

A. Monetary Theory of Production: Keynes and the Institutionalists

Dudley Dillard

During the past century, perhaps the two most powerful minds devoted to economics have been those of Thorstein Veblen and John Maynard Keynes. One can hardly imagine two men with greater differences in family background, personality, life-style, methodological orientation, and worldly success. Yet, I find their fundamental economic ideas basically similar. This surprising similarity may be explained on grounds that both men were acute and realistic assessors of modern economic institutions, and their respective theories reflect a common, underlying insight into the role of money in those institutions. Both had what may be called a Monetary Theory of Production. By this I mean that each viewed money as the strategic institution of modern capitalism and the chief impediment to full production and full employment in advanced industrial societies, which would be capable of inordinate production if freed from the fetters of monetary and financial institutions. This finding should prove useful as a step toward integrating their ideas into a realistic theory of modern capitalism. A possible outcome might be a macroeconomic theory of institutional economics.

A great fault of mainstream economics, beginning with Adam Smith, has been excluding money from the theory of production; indeed, from

The author is Professor of Economics, University of Maryland, College Park. This article was the Presidential Address presented at the Annual Meeting of the Association for Evolutionary Economics, Atlanta, Georgia, 28-30 December 1979.

economic theory generally. In repudiating mercantilism root and branch, Smith relegated money to the role of “the great wheel of circulation.”¹ David Hume conceded even less, maintaining that money is merely the grease that lubricates the wheel of circulation. In post-Smithian economics, money plays a role as a measure of value (David Ricardo), as a medium of circulation (J. S. Mill), and as a measure of the strength of economic motives (Alfred Marshall), but the core of classical and neoclassical economic theory has been the economics of neutral money. Like God in Unitarian theology, money is there, but it does not do very much. This is ironical because capitalism is above all a monetary economy, yet it was presumed to behave as if it were a barter economy.

General acceptance of Say’s Law of markets—that products are exchanged for products—reinforced the antimercantilism of early classicism and placed money even more securely outside the citadel of economic theory. Since the usefulness of economic theory depends in no small part on the realism of its abstractions, it is a great fault of mainstream economics to have abstracted away what is most vital to the operation of the capitalistic economy in which we actually live. Monetary theories of production do not include monetarism, although monetarism has the virtue of giving money an important place in economic theory. From the viewpoint of production, however, money matters more to Marx, Veblen, and Keynes than it does to Milton Friedman.

My hypothesis is that what Keynes called a Monetary Theory of Production may also be used logically to describe the economics of Thorstein Veblen, Wesley Mitchell, Clarence Ayres, and perhaps other institutionalists. Attention will be given specifically to Veblen’s Theory of Business Enterprise and more briefly to Mitchell’s Money Economy.

Keynes’s Monetary Theory of Production

Keynes’s lifelong preoccupation with money as an intellectual subject is well known and need not be repeated here.² He began his career as a fairly conventional neoclassical economist with a specialty in monetary theory. Keynes’s transition from the traditional monetary theory of price levels began with *Treatise on Money* (1930). A dramatic shift occurred in the autumn of 1932, when he changed the title of his course of lectures at Cambridge University from “The Pure Theory of Money” to “The Monetary Theory of Production.”³ The new Monetary Theory of Production was succinctly stated in Keynes’s essay in a *Festschrift* in honor of Arthur Spiethoff in 1933. In the concluding paragraph of that essay, Keynes wrote: “Accordingly I believe that the next task is to work out in some

detail a monetary theory of production, . . . that is the task on which I am now occupying myself, in some confidence that I am not wasting my time."⁴ His lectures contain references to the "realization" problem, that is, the problem of selling real output for money in order to "realize" its value.⁵ In the lectures, he used Marx's "general formula for capital," $M—C—M'$.⁶ $M—C$ is the use of money capital to purchase working capital and the hiring of labor for producing real output (C). $C—M'$ is the sale of real output for money in an amount in excess of the initial money capital (M) laid out for the output. The difference between M and M' is the profit realized from the buying and selling transaction. Keynes's use of $M—C—M'$ is extremely significant for the thesis of this article because it indicates recognition, at the level of theory, that under capitalism the objective of business firms is to make money. Everyone knows this, but few theories give it conceptual recognition.

The outcome of Keynes's self-assigned task of working out a Monetary Theory of Production was *The General Theory of Employment, Interest and Money* (1936). While the book does not carry the same title as the lectures from which the ideas emerged, the notion of a Monetary Theory of Production pervades *General Theory*. In the title of the book, *Employment* is the surrogate for *production*, and the noun *Money* replaces the adjective *Monetary* of the lectures. In the Preface Keynes tells how his thinking changed from the traditional view toward "pushing monetary theory back to becoming a theory of output as a whole."⁷ In the same paragraph, he refers to the existing order as a "monetary economy."⁸ In the text, in distinguishing microeconomics from macroeconomics, Keynes states: "But as soon as we pass to the problem of what determines output and employment as a whole, we require the complete theory of a Monetary Economy."⁹

Keynes's microeconomics is usually referred to as a theory of output and employment. From a substantive point of view, Keynes might as well have used the word *production* or *output* in place of *employment* in the title. One may speculate that Keynes, as a master of salesmanship and persuasion, chose the latter in order to focus more directly on the pressing human issue of unemployment. In any event, the change in title from the lectures to the book should not cause us to lose sight of the fact that the book is a Monetary Theory of Production.

