The 1937 sham fight of John Hicks, or: the ill-conceived use of IS-LM to cut Keynes down to size[♦]

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Still very preliminary, comments are welcome, but please do not quote without permission

"I wish that for just one time you could stand inside my shoes...
you'd know what a drag it is to see you..."
Bob Dylan, *Positively 4th Street*

1 Introduction

Soon after the publication of the *General Theory of Employment, Interest and Money* in February 1936, six economists produced models based on simultaneous equations to elucidate the analytical structure of Keynes' new theory.[1] With one notable exception, Keynes' reaction to these attempts was positive or even enthusiastic. The exception was his reaction to Hicks, the author of "Mr. Keynes and the 'Classics'" which would later turn out to be one of, if not the, most important contribution framing the understanding of Keynes' economics.

Keynes' reaction (in his letter of March 31, 1937) to Hicks' paper was rather tepid: "I found it very interesting and really have next to nothing to say by way of criticism" (Keynes 1973d, 79).
And while he directed no critical remarks at the model introduced by Hicks' as a representation of the *General Theory*, he did have no word of praise whatsoever either.

Ever since the publication of Hicks' 1937 article the relationship between the model presented in 1937 to Keynes General Theory analysis and the question of whether Keynes accepted or rejected it as representation of his ideas is the object of, sometimes heated, debates. Just recently, Mann (2017, 243) has expressed the present still unsolved state of these discussions very aptly by stating that Keynes "somewhat notoriously, vaguely endorsed" this model in a letter to Hicks.

In what follows the attempt will be made to go beyond this vagueness and arrive at a more precise assessment of Keynes' stance on the model presented in Hicks' 1937 contribution by observing the distinction between the model as such and the use Hicks made of this model in

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his 1937 paper (based on his 1936 contribution to the annual conference of the Econometric Society). Making this distinction will it make possible to see that Keynes, while endorsing the model, clearly rejected the use of it made by Hicks.

In the preface to his *General Theory* Keynes voiced his concern that some of its readers "... will fluctuate ... between a belief that I am quite wrong and a belief that I am saying nothing new" (Keynes 1936 [1973], xv). In his comparison of Keynes' analysis to "classical" economic theory Hicks goes one step further - he is extremely intent to show that Keynes is saying nothing new *and* that, *at the same time*, a central claim concerning the nature of the rate of interest is wrong, or more to the point, cannot be deduced from Keynes' own analysis (thus insinuating that Keynes did not understand his own theory properly). And, for good measure, he adds the claim that Keynes' *General Theory* is not really general at all. Hicks' highly critical attack questions any real difference between orthodox theory and Keynes' new analysis by suggesting an affirmative answer to his own question "... is the whole thing a sham fight?" (Hicks 1937, 153).

His critical discussion of Keynes' analysis proceeds along three different lines of argument. He argues that much of Keynes' theoretical arguments and political proposals are not novel. In addition, he contends that Keynes' *General Theory* is not really general and that a properly generalised version of it would loose much of its novelty. Finally, Hicks wants to show that Keynes' view of the rate of interest as a monetary phenomenon in general does not hold up but may potentially claim validity only in the extremely special economic situation of a deep depression. All in all, in 1937 his examination of Keynes' *General Theory* is characterised by an complete disregard for the distinguishing feature of Keynes' new theory: the possibility of equilibrium (or long-period) involuntary unemployment.

The paper is organised as follows. In the next section some short remarks on the history of IS-LM, the material used in the present paper and the chronology of the interaction between Keynes and Hicks up to the publication of the 1937 paper are presented. Section 3 addresses Hicks' first line of argument ("there is nothing new"). Section 4 offers a short explanation of the model used by Hicks in his critical assessment of Keynes' analysis along the second and third lines of argument. Although this model was the origin of the IS-LM model, a short explanation of its quite different character is expedient. Section 5 is devoted to the second line of argument ("the *General Theory* is not general at all") together with Keynes' riposte, while section 6 analyses the third line of argument ("Keynes cannot show that, in general, interest is a purely monetary phenomenon"), again together with Keynes' riposte. The penultimate section looks at Keynes' reaction to this and later episodes of misguided criticisms of his analysis and looks into the problem of whether Keynes accepted the IS-LM model used by Hicks and why his only lukewarm reaction to Hicks was so different from his positive or even enthusiastic reaction to other attempts at interpreting his, notably the contributions by Harrod and Meade. The last section concludes

[1] Champernowne (1936), Harrod (1937), Hicks (1937), Lange (1938), Meade (1937) and Reddaway (1936).

