Contributions to Modern Economics

Joan Robinson

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PREFACE

These papers are drawn from the work of fifty years. They include contributions to two great intellectual upheavals in economic theory – the Keynesian Revolution and the revival of the classical theory of profits led by Piero Sraffa – as well as some discussions of the formation of prices in capitalist and socialist economies and of international trade.

'Reminiscences', which serves as an introduction, relates the evolution of these ideas to the personal and historical events that influenced them.

The pieces selected are those which have been found most useful for students, but some, especially 'The new mercantilism' and 'What has become of employment policy?', may be of wider interest.

I am grateful to John Eatwell of Trinity College, Cambridge, for encouragement and help in producing this volume, and to Murray Milgate for reading the proofs.

Cambridge 1978 Joan Robinson

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REMINISCENCES

1

Marshall and Pigou

When I came up to Cambridge (in October 1921) to read economics, I did not have much idea of what it was about. I had some vague hope that it would help me to understand poverty and how it could be cured. And I hoped that it would offer more scope for rational argument than history (my school subject) as it was taught in those days.

I was somewhat disappointed on both counts. Alfred Marshall was the all-dominating influence on the Cambridge faculty; the last item in this volume (24) indicates how I took to him. I felt smothered by the moralizing and mystified by the theory; in particular, no one seemed to know what was meant by the 'representative firm'.

When I returned to Cambridge in 1929, they were still arguing about the representative firm (*Economic Journal*, March 1930) but meanwhile Piero Sraffa had turned up, rescued by Keynes from Mussolini. He was calmly committing the sacrilege of pointing out inconsistencies in Marshall, and, moreover, introducing us to other contemporary schools of thought (but they were no better).

My first book, *Economics of Imperfect Competition*, though inspired by a hint from Sraffa, was mainly influenced by Professor Pigou. Pigou seemed to have reduced Marshall's *Principles* to a logical and consistent scheme but there was an obvious defect in it. The whole argument turns on 'price equals marginal cost'. This entails that the sales of an industrial firm are limited by the capacity of its equipment. Short-period profit per unit of output is equal to marginal cost minus average prime cost. Plants that are yielding any gross profit at all are working up to capacity (with rising marginal costs) and the rest are shut down and kept in moth balls.

This was evidently absurd, particularly in the slump when most plants were working part time. With the aid of Richard Kahn, who had been studying actual pricing policy in the British cotton industry, I used the newly invented concept of 'marginal revenue' to show how short-period profits are positive even at under-capacity working.

With this apparatus, we produced a complete restatement of the Pigovian system with various amendments, in particular, the demonstration that, in Pigou's own terms, it is not true that wages are equal to the value of the marginal product of labour.

A few months before *Imperfect Competition* was published, Edward Chamberlin's *Monopolistic Competition* appeared. He was upset by the coincidence and all the rest of his work was devoted to showing that my theory was quite different from his. During his reign at Harvard, it used to be said that you could always get a good degree by abusing Mrs. Robinson.

I recognized that several of the questions that he raised, such as deliberate product differentiation as a means of competition, were more interesting than mine but obviously there was a very large overlap between the two books. I suppose that Chamberlin was annoyed at having to share all his footnotes and reviews with me, and he resented Nicky Kaldor's comment that he went in for unnecessary product differentiation, but there was a deeper reason.

I had been very well pleased to refute the orthodox theory of wages, which had stuck in my gizzard as a student, while Chamberlin refused to admit that his argument damaged the image of the market producing the optimum allocation of given resources between alternative uses. This ideological difference underlay an otherwise unnecessary controversy.

I soon abandoned the field; when I came under the influence of the incipient Keynesian revolution, I realized that my Pigovian book was leading up a blind alley.

First of all, it was all conceived *a priori*; some scraps of observation were introduced into the assumptions here and there but, in general, it was all a deduction from Marshallian assumptions as interpreted by Pigou. Keynes, by contrast, was concerned with an actual phenomenon – unemployment – and was trying to find out a theory to account for it.

Secondly, the whole problem of time was fudged. There is no clear distinction in the book between short and long-period relationships or between the future and the past, though I avoided the horrible neoclassical methodology of drawing a plane diagram showing a timeless relation between two variables and then moving about on it. (This point is raised in the 'Lecture delivered at Oxford' (13) below.) Keynes had instinctively recognized the nature of historical time in which today is an ever-moving break between the irrevocable past and the unknown future, though he did not express the point clearly till after the *General Theory* was published.[1]

[1] See 'The general theory of employment', 1937, *JMK*, Vol. XIV.