Chapter 17, "The Essential Properties of Interest and Money," provides the best guide to understanding Keynes's Monetary Theory of Production. This chapter attempts to generalize interest theory (own-rates) to all assets in order to highlight why the own-rate of interest on money "rules the roost,"¹⁰ and why it therefore has "predominating practical impor-

tance.”¹¹ As the highest of all own-rates of interest, the money rate is strategic in impeding new investment and leads thereby to involuntary unemployment of labor. This is Keynes’s ultimate explanation of why the means of production are withheld from labor as a normal condition in a money-making economy. In conjunction with unfavorable expectations about an uncertain future, owners of the means of production prefer to leave some of the plants idle rather than operate them. Full employment is not profitable in circumstances that are characteristic of twentieth-century capitalism.

The properties of money that account for its singular importance include its high liquidity premium, its low carrying cost, and its zero or negligible rates of production and substitution. Among all assets, money has the special property of having a liquidity premium most in excess of its carrying cost. This high premium arises from the security and convenience which the power of disposal over money gives to its owner. As the most liquid of all assets, money can be used in exchange for other assets more readily than other assets can be used in exchange for money. This is but another way of saying that it is easier to buy with money than to sell for money. The liquidity preference for money is enhanced by its being the standard of value in terms of which contracts are fixed and wages are usually paid. The high liquidity premium for money in conjunction with its low carrying cost renders it a very special form of wealth. Elsewhere, I have interpreted Keynes’s views of its special properties to mean that money is unlike any other asset because it is the socially recognized form of private wealth. The value of “real” output of a private producer is not “real-ized” until it is sold for money. Somewhat paradoxically, money is real wealth to the business firm; it makes money only by selling real output for money. The paradox is not resolved by invoking Say’s Law that if all business firms produce just the right products, involuntary unemployment will disappear. Given its command over all forms of wealth, the utility of money to individuals falls less rapidly than the utility of any specific form of wealth. The “sticky” price (interest) of money sets up barriers to investment and, through the multiplier in Keynes’s theory, prevents the attainment of full employment.¹²

Some critics of Keynes have attributed his involuntary unemployment to sticky wage rates rather than to sticky interest rates growing out of the essential properties of money and interest. Keynes’s position is that the properties of money and interest cause money wages to be sticky. Low elasticities of production and substitution give rise to expectations that the value of money will change relatively little; therefore, wage contracts fixed in terms of money will be expected to be relatively sticky.¹³ Hence, it is not

correct to argue, as is commonly done, that Keynes's system would reach equilibrium only at full employment if wages and prices were perfectly flexible. The logic of Keynes's general theory finds the explanation of unemployment in the money market, not in the labor market.

Money may be viewed as an institutional monopoly. *Monopoly* means control over supply. The zero or negligible elasticity of production and substitution of money means that when the demand for money increases, more money cannot be produced—as in the case of almost all other assets—and the price (interest rate) will rise. When the price of money (interest rate) rises and presents an alternative preferable to producing new capital assets (investment) or to utilizing existing capital assets, employment of labor will decline. Society is dependent for its employment and output on the money-makers, or potential money-makers, placing their privately owned, nonpersonal means of production at the disposal of workers. Thus, the properties of money and interest lead in some circumstances to denying workers access to the nonpersonal means of production. This is a corollary of Keynes's important conclusion that, in the absence of money, or of any other asset with the properties of money, own-rates of interest will reach equilibrium only at full employment.¹⁴

If it were possible to have an economy without the properties of money in a private-ownership economy, the chief obstacle to full employment would disappear. This is a way of looking at Keynes's solution to the unemployment problem—either create a nonmonetary economy or devise a program that will offset the consequences of the properties of money in a private enterprise economy. Compensatory fiscal policy, which is Keynes's chief recommendation associated with *General Theory*, is an offset policy, that is, it suggests compensating in the public sector for the deficiencies of effective demand in the private sector. If political and economic circumstances render compensatory fiscal policy unsatisfactory, for example, by association with chronic inflation, then a more basic solution would be to create a nonmonetary economy. Such an economy does not mean only a barter economy. It can also mean a socialist economy, which, although it uses money as a medium of circulation, removes the monetary incentive to withhold the means of production.

