Recent Japanese Studies in the Development of Keynes’s Thought: An Evaluation

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The object of this paper is to evaluate, from the point of view of my own stance on the issue, some recent studies which have appeared in Japan aimed at clarifying the developmental process undergone by Keynes’s economic theory. This exercise is useful for at least two reasons. Firstly, it will better illuminate the similarities and differences between researchers’ views than could an exhaustive marshalling of recent studies.1) Secondly, in recent years several critical remarks concerning certain hypotheses put forward by me (Hirai, 1987, 1990 and elsewhere) have appeared. Now that I have represented my account of the development of Keynes’s theory (Hirai, 1997, 1998), it may be as well to respond to these remarks here.

Clarification of Keynes’s theoretical development is, as we know, an exceedingly difficult task. To begin with, we have to contend with the existence of three Keynesian schools, each at odds with the other two, notwithstanding that all base their approaches on the General Theory. These are Income-Expenditure Approach Keynesians, the Disequilibrium Approach Keynesians and the Post-Keynesians. The controversies between these schools have come about not only because their interpretations of the General Theory differ so greatly, but also because their views on how the theory should be revised are remarkably divergent. Inevitably, this circumstance must have no small effect on how researchers who attempt to clarify the development of Keynes’s ideas understand the General Theory itself (the end-point of the process under consideration). Secondly, there also exist several rival understandings of Keynes’s Treatise (the starting-point). Thirdly, as a natural consequence of the first two facts, we have a number of competing views of the relation between the theories of the two great books. Any researcher who attempts to delineate the evolution of Keynes’s theorising will inevitably be influenced, consciously or unconsciously, by the reverberations of these controversies.

1. A Treatise on Money and the General Theory

A. The Treatise

I understand the central theoretical structure put forward in the Treatise—let us call this ‘Keynes’s own theory’—as follows (as will be explained later, the Treatise also contains a second theory, which may be referred to as...
as the ‘Wicksellian theory’):

The structure can be described as a dynamic process composed of ‘Mechanism 1’ (the determination of the price level of consumer goods in each period — this is in substance the same as ‘the first fundamental equation’), ‘Mechanism 2’ (the determination of the price level of investment goods in each period — this is determined either in the stock market or as the demand price of capital goods, the former case being related to the ‘bearishness function’ theory), and the ‘TM supply function’ (which describes the behaviour of entrepreneurs as being such that, if they make a profit (loss) in the current period, they expand (contract) output in the next).

The distinctive feature of this interpretation lies in its seeing the Treatise as articulating a dynamic process which includes the determination of both the price levels and the volumes of output. We stand by this interpretation because sufficient documentation to demonstrate its validity exists. As will be seen later, the development of Keynes’s thinking after the Treatise cannot be understood unless we accept this interpretation. Akashi (1988) clearly accepts it, as does Matsukawa (1991). Also in agreement, so far as interpretation of the Treatise theory is concerned, is Yoshida (1997) (the divergence between Professor Yoshida and I consists in the fact that he grasps the whole of Keynes’s theoretical work, including the General Theory, exclusively from this stance). Okada (1997) too is in agreement (the difference between Professor Okada and I lies in his treating the Treatise as exemplifying the ‘classical paradigm’). Thus we find that an increasing number of researchers are paying attention to the TM supply function and taking the Treatise to be proposing a dynamic process which embraces the determination of both the price levels and the volumes of output.

The orthodox interpretation of the Treatise theory, by contrast, understands it as expressing ‘a theory of the determination of the price levels under a fixed volume of output (and this fixed at the level of full employment) and as lacking a theory of output’. (Even when the TM supply function is referred to, it is treated as unimportant.) This interpretation, which is accepted by both the Income-Expenditureists and the Disequilibriumists, is also widely accepted by other researchers. Hishiyama (1993) pays attention, so far as the treatment of the commodity markets in the Treatise is concerned, to the determination of the price levels of consumption and investment goods, but neglects Keynes’s arguments concerning the volume of output.

(As discussed below, Professor Hishiyama grasps Keynes’s development in terms of the relation between the money and the natural rates of interest. Hishiyama (1965), however, explicitly deals with the changes in the volume of output through the changes in prices emerging as a result of the occurrence of profits.) The same stance is to be seen in Kanoh (1992). Kojima (1997) regards the Treatise theory as dealing with relations within periods, and on the whole does not accept the idea that it possesses a dynamic
attribute in the form of a sequential analysis (though he does touch upon the TM supply function). Asano (1987) adopts a delicate position, maintaining that the main Treatise theory is concerned with an account of the determination of the price levels, but also recognising that the Treatise contains in addition a theory dealing with changes in the volumes of output. However, he insists that the two theories are logically inconsistent, each belonging to a completely separate theoretical system, whereas I regard the two theories as being coherently connected, and as constituting a dynamic model based on sequential analysis.

