Poverty in Plenty: Is The Economic System Self-Adjusting?
John Maynard Keynes, *The Listener*, 21 November 1934

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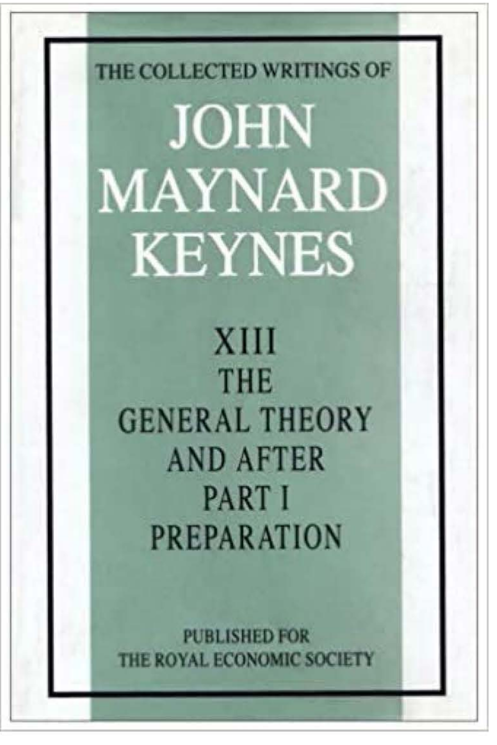

From THE LISTENER, *21 November 1934*

POVERTY IN PLENTY: IS THE ECONOMIC SYSTEM SELF-ADJUSTING?

If we consider what has been said in these talks so far, it is clear, I think, that there is one point about which we all agree—a point which was rightly emphasised by Mr Henderson. The point is this. Whatever may be the best remedy for poverty in plenty, we must reject all those alleged remedies which consist, in substance, of getting rid of the plenty. It may be true, for various reasons, that, as the potential plenty increases, the problem of getting the fruits of it distributed to the great body of consumers will present increasing difficulties. But it is to the analysis and solution of these difficulties that we must direct our minds. To seek an escape by making the productive machine less productive must be wrong. I often find myself in favour of measures to restrict output as a temporary palliative or to meet an emergency. But the temper of mind which turns too easily to restriction is dangerous. For it has nothing useful to contribute to the permanent solution.

But this is another way of saying that we must not regard the conditions of supply—that is to say, our facilities to produce—as being the fundamental source of our troubles. And, if this is agreed, it seems to follow that it is the conditions of demand which our diagnosis must search and probe for the explanation. Indeed, it is, I think, fair to say that all the contributors to these talks meet to this extent on common ground. If you will examine carefully what they have told you, you will find that each one of them finds the major part of his explanation in some factor which relates to the conditions of demand. But though we, your mentors, all start out in the same direction, we soon part company into two main groups. And even within each group every one of us has a somewhat different explanation of what is wrong with demand, and, consequently, a different idea of the right remedy. Between us, perhaps, we shall succeed in giving you a fair sample of the competing opinions of the contemporary world.

I have said that we fall into two main groups. What is it that makes the cleavage which thus divides us? On the one side are those who believe that the existing economic system is, in the long run, a self-adjusting system, though with creaks and groans and jerks, and interrupted by time lags, outside interference and mistakes. Of those who adhere, broadly speaking, to this school of thought, Mr Henderson lays stress on the increased difficulty of *rapid* self-adjustment to change, rightly attaching importance to the greater loss and delay involved in a change-over from one type of production to another—when changes in technique or in tastes make this necessary—in an environment where population and markets are no longer expanding rapidly; whilst Mr Brand stresses the growing tendency for outside interference to hinder the processes of self-adjustment; and Professor Robbins, to judge from his syllabus, stresses the effect of business mistakes under the influence of the uncertainty and the false expectations due to the faults of post-war monetary systems. These authorities do not, of course, believe that the system is automatically or immediately self-adjusting. But they do believe that it has an inherent tendency towards self-adjustment, if it is not interfered with and if the action of change and chance is not too rapid.