Veblen's Theory of Business Enterprise

Throughout Thorstein Veblen's writings runs the dichotomy between industrial and pecuniary employments, that is, between making goods and making money. Veblen's most systematic treatise on principles of economics, *The Theory of Business Enterprise*, is essentially an extension of

an earlier paper, "Industrial and Pecuniary Employments," prepared in 1900 for presentation at the annual meeting of the American Economic Association. Frank Taussig suggested that Veblen be asked to give a paper on a "theoretic subject" that would summarize Veblen's conclusions about economics.¹⁵ To be noted is that Veblen's paper was prepared specifically for professional economists. *The Theory of Business Enterprise*, which grew out of this paper, is likewise addressed to the "guild of economists,"¹⁶ in the same spirit that Keynes addressed *General Theory* to his "fellow economists."¹⁷

The pervasive theme of *Business Enterprise* is that the modern businessman and his interest in making money dominate the industrial process, which is concerned with making goods. One expression of this central theme appears in chapter 3, "Business Enterprise":

The production of goods and services is carried on for gain, and the output of goods is controlled by business men with a view to gain. Commonly, in ordinary routine business, the gains come from this output of goods and services. By sale of the output the business man in industry "realizes" his gains. To "realize" means to convert salable goods into money values. The sale is the last step in the process and the end of the business man's endeavor. When he has disposed of the output, and so has converted his holdings of consumable articles into money values, his gains are as nearly secure and definitive as the circumstances of modern life admit. It is in terms of price that he keeps his accounts, and in the same terms he computes his output of products. The vital point of production with him is the vendibility of the output, its *convertibility into money values*, and not its serviceability for the needs of mankind.¹⁸

This passage contains the essentials of a monetary theory of production. Under the system of business enterprise, goods are produced for the purpose of being sold in order to *realize* profits in money terms. Service to the community is incidental and subordinate to moneymaking. Production is "monetary" in that realization of money gains is the objective, the motivation, of the process. Balance sheets and profit-and-loss statements are kept in monetary terms and are the documents that determine the success or failure of the business transactions. The terms on which real output are converted into money represent the price and largely determine the profit of the transaction. All this is simple but fundamental.

If we pass from Veblen's 1904 *Theory of Business Enterprise* to his later writings, we find the same theme of the dominant role of moneymaking in the capitalist economy. In *Vested Interests and the Common Man* (1919), Veblen states: "The business man's place in the economy of

nature is to 'make money,' not to produce goods."¹⁹ He continues: "The production of goods is a mechanical process, incidental to the making of money; whereas the making of money is a pecuniary operation. The business men make use of the mechanical appliances and powers of the industrial system, but they make a pecuniary use of them."²⁰ In an introduction to a volume of Veblen's selected writings, Wesley Mitchell paraphrases Veblen's general view: "We make goods in order to make money. Veblen never tires of expounding that central paradox and of developing its consequences."²¹

One of the consequences is that serviceability to the community has deteriorated in the age of mass production. When small-scale industry prevailed, the divergence of interests between producers and consumers was limited by close personal relations. Craftsmanship under small-scale production gave vent to Veblen's instinct of workmanship. In contrast, under the regime of large-scale enterprise, in which relations between producers and consumers are remote and impersonal, "business management has a chance to proceed on a temperate and sagacious calculation of profit and loss, untroubled by sentimental considerations of human kindness or irritation or of honesty."²² The general rule of business is to charge what the traffic will bear. Monopolistic pricing becomes pervasive in the era of large-scale enterprise. Veblen cites Richard T. Ely: "But it is very doubtful if there are any successful business ventures within the range of the modern industries from which the monopoly element is wholly absent."²³

Since the conversion of real output into money on terms favorable to business is frequently difficult, systematic advertising is employed to establish and to perpetuate "a monopoly to custom and prestige."²⁴ Advertising adds to the cost to be covered in the selling price, even though it does not add to the serviceability of the product, except incidentally and unintentionally.²⁵ Advertising, if successful, gives vendibility, which is used in making money even though it has no utility to the buyer.

Veblen ridiculed the classical view that money is merely a medium of circulation, used because it is more efficient than barter. In a long footnote in *Business Enterprise*, he refers to Smith's characterization of money as the "great wheel of circulation" and to the related notion that "the end of all purchases and sale [is] consumable goods, not money values."²⁶ Veblen dismisses the position that production is for consumption in these words: "Within the range of business transactions this ulterior end [consumption] does not necessarily come into view, at least not as a motive that guides the transactions from day to day. The matter is not so conceived in business transactions, it does not so appear on the face of the negotiable in-

struments, it is not in this manner that the money unit enters into the ruling habits of thought of business men."²⁷ Veblen's repudiation of this notion has as its corollary the idea that production is for moneymaking. In business transactions, the bottom line is always expressed in money values.

*Veblen's Theory of
Unemployment and Business Cycles*

Chronic unemployment is a normal condition in Veblen's theory of business enterprise. Unemployment results from the application of business principles and concerns industry only because "industry is managed on a business footing."²⁸ Fluctuations in economic activity are strictly *business cycles*; it would be a misnomer to refer to them as industrial fluctuations.