B. The General Theory

As I understand it, the essence of the General Theory can be summed up as ‘the monetary economics of underemployment equilibrium’. Here ‘monetary economics’ is understood to have the following features: (1) it stems from dissatisfaction with the dichotomy of classical economics — both the dichotomy in the standard sense and that recognisable in the classical theory of the rate of interest; (2) it arises also through criticism of the ‘Wicksell Connection’, to be discussed in Section 2; (3) it analyses an economy in which money plays a vital role, as is shown by, for example, presentation of the theory of liquidity preference, and inquiry into the nature and significance of money by means of the concept of ‘own-rates of interest’. ‘Underemployment equilibrium’ is intended to convey the following ideas: (i) a state of the economy below full employment; (ii) a kind of ‘equilibrium’; (iii) a kind of ‘stability’; (iv) allowance for fluctuations within a certain range.

Keynes puts forward his ‘monetary economics of underemployment equilibrium’ in the form of a system of simultaneous equations, while also considering the causal relations between variables. It should be noted that in the General Theory Keynes characterises the market economy as possessing two contrasting attributes — stability, certainty and simplicity on the one hand, and instability, uncertainty and complexity on the other. In my view, any understanding of the General Theory which ignores either attribute must be inevitably inaccurate.

The most important theory which Keynes puts forward in the General Theory is, of course, the model showing how the level of employment is determined. This is based on three ‘ultimate independent variables’: (1) the wage-unit; (2) the quantity of money; (3) the three fundamental psychological factors, these being the propensity to consume, liquidity preference, and the schedule of the marginal efficiency of capital. Keynes argues that the level of employment is determined where the aggregate demand function (derived from these variables) meets the aggregate supply function (derived from the ‘first postulate of the classical economics’).

In this regard the following four points should be particularly noted. First, Keynes is sure that the ‘stickiness’ or ‘rigidity’ of money wages contributes to the stability of the economic system. Second, Keynes unambiguously rejects the concepts of ‘general price-level’ and ‘national dividend’, declaring that two fundamental units of quantity only — quantities of money-value and quantities of employment — should be used in
developing the theory of employment. Third, Keynes regards prices as flexible (his opinion being that they depend partly on the wage-unit and partly on the volume of employment). Fourth, Keynes argues that the working of the market economy depends on a variety of psychological and expectational factors which affect people's attitudes to the future: short-term expectations, long-term expectations, liquidity preference due to the speculative motive, and user cost. It is with these points in mind that I refer to the theoretical framework of the General Theory as the 'Heterogeneity—Expectations Approach' and attempt to reconstruct it as a model equipped with a 'two-tier' adjustment mechanism (micro- and macro-structures). Leaving to one side any questions concerning the appropriateness of my reconstruction, I am sure that the heterogeneity—expectations viewpoint sheds much useful light on the theoretical structure actually developed in the General Theory (see Hirai, 1981).

Surprisingly, few researchers studying the formation of Keynes's economics present a systematic account of the theoretical structure of the General Theory, as distinct from inquiring into the meaning of certain individual chapters, such as Chapter 17. This may be due either to the fact that disagreement as to understanding of what is put forward in the General Theory—one of the root causes of the conflicts between the above-mentioned Keynesian schools—makes it difficult for studies of Keynes's development to examine the theoretical structure directly, or else to the assumption that the meaning of the General Theory has already been fully elucidated. Thus recent studies such as, for example, Okada (1997), Kojima (1997) and Yoshida (1997), contain little or no systematic analysis of the General Theory. Rather, studies of Keynes's ideas generally focus their attention on the Treatise, on the theories of Keynes's contemporaries such as Robertson and Hawtrey, and on Keynes's own earlier theories. That is not in itself undesirable, yet to spell out his or her own understanding of the General Theory remains an indispensable task for any researcher.

Fukuoka (1997) maintains that the IS–LM model reflects Keynes's intentions faithfully. Akashi (1988) clarifies the points of difference between the Classicals and the Keynesians, taking the IS–LM scheme to be common ground between them. In so doing, Professor Akashi comes close to identifying the General Theory with the IS–LM scheme. I reiterate, however, that in the General Theory Keynes neither accepts the concept of the 'general price-level', nor indeed regards prices as fixed at all.

C. Keynes's Theoretical Development

How did Keynes alter and develop his economic theory between the Treatise and the General Theory? After presenting my own view in the form of 'hypothesis', I will examine other researchers' views concerned.