On the other side of the gulf are those who reject the idea that the existing economic system is, in any significant sense, self-adjusting. They believe that the failure of effective demand to reach the full potentialities of supply, in spite of human psychological demand being immensely far from satisfied for the vast majority of individuals, is due to much more fundamental causes. Dr Dalton stresses the great inequality of incomes which causes a separation between the power to consume and the desire to consume. Mr Hobson believes that the great resources at the disposal of the entrepreneur are a chronic cause of his setting up plant capable of producing more than the limited resources of the consumer can absorb. Mr Orage demanded a method of increasing consumer power so as to overcome the difficulties pointed out by Dr Dalton and Mr Hobson. Mrs Wootton, who is to contribute to this series next week, calls for planning, although she only half-rejects the theory of self-adjustment, having not yet reached, one feels, a synthesis satisfactory to herself between her intellectual theory and her spiritual home.

The gulf between these two schools of thought is deeper, I believe, than most of those on either side of it are aware of. On which side does the essential truth lie? That is the vital question for us to solve. That is the overshadowing problem of which these talks should make you clearly conscious, if they are to serve their purpose.

I can scarcely begin here to give you the reasons for what I believe to be the right answer. But I can tell you on which side of the gulf I myself stand; and I can give you a brief indication of what has to be settled before either school can thoroughly dispose of its adversary.

The strength of the self-adjusting school depends on its having behind it almost the whole body of organised economic thinking and doctrine of the last hundred years. This is a formidable power. It is the product of acute minds and has persuaded and convinced the great majority of the intelligent and disinterested persons who have studied it. It has vast prestige and a more far-reaching influence than is obvious. For it lies behind the education and the habitual modes of thought, not only of economists, but of bankers and business men and civil servants and politicians of all parties. The essential elements in it are fervently accepted by Marxists. Indeed, Marxism is a highly plausible inference from the Ricardian economics, that capitalistic individualism cannot possibly work in practice. So much so, that, if Ricardian economics were to fall, an essential prop to the intellectual foundations of Marxism would fall with it.

Thus, if the heretics on the other side of the gulf are to demolish the forces of nineteenth-century orthodoxy—and I include Marxism in orthodoxy equally with *laissez-faire*, these two being the nineteenth-century twins of Say and Ricardo—they must attack them in their citadel. No successful attack has yet been made. The heretics of today are the descendants of a long line of heretics who, overwhelmed but never extinguished, have survived as isolated groups of cranks. They are deeply dissatisfied. They believe that common observation is enough to show that facts do not conform to the orthodox reasoning. They propose remedies prompted by instinct, by flair, by practical good sense, by experience of the world—half-right, most of them, and half-wrong. Contemporary discontents have given them a volume of popular support and an opportunity for propagating their ideas such as they have not had for several generations. But they have made no impression on the citadel. Indeed, many of them themselves accept the orthodox premises; and it is only because their flair is stronger than their logic that they do not accept its conclusions.

Now *I* range myself with the heretics. I believe their flair and their instinct move them towards the right conclusion. But I was brought up in the citadel and I recognise its power and might. A large part of the established body of economic doctrine I cannot but accept as broadly correct. I do not doubt it. For me, therefore, it is impossible to rest satisfied until I can put my finger on the flaw in that part of the orthodox reasoning which leads to the conclusions which for various reasons seem to me to be inacceptable. I believe that I am on my way to do so. There is, I am convinced, a fatal flaw in that part of the orthodox reasoning which deals with the theory of what determines the level of effective demand and the volume of aggregate employment; the flaw being largely due to the failure of the classical doctrine to develop a satisfactory theory of the rate of interest.

Put very briefly, the point is something like this. Any individual, if he finds himself with a certain income, will, according to his habits, his tastes and his motives towards prudence, spend a portion of it on consumption and the rest he will save. If his income increases, he will almost certainly consume more than before but it is highly probable that he will also save more. That is to say, he will not increase his consumption by the full amount of the increase in his income. Thus if a given national income is less equally divided, or, if the national income increases so that individual incomes are greater than before, the gap between total incomes and the total expenditure on consumption is likely to widen. But incomes can only be generated by producing goods for consumption or by producing goods for use as capital. Thus the gap between total incomes and expenditure on consumption *cannot* be greater than the amount of new capital which it is thought worth while to produce. Consequently, our habit of withholding from consumption an increasing sum as our incomes increase means that it is impossible for our incomes to increase unless either we change our habits so as to consume more or the business world calculates that it is worth while to produce more capital goods. For, failing both these alternatives, the increased employment and output, by which alone increased incomes can be generated, will prove unprofitable and will not persist.