Veblen's ideas about unemployment and business cycles parallel those of Keynes not only in general but also in specific ways. Keynes's marginal efficiency of capital is the key concept in his explanation of business cycles. This rate of return on capital assets fluctuates in response to changing expectations about the terms on which real output can be converted into money in an uncertain future. Linkage between the present and the future is through durable capital assets. In Keynes's analysis, long-term expectations concerning future yields from these capital assets rest on a very precarious basis and are therefore subject to sudden changes. In Veblen's case, also, changing expectations about future profits are the chief disruptive force leading to crises and depressions. Unstable profit expectations cause frequent changes in the capitalized values of business firms. When the change in profit expectation is drastic, arising, for example, from the failure of a major banking house, massive liquidation occurs and may throw the economy into a crisis or panic of the type that characterized nineteenth-century capitalism. Before recovery from such crises can get under way, business firms must be liquidated. Bankruptcy and liquidation restore a kind of equilibrium to the capitalizations that have been distorted by the preceding speculation.²⁹ Credit plays a large role, and the shrinkages occasioned by the crises are pecuniary and do not significantly reduce the industrial capacity to produce. Veblen anticipates Keynes on the not unimportant point that the expectation of a future fall in the rate of interest will lower the schedule of the marginal efficiency of capital and depress current activity. Equipment produced today will have to compete, over part of its life in the future, with equipment that will expect to earn a lower rate of return.³⁰

Although Veblen does not have the formal concept of a *schedule* of the

marginal efficiency of capital, his theory does share with Keynes's the instability of prospective earnings (profits). Keynes operates with a formal schedule, but his emphasis on uncertainty, speculation, and instability makes mincemeat of the notion of a schedule that in any sense resembles a marginal productivity curve. In the appraisal of capital values as reflected in prices on the stock exchange, Keynes made a distinction between enterprise and speculation and suggests that the latter swamps the former. Real investments in capital assets are made not so much as a result of mathematical calculations of yields over the whole life of the assets as on a basis of spontaneous optimism, an urge to action rather than inaction, of animal spirits.³¹ Surely Veblen would have relished Keynes's statement that "speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."³² Keynes concludes this chapter on long-term expectations with one of his most significant pronouncements for possible future policy, pointing toward socialization of investment: "I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency of different types of capital, calculated on the principles I have described above, will be too great to be offset by any practicable changes in the rate of interest."³³

Interest as a Monetary Phenomenon

Veblen's explanation of interest, as does Keynes's, runs in purely monetary (pecuniary) terms. This view is clearly stated in Veblen's review article of Irving Fisher's *Rate of Interest*.³⁴ He criticizes Fisher for trying to explain interest in nonmonetary terms, such as marginal utility and time preference. Interest to Veblen is a by-product of the mature development of the institutions of property and of business enterprise. "The rate of interest is one of the phenomena involved in this business traffic, and its theoretical explanation must run in terms of business, and so in terms of money."³⁵ In another passage, Veblen writes: "Interest is rated in money and paid with a view to a money gain."³⁶ This stress on interest as a monetary phenomenon illustrates another similarity to Keynes and is consistent with the idea that Veblen's overall economic theory may appropriately be called a Monetary Theory of Production.³⁷

Wesley Mitchell's Money Economy

Wesley Mitchell is, of course, best known for his monumental work on business cycles. He was a self-professed institutional economist. During the period between the two world wars, Mitchell was widely acclaimed as America's leading economist, and in 1947 the American Economic Association awarded him the first Francis A. Walker Medal as the outstanding living senior economist in the United States.

What is more important for my present purpose, and what is probably less well known, is that Mitchell viewed business cycles as a special aspect of his larger vision of a Money Economy. At the age of 37, in an autobiographical letter to his future wife, Lucy Sprague, Mitchell wrote of his "decision to work out the subject of 'Business Cycles' as a *Vorarbeit* of the 'Money Economy.'" ³⁸

Mitchell's earlier decision to write a *magnum opus* on the Money Economy was, no doubt, influenced by Veblen, who had been one of his teachers in graduate study at Chicago. In his early years, Mitchell published two large books on the history of greenbacks and the related problems of gold, prices, and wages. Early in 1907, when he was a member of the faculty at Berkeley, Mitchell completed and revised several chapters of the Money Economy, and for several years this was his major research and writing project. In 1911, when he decided to do the *Vorarbeit* on business cycles, he set aside the "pile of manuscript" on the Money Economy. In the event Mitchell devoted the remainder of his long career to the study of business cycles and did not return to the manuscript on the Money Economy.