2 Some preliminary remarks concerning history, material and chronology

On the history of IS-LM

As O'Donnell & Rogers (2016, 349) recently pointed out, the history of IS-LM is " a long, controversial and convoluted history across time and economists". The role played by Keynes has been a matter of controversy, as well as the relation of the many variants of IS-LM models to the analysis presented by Keynes in his 1936 "The General Theory of Employment, Interest and Money" with some arguing that Keynes accepted the IS-LM model used by Hicks in 1936/1937, and if he did not accept it, he should have, while others see Keynes rejecting the IS-LM construct, and if he did not reject, he should have.

In order to focus on the exchange of arguments between Keynes and Hicks over the models used by Hicks in his 1937 publication and avoid being borne down by the "long, controversial and convoluted" history of the last eight decades, at least, in the this version of the present paper, this history will be neglected and not be commented upon.

On the material used

This analysis in this paper is mainly based on Keynes' 1936 General Theory of Employment, Interest and Money, Hicks' 1937 article Mr. Keynes and the "Classics"; A Suggested Interpretation" together with some correspondence between Hicks and Keynes (Keynes 1973c-e; Hicks 1973 a-c). In addition, Hicks' 1936 review "Keynes' Theory of Employment" will be used. And of course: anybody working on any problem even only remotely related to IS-LM must be aware of standing on the shoulders of Warren Young and his 1987 "Interpreting Mr Keynes. The IS-LM Enigma".The arguments presented in what follows draw on previous work by the present author, *i.e.* Barens (1999) and Barens (2003).

On chronology

The *General Theory of Employment, Interest and Money* appeared in the bookshops on 4 February 1936 (Moggridge 1992, 570). In June of the same year Hicks' review of the book appeared in the *Economic Journal* (Hicks 1936), commissioned by Keynes as its editor,. In September 1936 the first session of the conference of the *Econometric Society*, taking place at the university of Oxford was dedicated to a symposium on Keynes' *General Theory* with presentations by Harrod, Hicks and Meade. According to Young (1987), Hicks only started working on his own presentation, which would become "Mr. Keynes and the "Classics"; A Suggested Interpretation" published in *Econometrica* in April 1937, after Meade had sent him his own paper for the conference session. Meade sent his paper to Keynes before the conference, who answered on 14 September with a postcard stating his positive reaction to it. Hicks as well sent his presentation to Keynes, presumably after the conference (maybe in October 1936), with Keynes reacting only six months later on 31 March, 1937, shortly before the publication of Hicks' paper (see Young 1987, 31f).

3 The first line of critique: there is really nothing new

Hicks is intent on minimising or altogether denying novel elements in Keynes' *General Theory* analysis. Thus he argues that Keynes' new theories of money and the rate of interest actually are very similar to Marshallian orthodoxy and are "hard to distinguish from the revised and qualified Marshallian theories, which ... are not new" (Hicks 1937, 153). He emphasises that already Marshall spoke of the downward effect on the rate of interest due to increases in the quantity of money and that both Marshall and Lavington took into account the influence of the rate of interest on the demand for money (Hicks 1937, 151).

Already in his 1936 review of the General Theory Hicks pointed out that to speak of the "monetary character of interest is, of course no novelty; it has been generally recognised at least since the time of Wicksell" (Hicks 1936, 245)[2]. This will be taken up again in section 6 below.

In a similar vein, he speaks of Keynes as „not the first Cambridge economist to have a temperate faith in Public Works" (Hicks 1937, 154), presumably alluding to Robertson (1928) and Pigou (1933), who both advocated public infrastructure investment if monetary policy would be confronted with what today is called the Zero Lower Bound of the rate of interest.[3]

These references to allegedly non-novel features of Keynes' *General Theory* may seem to be somewhat disingenuous, due to the circumstance that these features are mentioned by Hicks strictly from the perspective of the business cycle. If unemployment is addressed at all, it is only mentioned as a concomitant phenomenon of industrial fluctuations (Hicks 1937, 150, 155, 158), implying that in his book Keynes was "largely concerned" with "Slump Economics". This persistent and significant characteristic of Hicks' 1937 contribution suppresses the one central novelty that, at least in the mind of Keynes, clearly and truly distinguished his new analysis from classical economic theory: the possibility of long-period involuntary unemployment, a possibility that Hicks had characterised in his 1936 review as "novel and startling" (Hicks 1936, 249).[4]

This disregard of the new theory of long-period unemployment in 1937 certainly introduced a definite bias against the significance of Keynes's arguments, because as Keynes had made clear in his letter to Hicks, dated 31 August, 1936, remarking on Hicks' review: "It is perfectly true that a great part of my theory ceases to be required when the supply of output as a whole is inelastic" (Keynes 1973c, 71).