Now the school which believes in self-adjustment is, in fact, assuming that the rate of interest adjusts itself more or less automatically, so as to encourage just the right amount of production of capital goods to keep our incomes at the maximum level which our energies and our organisation and our knowledge of how to produce efficiently are capable of providing. This is, however, pure assumption. There is no theoretical reason for believing it to be true. A very moderate amount of observation of the facts, unclouded by preconceptions, is sufficient to show that they do not bear it out. Those standing on my side of the gulf, whom I have ventured to describe as half-right and half-wrong, have perceived this; and they conclude that the only remedy is for us to change the distribution of wealth and modify our habits in such a way as to increase our propensity to spend our incomes on current consumption. I agree with them in thinking that this would be a remedy. But I disagree with them when they go further and argue that it is the only remedy. For there is an alternative, namely, to increase the output of capital goods by reducing the rate of interest and in other ways.

When the rate of interest has fallen to a very low figure and has remained there sufficiently long to show that there is no further capital construction worth doing even at that low rate, then I should agree that the facts point to the necessity of drastic social changes directed towards increasing consumption. For it would be clear that we already had as great a stock of capital as we could usefully employ.

Even as things are, there is a strong presumption that a greater equality of incomes would lead to increased employment and greater aggregate income. But hitherto the rate of interest has been too high to allow us to have all the capital goods, particularly houses, which would be useful to us. Thus, at present, it is important to maintain a careful balance between stimulating consumption and stimulating investment. Economic welfare and social well-being will be increased in the long run by a policy which tends to make capital goods so abundant, that the reward which can be gained from owning them falls to so modest a figure as to be no longer a serious burden on anyone. The right course is to get rid of the scarcity of capital goods—which will rid us at the same time of most of the evils of capitalism—whilst also moving in the direction of increasing the share of income falling to those whose economic welfare will gain most by their having the chance to consume more.

None of this, however, will happen by itself or of its own accord. The system is not self-adjusting, and, without purposive direction, it is incapable of translating our actual poverty into our potential plenty.

To develop so fundamental a matter any further than this would obviously lead us far beyond the opportunities of this brief talk. I will add no more than this: if the basic system of thought on which Mr Henderson, Mr Brand and Professor Robbins rely is, in its essentials, unassailable, then there is no escape from their broad conclusions, namely, that whilst there are increasingly perplexing problems and plenty of opportunities to make disastrous mistakes, yet nevertheless we must keep our heads and depend on the ultimate soundness of the traditional teaching—the proposals of the heretics, however plausible and even advantageous in the short run, being essentially superficial and ultimately dangerous. Only if they are successfully attacked in the citadel can we reasonably ask them to look at the problem in a radically new way.

Meanwhile I hope we shall await, with what patience we can command, a successful outcome of the great activity of thought amongst economists today—a fever of activity such as has not been known for a century. We are, in my very confident belief—a belief, I fear, shared by few, either on the right or on the left—at one of those uncommon junctures of human affairs where we can be saved by the solution of an intellectual problem, and in no other way. If we know the whole truth already, we shall not succeed indefinitely in avoiding a clash of human passions seeking an escape from the intolerable. But I have a better hope.

Meanwhile, it is not unlikely that English principles of compromise will mitigate the evils of the situation by leading statesmen and administrators to temper the worst consequences of the errors of the teaching in which they have been brought up by doing things which are quite inconsistent with their own principles, in practice neither orthodox nor heretic, of which some signs are already manifest.

With the beginning of the year 1935, Keynes set out his view of his new book in a letter to G. B. Shaw, which grew out of the Stalin–Shaw–Wells–Keynes controversy in the *New Statesman* (*JMK*, vol. XXIV). The full letter appears in that context, but the following passages are of interest as an indication of Keynes's state of mind at the beginning of what was to be a year of controversy with economists:

From a letter to GEORGE BERNARD SHAW *1 January 1935*

To understand *my* state of mind, however, you have to know that I believe myself to be writing a book on economic theory which will largely revolutionise—not, I suppose, at once but in the course of the next ten years—the way the world thinks about economic problems. When my new theory has been duly