Even though the Money Economy volume was never completed, it provided a general framework within which Mitchell did much of his subsequent thinking and writing. To Lucy Sprague he wrote: "Business Cycles is part and parcel of the Money Economy."³⁹ Among the by-products of the Money Economy is a series of articles, including "The Rationality of Economic Activity" (1911), "The Backward Art of Spending Money" (1912), "The Role of Money in Economic Theory" (1916), "Making Goods and Making Money" (1922), and "The Role of Money in Economic History" (1944). In deciding whether to remain on the faculty at Berkeley or move to Columbia, Harvard, Yale, Chicago, or Cornell, Mitchell chose Columbia in order to be in New York City, where he could observe at first hand the financial center of the money economy.⁴⁰

In a succession of books, Mitchell continued to view business cycles as a product of a money economy. For example, chapter 2 of *Business Cycles* (1927), "The Problem and Its Setting," spells out the connection

between business cycles and making and spending money.⁴¹ Cycles are properly called *business* cycles because they are a special product of business enterprises engaged in the pursuit of profit by making goods in order to make money.

Clearly, Mitchell's analysis of business cycles, as well as the monetary setting, takes its inspiration from Veblen, especially chapter 12 of *Theory of Business Enterprise*. Throughout his career, Mitchell remained an admirer and defender of Veblen. Nevertheless, the methods they used in their explorations of business cycles differed radically. Veblen's approach was qualitative and speculative; Mitchell's was quantitative and statistical. Early in his career, Mitchell expressed wonderment at Veblen's ability to reach correct conclusions concerning business cycles: "The real wonder is, however, how Veblen divined the facts without ascertaining them."⁴² Institutional economics, if we are to judge by the cases of Mitchell and Veblen, allows for quite different methods of economic inquiry. Keynes's method falls somewhere in between—much less empirical and statistical than Mitchell's, but more formal than Veblen's. Differences in method, however, did not preclude common inquiry into a Monetary Theory of Production.

Elements of a Monetary Theory of Production

A Monetary Theory of Production is one in which money plays a central and indispensable role in explaining the process of production. It is the appropriate theory of production for a monetary economy such as capitalism. Money is so central to the determination of output that it might be represented as an institutional factor in the functional relation between factors of production and output. Thus:

$$O = F(L, K, M),$$

in which O represents output or production as a whole, L represents labor, K represents capital assets, and M represents the institutional process for realizing the value of real output in money.

Monetary production means producing and realizing money values. The central problem of a monetary economy, to be reflected in a theory about it, is the realization of the value of real output (goods and services) in money terms; that is, the conversion of real output into money; that is, selling the product for money. A Monetary Theory of Production may be viewed as a type of institutional economics because it takes account of the way in which the institution of money capital affects the behavior of business firms and of the economy as a whole. As institutional economics, it

contrasts with the universalist type of analysis to which mainstream economics makes pretensions.

The task of a Monetary Theory of Production is to conceptualize a process which begins with money capital; this is used to purchase materials, capital equipment, and labor; these factors are converted into a product, which is offered for sale; the sale is a private exchange in which ownership passes from the producer to a buyer. Monetary production does not end with the creation of real output, but only with the conversion of real output into money.

A Monetary Theory of Production *is* a theory of production and as such differs from a theory about price levels, such as the quantity theory of money. Its concern is with money as money capital and not with money as a medium of exchange. It views money as an institution, as a special form of property within a specific type of economic system. Veblen's theory of business enterprise is a Monetary Theory of Production because it explains the process by which goods and services get produced in a system in which the producers aspire to make money.

Production functions for nonmonetary economies should not include money as one of the prime determinants of output. Nonmonetary economies may include in their production functions some other strategic institutional element, in addition to personal (labor) and nonpersonal (capital assets) means of production. Examples of nonmonetary economies include feudalism and socialism, as well as simple barter economies. Although used in a feudal society, money is not strategic to its functioning, as in the case of capitalism. In a fully collectivized economy, production is directly for consumption, in the legal and institutionalist sense, and hence money exists as a medium of exchange but not as money capital. The rules according to which collectively produced goods are distributed among the comrades may and probably will involve the use of money, but only in its role as a medium of exchange. Adam Smith might want to play with his great wheel of circulation in a nonmonetary economy. Mainstream economics, beginning with Smith, is more relevant to nonmonetary economies than to capitalism. There is truth in the quip that if one wishes to learn about capitalism, read Marx; if one wishes to learn about socialism, read Marshall.

On a practical level, it is difficult to comprehend how any society could tolerate involuntary unemployment of people able and willing to work. Labor is a social overhead cost, and unless society is willing to permit the unemployed to starve to death, it always pays society to put laborers to work as long as they produce anything more than nothing. Unemployment of labor has no rational economic basis for existence in a nonmonetary

economy, or in one which behaves as if it were a nonmonetary economy. The policy question in contemporary capitalism if there is failure of compensatory fiscal policy—because of high inflation—is whether there is some other way to eliminate involuntary unemployment short of socialism. Presumably, the possibility exists within the democratic process for making corporate capitalism responsive and responsible to the public interest. This is a large issue and cannot be discussed here.

