an increase of income directly or of employment and hence income indirectly, but allow the bulk of that increase to benefit the members of the lowest income brackets.

The result would be total expenditure and thus an increase in consumption equal to the increase in income. If that increase in income is used to buy installment plan goods, the demand upon output, hence consumption, will be equal to ten times the increase in income, the
balance to be paid for out of future savings. That the precarious
balance between consumption goods and production goods and between
income, saving, and investment which Keynes envisaged does not exist,
follows from this.

This condition is made possible because of two important concepts
overlooked by Keynes; first, he missed the significance of checkbook
money as a means of creating investment funds without influencing income
and second he assumed diminishing returns, a condition which does not
apply to industrialized society.

This attack, then, can and later will be directed at an even more
fundamental Keynesian hypothesis, that of the equality of savings and
investment.

Another opening for attack readily comes to mind and it must be
dealt with briefly. The reference is to Keynes' pre-occupation with
net income and with real income as a determinate of consumption patterns
while in actuality consumer buying patterns are determined by the clime
in which man lives—

... so likewise with habits, intellectual, emotional, active.
They shift and change in unpredictable ways, and each shift
and change affects the whole economic structure of industry
and markets, [10]

or as J. M. Clark presents the same idea

Calculation may tell a man just what it is he must sacrifice if
he does a certain thing, but it cannot tell him whether he wants
the thing badly enough to accept the sacrifice. That is something
he learns directly, and often he learns only when the choice is
actually forced upon him and he surprises himself by acting in a
way he himself would never have expected. [11]


The difficulty is that economists are too often men of methodical bent, and this refers particularly to men of the mathematical school such as John Maynard Keynes and men who indulge in syllogistic thinking, as do the classicists along with Keynes, and being of such a mind they have great difficulty in understanding the haphazard way in which most of the rest of the population approach their economic activities.

The natural end of the development of the propensity to consume is some means of putting the concept to work as a tool to combat the economic ills of society. Keynes foresaw the chief use of the propensity as a means of developing a multiplier, that is a mathematical tool to predict the extent to which investment can enlarge income.

Keynes gave credit for his development of the multiplier and for that matter, The General Theory, to R. F. Kahn who argued that with all other things held constant income would necessarily be a function of investment. Kahn aimed at laying general principles to establish a recognizable and measurable relationship between these two factors.

Kahn's multiplier measured the ratio of the increment to aggregate of employment resulting from an increment of primary employment in the investment industries which was the result of an increment in investment.

At this point the distinction made in the Keynesian theory between employment in investment industries and employment in consumption goods industries should be made clear.

Production to Keynes was one economic process; consumption was quite another process. The two were related only in the most vague sort of way by price and by money. There was one other relation, however, between these two forms of employment. Increased employment for investment

\[^{12}\text{Keynes, General Theory, pp. 113 f.}\]
must necessarily stimulate the industries producing for consumption, leading consequently to an increase in aggregate employment which is in direct ratio to the primary employment required by the increment in investment. Hence, there existed the multiplier.

Keynes multiplier, which he called the investment multiplier, differed somewhat from Kahn’s, being designed to tell the amount by which aggregate income would increase when there was an increment of aggregate of investment.

Keynes developed his concept of the multiplier and the propensity by saying,

If when incomes are at a given level the public consumes, let us say, nine-tenths of their incomes, the productive efforts devoted to consumption goods cannot be more than nine times the efforts devoted to investment if the results are to be sold without loss. Thus it is an indispensable condition of a stable increase in incomes that the production of investment goods, widely interpreted, should advance pari passu and in the right proportion. Otherwise the proportion of income spent on consumption will be less than the proportion of income earned by producing consumption goods, which means that the receipts of the producers of consumption goods will be less than their costs, so that business losses and a curtailment of output will ensue.\(^{43}\)

A major difference in the use of the multiplier has arisen between the followers of the various schools of economics. Keynes saw the multiplier increasing employment through investment and a high propensity to consume. Keynes saw a need to stimulate employment and industrial activity by the stimulation of investment.

C. E. Ayres, on the other hand, sees clearly that the worth of the multiplier depends not upon its application to investment but upon the expansion of consumer buying power.\(^{44}\)


\(^{44}\)Ayres, Theory of Economic Progress, p. 274.
If the concept of the multiplier is to stand, one more of the fundamental precepts of the classical theory will have to be destroyed and this duty Keynes was quite happy to undertake.

Keynes believed that the traditional contention that there can be no involuntary unemployment is obviously wrong, that prima facie evidence abounds which refutes the classical analysis and consequently he offered two objections, both of which will admit of general agreement by most progressive economists.

"The individual breadwinner without private means can never be in a position to refuse to work because real wages are too low to be worth the effort," says Joan Robinson as she sums up the first reason for involuntary unemployment.\(^45\)

Stuart Chase adds empirical evidence to strengthen this first objection by writing of "The Case of Roy Thompson," who wanted to work at any wage but who could find no labor to perform.\(^46\)

The second objection which Keynes raises and to which most economists will agree in principle if not in logic is that wages are not determined by wage bargains directly. However, Keynes' idea of what constitutes involuntary unemployment is something else again. Following the tendency of old line economists to clock the most simple of observations in the mysterious language of metaphysics, he claimed that "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 labor willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment.\textsuperscript{47}

Evidently he cannot wholly escape from the classical conviction that employment must always exist for those who want it, and this in spite of the fact that he makes particular note of conditions in the United States in 1932.\textsuperscript{48}

Nevertheless, using this definition of involuntary unemployment, Keynes has developed his complete theory of equilibrium at various levels of employment.

The propensity to consume is related to employment since at any given level of employment there must be investment enough to absorb that portion of the total product not absorbed by consumption, and full employment can exist only when investment, as determined by the interest rates and liquidity preference, absorbs the balance of product not used for consumption at that particular level.\textsuperscript{49}

The General Theory as it has been developed to this point may be briefly summarized.

As employment rises, income rises and consumption rises but not by so great an amount as income. Consequently, there is always under-consumption if the increased employment is all devoted to manufacture of consumer goods. Instead, the slack, that is the surplus as determined by the propensity to consume, must be taken up by current investment. Unless this investment is forthcoming, the entrepreneur cannot continue the level of employment. Investment is determined by the preference

\textsuperscript{47}Keynes, General Theory, p. 15.  \textsuperscript{48}Ibid., p. 6.  \textsuperscript{49}Ibid., p. 28.
for liquidity and consumption is determined by the objective and subjective factors which have been introduced; full employment is achieved by perfect balance and with perfect balance the postulates of the classic theory are applicable.\(^{50}\)

So much for the meaning of Keynes' concept. The reasons he felt the need for a new theory of economic behavior and the motives for the development of this particular theory require some investigation before the more detailed examination of the theory itself can be presented. J. A. Hobson has maintained that mankind has developed but three ways to give things increased power to satisfy wants. These are: first, adapting things to satisfy wants; second, adapting wants so that they can be satisfied; and third, denying some claims to fill others.\(^{51}\)

Economics is concerned with the first and the third of these activities and they are the two phases of economics which serve as motive for Keynes' General Theory. Employment is the method of adapting things to satisfy wants and the "ultimate object" of Keynes' analysis is to discover what determines the volume of employment.\(^{52}\) Assuming that Keynes means by employment the utilization of labor, this is an extremely important search for Keynes conceives of labor as the source of all value. He says

I sympathize, therefore, with the preclassical doctrine that everything is produced by labour, aided by what used to be called art and is now called technique, by natural resources which are free or cost a rent according to their scarcity or abundance, and by the results of past labour, embodied in assets, which also command a price according to their scarcity or abundance. It is preferable to regard labour, including, of course, the personal services of the entrepreneur and his assistants, as the sole factor of production, operating in a given environment of technique, natural resources, capital equipment, and effective demand.\(^{53}\)


\(^{52}\) Keynes, General Theory, p. 89

\(^{53}\) Ibid., pp. 213 f.
Employment is determined in Keynesian economics by the intersection of the aggregate supply function and the aggregate demand function or more exactly by the employment function which relates the amount of labor brought into a given industry by a given amount of demand directed to it. The demand is determined by the propensity to consume; therefore, the search for the true causes of fluctuation in employment is related to the thesis of this paper.

Employment is closely related to the aggregate demand function which was defined by Keynes as the relationship between the proceeds which entrepreneurs expect to receive from employing a given number of workers and that number of workers. It was the belief of Keynes that the role of this aggregate demand function has long been overlooked in economic theory and he set out to rectify this error.

The demand function relates a given level of employment to the sum of the amount which will be spent on consumption and the amount which will be devoted to investment to employment at that given level. From this stems the importance of the propensity to consume and the third of Hobson's conditions, the denial of some claims to fill others, for in order to maintain maldistribution of income and acquire investment funds, denial of some claims must take place.

There is another purpose in the General Theory that may not have been evident even to J. M. Keynes although various of his critics have made note of it.

Just prior to the publication of his General Theory, Keynes said, "A large part of the established body of economic doctrine I cannot

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51 Ibid., p. 25.
but accept as broadly correct. I do not doubt it. And throughout the General Theory there is an obeisance to the classic and an attempt, conscious or unconscious, to justify and defend the existing system or lack of system.

CHAPTER III.

THE OBJECTIVE FACTORS, THE SUBJECTIVE FACTORS
AND THE INCOME LEVEL
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THE OBJECTIVE FACTORS, THE SUBJECTIVE FACTORS,
AND THE INCOME LEVEL

Having first determined that the purpose of the paper is an investigation of the validity of the Keynesian concept of the propensity to consume and the multiplier, that the scope of the paper would be limited to these two factors and their ramifications, and then having done the necessary background research in Keynes' meanings, motives, and definitions, it is possible to proceed to a more detailed and analytical critique of the General Theory, following to some extent the pattern, development of which was begun in the previous chapters.

Recalling that the influences upon the propensity to consume were taken by Keynes to be the objective factors, the subjective factors, and the income level, these factors will be examined in that order.

The subjective factors, Keynes concluded, for numerous reasons, do little to influence the propensity to consume, and following his lead this investigation will treat those reasons for their impotency along with the objective factors. As a conclusion, then, after the treatment of the objective and subjective factors and the psychological law a summation of all the weaknesses of the concept will be made.

"Consumption," said Keynes, "is obviously much more a function of (in some sense) real income than of money income."\(^1\) A change in wage-unit income will be followed by a change in real income and thus by

\(^1\) Keynes, General Theory, pp. 91 f.

\(^2\) Ibid., p. 9.
a change in consumption.\textsuperscript{2} However, since the propensity is defined in terms of wage-units no further allowance has to be made.\textsuperscript{3}

This part of the concept makes a questionable basic assumption, that man calculates his future purchases from either real or money wage.

J. M. Clark comments upon this:

A consumer's scale of preference must remain stable long enough for him to express it in a rounded series of purchases which can fairly be called a budget. During this period, no advertising appeals must affect him, no changes in tastes, no environmental stimuli must influence his purchases other than the goods and their prices --- generally assumed to remain unchanged during the budgetary period.\textsuperscript{4}

With the consumer's action as unpredictable as Clark makes it, the probability would appear to be that a change in the wage-unit in the lower income brackets would reflect an equal change in consumption.

Keynes said, "... when our income is increased it is extremely unlikely that this will have the effect of making us either spend less or save less than before."\textsuperscript{5} Prima facie this would appear to be true, but it is not difficult to find a situation which does not fit into the pattern of Keynes' preconception.

A wage earner, drawing a given amount of money each week or every two weeks, finds that his income allows him to save a few dollars above his bare living costs, but that it is not large enough to allow him to make the monthly payments on an automobile.

Receipt of a wage increase will allow this worker to spend more, but it will cause him to save less, disputing the second part of Keynes' Theory.

\textsuperscript{3}Ibid., pp. 91 f.


If, on the other hand, the worker earns enough to cover his bare living expenses and just enough more to allow him a few “extras” each week, and as J. S. Davis says, “even the poorest insist upon extravagances,” an increase in income may tempt him to buy insurance and forego the extras, using both the increase and the former excess above a bare living for the insurance, a saving. The result is an increase in income resulting in a decrease in consumption, refuting the first half of J. M. Keynes’ statement.