[2] Three years later Robertson, in his lectures at the London School of Economics in the summer term of 1936, would point out that Marshall as well consider the rate of interest as a monetary phenomenon (Robertson 1940, 1).

[3] "What, after all, can be more sensible than that the Central Government should organise a collective demand for telephone equipment, or the local governments a collective demand for municipal lavatories...?" (Robertson 1928, 218).

[4] Whereas "involuntary unemployment" is mentioned twice in the 1936 review it is not mentioned at all in the 1937 article.

4 The model used by Hicks as representation of the *General Theory*

Hicks introduces four different models in his 1937 article (Hicks 1937, 149, 152f, 156; see Barens 1999). The one used as a representation of Keynes' *General Theory* consists of the following three "fundamental equations" (Hicks 1937, 149, 153, see 148 for the underlying assumptions):

(1) $M = L(i,I)$,

(2) $I_x = C(i)$,

(3) $I_x = S(I)$ **.**

The first equation is the equilibrium condition for "the money market", with M the quantity of money supplied, L money demand assumed to depend non the rate of interest i and money income I.[5] The second is the equilibrium condition for the investment goods market, equating the value of investment goods supplied (I_x) with the value of demand for investment goods (C(i)). The last expression, equating the value of investment goods supply with savings out of income, is the equilibrium condition for the consumption goods market[6].

Equation (1) yields the LM curve (or LL curve as Hicks labelled it in his article), while eliminating I_x from equations (2) and (3) leads to the equation of the IS curve. By construction this IS curve represents simultaneous equilibria of both commodity markets.

5 The second line of critique: the General Theory is not really general

Hicks argues that the General Theory is not really general (or, at least, not as general as it might be) by invoking "mathematical elegance" that, according to him, suggests "that we ought to have *I* and *i* in all three equations, if the theory is to be really General":

$$M = L(i,I), \qquad I_x = C(i,I), \qquad I_x = S(i,I) \textbf{ .}$$

Three aspects of Hicks' use of this *Generalized General Theory* model (Hicks 1937, 156) and his criterion of "generality" deserve attention. First, Hicks likens this model to Wicksell's theory, thereby hinting that a truly general theory would not be new; or, stated otherwise, that any novelty that Keynes might claim for his new theory hinges precisely on the fact that it is not a truly general theory.

Second, more significant is the fact that Hicks uses a formalist (or aesthetic) criterion of "generality", both devoid of any economic content and different from Keynes' own criterion without any discussion or even a hint of having taken account of Keynes' own criterion. On the very first page of his book Keynes tells his readers that he chose the title *The General Theory of*

[5] "The expression 'money market equilibrium'' is something of a misnomer. There is no single market in which money ... is bought and sold. Money changes hands against all other goods in all other markets. The expression 'money market equilibrium' which is too convenient a shorthand to do without, therefore simply means equality of demand for and supply of money (Buiter 1979, 13n11).

Employment, Interest and Money, "placing the emphasis on the prefix *general*" (Keynes 1936 [1973], 3) because of the of contingency of involuntary unemployment, *i.e.* the possibility of equilibrium at any level of employment up to full employment, restricting "classical theory" to the special case of full employment: "I shall argue that the postulates of the classical theory are applicable to a special case only and not to the general case, the situation which it assumes being a limiting point of the possible positions of equilibrium."

Finally, Hicks' use of the *special vs. general* dichotomy is not consistent. On the one hand, in passages like the one just referred to he employs a criterion of "generality" different from the one used by Keynes himself implying that Keynes' theory is the special case of a more general theory. But when he uses the *Generalized General Theory* model to discuss Keynes' and Wicksell's approaches, without acknowledging it he switches to Keynes' own criterion by pointing out that in the "special case" of full employment "Mr. Keynes' theory" will fit "Wicksell's construction absolutely" giving rise to Wicksell's *natural rate* of interest, solely determined by "real forces" (Hicks 1937, 158). If full employment is a "special case", then what will be the general case"?

In addition to just invoking "mathematical elegance", Hicks does offer one economic argument for including current income in the demand for investment function: an increase in income will raise the demand for consumption goods and thus may stimulate an increase in investment if expectations develop that the increase in consumption will be sufficiently long-lasting (Hicks 1937, 156).

