11 The ‘Elusive figure who hides in the Preface of Cambridge books’

An appraisal of Richard Kahn’s contributions

Maria Cristina Marcuzzo

1 Prologue

A complete monographic study on the life and work of Richard Kahn has yet to be produced, although we have a great many texts on specific aspects or the general framework of his thought. This paper, too, is limited in scope; it serves simply to reconstruct the context of Kahn’s work. What I mean by reconstructing the context is to bring light to bear on the network of professional and personal relations within which the thought of an author developed, and to bring into focus the problems and questions for which the authors sought solutions and answers. I have made use of all those fragments of evidence, drawing also on unpublished material and the correspondence, which could help place these texts by Kahn not in the context of our present studies so much as in their specific context. This is in no way to detract from their importance to contemporary economic theory and policy, but rather to appreciate the significance they held at the time they were written, without attributing them with the relevant language and criteria of contemporary economic theory.

The paper is organized in five parts according to the issues addressed. In general the texts in each part are presented in the chronological order in which they were written, the idea being to help the reader not only to follow the developments in Kahn’s thought over time, but also to appreciate the extraordinary consistency of his approach as a whole.

2 The theory of competition: market imperfections and entrepreneurial behaviour

Kahn’s role in developing the theory of imperfect competition, with its implications for the theory of oligopoly, does not seem to have received all due recognition. The suggestion made by Sraffa in the article of 1926, ‘to abandon the path of free competition and turn in the opposite direction, namely towards monopoly’ as a way out of the Marshallian inconsistencies (Sraffa, 1926, 542), was in fact initially taken up by the then twenty-three-year-old Kahn, who placed it at the centre of his early research activity. In the academic year 1928–9, Kahn had followed the lectures by Sraffa (‘Advanced theory of value’, PS D2/4), in
which the issue of market imperfection was addressed along much the same lines as in the 1926 essay. In the same year Kahn followed the course given by G. F. Shove - 'Economic theory' - a considerable part of which was dedicated to market imperfections.

It is therefore hardly surprising that the Preface to the Fellowship thesis which Kahn wrote between October 1928 and December 1929 included ample acknowledgement to these two economists. Nor, indeed, is it surprising that, due in part to the fact that it remained unpublished for nearly fifty years and in part to its title, The Economics of the Short Period, which made no explicit reference to market imperfection, the Dissertation failed to reveal the full importance of Kahn's contribution to the birth of the theory of imperfect competition.

In the well-established textbook tradition, Joan Robinson and Edwin Chamberlin were generally attributed with having launched that particular line of analysis. Moreover, despite her close collaboration with Kahn in drafting the Economics of Imperfect Competition, Joan Robinson read Kahn's Dissertation only in January 1933 (see JVR to RFK, 24 January 1933, RFK 13/90/1/75), or in other words when his book was still at the draft stage. Furthermore, Kahn had been corresponding with Chamberlin, having submitted to him the part of the Dissertation on duopoly, since 1930. Discussion with Kahn was taken up again in the days when the Theory of Monopolistic Competition was about to be published, in February 1933, when Kahn was visiting Harvard.

The main interest of the Dissertation lies in the explanation of why, in a depression, all the firms in a given industry work part of the time - closing plant down for some days and working at full steam on others - and not, as would be expected with perfect competition, some of the firms (the least efficient) having to close plant down while the others (the most efficient) going on working at full capacity. The core of Kahn's explanation lies in analysis of the quasi-fixed costs and prime costs (the difference, that is, between total costs and quasi-fixed costs), which are the costs that matter in the short period. If the firms work full out for a limited number of days (closing plant on the other days), as was the case with the British cotton industry in the depression of the 1920s, it must mean that this is the most advantageous way to maximize profits or minimize losses. And this, in turn, implies that the average prime cost follows a particular trend, constant up to the point corresponding to full productive capacity, at which it becomes infinite. However, if we retain the hypothesis of perfect competition - that is the hypothesis of a perfectly elastic demand curve for the firm, and that of the inverted L shape of the short-period average (and marginal) prime cost curve, then the price and the quantity produced by the single firm are determined corresponding to the level of full utilization of the plant. On the other hand, if we bring in the hypothesis of imperfect competition - that is to say, that each firm is faced with its own particular market, implying a negatively sloping individual demand curve - then the equilibrium production level can come below that of full plant utilization.

In what respects, however, does the Dissertation represent an innovative contribution?