These cases were concerned with individuals and the argument might be used to counter then that an increase in the income of the whole society would have the effect which Keynes predicts, but this, then, would in itself be a disavowal of Keynes who conceived of group action being organically coincidental with individual action. Moreover, the exceptions destroy the validity of the generalizations because it is easily conceivable that enough workers could be of a propensity similar to the one described above to turn the action of the whole society. It must not be concluded that exceptions such as the cases cited are the only manner in which Keynes’ concept of aggregate saving fails. In the discussion relating to the creation of money by banking activity in Chapter I, it was pointed out that investment stemmed from sources other than the accumulation of income. Since, in Keynes’ treatment of the subject, investment must be equal to aggregate savings, the General Theory is shaken by the existence of this institutional power to create and destroy money. Saving accumulated from income cannot maintain great importance in the face of rapid vacillations of the supply of money.

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The second objective factor, "a change in the difference between income and net income leads to a change in consumption," brings into the picture an inconsistency which relates very directly to the matter brought into the discussion of the first objective factor; that is, there was a confusion in Keynes' thinking about individuals on the one hand and the group on the other.

For example, he said, "We have shown that the amount of consumption depends on net income rather than on income, since it is by definition, his net income that a man has primarily in mind when he is deciding his scale of consumption." Even the most uncritical reader must admit that this is a rather shaky truism to use as one of the foundation pieces of an economic theory, but it is not upon that ground alone that the theory is here attacked, for in his definition of the term "net income" Keynes refers in one place specifically and exclusively to the entrepreneur and in another he is unequivocally referring to the group as a whole and not to any individual. This is a more grievous error.

Referring to the entrepreneur, "In reckoning, therefore, the net income and the net profit of the entrepreneur..." Keynes says

In his capacity as a producer deciding whether or not to use the equipment, prime cost and gross profit, as defined above, are the significant concept. But in his capacity as a consumer, the amount of the supplementary cost works on his mind in the same way as if it were a part of the prime cost. Hence, we shall not only come nearest to common usage but will also arrive at a concept which is relevant to the amount of consumption, if, in defining aggregate net income, we deduct the supplementary cost as well as the user cost, so that aggregate net income is equal to A-UV."

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7 Keynes, General Theory, p. 92.
8 Ibid.
9 Ibid., p. 57.
That is the only definitive reference to "net income" as such. There is another statement which casts light upon the other meaning he has assigned this term. Allowing $-U$ to be aggregate investment and $A$ to be total entrepreneurial return, "income of the rest of the community is equal to the entrepreneur's factor cost, aggregate income is equal to $A-U$.

"Income, thus defined, is a completely unambiguous quantity."\(^{10}\)

This last is an optimistic statement with which there may be some disagreement but the main point is that for the large part of the population neither "net income," nor any income of a very exact nature is defined in a usable manner by Keynes.

If the "man" who bases his consumption upon his net income is the entrepreneur then the vast group of worker-consumers may base their consumption or something quite different, perhaps total income or availability of credit. Also, if Keynes meant what he seems to imply, he conceived of wages, the returns to labor, as a residue which under competition would approach subsistence. Surely, this is not a startling innovation in economic theory.

In Keynes' belief about aggregate income there was included the idea that only changes in net income will affect consumption; that is, a change in the entrepreneur's total income not reflected in net income will not affect consumption.\(^{11}\) For example, if there is an increase in the total sale of goods which is matched by an increase in either investment or supplementary cost, a form of depreciation, then consumption will not be changed.

\(^{10}\)Ibid., p. 54.  \(^{11}\)Ibid., pp. 98 f.
That this is not necessarily true may be seen by examining the nature of $-U$, investment, defined by Keynes as including "the increment of capital equipment, whether it consists of fixed capital, working capital or liquid capital...\textsuperscript{12}\) If there was an increase in $A$, total output, it must have come from, and the goods gone to, either consumers or other purchasers. If it is from consumers, then there must have been an increase in consumption. If the increase is due to other producers whose total output was not increased then, by Keynes' own logic, the residue is lessened and there must be a drop in consumption. More than likely, however, the major part of $-U$ is eventually dissipated in wages and thus consumption raised. This must be the case if Keynes' own labor theory of value is to be credited.\textsuperscript{13}

Keynes' third major objective factor reaches to the very roots of a basic problem of economic tranquility, the distribution of income and wealth. If "windfall changes in capital—values not allowed for in calculating net income" change the propensity to consume so drastically that they are one of the major factors, then Keynes sees the danger from them clearly.\textsuperscript{14} What he fails to see clearly here and throughout the General Theory are the varying uses to which income is put at the opposite ends of the income scales.

Keynes put forward such claims as "the consumption of the wealth-owning class may be extremely susceptible to unforeseen changes in the money-value of its wealth,"\textsuperscript{15} which is reduced to absurdity by the slightest knowledge of the true activities of the wealth owning class.

\textsuperscript{13} P. 43, above.
\textsuperscript{14} Keynes, General Theory, p. 92
\textsuperscript{15} Ibid., p. 93.
In the United States in 1935, in the depths of a depression, about 40% of all incomes over $5000 per annum were saved. In the lowest income bracket, under $500, there was a negative saving equal to about 39% of the total income. In 1941, after nine years of constant windfall changes in capital values, savings of the incomes of those earning more than $5000 per annum still amounted to about 40%, but negative saving of those in the lowest income bracket, $500 per annum, amounted to a figure equal only to 9% of the total income. This appears to be evidence that capital-value windfalls in some way affect the consumption of the low income groups.

The answer lies in something that certain other economists have as much difficulty seeing as J. R. Keynes, the principle of involuntary saving. So concerned are these men with the price of investment funds and with the productivity and virility of money that they miss the obvious truth that J. A. Hobson sees: "... under consumption due to oversaving arising from maldistribution of income, ... the normal cause of cyclical depression." They fail to see as John R. Commons saw that Moulton's investigations prove excess savings go into ownership rather than production. Commons also concluded from the same study that "... capacity to produce and capacity to consume are not linked up with capacity to pay."  

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17 J. A. Hobson, The Economics of Unemployment, p. 35.
19 Ibid., p. 686.
What all of these statements lead to is the conclusion that income
distributed to the lower brackets is used for the consumption of goods
and for the betterment of the society generally while income distributed
to the already adequately provisioned upper income level groups who do
not consume it leads to dissipation in ownership or in competition for
investment, causing the destruction of checkbook buying power. On the
other hand, income of which the lower income level groups are deprived
leads to lower consumption and to poverty generally while income of
which the upper income levels are deprived stops no consumption, since
upper income level consumption is not a function of income, but does
stop the destruction of a commodity already limited by institutional
factors, buying power.

"Changes in the rate of time-discounting, i.e. in the ratio of
exchange between present goods and future goods" is the fourth of the
objective factors treated by J. M. Keynes as an influence on the
propensity to consume.20 Keynes makes considerable ado about the
fact that this rate of time discounting is not the same as interest, for
the calculation includes more than the pure aspects of liquidity pre-
ference, "since it allows for future changes in the purchasing power
of money in so far as these are foreseen."21 For practical approxima-
tions, Keynes conceded that this factor may be used interchangeably
with the interest rate.

Keynes' pre-occupation with interest leads Ayres to remark that
in spite of his apparent progressiveness, Keynes was still inescapably
a member of the neo-classic school22 but no matter with what theory he

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20 Keynes, General Theory, p. 93.
21 Ibid.
is affiliated, Keynes had an exaggerated opinion of the influence of the interest rate on both individual saving and group thinking.

The Brookings Institute Study makes two illuminating conclusions about interest rates. First, speaking of individuals,

... it appears that savings habits have thus far not been materially altered as a result of the change in interest rates? ... it is apparent that we have now had low interest rates for several years and that they have not stimulated any noticeable expansion of either long and short-term borrowing operations. This suggests that other factors than interest rates are of controlling importance in the decisions of business men."

Commons sums up the same thought when he says, "Commitments are the prime movers of business enterprise—made in anticipation of either profits or expenses."

To this factor, too, can be applied that most ubiquitous criticism most men do not conduct their economic activities in a rational, carefully thought out manner.

The fifth of Keynes' objective factors claims that "change in the Federal fiscal policy effects the propensity to consume," but to some degree the same weaknesses pointed out in the discussion concerning windfall changes in capital values apply to changes in fiscal policy, particularly as those fiscal policies are concerned with income tax, inheritance tax and the like. The importance of this factor lies in the good, direct, influence upon consumption that a Federal fiscal policy favorable to low income brackets will have and the good, direct influence upon plant creation, coupled with a good, indirect influence upon

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25 Keynes, General Theory, pp. 94 f.
consumption resultant from a federal fiscal policy unfavorable to unusually high incomes.

Neglected by Keynes in the discussion at this point and treated with an unfortunate attitude later as "pyramid building," social investment is, or should be, more than just public spending to ease the downward swing of the business cycle. As the source of social investment—expenditure for schools, highways, bridges, slum clearance, research, and all the rest of it—federal fiscal policy is potentially a major, active influence on the propensity to consume.

The sixth, or afterthought factor was included by Keynes to tuck in all the loose ends of objective motives. It is "changes in expectations of the relation between the present and the future level of income." Reasoning that while these "changes in expectations" may affect an individual's propensity it is not likely to affect the community as a whole since the expectations should average out.

The criticism that seems always to apply to these factors may be used here again. Man does not weigh present real income against future real income. Man does not always act in a rational or logical manner in economic matters. Propensity cannot be predicted, for it is a matter of mass individual behavior reacting to constantly changing stimuli.

There are general limitations to these objective factors taken as a group and the value of the propensity both to the theory and as an economic tool is lessened by them.

Speaking of method in the social sciences, Julian Huxley unintentionally spotlights the first of these general limitations.

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26 Ibid., p. 119.  
27 Ibid., p. 95.
the methodology of social science is inevitably different from that of natural science. It is different and must be different for one basic reason—the investigator is inside instead of outside his material. Man cannot investigate man by the same methods by which he investigates external nature . . . when he starts investigating human motive, his own motives are involved; when he studies human society, he is himself part of a social structure . . .

Causation in social science is never simple and single as in physics or biology, but always multiple and complex. One to one causation . . . is impossible in social science. Somehow the social scientist must disentangle the single causes from the multiple field of which they form an inseparable part. And for this a new technique is necessary.\footnote{28}

But Keynes borrows a page from the book of the classicist and conditions his theory with "In a given state of technique and tastes and of social conditions . . ."\footnote{29} which, of course, is an attempt to limit effects to single causes and under Huxley's limitations on social science cannot be accepted as good social science technique.

As a matter of fact, it is extremely doubtful that a given state of technique, taste and social conditions in a modern industrial society can be taken as static for even one day. Consider the case of advertising, of which art a leading practitioner states

Most folks—certainly the . . . so-called mass market—are incapable of imaginative, uninhibited, unemotional reasoning and have a strong tendency to shun anything that threatens to burden their intellects.

They have no conception of the meaning, genuis, and scope of logic—with the result that their hearts rule their heads and anything that feeds emotional hunger and offers an escape from sober meditation and the anxieties and frustrations of life has an irresistible appeal.

It's a pity but there it is.\footnote{30}


\footnote{29} Keynes, General Theory, p. 91.

A more respected and academic student of the science of marketing concurs in this opinion by saying, "In general emotion rather than reason motivates the purchaser. . . . Certain common human attributes, emotional in basis, underlie many purchases."\(^\text{31}\)

Keynes, always on the very verge of the great discovery, never was quite able to clear his mind of the attempt to discern a system, a natural order, in the ways of mankind when no such order exists. Perhaps he suffers from the condition pointed out by a social scientist in another field, some years ago. In 1835, Alexis de Tocqueville, a historian, said,

Historians who write in aristocratic ages are wont to refer all occurrences to the particular will or temper of certain individuals; and they are apt to attribute the most important revolutions to very slight accidents. They trace out the smallest causes with sagacity, and frequently leave the greatest unperceived. Historians who live in democratic ages exhibit precisely opposite characteristics. Most of them attribute hardly any influence to the individual over the destiny of the race, nor to citizens over the fate of a people; but, on the other hand, they assign great general causes to all petty incidents. These contrary tendencies explain each other.