In 1934 Keynes, in draft chapters of his book, indeed started from "generalised" equations similar to the ones suggested by Hicks (Young 1987; Keynes 1973f, 441f and Keynes 1973g, 483f)[7], pointing out that according to his view the rate of interest and marginal efficiency of capital are comparatively unimportant to consumption demand, and that current employment and income have not much bearing on investment demand, thus arriving at "simplified expressions". This assessment is argued out at length in various passages of the General Theory.

In his letter of March 31, 1937 to Hicks, Keynes seems to refer to passages like these, when he informs Hicks that "(a)t one time, I tried the equations, as you have done, with *I* in all of them. The objection to this is that it overemphasises current income. In the case of the inducement to invest, expected income for the period of the investment is the relevant variable. *This I have attempted to take account of in the definition of the marginal efficiency of capital. As soon as the prospective yields have been determined, account has been taken of income, actual and expected*. But, whilst it may be true that entrepreneurs are over-influenced by present income, far too much stress is laid on this psychological influence, if present income is brought into such prominence. It is, of course, all a matter of degree. My own feeling is that present income has a

[6] Nominal income is defined by Hicks as the sum of value of investment goods and value of consumption goods (I_y) (Hicks 1937, 148). If savings are defined as the excess of nominal income over the value of demand for consumption goods (C^D), a variable not introduced by Hicks, equation (3) becomes $I_y = C^D$ (see Barens 1999).

[7] I am grateful to Edward W. Fuller for drawing my attention to these passages.

predominant effect in determining liquidity preference and saving which it does not possess in its influence over the inducement to investment" (Keynes 1973d, 80f; emphasis added).

Even if Keynes seems to be quite conciliatory ("It is, of course, all a matter of degree") in his repudiation of Hicks' suggested generalisation of the investment function, some arguments against such a generalisation of the *General Theory* can be pointed out.

On the one hand, the "non-generalisation" of his theory is not due to some oversight on the part of Keynes but instead the result of a specific view of the determinants of consumption and investment demand. On the other hand, Hicks' suggestion to include current income in the investment function may betray an incomplete understanding of the concept of marginal efficiency of capital because such a suggestion comes close to a "double entry" of parts of the prospective yields pertaining to marginal efficiency of capital.

6 The third line of critique: interest is not a monetary phenomenon

Hicks' third line of critique is concerned with the problem of whether Keynes' view of (the rate of) interest as a monetary phenomenon is valid. The "benchmark question" that Hicks uses to decide this problem is whether an increase in the inducement to invest will raise the rate of interest or not: "...how does Mr. Keynes come to make his remarks about an increase in the inducement to invest not raising the rate of interest?" (Hicks 1937, 154).

In a first step, Hicks introduces a model, in which an increase in the inducement to invest will not raise the rate of interest:

(7) $M = L(i)$,

(8) $I_x = C(i)$,

(9) $I_x = S(I)$ **.**

But he points out at once that "in spite of the fact that quite a large part of the argument runs in terms of this system, and this system alone" this is not Keynes' *General Theory* and he decides to label it as "Mr. Keynes' *special theory*" (sic!), which, according to Hicks, Keynes does not believe in (Hicks 1937, 152).

In the *General Theory* model (eqs. (1) – (3)) an increase in the inducement to invest will shift the IS curve to the right and the rate of interest will increase together with income (see Figure 1). According to Hicks, this result makes Keynes' theory "hard to distinguish from ... Marshallian theories, which ... are not new" (sic!) (Hicks 1937, 153). It is at this point that Hicks raises the possibility that the controversy between Keynes and "classical economists" is just a sham fight.