Dichotomy between Industry and Finance

Keynes's categories, Industry and Finance, are cognates of Veblen's Industrial and Pecuniary Employments. In *Treatise on Money*, Keynes defines his terms as follows:

By *Industry* we mean the business of maintaining the normal process of current output, distribution and exchange and paying the factors of production their incomes for the various duties which they perform from the first beginning of production to the final satisfaction of the consumer. By *Finance*, on the other hand, we mean the business of holding and exchanging existing titles to wealth (other than exchanges resulting from the specialization of industry), including Stock Exchange and Money Market transactions, speculation and the process of conveying current savings and profits into the hands of entrepreneurs.⁴³

Industry and *Finance* in this sense are related to the Industrial Circulation and the Financial Circulation, respectively. These categories of *Treatise* evolve, in *General Theory*, into money held for transactions and precautionary purposes (M_1) and money held for speculative purposes (M_2). These categories are manifestations in Keynes's formal theory of a lifelong antipathy toward finance and sympathy for industry. Throughout his career, Keynes remained critical of speculation, the gold standard, policies of the Bank of England, and rentiers, or absentee owners. This is only to show in the case of Keynes what is true of economists generally, namely, that their theories tend to reflect their basic moral values. Reference is made below to some of the moral sentiments behind Keynes's distaste for moneymaking for its own sake, with the suggestion that he and Veblen had something in common in this respect.

Macroeconomics in Keynes and Veblen

Finance in Keynes's dichotomy enters his theoretical system through the rate of interest, which is a purely monetary phenomenon. Industry

enters Keynes's system through the marginal efficiency of capital, which is the rate of return on real capital assets. The direction of cause and effect runs mainly from the rate of interest determining the level to which the marginal efficiency of capital will fall, and not the other way round. Together, these bring investment to a halt short of the volume needed for full employment. Note has been taken of parallel concepts in Veblen: a purely monetary rate of interest, and a theory of profits and capitalization of the value of assets comparable to, although by no means identical with, Keynes's schedule of the marginal efficiency of capital.

One great virtue in Veblen, lacking in Keynes, is the emphasis given technology. He accounts for the chronic depressions beginning in the 1870s in terms of the relatively new technology of mass production. This constantly lowers the expected profits of old capital assets and tends to erode profits generally. Technological change has room to operate within Keynes's theoretical schema, but it is not brought explicitly into the picture. In Veblen's theory, the response of business was to form trusts and other types of combinations to offset destructive competition induced by the new technology. Output is reduced below the potential, and prices are maintained or boosted to profitable levels. Full employment was not profitable under the conditions that have come to prevail in the age of mass production. Veblen uses the phrase "conscientious withdrawal of efficiency" to denote the business practice of restraining industrial output in order to obtain higher prices and preserve profits for moneymaking producers. The social consequences of throwing workers out of employment and forcing consumers to pay higher prices are incidental to the pursuit of the business principle of making money.

Veblen envisions the chronic depression, as does Keynes, as taking place within a setting of unequal distribution of income and a consequent deficiency of effective demand. Veblen suggested that "wasteful expenditures" can offset some of that deficiency. On occasion, outside events, such as the Spanish-American War or the discovery of gold in Alaska, might throw the economy out of equilibrium, that is, into a period of prosperity.⁴⁴ The similarity between Keynes and Veblen on the notion of enriching the community, on balance, by wasteful expenditures is striking.⁴⁵

Overproduction has meaning to Veblen in relation to moneymaking principles. It means "an excess of goods, or of the means of producing them, above what is expedient on pecuniary grounds."⁴⁶ Overproduction is excess of output "above what there is an *effective demand* for at prices that will repay the cost of production of the goods and leave something appreciable over as a profit."⁴⁷ Overproduction does not mean that the

supply of consumable goods exceeds the physical capacity or the desire of the community to consume them. From the industrial side—as distinguished from the pecuniary—depression is a period of underproduction, not of overproduction. In summary, Veblen's theory highlights the frustration of technology under the constraints of business enterprise dominated by pecuniary values. This is the crux of his *Monetary Theory of Production*, his *Theory of Business Enterprise*.

Keynes's Sympathy for the Labor Theory of Value

Neither Veblen nor Keynes devotes much attention to the theory of value, which occupied a central place in classical and neoclassical economics. However, the notion that current output is kept artificially scarce—so explicit in Veblen—is reflected in Keynes's sympathy for the labor theory of value. In *General Theory* he says: "I sympathize, therefore, with the pre-classical doctrine that everything is *produced by labor*" and that it is preferable to regard labor as "the sole factor of production."⁴⁸ Capital assets that embody past labor, in Ricardo's sense, are "kept scarce because of the competition of the rate of interest on money."⁴⁹ Labor includes the personal services of entrepreneurs as a special form of skilled labor.

As a share in the distribution of income, Keynes's interest (on money) more nearly resembles Ricardo's unearned rent (on land) than it does wages of labor. Interest, which Nassau Senior and later mainstream economists tried so hard to justify as a reward for "abstinence" or "waiting," is excluded by Keynes as a functional form of income. As the "sole factor of production," labor is the only functional recipient of income. In the absence of a sticky rate of interest on money, Keynes speculated that the marginal efficiency of capital might fall to zero within one or two generations in advanced industrial countries such as the United States.⁵⁰ Whether Keynes's speculation on the potential saturation of capital assets is fanciful or meaningful is less important to our purpose than what it signifies for Keynes's view that interest on money leads to an artificial scarcity of capital assets.