The historians who live in democratic ages are not only prone to assign a great cause to every incident, but they are also given to connect incidents together, so as to deduce a system from them. In aristocratic ages, as the attention of historians is constantly drawn to individuals, the connection of events escapes them; or rather, they do not believe in any such connection. To them the clue of history seems every instant crossed and broken by the step of man. In democratic ages, on the contrary, as the historian sees much more of actions than of actors, he may easily establish some kind of sequence and methodical order among the former. Ancient literature, which is so rich in fine historical compositions, does not contain a single great historical system, while the poorest of modern literatures abound with them. It would appear that the ancient historians did not make sufficient use of those general theories which our historical writers are ever ready to carry to excess.

Those who write in democratic ages have another more dangerous tendency. When the traces of individual action upon nations are lost, it often happens that the world goes on to move, though the moving agent is no longer discoverable. As it becomes extremely

difficult to discern and to analyze the reasons which, acting separately on the volition of each member of the community, concur in the end to produce movement in the old mass, men are led to believe that this movement is involuntary, and that societies unconsciously obey some superior force ruling over them. But even when the general fact which governs the private volition of all individuals is supposed to be discovered upon the earth, the principle of human free will is not secure. A cause sufficiently extensive to affect millions of men at once, and sufficiently strong to bend them all together in the same direction, may well seem irresistible; having seen that mankind do yield to it, the mind is close upon the inference that mankind cannot resist it.

Historians who live in democratic ages, then, not only deny that the few have any power of acting upon the destiny of a people, but they deprive the people themselves of the power of modifying their own condition, and they subject them either to an inflexible Providence, or to some blind necessity. According to them, each nation is indissolubly bound by its position, its origin, its precedents, and its character, to a certain lot which no efforts can ever change. They involve generation in generation, and thus, going back from age to age, and from necessity to necessity, up to the origin of the world, they forge a close and enormous chain, which girds and binds the human race. To their minds it is not enough to show what events have occurred; they would fain show that events could not have occurred otherwise. They take a nation arrived at a certain stage of its history, and they affirm that it could not but follow the track which brought it thither. It is easier to make such an assertion than to show by what means the nation might have adopted a better course,32

Too, Keynes consistently over-estimated the importance of real wages in comparison to money wages in the mind of the consumer. As a practicing economist, as a teacher, as a bank director, as a mathematician, and as a matter of fact in all of his many capacities, Keynes was familiar with and had available statistical tools of every nature. There is evidence throughout his writing that he assumes the layman to have equal access to this technical knowledge. But consider for the moment the consumer and the economic tools with which he has to work. If he is an industrial worker, paid on an hourly basis he knows his wage rate per hour. He does not know what his weekly wage or monthly

income will be for he has no complete record of his accumulated hours of work and overtime. Such rules as "30 minutes docked for one minute late" do not make it easier for him and a great many factories maintain complicated incentive and bonus work systems with the accounting intricacies of which the usual worker is unable to cope.

So far as prices are concerned the worker has even less knowledge at his disposal. He can ascertain certain retail prices day by day by visiting the shops and he can determine the wholesale price of eggs, milk, certain vegetables, and the packer's price on animals from the newspapers, but except from time to time when the newspaper needs filler material or when some federal agency issues a publicity release, he has access to no comprehensive price data. Certainly there is no consistent, concentrated source of information for the worker-consumer and unless he is unusually intelligent, alert, and interested there is no source of information concerning price levels or price activity. How then, can it be claimed that the worker acts upon the basis of his real rather than his money wage? It might be replied that there is knowledge of past price behavior, or that a change in the power of money to command goods will inevitably be noticed. This is certainly a questionable method depending upon vague memories and hunches on the part of the consumer who keeps no record of prices or purchases. The answer is that real wages are an artificial concept. Only money wages have meaning to the usual consumer, and this fact in itself is enough to throw doubt upon the Keynesian concept.

By the same token, it is necessary to reemphasize the arguments already put forward to refute the idea of the importance of net income as compared to total income. There is no evidence that Keynes distinguishes between net income as a total, net income for the entrepreneur,
and net income for the other factors of production. Throughout Keynes' work, it is difficult to separate his discussions of economic behavior and abstract economic theory since he treats them simultaneously and interchangeably, consigning the syllogistic theories of one and the assumed "psychological laws" of the other to the same system of thought, when as a matter of fact, they are not compatible.

Are money savings made at the expense of a lag in consumptive demand? With some exceptions the Keynesians would generally agree that the answer to that question is an unequivocal yes, but in the sense that they understand the situation they would largely be wrong. They maintain that "the market for every sort of investment goods is derived from some part of the consumption market," but what they overlook is the indirect method in which buying power is destroyed. It is not just a matter of withdrawing buying power by saving. Far more serious than this, the accumulation of unused income forces the destruction of bookkeeping money, thus destroying buying power at its source. The manner in which this destruction takes place has been discussed in earlier chapters, but so great is the importance of this phenomena that it cannot be over-emphasized as the chief omission in Keynes' theory. The consumption of the wealth owning classes actually makes relatively little difference in the total scheme of things since they practice full satisfaction of desire; that is, even at their lowest income level they still do not find it necessary to curtail their personal expenditures. Their income, however, is a different and more important matter.

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Those are the objective factors and the objections to them, but the causatives which Keynes felt were of little importance, the subjective factors, may prove in the end to be the most upsetting to the Keynesian concept, for they allow the admission of the element of human behavior, a field in which Keynes may prove weakest.\textsuperscript{34}

These subjective factors are said by Keynes to include "psychological characteristics of human nature and \ldots social practices and institutions."\textsuperscript{35} The basis of the propensity to consume lies in the "fundamental psychological law."\textsuperscript{36} There must be a union between the psychology of the subjective factors and the psychology of the fundamental law but the latter is the basis of the whole theory while the former is so unimportant to the theory as to be disposed of with "Since, however, the analysis of these factors raises no point of novelty, it may be sufficient if we give a catalogue of the more important, without enlarging on them at any length."\textsuperscript{37}

Keynes listed eight of these subjective factors, each of which will be considered in its turn as a part of the psychological pervasion of the propensity to consume. In addition, a major part of this section of the paper will be devoted to an investigation of numerous additional factors which have an important bearing upon the propensity but which were neglected by Keynes although some of them had been previously discussed by Veblen and others.

First of Keynes' factors is the motive "to build up a reserve against unforeseen contingencies"\textsuperscript{38} which is acceptable enough as a

\textsuperscript{34} Keynes, General Theory, p. 91.  
\textsuperscript{35} Ibid.  
\textsuperscript{36} Ibid., p. 36.  
\textsuperscript{37} Ibid., p. 107  
\textsuperscript{38} Ibid.
motive for certain forms of saving at those economic levels where any saving at all can be affected. In the United States in 1935 this was 47% of the total population, while another 22% had so little savings as to be almost non-savers. That is a total of 69% of the population who could not save to accumulate reserves against unforeseen contingencies because they could not save at all. The phrase "could not" is used advisedly since it is the basic contention of this paper that saving is not a voluntary process.

The second of the subjective motives for saving attributed by Keynes to the consuming group is "to provide for anticipated future relations between the income and the needs of the individual or his family different from that which exists in the present, as, for example, in relation to old age, family education, or the maintenance of dependents." This second factor concerns itself with saving for a definite future purpose; education, retirement in old age, and the maintenance of dependents are those future contingencies to which Keynes specifically referred.

It may be wise to examine the conditions which might form those factors if it is assumed that they actually are of any great importance in influencing the large group to save.

Keynes was of the opinion that the influence which they may have would be felt only over the long run; therefore, these subjective factors, although of great influence, would exert an almost constant force which would present no problem in the study of a short run or momentary propensity to consume.

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40 Keynes, General Theory, p. 107.
41 Ibid., p. 110.
Some question must inevitably arise about the constitution of secular trends and short term cycles since the length in time which determines the status of a trend as long term or short term is completely and wholly arbitrary. Keynes made no particular effort to distinguish between long term and short term except in the most general manner of usage. However, it will be the contention of this paper that these contingencies could affect propensity in the short run if they were of any great effect on propensity at all. Even within the limitations of a five or seven year cycle or less they will have effect.

In the matter of saving for old age, taking as given the fact that most of mankind is concerned about its future and is able to make some provision to offset future hardships, a stable population would be necessary for a stable influence upon the propensity. However, in the ten years just prior to the recent world war, the population of the earth increased by 200,000,000 and between 1900 and 1940 by 563,000,000.\textsuperscript{42} Moreover, as population grows, there is a marked tendency for the population to age; that is, the average of the population increases until the old are the largest single age group in the population, out of all proportion to the rest of the group.\textsuperscript{43} This tendency is accentuated by the development of superior medical techniques and biological knowledge which enables the whole population to live longer. The population of the earth has tended recently to double itself about every ninety years; in the United States population has doubled in the past at a rate of about every thirty years.\textsuperscript{44} At the present time, it is growing at the rate of about 1,250,000 per year.\textsuperscript{45}

\textsuperscript{43}Ibid., p. 46.
\textsuperscript{44}Ibid., p. 49.
\textsuperscript{45}Ibid.
These statistics on population coupled with Keynes' second subjective factor lead to the conclusion that the rate of growth and variation by age in populations is enough to influence the propensity to consume year by year, month by month and almost day by day. If the population changes at such a rate, and it is by no means a necessarily steady rate nor is it necessarily in one direction, the propensity must be affected in the short run, and if propensity is not so affected then some other causal force must be acting upon the propensity. As will be pointed out presently, that is undoubtedly the case.

The second of the particular contingencies which Keynes believed might inspire saving is education, and in general the same shortcomings are evident in this conception as were present in the matter of saving for old age. In addition to these, there is the constant pressure in our culture for expanded and intensified education among all groups.

The Lynds give some insight into the changes of attitude concerning education which have taken place in the United States at least as these changes are represented in Middletown.

While the city's population has increased but three and one-half fold since 1890, enrollment in the four grades of the high school has mounted nearly eleven fold, and the number of those graduating has increased nineteen fold. In 1890-91 there were 170 pupils in the high school, one for every sixty-seven persons in the city, and the high school enrollment was only 8 per cent of the total school enrollment, whereas in 1923-24 there were 1,849 pupils in high school, one for every twenty-one persons in the city, and the high school enrollment was 25 per cent of the total school enrollment. In 1882, five graduated from high school, one for each 1,100 persons in the community; in 1890 fourteen graduated, one for each 810 persons; in 1899 thirty-four graduated, "one of the largest graduating classes the city ever had," making one for each 580 persons; in 1920 114 graduated, or one for each 320 persons; and in 1924 236 graduated, or one for each 101.

Equally striking is the pressure for training even beyond high school. Of those who continue their training for twelve years long enough to graduate from high school, over a third prolong it still further in college or normal work. Two of the fourteen members of the high school graduating class of 1890 and
nine of the thirty-two graduates of 1894 eventually entered a
college or normal school, while by the middle of the October
following graduation, a check of 153 of the 236 members of the
class of 1924 revealed eighty as already in college, thirty-six
of them in colleges other than the local college and forty-four
taking either the four-year college course or normal training at
the local college. Between 1890 and 1924, while the population
of the state increased only approximately 23 per cent, the number
of students enrolled in the State University increased nearly
700 per cent, and the number of those graduating nearly 800 per-
cent. During the same period the number of students enrolled
in the state engineering and agricultural college increased 600
per cent, and the number of those graduating over 1,000 per cent.46

The significance lies in the rapid change in the attitudes toward
education in the thirty year period, a relatively short time, and
especially the rapid changes between the years 1890 and 1899 and between
1920 and 1924. Here in a nine year and in a four year period there
are such great increases in the number of students in the high schools
and colleges that, had there been prior saving to insure their being
there, the propensity to consume would have been affected in a short run.

Here, as so many times before, the answer must lie beyond logical
reasons for not spending money and in involuntary saving. In commenting
upon the Brookings Study, A. F. Burns makes a comment which well might
be interjected at this point to reflect doubt upon the validity of
Keynes' concept.

We know little about the level of the rates of saving along
the income range and we know less of temporal changes in the saving-
income function. This much seems plain: since we lack definite
knowledge of thrift, no reliable deduction about the trend in the
proportion of national income saved is possible.47

The third of the subjective factors, "to enjoy interest and
appreciation, i.e. because a larger real consumption at a later date

46 R. S. Lynd and H. M. Lynd, Middletown, pp. 182 f.
47 A. F. Burns, "The Brookings Inquiry Into Income Distribution and
is preferred to a smaller immediate consumption," the fourth, "to enjoy a gradually increasing expenditure, since it gratifies a common instinct to look forward to a gradually improving standard of life rather than the contrary, even though the capacity for enjoyment may be diminishing," and the fifth, "to enjoy a sense of independences and the power to do things, though without a clear idea or definite intention of specific action," expose most cruelly the ignorance of Keynes concerning the true nature of the distribution of income and the uses to which money-wages are put by the underlying population.