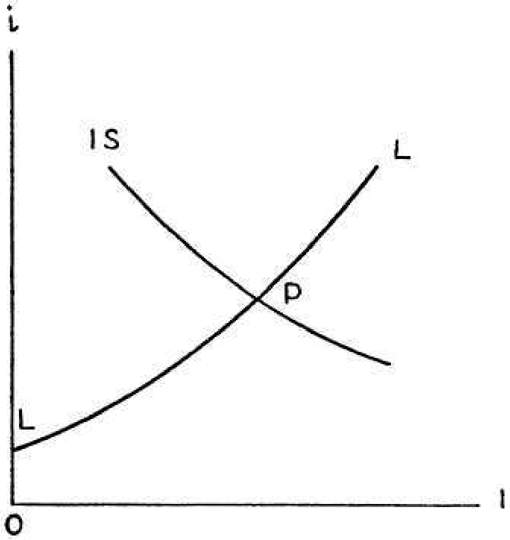

FIGURE 1

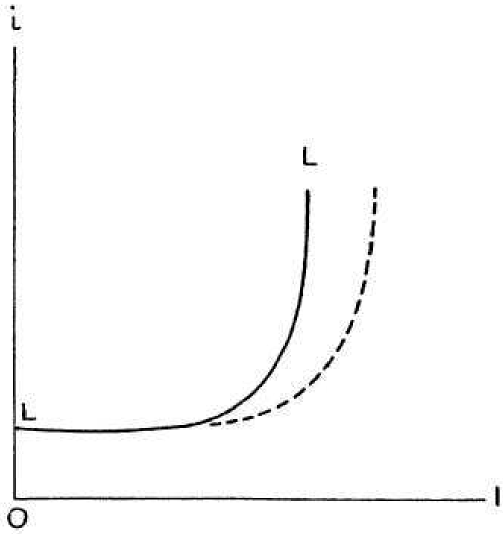

FIGURE 2

(Hicks 1937, 153)

After having argued that Keynes alleged remarks are invalid in the general case, Hicks concedes that interpreting the rate of interest as a purely monetary phenomenon nevertheless may still be valid in a special economic situation due to the shape of the LM curve of the General Theory model. If the left part of the LM curve becomes horizontal (or nearly so) and if the rightward shift of the IS curve takes place within this part there will be no effect on the rate of interest (Hicks 1937, 154)(see Figure 2).[8] According to Hicks, this possibility is the "the most important thing in Mr. Keynes' book" (*ibid.*). But even if in this situation the notion of interest as a purely monetary phenomenon may be valid, or at least not utterly implausible, this will come at a price, because, according to Hicks (who somewhat jumps to this conclusion), this turns the General Theory into quite another special theory, the "Economics of Depression" (Hicks 1937, 155).[9]

Before turning to Keynes' reply to Hicks' contention that the purely monetary nature cannot be deduced from the General Theory model various problematic aspects of the latter's argument should be pointed out. Firstly, it can be noted that in his comparison of the received theory of interest and Keynes' theory Hicks relies on observational equivalence, *i.e.* whether an increase of the inducement to invest will have the same effect in both theories. Such a procedure is liable to neglect any analytical differences in both theories that may exist in spite of their observational equivalence and will run the danger, as will be argued below, of looking at the "wrong effects".

Secondly, by interpreting a positive lower limit of the rate of interest due to the horizontal part of the LM curve in turn caused by "absolute liquidity preference" (Keynes 1936 [1973], 207) as the "most important thing in Mr. Keynes book" stands in stark contrast to Keynes' own explicit

[8] Hicks' argument has a somewhat weird implication – the notion of interest as a monetary phenomenon is validated in a situation in which the functional relation between the quantity of money and the rate of interest ceases to exist.
[9] Elsewhere in his article, Hicks speaks of "Slump Economics with which Mr. Keynes is largely concerned" (Hicks 1937, 158).

statement in the *General Theory* that according to his knowledge such a situation had never materialised (*ibid.*; see as well O'Donnell/Rogers 2016, 359).

Finally, Hicks' argument has a somewhat weird implication – the notion of interest as a monetary phenomenon, based on the inverse functional relation between the quantity of money and the rate of interest, is validated in a situation in which precisely this functional relation ceases to exist.

Hicks refers to Keynes' „remarks about an increase in the inducement to invest not raising the rate of interest" (Hicks 1937, 154) and this seems to the source of his benchmark question. But is the benchmark question used by Hicks the appropriate one to capture Keynes' ideas about interest? Can the rate of interest be understood as a monetary phenomenon even if an increase of income caused by an increase in the inducement to invest raises the rate of interest?