(Hypothesis 1)

Keynes remained in the world of the Treatise until just before the manuscript 'The Parameters of a Monetary Economy' written at the end of 1932.
‘Remained in the world of the Treatise’ means ‘stuck to Keynes’s own theory’. Recall that a second theory — the ‘Wicksellian theory’ — was to be abandoned by Keynes from immediately after the Treatise on. Worthy of attention concerning Keynes’s own theory is the fact that Keynes held on to the TM-supply function in spite of criticism from, among others, the ‘Cambridge Circus’. In this respect, Yoshida (1997) is in accord with my argument. (The difference between Professor Yoshida and I lies in his playing down the General Theory, with the assertion that it represents no more than a pared-down version of the Treatise, while I argue that a great change occurs between the two.) Virtually in line with my own view of Keynes’s development is that of Akashi (1988), as is indicated in the following statements: ‘the transformation of Keynes’s thought process can be found in the shift of his concern from the fluctuations in output to the “equilibrium” level of output attained as a result of them’ (p.106); ‘the methodological transformation [is] from a sequential analysis to an equilibrium analysis’ (p.111).

(Hypothesis 2)

The ‘qualitative transformation’ from the world of the Treatise to that of the General Theory takes place in the manuscript The Parameters of a Monetary Economy’. I see support for this hypothesis in the following features of the manuscript: (1) the adoption of the notion of ‘investment-saving equilibrium’; (2) the formulation of a supply schedule as a function of the ‘price complex’ (the essential disappearance of the TM-supply function); (3) the presentation of a system of simultaneous equations equipped with an idea similar to the multiplier theory.

The manuscript adopts an equilibrium analysis, abandons a sequential analysis, and incorporates important components to be used later in the General Theory, so that it can accurately be said to be completely independent of the Treatise. On the other hand, however, it is still some way short of the General Theory in that it lacks an account of how the level of employment is determined. It is for these reasons that I identify ‘The Parameters of a Monetary Economy’ as the crucial turning point.

Researchers who emphasise the importance of this manuscript in Keynes’s developmental process include Hishiyama (1993), Kojima (1997) and Okada (1997). Professor Hishiyama uses ‘the Wicksellian mode of adjustment’ to mean the adjustment of the money rate of interest to the natural rate, and regards the Treatise as exemplifying this mode of adjustment. He maintains that Keynes’s thinking underwent a great transformation between the Treatise and the General Theory as a result of his coming to accept Sraffa’s idea that the natural rate of interest adjusts to the money rate of interest, and that The Parameters of a Monetary Economy provides evidence for this. (I agree with his view that the Treatise has the Wicksellian mode of adjustment, but I would stress again that it also contains another theory — Keynes’s own theory — and that Keynes drops the Wicksellian mode of adjustment.
(the ‘Wicksellian theory’) immediately after the *Treatise.*) Kojima (1997) attempts to confirm Professor Hishiyama’s hypothesis by examining Sraffa’s 1932 review of Hayek’s *Prices and Production*, but his reasoning is open to several questions. In the first place, it rests more on conjecture than on documentation. Secondly, Professor Kojima identifies the ‘natural rate of interest’ with Sraffa’s ‘commodity rate of interest’ defined in terms of the price relations between the spot and the forward markets (p.10), and then treats it as if it were identical to Wicksell’s ‘natural rate of interest’. Thirdly, although he insists that ‘The Parameters of a Monetary Economy’ emerged as a result of Sraffa’s critique of Hayek’s theory, the assertions he makes in support of this contention — regarding (i) the adoption of the concept of a ‘complex’, and (ii) the exogeneity of the money rate of interest — are unpersuasive. In the manuscript, the money rate of interest is in fact treated as an endogenous variable, as is evident in the formulation \( \rho = A(-) \) where \( \rho \) is the (money) rate of interest, \( A(-) \) the state of liquidity preference, and \( M \) the quantity of money, which is an exogenous variable.

Okada (1997) similarly emphasises the significance of ‘The Parameters of a Monetary Economy’, but from a quite different angle, asserting that ‘we can confirm that Keynes, in the late 1932 on the way from the *Treatise* to the *General Theory*, accomplished the most radical change, when the Keynesian Revolution essentially took place’. (p.204) I agree with the first part of this statement, but not accept the second part on the following grounds: (1) the manuscript sets out no investment theory leading up to the investment theory of the *General Theory*; (2) the manuscript offers no account of how the level of employment is determined. In addition, Professor Okada overlooks the fact that Keynes’s methodology has already shifted from sequential analysis to equilibrium analysis.