In 1944, a wartime boom year of unprecedented prosperity, approximately 58 per cent of the wage earners in the United States were apparently unable to accumulate any savings. These 58 per cent were in the $3000 or lower wage bracket and an additional 20 per cent were in the $3000 to $4000 group which was able to save only a small quantity of money per capita.

Is it conceivable that over one-half or three-quarters of the population of the United States have no desire for a future larger real income, or have no desire to enjoy a sense of independence? Of course, that cannot be the case, for the cultural basis of saving is broad enough to forbid any such circumstance. As evidence of this, it should be noticed that in 1935 the non-saving group was increased to about 82 per cent of the population.

Clearly enough, the great part of savings is due to certain members of the society being unable to consume their full allotment.

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48 Keynes, General Theory, p. 107. 49 Ibid., p. 108. 50 Ibid.
of buying power. Examining some of the saving figures for the year 1944, it may be noticed that in the median income group, $2500 to $3000, the average per capita savings amounted to $236.

Taking this as a normal figure this group could save on the average $9440 each after a lifetime (40 years) of saving. At simple interest and at somewhat above the normal rate, the appreciation on this saving would amount to $4720 or one and one-half year's income as the return on forty years saving and investment. This total, $14,160, is enough to support the worker at his normal income for less than five years, not enough to allow him to enjoy a great sense of independence. It is enough to allow the worker to buy a house at the end of his life span, but not enough to allow him a great increase in real income over any period in which it might be usable. It is submitted that the quantity of saving it is possible for the vast majority of worker-consumers to accumulate is nowhere nearly great enough to induce them to forego immediate purchases.

As an afterthought, it should be added that since income drops so rapidly in panic or depression years, the figure used as an approximate average errs by being much too high. Actually no more than 10 per cent of the American earners are ever able to accumulate anything more than a pittance after forty or fifty years of labor. The great majority of workers accumulate nothing for their years of work. It is not logical to say that the 90 per cent are more lacking in thrift than the 10 per cent or that the motives for thrift are stronger among the 10 per cent than among the 90 per cent.

Saving "to secure a masse de manoeuvre to carry out speculative or business projects"53 the sixth of Keynes' subjective factors, may

53 Keynes, General Theory, p. 108.
readily be seen to be an influence only on those in the upper income brackets. Only a few persons can be deeply concerned with this motive since only those earning large incomes can accumulate funds enough to enter into any modern businesses.

Actually, it is irrelevant to consider this motive as being of extreme importance because of the prevalence of bank credit in the foundation of both large and small business enterprise. In no sense can bookkeeping money be construed to be a part of saving. It is created from the bank's institutional power and destroyed by the same power. According to Thomas C. Elaisdell, Jr. of the Securities and Exchange Commission as cited by Harold Moulton,

The commonly accepted notion that business enterprises expand plant and equipment by obtaining savings through the securities market is greatly exaggerated. Business enterprises rely upon the securities markets, that is, upon the savings of individuals, for only a small part of new funds which they invest in plant and equipment and their going businesses.

Keynes contended that the creation of bank credit cannot take place without equivalent saving because when the addition of assets to the entrepreneur's stock allows him to make an addition to current investment which otherwise would not have been made, incomes will be increased, and with the multiplier in effect, by an amount greater than the investment. According to Keynes, with income increased, saving must be increased; consequently, the equation between saving and investment will be maintained.

Keynes was wrong in this contention for two reasons: first, there is nothing to indicate that accruals to the entrepreneur necessarily become income in the sense of output. Investment funds can be dissipated into

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5th. T. G. Elaisdell, Address before the Institute of Public Affairs, University of Virginia, July 10, 1949, (cited by) H. G. Moulton and Others, _Capital Expansion, Employment, and Economic Stability_, p. 188.
ownership instead of production. Second, Keynes' argument that when "the banking system ... parts with an asset, someone must be parting with cash" is evidence of his weakness here. That no cash need be involved in the creation or destruction of bookkeeping money was apparent in the examinations of that subject made above.

The last two factors, still assuming that these are valid causes for saving, are "to bequeath a fortune" and "to satisfy pure miserliness." These are rather useless inclusions since the latter could not be applied to any significant part of the group and the former is beyond the fondest dreams of the large part of the population. In either the long or the short run, neither of these two factors is worthy of serious consideration.

One conclusion which must now be drawn is that if these subjective factors are important as causes of saving they would apply in the short run as well as the long; hence, Keynes' theory is shaken by this misconception.

However, most of the foregoing is in the nature of idle speculation and the nature of saving is considerably more simple than Keynes would make it. Saving is closely related to income distribution; the greater the skewness to the right, the greater will be the quantity of saving, for, as has been previously pointed out, saving is actually a residue, occurring not from motives either subjective or objective but from the inability of certain groups to completely use up that portion of buying power which was allotted to them by society.

A question may arise concerning the reasons for discarding the motives for saving in such a cavalier manner. In a word, they must

55 Keynes, General Theory, p. 82. 56 Ibid., p. 108.
be disregarded first because the distortion of the distribution of income is so great that the great mass of the population has no opportunity to save under the force of any motive no matter how strong, second, because there are consumption factors which Keynes passed over almost without notice which offset the saving motives, and third, because there is always an opportunity for expenditure open to the members of an industrial society.

Keynes noted "Enjoyment, short-sightedness, Generosity, Miscalculation, Ostentation and Extravagance" as motives to consumption but presumably feels them to be of less magnitude than the savings motives. However, the motives of the consuming classes are of somewhat more importance than Keynes cared to admit.

Consider this:

The motive that lies at the root of ownership is emulation; and the same motive of emulation continues active in the further development of the institution to which it has given rise and in the development of all those features of the social structure which this institution of ownership touches. The possession of wealth confers honour; it is an invidious distinction. Nothing equally cogent can be said for the consumption of goods, nor for any other conceivable incentive to acquisition, and especially not for any incentive to the accumulation of wealth.

Pecuniary emulation is a motive setting aside Keynes' psychological law. "Conspicuous Leisure," of which Veblen said,

In order to gain and hold the esteem of men it is not sufficient to possess wealth or power. The wealth or power must be put in evidence, for esteem is awarded only on evidence. And not only does the evidence of wealth serve to impress one's importance on others and to keep their sense of his importance alive and alert, but it is of scarcely less use in building up and preserving one's self-complacency.

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57 Ibid., p. 108.
is the second of the consumption motives which give the lie to Keynes' assertions on the subject. "Non-productive consumption of time"\(^60\) is doubtless an institution of major importance in this culture.

In conjunction with this factor is the third of Veblen's consumption motives, "conspicuous consumption . . . a means of reputability to the gentleman of leisure."\(^61\)

The potlatch of the Kwakiutl as described by Ruth Benedict\(^62\) took on a deeper meaning as Veblen compared it to the actions of civilized, cultured groups, and particularly to the behavior of the "gentlemen of leisure."

As wealth accumulates on his hands, his own unaided effort will not avail to sufficiently put his opulence in evidence by this method. The aid of friends and competitors is therefore brought in by resorting to the giving of valuable presents and expensive feasts and entertainments.\(^63\)

What Keynes neglected so obviously are those factors which Veblen saw so clearly and referred to as "the pecuniary standard of living,"\(^64\) the "pecuniary canons of taste,"\(^65\) and "pecuniary culture and dress."\(^66\)

Keynes said of the standard of living, " . . . a man's habitual standard of life usually has the first claim on his income, and he is

\(^{60}\)Ibid., p. 90.

\(^{61}\)Thorstein Veblen, "Conspicuous Consumption," Ibid., p. 117.

\(^{62}\)Benedict, Patterns of Culture, p. 174.

\(^{63}\)Veblen, "Conspicuous Consumption," The Portable Veblen, p. 117.

\(^{64}\)Veblen, "The Pecuniary Standards of Living," Ibid., p. 149.


\(^{66}\)Veblen, "Dress as an Expression of the Pecuniary Culture," Ibid., p. 196.
apt to save the difference which discovers itself between his actual income and the expense of his habitual standard. . . ."68 but Veblen says,

For the great body of the people in any modern community, the proximate ground of expenditure in excess of what is required for physical comfort is not a conscious effort to excel in the expensiveness of their visible consumption, so much as it is a desire to live up to the conventional standard of decency in the amount and grade of goods consumed. This desire is not guided by a rigidly invariable standard, which must be lived up to, and beyond which there is no incentive to go. The standard is flexible; and especially it is indefinitely extensible. . . ."69

Of the two opinions, it seems there can be no doubt that Veblen's is the deeper insight into human nature. The constant tendency to increase monetary expenditure as evidenced by the "pecuniary canons" and aided as it is by advertising on every hand, but the constant presence of new, different, and intricately attractive gadgets for sale, and by the rapid acceptance by this supremely plastic culture of innovations of every nature overcomes the weaker urge to save in most members of the society. Let it be reiterated, saving of significance is an involuntary process engaged in by those unable to consume an amount equal to their income and intensified by limitations of a cultural nature upon both income distribution and income use.

In 1929, thirteen billion out of a total saving of fifteen billion was saved by ten per cent of the population. Two-thirds of the entire savings were contributed by 2.3 per cent of the families while the lowest 59 per cent of the families could contribute but 1.6 per cent of the saving. Sixty thousand families at the top of the income stratification saved as much as 25,000,000 families at the lower levels.70

68 Keynes, General Theory, p. 97.
The Force which produces a really significant change in the proportion of income saved is the increase in incomes in the higher income groups where the larger part of the increased revenue gets saved more or less automatically. It takes a great heap of penny savings, among the masses of the people to equal a single hundred thousand dollar saving of an individual in a high income group.71

The psychological law of Keynes seems to actually be a biological law; the capacity of a human being to eat, to sleep, to amuse himself is strictly limited by time and by space.

Four additional subjective factors were treated by Keynes, but they are thought to apply to corporations rather than to individuals. To secure resources for expansion, to secure liquid resources for emergency, to secure a gradually increasing income, to secure stability of funds were Keynes' conception of why corporations save.72

Overlooked in this theory are certain characteristics of corporations which set them apart as unique institutions in our society. Keynes apparently conceived of the corporation as a super-human intelligence apart from its employees, but this is not true. However, that the corporation is an entity, an organism with perpetual existence is true, in a sense. Savings by corporations are apt to be like saving in high income groups everywhere, either automatic and involuntary or else due to sincere but mistaken beliefs in the advantages to be gained thereby.

There is available in the United States no coercive tool strong enough to force the dissemination of accumulated funds either to labor groups or to the stockholders; consequently the tendency is for the corporation to allow funds to accumulate. In England intensive taxation has given way to social control in some industries in an attempt to

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71Maurice Leven, H. C. Moulton, and Clark Warburton, America's Capacity to Consume, p. 108.
72Keynes, General Theory, pp. 108 f.
combat this condition. In the United States only relatively mild
taxation has been attempted thus far, but corporate structure is such
that no tax program is likely to be successful. This condition is
aggravated by the frequent lack of coincidence of the interest of the
company on the one hand and the directorate on the other. When there
is such a conflict, the impersonal and immobile corporation is apt to
give way to the active directors, who are by their very nature skilled
in the art of financial manipulations.

Moreover, the constitution of corporations in the United States
at least is such that most of their actions are matters of tradition
and "standard company procedure," hence are to a large degree automatic.
A corporation does not require motives in order to save; it saves be-
cause there is no person within the company with authority to dispose
of accumulated funds, and the directorate is too preoccupied with other
matters to bother. Moreover, the directorate's best interests lie in
gaining independence from the stockholders, which end can be achieved
by the accumulation of large reserve funds. With access to ample mone-
tary resources within the corporate organization, control is retained
within the management group. These funds can be built up by corporate
saving.

