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Book Review

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Money, Investment and Consumption: Keynes's Macroeconomics Rethought

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O.F. Hamouda
Cheltenham, Edward Elgar, 2009, 260 pp., £65.00 hardcover
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This book contributes to the ever-growing literature reappraising the economics of Keynes, as distinct from the Keynesians (Old, New and Cambridge). Its stated purpose is to 'address the myth' created by the initial reviewers, notably Hayek and Hicks, of both Keynes's *A Treatise on Money* (Keynes, 1930, hereafter 'the *Treatise*') and *The General Theory* (Keynes, 1936, hereafter 'the *GT*'), by the usual method of a close reading of the original texts. Understood as an attempt to grapple seriously with Keynes's genuine thought, this is a worthwhile foray in the search for a solid platform for a new macroeconomics.

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Hamouda offers some valuable insights that other Keynes scholars may find helpful. These include a recognition of the centrality of the entrepreneur as the primary actor in Keynes's system, which is what Hamouda means when he states that Keynes was a supply theorist and his economy is production-driven, not demand-driven. Most valuable is the recognition of the complex time structure of production in Keynes's thought, reflected partly in the division of capital assets into the various classes of fixed, working and liquid capital, as well as the further division into finished and unfinished goods. Hamouda draws out how subtle and important were those concerns, not only of Keynes but also of Hayek, Hicks and their contemporaries, which modern macroeconomics has chosen simply to ignore by writing *K* for capital, *Y* for output, and having done with it. As part of this analysis, Hamouda draws attention to the *Treatise* distinction (absent from the *GT*) between productive and unproductive consumption. Also of value is the discussion in Chapter 2 of the genealogy of Keynes's approach to the Quantity Theory and the need to recognise that Keynes addressed fully and did not ignore this tradition in both his main works. The distinction between the concerns of Keynes and Wicksell is clearly brought out in Chapter 6. Furthermore, Hamouda notes that the 'technical monetary detail' absent from the *GT* can be found in the *Treatise*.

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Hamouda's primary thesis, set out in Chapter 5, is of theoretical continuity between the *Treatise* and the *GT* to the extent that the former 'was the backbone of the latter and the theory from which [Keynes's] generalized General Theory derived'. In a novel twist from the usual claim, the *GT* is held to be a special case of the *Treatise* (rather than of neoclassical theory) with a narrower focus, on one phase of the credit/trade cycle and on employment. The Fundamental

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Equations of the *Treatise*, the second equation FE(II) in particular, are said to be present and essential to both works and the basic theoretical structure is the same. These are strong claims, which do not bear scrutiny.

No reference is made to Amadeo's (1989) detailed study on the transition between the *Treatise* and the *GT*, which reached quite the opposite conclusion. Where does FE(II) appear in the *GT*? In a footnote (p. 178), Hamouda connects it with Keynes's equation for the ordinary supply curve (*GT*, p. 44). *GT* Chapter 21 ('The Theory of Prices') is mentioned as 'the distillate' of the discussion of the various types of inflation in the *Treatise*. Neither the ordinary supply curve nor the 'income inflation' elasticities derived in *GT* Chapter 21 bear any relation to the imbalance between savings and investment (on the *Treatise* definition) which creates the windfall profits that are the dynamic motor of the *Treatise*. The windfall profits of the *GT* are quite different, arising from changes in the state of expectation and not affecting 'the actions of entrepreneurs but merely [directing] a *de facto* windfall of wealth into the laps of the lucky ones' (*GT*, p. 288). Hamouda neglects the change between the *Treatise* and the *GT* in the concept and use of equilibrium. The *Treatise* considers departures from Marshallian long-period equilibrium and disequilibrium dynamics. The *GT* presents a static analysis based on a new concept of short-period equilibrium, the principle of effective demand, which is not to be found in the *Treatise*. In the *Treatise*, the 'windfall term' in FE(II) is zero in equilibrium but in Hamouda's restatement of FE(II) for the *GT* (on p. 131) the windfall term is positive in equilibrium at the point of effective demand. Whereas in the *Treatise* a non-zero windfall term indicates disequilibrium and its direction, the restated identity has no explanatory power.

In another example of his continuity thesis, Hamouda seeks to connect *GT* Chapter 22 ('Notes on the Trade Cycle') with the credit cycle of the *Treatise*. In his Chapter 4, Hamouda has carefully traced the dynamics of both Hayek's and Keynes's models of production and this work sheds light on the *GT* passages relating to the disequilibrium dynamics around Keynes's expectation-contingent long-period equilibrium. Yet he does not address Keynes's statement (*GT*, pp. 49–50) that 'It was movements of this kind which I discussed in my *Treatise on Money* in connection with the building up or the depletion of stocks of working and liquid capital consequent on change' as distinct from the shifts in the determinants of the equilibrium position itself. Furthermore in *GT* Chapter 22, we read 'The Trade Cycle is best regarded, I think, as being occasioned by a cyclical change in the marginal efficiency of capital, *though complicated and often aggravated by associated changes in the other significant short-period variables of the economic system*' and '*some part* of the discussion in my *Treatise on Money* bears on the above' (*GT*, pp. 313, 319n, emphasis added). While undoubtedly there are common elements, Hamouda has missed the change in method between the *Treatise* and the *GT*.

A secondary, equally strong, claim is that Keynes's 'actual model, ensuing from a fusion of *A Treatise* and *The General Theory*' can be depicted by Hamouda's Efficiency of Capital – Supply Price (EC-SP) model. The model clearly identifies expectation as the driving force, which translates into outcomes (cf. the title of *GT* Chapter 5: 'Expectation as Determining Output and Employment').

It also highlights the direction of causation obscured by Hicks's IS-LM. The core of the model is a complicated diagram that shows the prospective yield and supply price of investment at the margin in a standard demand-supply diagram. (See Hamouda's Figure 5.6; this is one of several dense diagrams, many of which are marred by poor typesetting.) The intersection of the two curves identifies the equilibrium level of investment; and various intra-marginal sections marked off by the intersecting curves show the distribution of income. The diagram also captures Keynes's idea of the euthanasia of the rentier, since the profit share reduces as the rate of investment increases.

Yet Hamouda's diagram does not accurately reflect Keynes's definition of the marginal efficiency of capital as 'the rate of return over cost' (*GT*, p. 140). There is a dimensional problem with the diagram, since the prospective yield is a flow through time over the life of an asset and the supply price is the asset's current replacement cost; the problem is not overcome by including the interest cost in the supply price. Keynes's diagram, had he drawn one, would have shown either rates of return or discounted present values on the vertical axis. Hamouda's diagram measures the vertical axis in terms of factor payments, but for which period? If intended to show the distribution of aggregate income at a point in time, the diagram fails. One can see what Hamouda is driving at, and such a simplification, with the necessary caveats, may have its uses. However, for better or for worse, I cannot see EC-SP displacing IS-LM.

In dispelling old myths it is important not to create a new one, i.e. the idea that the *Treatise* and the *GT* are really a single opus. Yet Hamouda has put up a serious argument and although I have tried to knock it down, the argument deserves respect. He has grappled with some difficult topics and displays a deep intuitive grasp of the key features of Keynes's thought. Far better to put one's effort into engaging with the mind of the most brilliant economist of the 20th century, with whatever degree of success, than into the largely useless modelling of modern macroeconomics.

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