Keynes's Moral Sentiments about Capitalism

Veblen and Keynes were philosophers as well as economists. Their moral sentiments may help explain an economics that shows hostility toward moneymaking, financial speculation, wide inequalities in wealth and income, absentee ownership, and rentiers.

When Keynes visited the Soviet Union in the mid-1920s, he was not

very favorably impressed, but one deep impression is apparent from what he wrote about the visit. In the new Russia, he observed, "money-making and money-accumulating cannot enter into the life-calculations of a rational man who accepts the Soviet rule in the way in which they enter into ours. A society of which this is even partially true is a tremendous innovation."⁵¹ In this respect, Keynes felt that what was happening in the Soviet Union was more important for the future than anything occurring, for example, in the United States.⁵²

For Western capitalism, Keynes accepted the widely held view that the Protestant Reformation provided moral justification for capitalism when it was young and struggling for a position in the sun. In these early centuries, capitalism was morally tolerable because the capitalist spirit and the Protestant ethic were parts of a unified philosophy of life, one part pertaining to this earth, and the other to heaven. In recent times, however, business and religion have been relegated to separate compartments, and the moral justification for capitalism has been lost in the process. Keynes wrote in 1925: "For modern capitalism is absolutely irreligious, without internal union, without much public spirit, often, though not always, a mere congeries of possessors and pursuers."⁵³

Most religions and most philosophies, Keynes wrote in 1926, "deprecate, to say the least of it, a way of life mainly influenced by considerations of personal money profit."⁵⁴ He saw a grave moral problem for capitalism growing out of the appeal to the money motive.⁵⁵ As a practical person, Keynes accepted the moneymaking businessman for the present, but he looked forward to the time when moral values would be quite different, when the traditional virtues would look upon the love of money as "detestable."⁵⁶

In his essay, "Economic Possibilities for Our Grandchildren," Keynes said of the future: "We shall be able to afford to dare to assess the money-motive at its true value. The love of money as a possession . . . will be recognized for what it is, a somewhat disgusting morbidity."⁵⁷ These strong sentiments against the love of money illustrate the moral values that may help to explain, to some degree, Keynes's formal concepts and categories that are intended to say that money is responsible for the major shortcomings of contemporary capitalism.

Conclusion

The main thrust of this article has been to show that Keynes's Monetary Theory of Production has the same underlying theme as Veblen's Theory

of Business Enterprise. Both theories contend that production and employment are constrained because they are left to depend on individual decisions and actions designed to make money. I wish now to relate this conclusion to a larger task of the economics profession, rewriting the principles of economics.

A complete principles of economics should contain three parts: (1) a theory of economic development, which for our economic system would be a theory of capitalist development; (2) macroeconomics; and (3) microeconomics. Thorstein Veblen's economics is primarily of the first type, a theory of cumulative change, with technology as the dynamic force, which under the system of business enterprise is continually frustrated by financial institutions.

Keynes, in founding modern macroeconomics, generated a revolution in economic theory. Although no one, to my knowledge, has claimed Keynes as an institutional economist, his macroeconomics is compatible with the institutional approach. He has much to offer the macroeconomics of institutional economic theory. Moreover, macroeconomics would be immensely strengthened with an infusion of the economics of technology, which is lacking in Keynes.

Nothing has been said here about microeconomics, but there is a wealth of material, mostly from the institutional camp, upon which to build a theory of the large-scale corporate firm. The integration of micro- and macroeconomics can be greatly facilitated within the framework of a Monetary Theory of Production.

Conditions are ripening for a new revolution in economic theory. Discontent is widespread even among our colleagues who teach conventional courses in principles of economics from texts that seldom mention institutional economics. More important in the long run, the general public has lost faith in the ability of traditional economics to point the way of escape from the present crisis in economic policy. Theory and policy must march together and while the current trends are conservative, at least the situation is fluid. We should be able to show in the light of growing concentration of conglomerate industry and the ever-extending circumvention of the market by business combinations that, as Adolph Lowe has said, "a return to anything resembling laissez-faire must bring about the total breakdown of the system."⁵⁸ We might even mount a campaign to show that a return to laissez-faire is "a subversive plot of revolutionary Marxists."⁵⁹

For too long, Keynes's ideas have been impounded in the IS-LM diagram. This revolutionary thinker is a hostage of those who believe

Keynes's destiny is to be part of a neoclassical synthesis. The time has come to free the hostage and make his theory part of a neoinstitutional synthesis.