A brief glance into corporate management will verify these conten-
tions. For example, the thirty-seven men who hold the thirty-nine seats
on the directorate of two corporations, American Telephone and Telegraph
and United States Steel, hold among them 302 directorships in 103 firms.
Among these thirty-seven are distributed twenty-five board chairmenships
and fifty-four offices other than that of director among the 103 organi-
zations. There are included in the group of affiliations those with
banks, investment houses, insurance companies, oil refiners and producers,
mail order houses, manufacturing companies in all fields ranging from Ludlow typography machines to Berkshire hosiery mills, meat packers, railroads, steamship lines, and enumerable others.\(^{73}\)

The need for corporate saving is clearly abolished by the interlocking directorates of industrial corporations, financial institutions, and banks. The expansion of the power and influence of insurance companies is a case in point. For example, in 1948, assets of the United States and Canadian insurance companies amounted to $59,500,000,000, 95 per cent of which was held by the United States companies. Among those United States companies, corporate bond holdings increased by more than $4,000,000,000 to a total of $19,000,000,000. Mortgage portfolios rose to $11,000,000,000 and federal government securities amounted to $17,000,000,000. This is a growth of 1100 per cent from 1860, but the increase alone is not nearly so significant as the extent of the holdings. One-third of the farms in the United States were mortgaged in 1948; although all of these mortgages were not held by insurance firms, a substantial portion were. About three-fourths of the corporate bond flotations in 1948 were taken up by insurance houses.\(^{74}\) The inevitable conclusion must be that corporations do save but they do not save for sound logical reasons for the most part. They save because of an inability to use their accumulated funds.

This must be the conclusion about the subjective and of the objective factors: They might have a bearing if the consuming groups in any great numbers had opportunity to save, but they do not. Low income and the

\(^{73}\)Investigation of Concentration of Economic Power, Temporary National Economic Committee.

\(^{74}\)Britannica Book of the Year, Walter Yust, editor, pp. 378 f.
pecuniary standard of living resolve the practice of saving among individuals to those income groups who, due to the biological laws of consumption are unable to use all of their income.

Saving exists among corporations, but not for the reasons Keynes puts forth. Instead, they exist because directorates attempt to accumulate funds for power, because inertia forbids the distribution of accumulated funds, because of a belief in the need for saving, and because of the accumulation of funds more rapidly than they can be used.
CHAPTER IV.

THE PSYCHOLOGICAL LAW AND THE MULTIPLIER.
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Having disposed of the causal relationship between the saving factors, objective and subjective, and the propensity to consume, the next steps in the investigation must be the determination of the relationship between income and consumption, the investigation in detail of the psychological law, and the validity of the Keynesian multiplier.

It has been evident throughout this paper that a discernible relationship between income, buying power and consumption does exist; it is equally evident that that relationship is not necessarily a functional one and that it is definitely not a constant, proportionate relationship. It has become necessary to attempt to discover exactly what causes the arrangement of consumption patterns at various income levels. With "pecuniary emulation" and "conspicuous consumption and waste" this matter has been hinted at. It is now time to investigate it thoroughly.

The basic hypothesis in the Keynesian concept of the marginal propensity to consume is that "employment can only increase pari passu with investment." However, Keynes did not make it clear if the reciprocal of this hypothesis is effective, that is, if investment also depends upon employment and this lack of treatment leaves one of the cloudy spots in the Keynesian theory generally. Moreover, that employment is a function of investment in the sense which Keynes used the word is a precept which requires proof before it can be accepted as an invariable condition.

1Keynes, General Theory, p. 113.
Assumed too, by Keynes, is that "if there is a decreasing return at the margin as the number of labour-units employed on the given capital equipment is increased, income measured in terms of wage-units will increase more than in proportion to the amount of employment, which, in turn will increase more than in proportion to the amount of real income measured (if that is possible) in terms of product."\(^2\)

What Keynes actually assumed is marginal utility, a concept which under the same circumstances even Marshall disavowed.\(^3\) It is upon this assumption that this paper will criticize the marginal propensity.

The final leg of the Keynesian trivet for marginal propensity is the psychological law of which so much has been said and of which more will be said shortly.

Assuming as he did that consumption is always less than income and that consumption increases with income but at a lesser rate, Keynes conceives of the marginal propensity as the relationship between consumption and investment as the last increment of output is added.\(^4\)

The marginal propensity is important because when it is known accurate predictions can be made as to the amount of each additional increment of output which will be divided between consumption and investment.

In the view of this paper, Keynes was attempting to endow with a system of natural order a process which in its natural state is consistent only in its disorder.

Investment, to Keynes, was the equivalent of saving and is also by his definition the addition to the value of capital equipment in any

\(^2\)Ibid., p. 114.

\(^3\)Alfred Marshall, Principles of Economics, p. 139.

\(^4\)Keynes, General Theory, pp. 114-115.
period, thus destroying his own theory, since the two are not equal. Throughout Keynes this basic misconception, that there is some connection between the flow of goods and the flow of money, is evident.

The ambiguous meaning of capital destroys the meaning of the investment-saving equation in the sense that Keynes used it. As the term is used, capital is production goods; capital is money; capital is ownership. Capital can mean all of these three things at one time, but goods are neither money nor ownership, money is neither ownership nor goods, and ownership is neither goods nor money. Consequently, investment, if it is an increment to capital equipment, cannot be ownership increment and cannot be money. Savings, on the other hand, can go into investment as Keynes uses the term, but it can also go into ownership increments, payment for vested rights, and into money. Neither ownership nor money is productive of consumer goods, that being the exclusive characteristic of production or capital goods.

The balance that Keynes envisages between savings and investment simply does not exist. Further, if Keynesian investment can be diverted into money or ownership it need not be used in the production of goods; increased employment need not follow and the whole unity and functional relationship between investment and employment is destroyed. Throughout the General Theory Keynes apparently assumed an equation of goods and money which does not exist. However, the development is so subtle that the critic is offered no specific ground upon which to attack it.

Marginal utility theory cannot apply to modern industrial situations because the nature of the machine, and of machine production forbids it in numerous ways. A modern machine factory cannot be used to its full capacity or its maximum efficiency or to the point, in other words, where added labor would mean a decreasing return. A point may be
reached when the factory is operating at full time (365 days of 24 hours per annum) using the number of workers required to operate the machines, (in factory parlance, a full crew) that an added unit of labor would add no product but that point would not have been reached by way of diminishing returns.

To return the criticism to somewhat more academic grounds, Gottfried Haberler, the Swiss economist, is convinced that "the marginal propensity to consume of the society as a whole (which corresponds to the multiplier) cannot be identified with a psychological law about the individual consumer, for many other factors besides the consumer's behavior determine the marginal propensity to consume of the society."\(^5\) While a little earlier an American R. G. Holden, criticized the same phase of the theory by generalizing, "Mr. Keynes' consumption function has no proven validity, but is, on the contrary, based upon a purely hypothetical assumption which itself runs counter to another long accepted and still widely held postulate."\(^6\) What Haberler and Holden fail to see is the possibility of behavior laws which run contrary to both Keynes and to the classic concept.

Why does a consumer spend money in the manner in which he does? Some of the Veblenian causal factors have been discussed above and they may be supplemented by the opinions of other economists. J. M. Clark defines man as

\[ \ldots \text{but a set of tendencies to react and to seek which are themselves the joint product of certain other underlying tendencies,} \]

\(^5\) Gottfried Haberler, *Prosperity and Depression*, p. 226.

developed and given their shape and direction by the universe outside. He is at the mercy of whatever system he happens to be born into for creating, transmitting, and directing stimuli. 7

Man is a creature of his environment and his environment is a matter of culture for, as Ruth Benedict makes clear, "... not one item of his tribal social organization is found in his germ cells." 8 Consumer buying patterns are a matter, not of psychological laws, but of institutional behavior.

A concept much older than the Keynesian theory must be brought into bearing in this matter of institutional consumption patterns. That concept is Engels' law, familiar to economists as the determinate of the uses to which income will be put at its various levels. Although Engels' law in its pure form is not applicable to American or modern British society, the theory of different patterns of consumption at different income levels does hold good, making a much more stable basis for studying the propensity to consume than Keynes' psychological law.

Keynes called it a fundamental psychological law that men are disposed to increase their consumption as income increases but not by so large an amount. This is a generalization evidently made from Keynes' own observation and experience. It may have been true in Keynes' limited circle of associates. It is not true as a sociological law, as a psychological law, or as an economic law because the preconceptions of Keynes do not agree with the known truths of those fields of investigation.

Keynes claimed that we "... have entirely freed ourselves ... the philosophy of the laissez faire establishment," 9 but he never quite

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8 Benedict, *Patterns of Culture*, p. 12
escapes from that pervading air of inevitability that is so characteristic of classical economics in spite of the fact that he does recognize the need for social control. Such statements as "... apart from the necessity of central controls to bring about an adjustment between the propensity to consume and the inducement to invest, there is no more reason to socialise economic life than there was before," and "... I see no reason to suppose that the existing system seriously misemploys the factors of production..." cannot be interpreted another way.

A recent critic has said of Keynes, "He is the last of pure economists, accepting autonomy and automation of the market." That appears to be a penetrating observation with which this paper must agree.

Keynes made no allowance in his psychological law for the speed with which change can occur in a modern culture under the influence of advertising and mass sale technique, preferring at all times to take refuge in the device for which he scolds the classicist. "Our criticism of the accepted classical theory of economics has consisted not so much in finding logical flaws in its analysis as in pointing out that its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world."

Keynes' psychological law overlooked the machine methods of modern industry and the General Theory holds to a belief of the necessary scarcity of goods.

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10 Keynes, General Theory, p. 379.
12 Keynes, General Theory, p. 378.
"The only reason why an asset offers a prospect of yielding during its life services having an aggregate value greater than its initial supply price is because it is scarce..."\textsuperscript{13}

"Moreover there are all sorts of reasons why various kinds of services and facilities are scarce..."\textsuperscript{14}

Indeed, so concerned was Keynes with the price equations, with interest and with the concept of capital as funds that he tended to disregard goods treated as things and not as something lurking mysteriously in the background; this disregard means that Keynes has established a system of logic intended to supplant the classical theory but unfortunately built upon the same firm foundation of shifting sand.

That Keynes failed to see clearly is that the extent of resources, the extent of knowledge, and the extent of productive capacity of the industrial quarters of the world are such that it is necessary to maintain some sort of restriction in order to keep any balance between buying power and goods. What Keynes did, apparently without realizing it, is to attempt to justify the maintenance of that equilibrium and to seek to devise a means within the classical framework to establish that artificial equilibrium at the point of full employment.

However, without a more complete understanding of the problem than Keynes apparently possessed the far-reaching psychological law cannot be formulated.

Having combined his version of the psychological law with the marginal propensity to consume, Keynes moved on to the practical use to which this concept can be put. That practical use is what Keynes called the “investment multiplier,”\textsuperscript{15} the concept which having been

\textsuperscript{13}\textit{Ibid.}, p. 213. \textsuperscript{14}\textit{Ibid.}, p. 214. \textsuperscript{15}\textit{Ibid.}, p. 115.
broached in an earlier chapter must now be investigated before this paper can proceed to a conclusion about the worth and validity of the whole of Keynes' General Theory.

The multiplier is not a new idea in economic theory and practice, and as has been indicated above, Keynes is quick to point out his source of the idea. Keynes' multiplier, the "investment multiplier," indicates the amount by which income will increase, when there is a given increment of aggregate investment. By equating the aggregate of output to the product of the multiplier and the aggregate of investment, a relationship is established which allows the economist to determine the necessary level of investment to maintain any desired level of employment.

What the multiplier, as used by Keynes, is derived from is the marginal propensity to consume, being the relationship

$$1 - \frac{1}{k} = \frac{dC}{dY}$$

Where $k$ is the multiplier, $dC$ is marginal consumption and $dY$ is marginal output.\(^{16}\)

Kahn's "employment multiplier," as will be recalled from the discussion above, indicates the ratio existent between employment in the investment industries and total employment, but as Keynes pointed out, there is no reason that Keynes' multiplier and Kahn's multiplier should necessarily be equal.\(^{17}\) However, for the purpose of simplicity, Keynes does assume that in most cases the two factors will be equal and can be treated as such.\(^{18}\)

Taking the case which Keynes used as an example, what is the result of a knowledge of the multiplier?