It is worthwhile to go back to Wicksell's distinction between the market rate of interest (*Geldzins*) and the natural rate of interest (*Güterzins*) for an answer to this question. Wicksell was well aware that, in the first instance, the rate of interest was determined by monetary factors like changes in the quantity of money: "The money rate of interest depends in the first instance on the excess or scarcity of *money*. How then does it come about that it is eventually determined by the excess or scarcity of *real capital*?" (Wicksell, 1936 [1898], 108; emphasis in the original). But, according to him, a careful analysis eventually would come to the conclusion that the level the market rate constantly gravitates towards (or oscillates around) is determined by the marginal productivity of capital and the saving behaviour of the public (or by productivity and thrift, to use Robertson's terminology). Because this unique equilibrium level of the market rate of interest is determined by "real" factors (productivity and thrift), it would be misleading to adhere to the first impression and consider the rate of interest a monetary phenomenon: The market rate of interest is determined by the natural rate of interest and therefore is best interpreted as a real, or non-monetary, phenomenon. Under given circumstances, the natural rate is uniquely determined because the economy is seen as constantly gravitating towards (or oscillating around) the full employment level of real income. In Wicksell's world, an increase in the inducement to invest would push the natural rate above the market rate and set off a process of price inflation, which can only be stopped by the adjustment of the market rate to the new higher level of the natural rate. *Mutatis mutandis*, this was the view held by Keynes in his *Treatise on Money*.

But what if the economy can settle at any level of employment, as Keynes argues in his General Theory? After the publication of the Treatise and his "discovery" of the propensity to consume, Keynes came to the conclusion that aggregate demand will determine the equilibrium level of employment and production and that this equilibrium can be reached at any level of employment (up to full employment) depending on the level of aggregate demand. Aggregate demand will depend, via the multiplier relation, on the level of investment, which in turn depends of the rate of interest. So, *cet. par.*, to any conceivable level of employment (up to full employment) there corresponds a distinct level of the rate of interest (and vice versa). In this case the notion of a unique natural rate, determined by "real" factors and governing the market rate of interest, loses all plausibility. As Keynes argued in 1932 (Keynes 1979, 54-57) the equilibrium the economy actually settles in depends on the “character of the policy of the monetary authority”. Full employment, the realm of “classical” economists, is only “*a special case*, i.e. with a long-period position corresponding ... to a *particular* assumed policy on the part of the monetary authority” (see as well Keynes 1936 [1973], 191). In the *General Theory* (1936 [1973], 242-4) he returns to this observation and emphasises that because, in contrast to his *Treatise on Money*, he now understands that the economy can be in equilibrium with less than full employment, he explicitly dismisses the notion of an uniquely determined natural rate of interest. Instead of using the term natural rate he proposes to speak of an unique “neutral” or “optimal” rate of interest, the rate of interest consistent with full employment.

The relationship between the marginal productivity / efficiency of capital and the market rate of interest then becomes inverted. Instead of the natural rate governing the market rate à la Wicksell, in Keynes’ world the market rate of interest governs the marginal efficiency of capital (with the latter oscillating around the former, as Keynes points out elsewhere in the General Theory). Because there no longer exists an “anchor”, determined by “real” factors, for the market rate of interest, the latter can no longer be considered a non-monetary phenomenon. Instead it can be seen as a monetary phenomenon that determines the marginal efficiency of capital. This inversion of the (causal) link between the rate of interest and the marginal efficiency of capital is, according to Hawtrey (1937, 230), the “principal thesis” of the General Theory.

In situations of less than full employment, and, as was pointed out in the above, Keynes only claimed to have to say something new and different from “classical” economics theory concerning such situations [10], *cet. par.* an increase in the inducement will indeed, *in the first instance*, raise the rate of interest because the increased income will raise the demand for money for transaction purposes, but this increase in the rate of interest, unlike in Wicksell’s world, can be counteracted by the monetary authority.

Unfortunately Hicks does not give any references for the alleged remarks by Keynes. And it is very difficult indeed to find any passage in the *General Theory*, in which Keynes, explicitly or implicitly, states that an increase of the inducement to invest will not raise the rate of interest. Quite on the contrary, in at least one passage, Keynes does acknowledge, even if only somewhat indirectly, that an increase in output and prices *cet. par.* will raise the rate of interest because it will “... increase the quantity of money necessary to maintain a given rate of interest Keynes” (Keynes 1936 [1973], 173).

The only passage that can be found is his statement that the classical view of the effect of an increase in the inducement to invest is “erroneous” in Chapter 14: “Certainly the ordinary man—banker, civil servant or politician—brought up on the traditional theory, and the trained economist also, has carried away with him the idea that ... each additional act of investment will

[10] As Keynes makes clear in a letter to Hicks, dated August 31, 1936: “It is perfectly true that a great part of my theory ceases to be required when the supply of output as a whole is inelastic“ (Keynes 1973c, 71).

necessarily raise the rate of interest, if it is not offset by a change in the readiness to save" (Keynes 1936 [1973], 177; emphasis added).