My own impressions of my book after thirty years are included in this volume – *'Imperfect Competition' Revisited* (14).

After passing through another intellectual revolution, I took a more kindly view of Marshall. Though he fudged the problem of time, he was aware of it, and he took pains to avoid the spurious neoclassical methodology. It was Pigou who had flattened him out into stationary equilibrium. When I republished the 'Lecture' and some other pieces (in *CEP*, Vol. IV) I wrote:

> These essays were written in a hilarious mood after reading Piero Sraffa's *Introduction* to Ricardo's *Principles*, which caused me to see that the concept of the rate of profit on capital is essentially the same in Ricardo, Marx, Marshall and Keynes; while the essential difference between these, on the one side, and Walras, Pigou and the latter-day textbooks on the other, is that the Ricardians are describing an historical process of accumulation in a changing world, while the Walrasians dwell in timeless equilibrium where there is no distinction between the future and the past.

2

Effective Demand

In the summer of 1930 Keynes was lecturing from the proof sheets of his *Treatise on Money* and the book was published in October. Meanwhile Kahn had produced the first draft of what became his famous article on the multiplier.[2] In the term beginning in April 1931, we got up a circus, as we called it, to discuss the *Treatise*, and from then till the completion of the *General Theory of Employment, Interest and Money* in the winter of 1935, and beyond, I was involved, along with Kahn, in a continuous series of discussions, writings, lectures and correspondence around the development of Keynes' ideas.

It is difficult to convey an impression of Keynes to someone who did not know him. In the world, he was considered arrogant and harsh; this was because he loved to put a pin into any pompous balloon that he encountered. With us in Cambridge he was far from harsh. He had exacting standards but withal he was warm-hearted and generous. He was conscious of being far more intelligent than nearly everyone whom he met, but that was just a fact; he had no need to puff himself up. He had a sense of absolute values; he was willing to argue with anyone on the merits of the case in

[2] 'The relation of home investment to unemployment', *Economic Journal*, June 1931. Reprinted in *Selected Essays on Employment and Growth*, Cambridge University Press, 1972.

hand; he could be ferociously obstinate but it never occurred to him to use his authority and eminence to crush a younger disputant and he was ready to take an interest in fresh ideas wherever they came from.

He was great fun; even a boring committee meeting could be amusing when he was present. At a party, he did not lapse into talking college shop as so many academics do, but entertained the company by enlarging on some striking thesis, such as that the continent of North America cannot support human life.

His mind worked many times faster than anyone else's so that, however much work he was doing, there was always plenty of time in his day. Above all, he was blessedly free from the vice of wanting to have been right. He quickly absorbed the criticisms of the *Treatise* (conveyed to him by Kahn) that were raised at the circus; immediately, his mind began to race towards new formulations.

In those days seminars were unknown. Our circus, first proposed by Piero Sraffa, was organized as an unofficial venture. The main speakers were Kahn, James Meade, who was spending a year in Cambridge in order to transplant economics to Oxford, Sraffa (who was secretly sceptical of the new ideas), Austin Robinson and myself. Only students who were considered up to it were allowed to come.[3]

To understand the argument at the circus, it is necessary to recapture the central position of the *Treatise*. When he was writing it, Keynes believed that 'monetary theory' was only about prices. On the plane of policy, he had supported Lloyd George's scheme to conquer unemployment by expenditure on public works, but in the high abstraction of the *Treatise*, employment was hardly mentioned.

The argument postulates a position of equilibrium at a moment of time when saving is equal to investment and the level of profits is normal. Then an increase in investment causes prices to rise and so profits to increase. Owing to peculiar definitions, this is called an excess of investment over saving. This excess is not reduced by expenditure on consumption, for if part of profits are spent, prices rise all the more; profits are a widow's cruse that cannot be exhausted. On the other tack, if entrepreneurs reduce consumption in order to save more, 'the cruse becomes a Danaid jar which can never be filled up'.[4]

One of the main topics at the circus was the relation between demand and output. Austin Robinson immediately spotted the fallacy in the widow's cruse at a time of unemployment. If businessmen increase

[3] See *JMK*, Vol. XIII, Chapter 5.