It follows . . . that, if, the consumption psychology of the community is such that they will choose to consume, e. g., nine-

\(^{16}\)Ibid., p. 115.  
\(^{17}\)Ibid.  
\(^{18}\)Ibid., p. 116.
tenths of an increment of income, then the multiplier is 10; and the total employment caused by (e.g.) increased public works will be ten times the primary employment provided by the public works themselves, assuming no reduction of investment in other direction.\textsuperscript{19}

Let it be assumed, then, that a community which owes ten per cent of any income and thus has a multiplier of ten, receives public works in the amount of $100,000. The multiplier was arrived at by the formula $1 - \frac{1}{k} = \frac{dW}{dW}$ already discussed; substituting $100,000$ for $dW$, the increment of output, and $90,000$ for $dW$, the increment of output, the marginal propensity is seen to be $9/10$. It follows:

\begin{align*}
1 - \frac{1}{k} &= \frac{9}{10} \\
1 - \frac{9}{10} &= \frac{1}{k} \\
\frac{1}{10} &= \frac{1}{k} \\
10 &= k
\end{align*}

and the total wages arising from the public works paid in that community will be $10 \times 100,000$ or $1,000,000$.

There in theory and in example is the multiplier in action and with it a strong argument for public works.

Two assumptions accompanied Keynes version of the multiplier, and they may be enough to destroy its value.

The first and most important is the ever present weakness of the psychological law. Keynes was forced to prefix his every assertion with such things as "With normal psychological suppositions . . ."\textsuperscript{20} which serves much to alert the reader to the questionable value of the material which follows. Could it be that Keynes has fallen into the trap of which Hobson has warned?

For though the trend of a large modern school of economists

\textsuperscript{19}bid. \textsuperscript{20}ibid., p. 117.
has been to find in consumption the vis motrix of all economic processes, and to bring close study to bear upon the pressure of consumer's wants as they operate through demand in the markets of commodities, this volte-face in the theory of values does not render much assistance to our human valuation. For the analysis of demands does not help us to interpret expenditure in terms of human utility.  

Keynes was treating of demand, a subject he defined twice, first as "... simply the aggregate income (or proceeds) which the entrepreneurs expect to receive ..." and second as the point of coincidence of the aggregate supply function, the relationship between a number of workers and the aggregate supply price of their output, and the aggregate demand function, the relationship between a number of workers and the proceeds accruing to the entrepreneur from their employment.

No matter what the discrepancies may be between these two concepts, both of them are concerned with an equilibrium of demand and supply equated by definition. They are matters of price and exchange value in a non-existent equilibrium. But if "psychology deals with the behaviour of living beings" how can Keynes couple a "psychological law" or "normal psychological suppositions," in other words, rules of human behaviour, to economic canons such as "effective demand," and "effective supply?" What Keynes has obviously done, albeit cleverly, is to bring back into economics once banished natural law and natural order. Keynes' psychological law is the twentieth century garb of Adam Smith's Unseen Hand. Both of them leave the individual to his own devices, Keynes

22 Keynes, General Theory, p. 55.  
23 Ibid., p. 25.
secure in the knowledge that interest manipulation would protect the system just as Smith was sure the businessman was promoting a beneficial end far beyond his anticipation. 25

As a matter of empiric fact, there is no end to the possible mutation of consumer demand and expenditure. There is no order in human nature beyond that of culture and one of the basic characteristics of English and American society is the pliability of the consumer group.

The second of Keynes' two assumptions made in connection with the marginal propensity to consume and the multiplier was that investment metamorphoses into income. This concept is fundamental to the multiplier but nowhere does there exist empirical evidence that this transposition necessarily takes place or that investment cannot go into other uses than that of production. The evidence, in fact, points to the existence of the opposite condition, investment accumulation without increased employment or income. The Brookings study offers such evidence when it reports, "Instead of a scarcity of funds for the needs of business enterprise, there tends to be an excessive supply of available investment money, which is productive, not of new capital goods, but of financial maladjustments." 26

It is difficult to stray far from the basic Keynesian assumption of

Income = value of output = consumption / investment
Saving = income-consumption
Therefore saving = investment, 27

because it so permeates the rest of his thinking but by numerous tests it has been proved untrue except in the one narrow definition which

25 Adam Smith, Wealth of Nations, Pp. 320 f.
27 Keynes, General Theory, p. 63.
Keynes gave but to which even he did not adhere. If this relationship does not always hold true, then Keynes' conclusion that "... we have here established the law that increased employment for investment must necessarily stimulate the industries producing for consumption and thus lead to a total increase of employment which is a multiple of the primary employment required by the investment itself," cannot be true, and in one stroke the value of the multiplier is destroyed.

Reviewing the weak links in the chain of marginal propensity and the multiplier, it may be readily seen that the psychological law is not valid, investment need not be dependent upon or equal savings, and investment is not necessarily dissipated into income or output.

Keynes, following Kahn, established a sort of mystical relationship between wage-goods industries and production-goods industries. It is not difficult to trace the development of the separate categories of goods from Adam Smith's concept of "stock," but it is difficult to understand how Keynes, as a heretic, failed to see the continuity of the productive process. That he did not see it is plain, for the basis of the theory of the propensity to consume is Keynes' statement that "consumption—to repeat the obvious—is the sole end and object of all economic activity."  

J. M. Clark wrote of the "eternal cause and effect circle of production and consumption," and had Keynes but seen as clearly he might have avoided the error of assuming the different status of men's

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28 Ibid., p. 118.
29 Smith, Wealth of Nations, p. 142.
30 Keynes, General Theory, p. 104.
wages as determined by the kind of goods they work at producing. Of course, there can be a disparity of production goods and consumption goods, but that is an unbalanced condition which never has and never will be solved in the market place, by natural laws of any sort, and it is a disparity which Keynes could do very little about with interest manipulation. It requires social control.

Keynes, however, missing the point entirely went on to analyze the multiplier and investment in various potential relationships until he reached the conclusions which condemn the whole theory to absurdity.

"Pyramid building, earthquakes, even wars may serve to increase wealth," said Keynes. "Ancient Egypt was doubtfully fortunate, and doubtless owed to this its fabled wealth, in that it possessed two activities, namely, pyramid-building as well as the search for precious metals, the fruits of which, since they could not serve the needs of man by being consumed, did not stale with abundance."33

In a less joking manner he said, "...the maintenance of prosperity and of a stable economic life only depends on increased investment if we take as unalterable the existing distribution of purchasing power and the willingness of those who enjoy purchasing power to use it for consumption. The wealthier we get and the smaller, therefore, the profit to be gained from adding to our capital goods, the more it is incumbent on us to see that those who would benefit from increasing their consumption have the power and opportunity to do so."34

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32 Keynes, General Theory, p. 129.  
33 Ibid., p. 131.  
How fortunate it would have been had Keynes been less preoccupied with pyramid building and the traditional concept of marginal utility so that he could see as clearly as some contemporaries, J. E. Ayres, for example, that the value of the multiplier depends upon expanding consumer purchasing power, a device which the Keynes tools do not make use of at all.

To be wholly objective, certain other appraisals of Keynes and his theory as well as rebuttals and refutation of some of the material critical of him must be included.

That the General Theory was not fully understood so that some, perhaps a great deal, of the early criticism was not aimed so much at what Keynes said but at what certain people may have thought he said. For example, an anonymous magazine editor puts words such as these in his mouth purportedly speaking of the expansion in housing and the automobile industry before the depression of the 1930 decade.

Such unheard of multiplication of vehicles and housing was, of course, madness. It was both a cause and an effect of the hysteria which in 1929 drove us off a steep place into the sea of depression. This demand, thanks to hard times, has suffered a long postponement... It has accumulated a pressure whose relief should benefit the builder as it already blessed the motorcar manufacturer.

Those are not Keynes' words nor would he ever have been guilty of saying them. Still in a way they were his, for they represent what people thought he said; consequently, they were a part of his influence.

What Keynes did say about the United States was "wealth producing capacity which is now going to waste in the United States is so far

---35 Ayres, Theory of Economic Progress, p. 274.

36 "Imaginary Conversation Between the President and a British Economist," (Author not given), Literary Digest, Vol. 68, (Aug. 25, 1934), pp. 11 f.
beyond our powers of measurement that it is useless to hazard a figure for it," but with this capacity Keynes saw a shortage of investment finally concluding that the lack was due to "... institutional factors which tend to encourage accumulation and retard the growth of consumption when incomes increase."  

The solution to the United States' untapped capacity lies in "more investment and more spending," but with production controlled so that there would be no real wage increase. This line of reasoning finally leads to what is probably the most naive of all the Keynesian concepts, "Investment for war has not the remotest connection with private consumption." No connection, of course, except to stimulate it and distort it beyond the power of any "psychological law" to control.

Of the economists who are sympathetic to Keynes, probably A. H. Hansen has come nearest to complete understanding and agreement on the question of the multiplier.

Hansen says, "What is needed is either to raise the propensity to consume by a better distribution of wealth and income or else fill the gap between private outlays (consuming plus investment) and the desired full employment income by useful and productive public outlays." However, he had previously questioned the propensity concept and although the foregoing was something in the way of a recantation, it might be not amiss to examine Hansen's question about the propensity.

This may be summed up by the three conditional answers which Hansen gives to the query, what is the propensity to consume.

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38 Ibid.
39 Ibid., p. 156.
40 Ibid., p. 157.
Is it, Hansen asks, the ratio of anticipated consumption to anticipated income, the ratio of planned consumption of a period to income of that period, or is it the ratio of realized consumption to realized income? Following this a little farther, Hansen might have asked if perhaps the propensity was the ratio between present consumption and anticipated income, which certainly is sometimes the case.

No matter what the propensity is taken to be, so long as it is recognized and understood to be in whatever particular form it may take, Hansen believes it will be useful and the establishment of an automatic economic order will be possible. This is the same order that Keynes anticipates, and there is but trivial change in its mechanics as they are explained by Hansen.

If planned saving exceeds realized investment, the income of the community is driven down to a point at which the planned saving and the realized investment equate. If planned saving and realized investment equate, there would be no tendency toward any further change in income and employment. This equilibrium is reached only when the propensity to consume and the inducement to invest stand in a particular relationship to one another. Hansen follows Keynes in making one more oversight, that of mis-determining resources and the need for development of those resources in an economy which must be maintained by restricted production. He points out the vast resources available to the United States and urges the full utilization of those resources but overlooks completely the disorder which must follow production of more than enough goods to equal buying power. Unconsciously, he and Keynes in this matter always return to Say's law, expecting production to make its own market as it might

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43 Ibid., p. 675.

be expected to do in a New Harmony where production is gauged and measured by the hours of labor contributed; Say's law might be valid in an Adam Smith world where labor is the basis of wealth and is the real standard of all values,\textsuperscript{15} but it is not true in a monopoly world where there need be no scarcity of goods. A situation of this sort only serves to make more apparent the lack of order in economic syllogisms when marginal utility cannot be used as a basic premise.

Other critics of the concept of marginal propensity and the multiplier have based their objections on numerous real or fancied errors in Keynes. Some of the more valuable of these comments must be noted.

A. G. Hart, in full agreement with the psychological law, says "Keynes is plainly right that the number of dollars saved per year must rise as national income rises,"\textsuperscript{16} but he takes issue with the relationship Keynes argues exists between consumption and saving. Following the lead of the Brookings study, Hart maintains that "investment is based upon future estimated sales, not upon present consumption."\textsuperscript{17}

That is probably true, but also true is the tendency on the part of many, if not most, business men to anticipate future sales on the basis of projected present sales trends. Barring wizardry, it is the only usable method of business prediction available to most business men, particularly those in retail and wholesale trade.

The distinction here is an important one because Keynes' theory

\textsuperscript{15}Adam Smith, \textit{Wealth of Nations}, pp. 58 f.


\textsuperscript{17}Ibid., p. 14.
depends upon the correctness of the savings, consumption, and investment relationship, and that relationship is put in jeopardy by investment as a function of future sales instead of liquidity preference.

Another serious criticism of Keynes' theory is directed by F. A. Lutz at the very roots of marginal propensity and the multiplier. Savings and investment are economic factors independent of the multiplier, neither affecting nor affected by it. The propensity to consume and the multiplier are ex post facto calculations and as such are useless to the economic planner or forecaster. There is some merit in this argument although a common failing exists in it and in that part of Keynes' theory at which it is directed. Neither of them can be considered universal laws. Cases may be cited in which the propensity may be accurately predicted, but on the other hand, just as many cases may be examined in which the multiplier can be determined only after the investment has been made.