In the Principles Marshall had addressed the problem of the determination of monopoly equilibrium (Marshall, 1961, 704), that is the point of maximum difference in price between demand and supply curves multiplied by the level of production. Marshall's solution was no different from the solution deriving from equality of marginal cost and marginal proceeds but had not been formulated in those terms, and the definition of marginal proceeds was only hit upon between the late 1920s and early 1930s, independently by various authors. Moreover, Marshall had not ventured very far into the effects of the behaviour of rival firms on a firm's demand elasticity, nor indeed into the effects of one firm's price policy on the behaviour of the rival firms. Despite the works by Cournot and Edgeworth on duopoly, at the time the Dissertation was being written a decisive solution to the problem had yet to be arrived at and integrated into general analysis of imperfect competition.

Nor, in fact, does the Dissertation offer a definition of marginal proceeds, but there are two aspects of particular interest marking it out from the previous literature on oligopolistic markets. The first is Kahn's invention of a way to measure the degree of market imperfection assuming linearity in the demand and average unit cost curves, through the 'annihilation coefficient', which is analytically identical with that measurement that was subsequently to become known as the 'degree of monopoly'.

The second interesting aspect is the approach taken to the effects on the firms' demand curves when one of the firms changes a price. A whole section is dedicated to this issue, and here Kahn also criticizes the conclusion Sraffa had arrived at in his 1926 article, to the effect that in an imperfect market - one, that is, where there are many firms each with its own individual market, and thus a negatively sloping demand curve for its product - the final equilibrium price is the price that would be arrived at if the market were entirely controlled by one single monopolist. Kahn argues his point on the basis of the idea that the slope of the individual demand curves reflects the conjectures that each firm makes on the behaviour of the others. Kahn demonstrates that, whatever the hypothesis on the conjectures, the relation between the individual and market demand curves is such as to produce equilibrium at the monopoly price, but at a lower price, and consequently with a greater quantity than would have been chosen by a monopolist in the same technical conditions (Kahn, 1989, 117).

I have discussed the Dissertation at some length because this work defines with all due clarity the two fundamental questions that arise once the hypothesis of perfect competition is abandoned: (1) If the firms are no longer subject to the perfect competition price but decide it themselves, how will they take into account the behaviour (the reactions) of the other firms? (2) Is pursuit of maximum profit, here too, the best way to describe the firm's behaviour?

Three papers by Kahn, 'Imperfect competition and the marginal principle' (Kahn 1932), 'The problem of duopoly' (Kahn 1937) and 'Oxford studies in the
price mechanism’ (Kahn, 1952a), represent successive stages in the evolution of Kahn’s thought and the contemporary literature that developed on the subject, but what they have in common is the same approach in answering these two questions.

With regard to the first article, as yet unpublished, we know that Kahn took it with him on his travels in the United States, which began in December 1932 and ended in April 1933. On the evidence of a particular detail, we can date the completion of this draft to a few weeks before his departure, but it is not so easy to determine when it was started. This article was evidently fruit of the work generated by discussions at ‘The Trumpton Street School’, as it was, with tongue in cheek, called after the name of street where Joan and Austin Robinson - back from India at the end of 1928 – set up house in Cambridge, Kahn being a frequent visitor there. The discussions were clearly prompted by Sraffa’s critique of Marshallian theory, while also having to do with the implications of Keynes’s Treatise on Money, which was the subject of the meetings held by the ‘Circus’, as we will see later on.

Kahn set sail for the United States on the Majestic in December 1932 taking along with him this article, which must have summed up part of the discussions. Over the last two years Kahn had been hard at work together with Joan Robinson on various problems that had arisen while drafting the Economics of Imperfect Competition. The major analytic finding offered by this text – ‘the dual condition’ of equilibrium given by the point of tangency between the average revenue and average cost curve and the point where the marginal revenue curve meets the marginal cost – had already been presented in an article (Robinson, 1932), published in the Economic Journal in 1932 and subsequently incorporated in the book, which was to be known as ‘Kahn’s theorem’.

Kahn presented his article in various conferences in the United States and gave it to Taussig for publication in the Quarterly Journal of Economics. However, the article was not accepted. It emerges from Kahn’s correspondence – which offers among other things a particularly interesting account of the situation in the country and aspects of American academic life – that Kahn reacted with characteristic modesty, and made no further attempts to have it published.

Some years later, however, he decided to publish an article, ‘The theory of duopoly’, which was eventually to become a classic on the subject, earning an accolade from Keynes: ‘I thought the article a beautiful piece of work’ (JMK to RFK 1 January 1935, in RFK 13/57/122). In this essay, unlike the Dissertation, no use is made of any mathematical tool, and the whole complicated discussion on the effects of the actions of a single monopolist on the behaviour of another, and thus the role of the strategies implicit in every move of each firm, is embarked upon with no such support – an aspect that marks it out from the bulk of the literature, and most decidedly from the more recent production.