Although he detects certain progressive elements in ‘The Parameters of a Monetary Economy’ which points towards the *General Theory*, Asano (1987) nonetheless considers that Keynes is here still ‘adhering to the theoretical framework of the *Treatise*’ (p. 89). For, according to Professor Asano, at this stage Keynes still clings to the TM supply function, continues to use prices as the principal variables of the system, and adopts the liquidity preference theory which, lacking a speculative motive for holding money, represents the remnants of the bearishness function approach. Here I would suggest that Professor Asano fails to pay sufficient attention to the fact that in the model of this manuscript the TM supply function does not play any substantial role, and that the method of analysis changes completely. In general, Professor Asano evaluates the manuscript from a perspective which looks back to the *Treatise*, whereas I evaluate it from a forward-looking stance. At the same time, though, he does acknowledge that ‘there was a decisively important progress in thought in the late 1932’ (p.100), as witnessed, in his opinion, by the article ‘The Monetary Theory of Production’, which appeared as Keynes’s contribution to *Spiethoff Festschrift*. In maintaining this position Professor Asano...
is concerned to emphasise, above all, the 'negation of the neutrality of money'. Concerning this I would point out that this matter was discussed in the first lecture of the Michaelmas term of 1932, and that the core of that term's lecture course was an exposition of the same model as is put forward in 'The Parameters of a Monetary Economy'.

(Hypothesis 3)

In the three manuscripts of 1933 we encounter the origins of Chapter 3, 'The Principle of Effective Demand', of the General Theory, as they discuss the equilibrium and stability conditions of the level of employment. Yet we also detect several logical ambiguities, so that it is clear that Keynes is still engaged in 'searching efforts'.

The three manuscripts of 1933 have been examined in detail in both Asano (1987) and Hirai (1987). As Professor Asano's exegesis is close to the mark and there is no great divergence between our interpretations, I would here like just to proceed with my own view. I regard the First Manuscript as a system of simultaneous equations which determines the level of employment, in consequence of which I evaluate it in relation to Chapter 3 of the General Theory. Akashi (1988) takes a similar stance. (As Professor Asano rightly points out, the First Manuscript retains the last remnants of the TM supply function. I would stress, however, that this is so changed that it is no longer the TM supply function, but rather a quite distinct function (which I refer to as the 'pseudo-TM supply function').

As to the Second and Third Manuscripts, I see as their essential feature the argument for the stability of the equilibrium position. Asano (1987) is accurate when in his evaluation of the Second Manuscript he points out that 'Although he continued to take pains to give readers the impression of the continuity with the Treatise, Keynes in fact took a rather decisive step away from it' (p.130).

It is around the period of the Second Manuscript that Keynes adopts the 'first postulate of the classical economics'. Asano (1987) maintains that this implies a decisive shift in Keynes's thinking — 'a great transformation of the supply function from that in the Treatise to a new idea based on marginal analysis' (p.175) — and that this transformation is attributable to Kahn's persuasion. I agree with Professor Asano's analysis. Yoshida (1997), on the other hand, insists that the first postulate is no more than 'noise' which was never incorporated into the foundations of Keynes's theory, and furthermore that the Cambridge Circus obstructed the natural development [of the Keynesian Revolution]' (p.183). I do not concur with this view. Professor Yoshida fundamentally believes the concepts of 'demand, supply and equilibrium' to be harmful to sound economic analysis. It is from this point of view that he looks at Keynes's development. He holds the Treatise in highest esteem, for he finds it the only book free of such concepts. When we turn to the General Theory, however, we see that Keynes makes much use of these concepts. (As noted earlier, Keynes's method also
shifts, from sequential to equilibrium analysis). That is why the *Treatise* receives so much attention from Professor Yoshida, at the expense of the *General Theory*, which he rather neglects. This stance ties in closely with his rejection of the first postulate. Professor Yoshida repeatedly emphasises the importance of ‘the original text’, yet he nevertheless seems to ignore it.

With regard to the period following the end of 1933, I would like to draw attention to the following points. (1) It was from late 1933 to early 1934 that Keynes essentially completed the consumption theory and substantially improved the investment theory. (2) In Hirai (1987, Chapters 8-10; 1997, Chapters 12-14), I examined various manuscripts from ‘The General Theory’ of spring 1934 to the galleys of the *General Theory*. I think it important that these should be examined in relation to the theoretical structure put forward in the *General Theory* - which makes it incumbent on researchers to spell out their own understandings of the *General Theory* in advance. In this light, it is my impression that the manuscripts of this period have up to now received very little in the way of really serious examination.