Gottfried Haberler takes to task the investment theory because of the assumption of coincidental motives and action of individuals and society. It is the contention of Haberler that the correlation of savings, investment, and consumption applies to individuals but does not apply to society as a whole. The reasons Haberler gives for this attitude are generally sound and all in all this is a sound and deserved criticism.

One last word must be said concerning one of the authorities whose judgment and knowledge has been used as a ram to batter down the

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49 Haberler, Prosperity and Depression, p. 171, p. 196.
ramparts of marginal propensity and the multiplier. H. G. Moulton has contributed greatly to the store of empirical data from which this paper has drawn, but since he is not without detractors, in order to secure objectivity and in fairness to J. M. Keynes, some of those critics must be heard.

H. H. Villard has cast some doubt upon the validity of the statistical basis of Moulton's study, particularly on the claims that new plant follows consumptive demand rather than the volume of savings. In a disagreement of this sort, the only resolution can be to the original opinions of the disputants. Reason and fact both seem to be on the side of Moulton, but Villard's point must be considered.

Another approach to the criticism of Moulton's work is that made by A. F. Burns who contends that the knowledge of saving motives and methods is so scanty any conclusion drawn about them is presumptions. "Indications are," Burns says, "that the variability of family savings is enormous." So great is this variability that the investigative method has not yet been developed to handle properly the problem.

Again there is right on both sides, but again the best fact and best reason seem to bear out Moulton and thus sustain this paper's comments upon the multiplier and upon marginal propensity to consume. However, Burns' contentions do nothing in the way of strengthening Keynes' position.

The marginal propensity to consume and the multiplier do not

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stand close observation but even if they were sound precepts, the
preconceptions and the "psychological law" upon which they are constructed
would destroy them as useful tools in the study of economic behavior.
CHAPTER V

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John Maynard Keynes traces his interest in over-saving, which is, after all, the core of the General Theory, to work done by J. A. Hobson and A. F. Mummery in their work, The Physiology of Industry. He notes, too, J. M. Robertson's The Fallacy of Saving as a work of lesser importance and influence but still a pioneer in that field of thought.¹ Keynes, by implication, lists himself as another member of that "brave army of heretics . . . who, following their intuitions, have preferred to see the truth obscurely and imperfectly rather than to maintain error, reached indeed with clearness and consistency and by easy logic, but on hypotheses inappropriate to the facts."² There is that in Keynes which leads to the conclusion that he feels that he alone of all the heretics at last sees the truth clearly and perfectly.

But does Keynes contribute anything new to economic knowledge? A cursory examination of the history of the over-saving doctrine is in order here as a means of appraising the contribution of Keynes.

Over-saving and over-production theories probably originate with the Earl of Lauderdale who in 1604 published his An Inquiry into the Nature and Origin of Public Wealth, which apparently makes public wealth the symbol of abundance and private wealth the equivalent of

¹Keynes, General Theory, pp. 365 f.
²Ibid., p. 371.
scarcity, or with Sismondi who in 1819 published his New Principles of Political Economy in which he insisted on the proper use of wealth to produce happiness. According to the classic theory, said Lauderdale, free goods have no value; if they are captured in some manner and owned they will then have value and the society will be richer. ¹ This certainly appears to follow from the classic hypotheses. Malthus, Marx, Gesell, Hobson and finally Keynes have based much of their argument upon adaptations of Lauderdale's contentions which, oddly enough are still being attacked by some writers on the same basis as Ricardo used in countering them. ² What Lauderdale and Sismondi failed to see, and incidentally what all the rest of the group up to and including Keynes have failed to see, is the need to discard the whole of classic theory and not just the part which is offensive to them. A good part of the theory of each has been based upon the classic precepts with the peculiar results to be expected from a criticism based upon the same assumptions as that against which it is directed. Against what he believed to be the classic argument, "the wants of man being expandible without limit, how is it possible that too much can be produced," ⁵ Hobson submits, "... under-consumption due to over-saving arising from maldistribution of income, is the normal cause of cyclical depression," ⁶ which is probably a statement that is largely true but certainly is one which treats the symptoms while it ignores the disease.

³ J. A. Hobson, The Economics of Unemployment, p. 32.
⁴ Ibid., p. 36.
In the United States notice was taken of over-production and
under-consumption by one Uriel H. Crocker who argued that over-saving
causéd an over-supply of production goods leading to a surplus of con-
sumer goods, hence to over-production. The relation of Crocker's
argument to the classical theory on the basis mentioned above lies
in his assumption that saving not only equates but in some way becomes
production or investment goods. This is exactly the same mistake into
which Keynes repeatedly was led in the General Theory. Crocker makes
another, more glaring error when he claims

... this inequality between supply and demand may properly be
called either "over-production" or "under-consumption." Each
term equally well describes the situation, and each has been
employed by different writers, but that which has been most
usually employed by economists has been "over-production."

Over-production means to those economists who subscribe to the
theory a condition in which a larger quantity of goods are produced
than can be bought, due to a disparity of income and savings—
investment equation with which production of investment goods must
advance pari passu.

Under consumption, on the other hand, designates the condition
which exists when consumer income, for any reason, although usually
because of maldistribution, is insufficient to buy the quantity of
goods produced by the existent plant.

The principal difference in the two concepts is the role played
by savings. In the over-production theory savings contribute to
investment goods and hence to excessive production. In under-consum-
ption on the other hand, saving plays the villain by taking buying

8 Ibid., p. 15.
power from circulation, thereby converting a dynamic economy into a static one.

Thorstein Veblen took some notice of Crocker's over-production theory, but his objection to it was somewhat different from that mentioned in this paper, since his criticism of the concept is based upon price, particularly upon a divergence between the accepted valuation and the actual value of capital. Depression, Veblen's argument states, is a matter of changing values; it is first a psychological fact and second a period of shifting ownership. 9

The connection of all this discussion to John Maynard Keynes should be evident, for with the exception of more modern terminology and the addition of mathematical formulae, the thought is basically the same in the early phases of the over-saving theory as in Keynes.

The fact that the general conclusion reached by Keynes that some kind of redistribution of wealth is necessary coincides with the conclusion of the socialists, the conclusion of the holistic economists, and the logical conclusion to which the classical theory always eventually leads probably lends prestige to that conclusion and gives at least one common point of agreement to almost all schools of economic thought. That minor area of coincidental thought will act as an excellent reference point for a summary of Keynes' theories beyond over-saving, for a summary of the objections to those theories that it has been necessary to raise in this paper, and for whatever conclusions may then be drawn.

Hardly anyone, social scientist or layman, will deny that there is evil and danger in a condition of widespread and long lasting unemployment.

Only a very few persons will not concede that from time to time in most economic systems, particularly in those of Western Europe and North America, periodic widespread unemployment does exist and apparently grows more severe with each recurrence.

Question the basic nature of that unemployment, however, and immediately the area of disagreement becomes evident. One group of some importance and learning argues,

For so long as anybody is unemployed, he will offer himself for employment and, in order to secure it, will beat wages down— if beating down is necessary—until it becomes profitable for employers to engage the services of everybody who is offering them. This argument, it should be observed, is independent of whether employers compete freely with one another for purchasers of their goods or—some or all of them—exercise some degree of monopolistic power. The rate of wages that secures full employment is, indeed, likely to be lower in the latter case than in the former; but in either case employment will be full.¹⁰

According to Pigou this is the classical theory and with it he generally agrees, although making certain exceptions.

The gist of the classical argument is that unemployment cannot normally exist for a long period of time, or if it should be present, it is due to labour's unwillingness to accept the wage to which the natural order of events leads. Involuntary unemployment cannot exist if that theory is valid and the absurdity to which the idea may be carried by its exponents may be illustrated by the words of one writer in the classic vein, John Fell, who, when confronted by the existence of widespread unemployment while armed with only the classic theory, concludes that "unemployment is the product of civilization." Apparently he is resigning man to his inevitable fate, a part of which is enforced idleness.¹¹

¹⁰A. C. Pigou, Lapses From Full Employment, p. 18.

Most economists do recognize the danger in unemployment, however, and make some more dynamic attempt to overcome it.

F. W. Taussig discusses the importance of emphasis in economic thinking on the employment problem. He does not agree with the concept of over-investment, however, for, returning to Say's law as a basic hypothesis, Taussig argues that the only remedy for unemployment is the expansion of plant.\(^{12}\) Since Taussig makes the usual assumptions of the classic theory, this expansion of plant presumably advances pari passu with savings.

There can be no greater difference of opinion than that existing between Taussig and Keynes. It is a matter of the virtue of an increased supply of production goods on the one hand and the virtue of a limited, or, at least, stabilized supply of production goods on the other. Both Keynes and Taussig work largely from the same general group of theories to reach these divergent conclusions but that, startling as it may appear, is not the real ambiguity in this relationship. The truly strange thing is that both Keynes and Taussig are right, although at the same time both of them are quite wrong.

The errors in their respective theories have been treated and will be summarized but the point of mutual correctness needs to be explained. In an economy maintaining full employment, there will be times when more goods of any given variety—consumption, production, or energy—will be produced than can actually be used, to say nothing of bought. In circumstances of that sort, restrictions on the expansion of plant is necessary to avoid gluts, price war, panic, depression, and perhaps even violence in competition between producers.

At other times, newly developed needs and desires, or lessening needs and desires, will cause changes in the pattern of consumption. Increasing population may cause an increase in the need for certain kinds of goods. Whatever the cause may be, times do occur when a segment of a society's industrial pattern and perhaps even the whole pattern is inadequate and in those times plant must be expanded in order to maintain the standard of living and full employment.

In both of these cases, the action of expanding or contracting plant was resorted to as a means of maintaining or establishing a standard of living and of maintaining full employment, i.e., of fully utilizing resources. Dispelling unemployment and guarding against its occurrence is more of another problem one which will be treated more fully after some other ideas concerning unemployment are considered.

That deviation from full employment is always due to one or more of three factors is an idea which may have merit. According to the observer putting forth this thesis, these factors are the advancement of technology, an increase in the number of workers, and fluctuations in the price level. This writer assumes that full employment is a desirable condition.

The classical view is that technological unemployment will occur but that the workers will eventually be absorbed into other industry due to the increased output from the technological advance. Keynes accepted this theory, adding his version of involuntary unemployment. Two quite obvious errors are evident in the concept. First, in a machine society, there is a tendency toward highly specialized labor.

which means highly immobile labor. Labor, it must be remembered means men, and men cannot readily change their habits or be retrained to new skills. Consequently, there is an ever growing tendency for the technologically unemployed to remain in that status.

Second, there is a persistent fantasy that the demand for goods will equal the output; this probably stems from the true, by definition, equation of effective demand and effective supply. Overlooked is the fact that the output of a machine is considerably greater than either the manpower it replaces or the manpower required to fabricate it. When a machine replaces hand methods the proceeds of the advanced technology will go to ownership and the replaced labor may be permanently disincomod. A constantly increasing labor supply would mean a constantly increasing market if that labor supply had income. In a machine economy where the plant is usually large enough to overfill the need for goods, an increased labor supply is apt to mean lower wages balanced against higher profits in an artificial stabilized economy. To his credit, Keynes recognized that something like this condition could exist, although he did not clearly see that the causes were institutional. Instead he turned to the monetary syllogistics which eventually led to the Propensity to Consume and the General Theory.

Keynes apparently was unable to recognize the basically simple nature of involuntary employment. He defines it:

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 aggregate demand for it at that wage would be greater than the existing volume of employment.\(^1\)

This means practically nothing and certainly means nothing practical.

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\(^1\) Keynes, General Theory, p. 15.
Involuntary unemployment exists when men desire to work at the prevailing wage or lower but cannot gain employment. It is not a matter of wage goods, real wages, or money wages. It is a matter of men possessing muscle power and manual skill unable to utilize them because of no fault of their own. Keynes might have profited to have read one phrase gleaned from an otherwise inept appraisal of the General Theory. This phrase runs "Demand for money is a demand for money and the supply of money is a supply of money and nothing more." 15 Money and price have no more real relation to men and goods than a picture postal card bearing an image of Niagara Falls does to the real scenic wonder.

The three approaches to unemployment, the classic, the Keynesian, and the institutional have some points of accord, but in the main the former two differ only in certain detail while the third seeks to strike at the root of the evil.