Notes

1. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, edited by Edwin Cannan (New York: Modern Library, 1937), pp. 273, 276, 280.
2. See Dudley Dillard, "The Theory of Monetary Economy," in *Post-Keynesian Economics*, edited by Kenneth K. Kurihara (New Brunswick, N.J.: Rutgers University Press, 1954), pp. 3-9.
3. John Maynard Keynes, *Collected Writings*, edited by Donald Moggridge (London: Macmillan, 1973), vol. 13, pp. 343, 411-12.
4. *Ibid.*, vol. 13, p. 411.
5. *Ibid.*, vol. 13, p. 420.
6. From conversation with Donald Moggridge and from correspondence with Loric Tarshis, who attended the lectures and has classroom notes.
7. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace and Company, 1936), p. vi.
8. *Ibid.*, p. vii.
9. *Ibid.*, p. 293.
10. *Ibid.*, p. 223.
11. *Ibid.*, p. 225.
12. D. H. Robertson complained to Keynes about the obscurity of a draft of the chapter entitled "The Essential Properties of Interest and Money." Keynes acknowledged the obscurity. That Keynes was pushing his own intellectual frontier is suggested by his further statement to Robertson: "A time may come when I am, so to speak, sufficiently familiar with my own ideas to make it easier." Meanwhile, he referred Robertson to the "much simpler way . . . in the chapter on liquidity preference." See Keynes, *Collected Works*, vol. 13, p. 519.
13. Keynes, *General Theory*, p. 238.
14. *Ibid.*, p. 235.
15. Thorstein Veblen, *Essays, Reviews, and Reports*, edited by Joseph Dorfman (Clifton, N.J.: Augustus M. Kelley, 1973), p. 59.
16. *Ibid.*, p. 65.
17. Keynes, *General Theory*, p. v.
18. Thorstein Veblen, *The Theory of Business Enterprise* (New York: Charles Scribner's Sons, 1904), pp. 50-51 (emphasis added).
19. Thorstein Veblen, *The Vested Interests and the Common Man* (New York: Augustus M. Kelley, 1964), p. 92.
20. *Ibid.*
21. Wesley C. Mitchell, ed., *What Veblen Taught* (New York: Augustus M. Kelley, 1964), p. xlii.
22. Veblen, *Business Enterprise*, p. 53.
23. *Ibid.*, p. 54.
24. *Ibid.*, p. 55.

25. *Ibid.*, p. 59.
26. *Ibid.*, p. 83n.
27. *Ibid.*
28. *Ibid.*, p. 180.
29. *Ibid.*, pp. 18'–209.
30. *Ibid.*, p. 224; and Keynes, *General Theory*, p. 143.
31. Keynes, *General Theory*, pp. 161–62.
32. *Ibid.*, p. 159.
33. *Ibid.*, p. 164.
34. Thorstein Veblen, *Essays in a Changing Order* (New York: Viking Press, 1943), pp. 137–47.
35. *Ibid.*, pp. 143–44.
36. *Ibid.*, p. 145.
37. Keynes credited Fisher with anticipating the concept "marginal efficiency of capital" under the name "rate of return over cost." In *Essays in Honor of Irving Fisher*, Keynes rephrased his own theory of interest. He called the rate of interest on money the "marginal efficiency of money measured in terms of itself" and distinguished it from the marginal efficiency of all other assets. In *General Theory*, Keynes distinguished the own-rate of interest on money from the own-rates of interest of all other assets. See Keynes, *Collected Works*, vol. 14, pp. 101–108.
38. Lucy Sprague Mitchell, *Two Lives, The Story of Wesley Clair Mitchell and Myself* (New York: Simon and Schuster, 1953), p. 187.
39. *Ibid.*, p. 177.
40. Joseph Dorfman, *The Economic Mind in American Civilization* (New York: Viking Press, 1949), vol. 3, p. 458.
41. Wesley C. Mitchell, *Business Cycles, The Problem and Its Setting* (New York: National Bureau of Economic Research, 1927), pp. 71–86.
42. Mitchell, *Two Lives*, p. 178.
43. John Maynard Keynes, *A Treatise on Money* (London: Macmillan, 1935), vol. 1, p. 243 (emphasis in original).
44. See Rutledge Vining, "Suggestions of Keynes in the Writings of Veblen," *Journal of Political Economy* 47 (October 1939): 692–704.
45. Compare Keynes, *General Theory*, pp. 128–31 with Veblen's *Business Enterprise*, pp. 252–58.
46. Veblen, *Business Enterprise*, pp. 216–17.
47. *Ibid.* (emphasis added).
48. Keynes, *General Theory*, pp. 213–14 (emphasis in original).
49. *Ibid.*, p. 213.
50. *Ibid.*, pp. 220–21.
51. Keynes, *Collected Works*, vol. 9, p. 261.
52. *Ibid.*, vol. 9, p. 270.
53. *Ibid.*, vol. 9, p. 267.
54. *Ibid.*, vol. 9, p. 293.
55. *Ibid.*, vol. 9, p. 268.
56. *Ibid.*, vol. 9, p. 331.
57. *Ibid.*, vol. 9, p. 329.
58. See this issue of the *Journal of Economic Issues*, p. 251.
59. *Ibid.*