If this view is erroneous, the correct one would be that an additional act of investment will *not necessarily* raise the rate of interest, even if it is not offset by a change in the readiness to save. The clarifying answer Keynes gives to Hicks' concerning the monetary nature of the rate of interest is straightforward and consistent with this interpretation of his position (Keynes 1973d, 80, emphasis in the original): "... it is important to insist that my remark is to the effect that an increase in the inducement to invest *need* not raise the rate of interest. I should agree that, unless the monetary policy is appropriate, it is quite likely to." And it is here that Keynes locates the benchmark question as to the monetary or non-monetary nature of the rate of interest: "In this respect I consider that the difference between myself and the classicals lies in the fact that they regard the rate of interest as a non-monetary phenomenon, so that an increase in the inducement to invest would raise the rate of interest irrespective of monetary policy".[11]

If, in contrast to Hicks' benchmark question, Keynes' benchmark question is the appropriate criterion then it can be shown in Hicks' own diagram that a after a rightward shift of the IS curve the rate of interest can be kept constant by a rightward shift of the LL curve, representing the appropriate monetary policy, as long as the economy stays below full employment (see Figure 1). And as no recourse is needed to the horizontal part of the LL curve to validate Keynes' view concerning the monetary nature of the rate of interest there is no need to single out a situation of economic depression, turning Keynes' theory into the economics of a special case, as "the most important thing". Most significantly, Hicks' contention that Keynes' analysis offered nothing new and central parts of it were invalid, reducing Keynes' critique to a sham fight, becomes untenable.

7 The reason(s) for Keynes' reaction to Hicks' 1937 paper

As has become evident in the above, both the second and third of critical argument by Hicks have been at odds with *explicit* statements of Keynes, either in his correspondence with Hicks or already in the *General Theory*. Keynes' position with regards to the monetary nature of the rate of interest did not deny the possibility or probability that an increase in the inducement to invest would raise the rate of interest. Instead his position was that in situations of less than full employment such an *initial* effect could be counteracted by monetary policy, in contrast to the "classical" world of long-period full employment equilibrium, in which the *initial* effect would be the *persistent* effect as well. And regarding the question of generality of the General Theory, Hicks just used a different criterion without mentioning this difference or discussing the comparative merits of both criteria. It is extremely striking that unemployment as an equilibrium phenomenon, the central problem discussed in the General Theory, does not play almost no role in Hicks' discussion. If unemployment is mentioned at all, it is in the context of (more or less

[11] Barens (2003,10) characterised Keynes' answer as "quite lame"; in the light of the above this verdict has to reconsidered.

severe) cyclical downturns, as witnessed by Hicks' insistence that General Theory should best be understood as an economic theory for slumps and depressions.

Keynes may have felt to be in a similar situation as in 1932, when Hayek published his review of the *Treatise on Money* and his reaction was that "...Hayek has not read my book with that measure of 'good will' which an author is entitled to expect of a reader. Until he can do so, he will not see what I mean or know whether I am right" (Keynes 1973e, 243), which is echoed in a 1934 draft for the draft of the future General Theory: "an economic writer requires from his reader much good will and intelligence and a large measure of co-operation; ... there are a thousand futile, yet verbally legitimate, objections which an objector can raise... you cannot convince him, ... if his head is already so filled with contrary notions that he cannot catch the clues to your thought..." (Keynes 1973a, 470). It would not be too surprising if in 1937 Keynes would have felt thrown back five years in time. And maybe his experience with Hicks' 1937 paper was one important influence on his negative view of Hicks after reading Hicks' *Value and Capital* in 1939: "I don't think I ever read a book by an obviously clever man, so free from points open to specific criticism, which was so utterly empty I did not, at the end, feel a penny the wiser about anything. He seemed able to decant the most interesting subjects of all their contents, and to produce something so thin and innocuous as to be almost meaningless. Yet, in many ways, it is well written and clear, clever and intelligent, and without mistakes. But about nothing whatever. Simple things are made to appear very difficult and complicated, and the emptiest platitudes paraded as generalisations of vast import" (quoted from Moggridge 1992, 553).

Be that as it may, Hicks' 1937 contribution certainly was the first episode in a series of misreadings, misrepresentations and misinterpretations that soon induced Keynes, in an open letter in the August 1939 issue of the *Quarterly Journal of Economics*, to suggest "... an occasional re-reading of what I did say!" (Keynes 1973b, 277).[12] In this open letter he expresses his puzzlement of how to act in such situations and gives a description of a potential reaction that seems to perfectly fit his experience with Hicks: "It may be worth while to defend what one has said, if one still sticks to it. But a controversy arising out of somebody attributing to one what one has not said and does not hold can scarcely be fruitful" (Keynes 1973b, 276).