None of the three have a monopoly on either the means or the end and such diametrical organs as The New Republic 16 and Fortune Magazine 17 have noted some of the advantages of redistribution of income and wealth. Empirical examination of unemployment and the practices connected with it lead to diverse conclusions, all of which are contributions to the vast store of facts needed before workable and provable theories of unemployment can be formulated. Noticeable among all of these pragmatic


studies is an agnosticism concerning the nature of the subject. C. L. Long emphasizes the lack of knowledge about what unemployment is or how it may be measured. 

William Fellner insists that unemployment is a real problem not a psychological one while H. G. Moulton recognizes wages as administered prices and insists that they be held at a high level by whatever means are necessary.

In common they see the thing that Keynes never saw. Unemployment is not a matter of price and money manipulation. It is a matter of economic behavior as a part of the larger behavior pattern of man, a social animal, capable of conceptual thought.

Over-saving and involuntary unemployment have been treated because they are inseparable from the Propensity to Consume. In the foregoing chapters that theory has been examined and found wanting. But it must not be argued that the end Keynes sought was a bad one, even though the motive for wanting that end and the methods prescribed to reach it were weak. The desire for a stable economic life at the level of full utilization of labor is an admirable one, and that Keynes worked not as a scientist seeking the truth wherever it lay but as a banker seeking the means of preserving the existent economic system does not detract from the nobility of the end.

The misconceptions with which the Keynesian theory is permeated reduce it to absurdity and consequently do detract from the end.

The Propensity to Consume, for example, was believed by Keynes to

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be based upon a psychological law which causes the ratio between income and saving to remain practically constant at various income levels. This apparently was based on nothing deeper than his own observations but the fact in the matter, that the amount of savings increase as income increases, is generally not disputed. C. E. Ayres confirms this observation with his own that "the larger the income the greater the proportion of it that is saved."21 The belief in the constancy of the relationship and the reasons why it exists are the matters in which the Keynes concept is lacking in logic and in basis.

What are some of the objections to the propensity other than those already given? Elizabeth W. Gilbroy has unearthed some of them and confirmed others which originated here. She points out that the "psychological law" must always be true in highly capitalized countries because of the maldistribution of income. If the "psychological law" does not apply when incomes are redistributed, then the Keynesian theory must be qualified by being called applicable only in places where income is sharply skewed to the right.22

Gilbroy notes, too, that the elasticity of saving is highly variable, variation exists by occupations by geographical location, and by ethnomedical groups.23 Probably high variations in savings patterns by other groups could be found upon investigation. She points out the decreasing elasticity of saving as income increases as also being a factor24 and

23. Ibid., p. 134.
24. Ibid., p. 137.
George Soule observes that "families with budgets of various sizes divide their spending in widely different ways." 25

In a study of savings and spending habits in seven unrelated areas, Gilbroy finds that saving is the only item which is elastic in all income groups in all areas 26 leading her to conclude that spending is the new philosophy of western society, 27 and that the pressure to spend in western society is so great as to be almost irresistible. 28 Finally, "... the relation between income, consumption, and saving is neither as simple nor as stable as Mr. Keynes assumes in the propensity to consume." 29

The conclusion must always be that the Keynes version of the propensity to consume was a purely illusionary concept. Desire to possess and use goods of any nature is an outgrowth of both biological and sociological factors. Need for food, to illustrate, has a basic biological origin, but the desire for a particular kind or quality of food is the result of environmental conditioning. Those factors are so widely variable that no two persons have the same desires; certainly no valid psychological laws can be drawn on the basis of consumer attitudes and although some generalizations may be made about the tendencies to save and spend by income groups, they are of little value because of the constantly shifting and reshifting constituency of the various groups with the rise and fall of the income cycle. Moreover, it is not difficult to prove that the largest part of the total saving at any stage of income distribution is involuntary.

27 Ibid., p. 138. 28 Ibid., p. 139. 29 Ibid., p. 140.
There is no manner in which Keynes' constant concern with static economics can be escaped. The Keynesian General Theory is a monetary theory; it is a price theory; it is devoted to determining a theory of distribution; it is in almost every way an extension of the classical theory.

In another place Keynes noted and discussed the true nature of capitalism and the classical theory, tacitly accepting them as fundamentally immutable.30 The precepts he assumes there to be true are in the main part the precepts he assumes to be true in the General Theory.

Economic theory as seen by Keynes, was a problem of equilibrium. Certainly the grounds upon which he is attacked by the neo-classicists are not those assumptions about human behavior which he makes without verification and upon which this paper questions his theory.

To prove this point, some of these criticisms may be cited. Jacob Viner, for example flies at the hoarding propensity statement with

... the savers, those who add each year to their establishment ... typically hold in cash a smaller percentage of their incomes, let alone of their total resources, than do the spenders. The former have investment habits and abhor idle cash as nature abhors a vacuum.31

Great ado has been made about whether Keynes meant the percentage of consumption declined or the total amount of consumption declined. In the Quarterly Journal of Economics, for example, there were no less than twelve exchanges of opinion extending over almost three years in time discussing the merits of this particular point with an outcome

30 John M. Keynes, Economic Consequences of the Peace, pp. 18-20.
that satisfied no one. Almost ten years later the first chapter of a major work concerning Keynes opens with this same problem.

Joan Robinson defends Keynes in most of his contentions, but defends them in the same way that those just discussed have attacked him, on assumptions in the classical vein even though the writers themselves do not seem at times to recognize the source of their beliefs. Robinson, for example, recognizes that "... the individual ... can never be in a position to refuse to work," thus putting involuntary unemployment in the same light as this paper puts it; however, she perverts her own argument by transferring the properties of the economic man to the organized labor groups. "... a trade union will threaten to withdraw its laborers, not when any particular level of real wages is reached, but whenever the general situation (in which the level of real wages is only one element) appears to offer a favourable opportunity for doing so." There is a constant tendency in


33 Seymour Harris, "Appraisal of the General Theory," The New Economics, Seymour Harris, editor, p. 27.


35 Ibid.
the neo-classic theory as well as in the various mutations springing from it (monopolistic competition, Keynesian, and the rest) to transfer properties from one institution to another so that actually the religion stays constant while the saints are changed from time to time. Keynes actually is espousing Eighteenth Century liberalism without the benefit of laissez-faire, substituting for the natural order as set into motion by the creator a natural order with the banking system's regulation of interest rates as governor.\footnote{36}

The importance of all of these comments is not because of their value as criticism nor is it because of any deep insight into Keynes' thinking. Rather, they are important because they show Keynes' argument with the classicists to be an intramural affair with the new postulates being transferences from the old doctrines rather than new ideas.

Keynes starts out with the statement that human behavior in economic life is not, as the classic economists assumed, determined by objective economic forces but that, on the contrary, economic forces are directed, if not determined, by human behavior. He ends by asserting as rigid an economic doctrine of human behavior and actions as any Ricardo or Malthus ever proclaimed.\footnote{37}

So one writer proclaims, and so this paper concurs, making the reservation that Keynes' failure to prove his basic hypothesis does not prove the classic. It merely proves that Keynes, with a proper end in view and a faint glimmering of the causal factors as a beginning became hopelessly and irretrievably lost in the maze of classic syllogism.

To conclude this survey of the Keynesian concept of the propensity to consume, the marginal propensity, and the multiplier, there are two groups of considerations to be summarized. The first of these has to


do with the places where the General Theory has been found wanting and the second is concerned with the influences that Keynes maintains and the apparent future of the theory.

Looking backward, it may be seen that to a high degree, a criticism of Keynes' concept by itself is beside the point since Keynesian economics is classical economics with a thin veneer of progressivism.

Consider the precepts common to the two—marginal utility, disutility of labor, decreasing returns, savings as means of increasing the plant of a society, interest as payment for sacrifice, labor as the source of value, the productivity of money, the inelasticity of the supply of money, and so on until almost the complete doctrine is transferred and the truth of the contention that there is little new, little heretical in Keynes is obvious.

That the classical theory applies to only a special case and consequently is not applicable to the general economic situation is one of Keynes' contentions. The special case to which the classical theory applies is that of full employment, according to Keynes. With this proposition hardly established Keynes moves on to build his own postulates within a framework of conditions as great or greater than those of the classical theory.

Here are some of the static factors which Keynes assumed: an immobile psychological state, investment stemming from savings and from no other source, a constant money supply, savings flowing to productive investment or held in hoards, aggregate output of wage goods equal to aggregate wages, the sum of aggregate wage goods and aggregate production goods equal to the sum of wages and investment, a functional relationship between income and saving, and many others. Keynes offers
a theory which applies only in a certain case, and that case is one which cannot ever occur.

But these two are not the greatest of the weaknesses in the General Theory. That doubtful distinction goes to the notion with which this paper has been most concerned, the psychological law upon which the propensity to consume and the whole General Theory is based. In social science, an unchangeable law may be either one of two things which at their roots are very nearly the same. First, the constant law may be a statement of coincidence in past occurrences, as in the past, action A has always been followed by result B, or result B has always been preceded by action A under certain conditions of circumstance. Hence, the law exists that in these circumstances A may be expected to be followed by B. From that relationship generalizations may be drawn, but the law's scope is limited by the coincidence qualification and by the conditions of circumstance mentioned.

The second law of social science is the statement of central tendencies. If following the mathematics of chance, permutation and combination, it may be determined that in a sufficiently large number of occurrences a certain definite proportionate relationship will be established then a law may be said to exist.

Keynes' psychological law is to the effect that as income increases, consumption increases but not by so great an amount as the increase in income. If this is a law, it must fall into the first category since obviously it is a matter of behavior, not a matter of mathematics.

The investigations of the savings activity upon which this paper's objection to Keynes' theory have been based all pointed to the increase of saving as income increases as beginning after income reaches a certain level. That is, an increase from a low income bracket to one just a
little higher might not institute saving, while one from a middle bracket level to a higher one might cause an increase. This, along with other circumstances which have been previously pointed out, leads to the conclusion that saving is an involuntary process resulting from certain groups whose income is such that they are physically unable to consume it all. Keynes holds the erroneous belief that spending tends to follow an immutable pattern; that is, men, as their income changes tend to follow their customary spending pattern, thus destroying or creating saving. It has been pointed out in this paper that the contrary is true so far as rising incomes are concerned. Pecuniary standards of living lead to total expenditure of income in the middle and lower income brackets and often lead to negative saving or to spending of future savings. The only general saving that occurs in these brackets is that which is closely connected to consumption, e.g. insurance or housing.

With falling incomes the tendency is to maintain the standard for as long as possible, consequently any savings held are apt to be dissipated and more negative saving and spending of anticipated income will be encountered. Thus the psychological law is of highly doubtful validity.

Keynes' concern with real wages as a greater influence upon the propensity to consume than money wages has been shown to be fallacious because of the nature of the consumer.

Finally, it has been shown that man does not act in a logical or rational manner so far as economic activity is concerned. Without a rational economic man the Keynes theory does not hold up.

All in all, the Keynes concept of the propensity to consume has been proved to be of doubtful validity for all of these reasons.
and as the propensity to consume fails, so does the whole of the General Theory.

Unfortunately, the mere fact that the Keynes belief is of highly doubtful worth and of questionable truth is not enough to cause it to be discarded either by economists or by politicians. On the contrary, the theory is so attractive superficially that it appears apt, perhaps temporarily, to replace Marshall's neo-classicism as the standard of economic belief.

To the economist, the General Theory offers a set of natural laws to delight the heart of Rousseau and in addition sweetens the offering with a function of control and manipulation capable of being performed only by economists. It concerns itself with price, value, and the distribution theories so that it does not deviate too greatly from the normal path and in the end protects the accepted system.

This latter, the protection of the accepted system, makes Keynes beloved of some politicians but this is probably not so attractive as the justification the theory gives for high revenues and for government spending while still maintaining the status quo and the existing order.

The danger in Keynes' theories probably lie in this region. A belief that is false but which is all things to all men—now without losing much of the old, mildly liberal but in such a way that neither the socialists nor the less progressive capitalists are offended, with a behavior theory for the quasi-institutionalist and ample mathematics to satisfy the econometricians—the Keynes theory is almost certain to become the popular theory of economics. That this acceptance of Keynes may be only a period of transition from a metaphysical theory to a scientific one is an opinion which may be justified by some
evidence and in view of the findings presented here is sincerely to be hoped for. Be that as it may, in the foreseeable future, the student of economics is likely to be concerned with John Maynard Keynes.
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