2. The ‘Wicksell Connection’

In parallel with studies of the development of Keynes’s economic theory, several studies of the economic theories of his contemporaries have emerged in recent years. In this section I would like to discuss some studies relating to one contemporary strand of economic thought — the ‘Wicksell Connection’. I use this term to denote either the group of economists who accepted (critically) and developed Wicksell’s ‘theory of cumulative process’ in one way or another (Lindahl, Myrdal, Mises, Hayek, Robertson, Keynes of the *Treatise*, Hawtrey, and others) or the strand of economic theories generated by these economists. This movement rejected ‘the quantity theory of money, Say’s Law, and the classical dichotomy’ and attempted to construct a monetary economics. The earliest of the recent studies of the Wicksell Connection to be considered here is Akashi (1988, Chapters 1-4), which develops a clear-cut position on the Connection (he uses the term Wicksell Paradigm’). The Wicksell Connection or Paradigm is argued to have produced, on the one hand, Hayek and the Stockholm School (Lindahl and Myrdal), and on the other the Cambridge School (Robertson and Keynes). I am in agreement with Professor Akashi’s account. This view can be traced back to Professor Hishiyama (see Hishiyama, 1990; 1993). Professor Hishiyama accurately grasps that Wicksell’s theory of cumulative process challenges the classical dichotomy, undermines the quantity theory of money, and denies the automatic adjustment ability of the rate of interest to adjust automatically. The *Treatise* is regarded as exemplifying the ‘Wicksellian mode of adjustment’. A notable feature of Professor Hishiyama’s analysis is, again, the idea that Sraffa criticised Wicksell–Keynes indirectly through his criticism of Hayek, and that Keynes grasped this and was thus prodded to shift his thinking in the direction which was eventually to lead to the *General Theory*. 
Kojima (1997) denies the validity of the Wicksell Connection concept. In its place, he puts forward an alternative concept called the 'Hawtrey Connection'. His argument, however, is less than persuasive. In the first place, Professor Kojima himself refers to and discusses the connection between the Treatise and Wicksell's theory, while his discussion of the Hawtrey Connection never rises above conjecture. Secondly, his definition of the Hawtrey Connection (p.100) seems to be narrow. It is defined in terms of (i) a theory of the essence of money, and (ii) 'a circular-structural understanding of monetary economy' (thus Professor Kojima's interpretation of the production structure of the Treatise again lacks the TM supply function). The problem with this definition is that it relates not to the connection between Hawtrey, the Treatise and the General Theory, but only to the connection between Hawtrey and Keynes in the 1920s. (It is the former connection, in my view, that really matters.) Though Professor Kojima allocates three chapters to Hawtrey, the argument in Chapters 4 and 5 in fact has little to do with the definition which appears in Chapter 3. Yoshida (1997) likewise criticises the concept of the Wicksell Connection. This stems from the fact that, with respect to the Treatise, Professor Yoshida rather overemphasises 'Keynes's own theory' (in my terminology), and neglects the Treatise's other theory — the 'Wicksellian theory'. This stance, though not exactly wrong, is nevertheless somewhat biased.

I would now like to refer briefly to an interpretation of the positions of Wicksell's theory and the Treatise in the history of economic thought due to Okada (1997). Being concerned with neither the differences between the classical and neo-classical schools (plutology versus catallactics), nor the theories held in common by the two schools (the classical dichotomy, Say's Law, and the quantity theory of money), nor the differences between these two schools and the Wicksell Connection (real economics versus monetary economics), Professor Okada regards both Wicksell's theory of cumulative process and the Treatise as belonging to the 'classical school', considered as accepting the quantity theory of money and the classical dichotomy. Then he sees the General Theory as freeing itself of the 'classical school'.

I conclude this paper with a restatement of my own view of the relations between the Wicksell Connection, the Treatise and the General Theory. The Treatise contains two distinct theories — 'Keynes's own theory' and the Wicksellian theory'. In the immediate post-Treatise period, Keynes came to pay attention exclusively to the first of these theories. Through intensive reflection upon it, together with his adoption of an equilibrium analysis approach, he came to formulate the General Theory as the 'monetary economics of underemployment equilibrium'. Thus the General Theory represents a monetary economics which differs from that of the Wicksell Connection. In short, it was not only 'classical economics' but also the Wicksell Connection that Keynes attacked in the General Theory.
Notes
1) Fujii (1994) provides an examination of recent studies in the field, inclusive of foreign papers.
2) The framework for the controversy over the Wicksell Connection has already been prepared by Komine (1997). The controversy is likely to get more heated from now on.

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