If Keynes considered starting a controversy with Hicks as "scarcely fruitful" this would explain the tepidness of his reaction together with the impression that he lacked interest in the matter, as Skidelsky (1992, 615) has surmised. But such an impression would be utterly misleading. Contrary to Skidelsky's contention, the arguments Keynes raised against Hicks' interpretation were not just "quibbles" but aimed straight at the centre of his ill-conceived attempt to cut Keynes down to size.[13]

[12] These problems sometimes seem to have been of quiet a magnitude: "...it was going a little far, I felt, when one of the writers in a Harvard journal, who had attributed to me an opinion the opposite of the one I had expressed, excused himself by saying that the relevant page in my book was so covered by his own annotations that my own words had become illegible!" (Keynes 1973b, 277).

[13] Besides the two counter-arguments mentioned in this paper Keynes raised a third one that will not be discussed in this version of the present paper. He denied the suitability of Hicks' model of classical economics as the basis of comparing the "classicals" with his own theory, seeing it as an "inconsistent hotch-potch" (Keynes 1973d, 79; see as well Barens 1999).

Even if Keynes was deeply dissatisfied with the ill-conceived basis of Hicks' critical onslaught,[14] his dissatisfaction should not be understood as extending to the General Theory model used by Hicks. This model was just a slight but far-reaching modification of the simplified model presented at the same October 1936 conference of the *Econometric Society* by Meade and later published in the *Review of Economic Studies*. According to Young (1987), Hicks only started to work on the model to presented at the conference after having received a copy of Meade's conference paper. Both Hicks' and Meade's model are developed from the same basic equations (compare Hicks 1937, 148 and Meade 1937, 99 and 105; Young 1987). Besides the fact that Meade introduced some additional variables needed for the specific purpose of his own analysis, the obvious difference lies in the way he conceived the three market equilibrium conditions (Meade 1937, 105), which did not allow to represent them with two curves in interest rate / income space as the model that Hicks used (see Barens 2003 for a comparison of Hicks' and Meade's models).

The fact that both models are extremely similar may supply (together with the fact that Keynes' counter-arguments were concerned not with the General Theory model but with its use by Hicks) the decisive clue to answer the question of whether Keynes rejected the General Theory model presented in the 1937 paper of Hicks. It can be pointed out that he accepted this model, even if only indirectly, by praising Meade's model. On 14 September 1936 Keynes sent Meade a postcard with this assessment of Meade's paper: "It's excellent. I have no criticisms to suggest"; According to Meade, Keynes later wrote him that his paper was "a true representation of the *General Theory*". (Howson (2017, 731; Young 1987, 34 and 37).

8 Conclusion

Every aspect of Hicks' three-pronged assault on Keynes' new theory was deeply flawed. His third line of critique, arguing Keynes had been unable to show the monetary nature of interest, proved to be invalid because it rejected a position Keynes had not subscribed to. His second line of critique, arguing that the General Theory was not general at all, was, at best, confused or, at worst, misguided or even inconsistent, being based on a notion of generality different from the one used by Keynes. His first line of critique, denying any substantial novelty of Keynes' analysis, was simply irrelevant, because it completely disregarded what Keynes' saw as his central innovation, the possibility of long-period involuntary unemployment, instead arguing from a business cycle perspective emphasising deep economic downturns.

Against this background it can be argued that Keynes' comparatively tepid reaction to Hicks was not due to his rejection of the General Theory model used by Hicks (a model which he indirectly accepted by praising Meade's model) or the extremely critical nature of Hicks' assessment *as such*, but because Hicks attributed to Keynes what he had not said and disregarded what he

[14] Apparently it was this ill-conceived basis of Hicks' contribution that had irked Keynes, because he praised Harrod's 1937 paper quite enthusiastically (see JMK CW XIV, 84) even though Harrod expressed the view that – from a higher standpoint – the General Theory did not offer anything radically new. Harrod (1937) argued that Keynes' new analysis might be considered as a "specialised branch" or "special theory" in contrast to the "general theory of value", not

had said. Hicks ill-conceived discussion of Keynes' General theory certainly had to be seen as a "scarcely fruitful controversy".

Or to put it differently: Keynes' reaction may have been what it was because he may have recognised Hicks' critical assault for what it was – a sham fight.

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