[4] Quoted, loc. cit., p. 339.

consumption when profits rise, there will be an increase in the output of goods and services, with not necessarily any rise in prices at all.

This was the first step from the theory of money to the analysis of output which is described in my article of 1933 (2), included in this volume.

A second topic was the amendment of the *Treatise* definitions. Kahn's article was expressed in the language of the *Treatise*, but he now discovered that the saving over any period is necessarily equal to investment in that period. This was described as Mr. Meade's relation, because James had assisted in the discovery.

There was some confusion at this time between an accounting identity that must be true by definition and a causal relationship. The important point was the causal relationship, that is, the manner (shown in the multiplier) in which a given increase in investment leads income to go on rising until it reaches the level where saving is increased by an equal amount. At the same time, what was most shocking to Marshallian orthodoxy, a reduction of expenditure on consumption (with investment unchanged) will not increase saving but only reduce income.

Kahn reinforced the point (unwittingly following the Marxian schema of expanded reproduction) by imagining cordons drawn round the investment and the consumption-good industries and studying the trade between them. The excess of the income of the consumption sector over its own consumption – that is, its savings – is equal to the expenditure on consumption of the investment sector. Thus the sum of the savings of the consumption sector and of the investment sector is equal to the value of investment.

Another point which we took up was the notion of normal profits. If, as Kahn argued, there is a supply curve of output as a whole (given money wage rates) in a short-period situation with fixed total productive capacity, then, corresponding to any given state of demand, there is a particular amount of employment, level of prices and flow of gross profits. There is no one level of profits that is more 'normal' than any other.

It is interesting that Gunnar Myrdal, in *Monetary Equilibrium*, found almost the same way of reconciling Wicksell's theory with the experience of unemployment.

There was one more topic, though I do not remember if it came up at the circus or later – that was the 'buckets-in-a-well' fallacy. Dennis Robertson tried to maintain that whenever there was an increase in saving, more money would be passed to the Stock Exchange and used to finance a corresponding increase in investment. This view arises from the all-too-prevalent confusion between a flow of income and a stock of wealth. A reduction of expenditure on consumption does not increase the total flow of saving if the flow of investment remains the same, but causes income to run down until the new flow of saving is equal to the old flow of investment. At the same time, when net investment is going on, the total of wealth is growing and part of the corresponding savings are made by individual owners of wealth, who may hold them in the first instance as an addition to their money balances and later use them to reduce debt or purchase other assets. The demands for money and other assets relatively to the stocks in existence at a moment of time affect the level of interest rates and the value of shares (common stock), which have only a secondary and indirect influence on the flow of investment.

It is worthwhile to repeat these old arguments, for modern teaching has been confused by J. R. Hicks' attempt to reduce the General Theory to a version of static equilibrium with the formula IS/LM. Hicks has now repented[5] and changed his name from J. R. to John, but it will take a long time for the effects of his teaching to wear off.

Dennis Robertson was sarcastic about the circus, and came to only one meeting. He had an ambivalent attitude to Keynes, who had been a close friend. He admired Maynard's intellectual daring and yet was frightened by it. He clung on to old doctrines, such as that a cut in wages must necessarily increase employment, and he kept up a running fire of criticisms, some of which were useful, though on peripheral points.

As the argument went on, he became embittered. He tried to prevent me from expounding the new theory in my lectures (but Pigou ruled in favour of free speech). Lord Robbins[6] and others have drawn a pathetic picture of Dennis, but it was Keynes who was grieved by his hostility. After Keynes' death, when Robertson had returned to Cambridge as Pigou's successor, he created a lasting schism in the faculty by trying to re-schedule the syllabus so that Keynes' theory could not be taught (if at all) before the final year.

In the days following the meetings of the circus, there was a clear distinction between those who had seen the point and those who had not. Austin Robinson said that we went about asking: Brother, are you saved? George Shackle has given a touching account of his conversion.[7]

All this time, controversy over public-works policy was raging between Keynes (who was supported by Pigou although from a quite different theoretical position) and Professor Hayek, at the London School of

[5] Cf. Joan Robinson, 'What are the questions', *Journal of Economic Literature*, December 1977, reprinted in *CEP*, Vol. V.

[6] See *The Autobiography of an Economist*, Macmillan, 1971, p. 222.

[7] See *The Nature of Economic Thought*, p. 53.