As we know, Kahn was among the inventors of the ‘kinked demand curve’, and in general introduced ‘conjectures’ into demand curves, in the form of elasticity values, for analysis of price and quantity produced in a duopoly or, more broadly speaking, oligopolistic markets. What in particular characterizes Kahn’s approach to the theory of price formation in non-perfect markets is retention of the hypothesis of profit maximization as the one certain rule upon which to base analysis. In contrast with the traditional marginalist analysis, Kahn unfailingly – as from his very first unpublished paper – interpreted the hypothesis of pursuit of maximum profit by firms as tantamount to a ‘trial and error’ method rather than as manifestation of an optimizing rationality, not to speak of resort to marginal calculation on the part of the entrepreneurs. But, again marking himself out, also from approaches alternative to those based on marginal analysis, Kahn never accepted explanations of the price formation mechanism of the descriptive type or based on a hypothesis of non-rational behaviour (see Marcuzzo and Sanfilippo, 2007). These are all factors that must be borne in mind if we are to understand the keenly critical position taken by Kahn with regard to the price formation theories based on ‘what the entrepreneurs say they do’, harking back to the 1939 article by Hall and Hitch (1939).

From the theoretical point of view, the leading advocate for abandonment of the theory of perfect competition and of the hypothesis of profit maximization in favour of price formation theory based on (fairly steady) mark-up on (fairly steady) prime costs was Michal Kalecki, who formulated his theory subsequent to study of the prices, proceeds and costs of a number of British industries. And it was Joan Robinson who, impressed by his qualities from their very first meeting in the summer of 1936, took it upon herself, as she put it, ‘playing the trumpet for him’ (Robinson, 1979a, 186). Kalecki then moved to Cambridge at the end of 1937 and the group around Keynes found the funding necessary for his research. Instituted at the end of 1938 was the Cambridge Research Scheme of the National Institute of Economic and Social Research into Prime Costs, Proceeds and Output, which gave Kalecki a job at Cambridge. At the end of his first year Kalecki presented the major findings of the research in the form of particular reports on the industries taken into consideration (in collaboration with Hsu and Tew) and an ‘Interim Summary of Results’ of the research in general (RFK 5/1/83-86). These reports came in for some fairly critical comments by J. Robinson (RFK 5/1/142-44) and above all by Kahn (RFK to M. Kalecki of 10 July 1939 (5/1/149-58) and 11 July 1939 (5/1/159-162), objecting to the methodology Kalecki had adopted. Kalecki promptly resigned, but also answered to the criticisms that had been levelled at him point by point (RFK /5/1/163-169) leaving Cambridge at the end of the summer of 1939. Unlike Robinson, who subsequently adopted it, Kahn remained averse to ‘mark-up pricing’, still maintaining fifty years later:

I think that the concept of the horizontal short period supply is exaggerated. I do not hold altogether with the ideas of Wynne Godley about the fixed write up margin. What determines the size of this margin? And of course it varies between firms in accordance with their differences in prime costs.

(RFK to R. Marris, 2 May 1987 in Marris, 1991, 184)
3 Employment theory: the Keynesian approach and relations with Keynes

Of all academic economists, it was Kahn who remained closest to Keynes, from 1930 to the death of Keynes in 1947. To begin with, as Kahn himself recalled, he would meet Keynes once a fortnight for supervision together with three other King’s students. But it did not take long for Kahn to show just what an exceptional student he was, inspiring Keynes to write glowing remarks on the essays he wrote for supervision. Once, shortly before the exams, Keynes wrote to his wife: ‘Yesterday my favourite pupil! Kahn wrote me one of the best answers I ever had from a pupil – he must get a first class’ (JM to LLK, 28 April 1928 in JMK PP/45/1904). Effectively, indeed, Kahn fully lived up to expectations, taking his place among the best (First Class) in the 1928 Economics Tripos. But when it came to choosing a subject for the thesis to compete for a position as Fellow at King’s, Keynes suggested a topic (entailing the use of Midland Bank monetary statistics) that proved unfeasible (the Bank showing no inclination to grant them public circulation). So it was that when, prompted by Shove and Sraffa, Kahn suggested he might deal with the ‘economics of the short period’, looking into the way firms in a given industry reacted in a phase of depression through analysis of the type of costs and type of market they worked on, Keynes obligingly provided him with the cotton industry statistics but showed no great interest in the matter. Actually, however, Kahn would write nearly fifty years later, ‘Neither he nor I had the slightest idea that my work on the short period was later on going to influence the development of Keynes’s own thought’ (Kahn, 1989, xi).

Collaboration with Keynes was resumed only after Kahn was elected Fellow of King’s in March 1930; once again Keynes was fired with enthusiasm, writing in his letter of congratulations to Kahn: ‘The election went through with ease and certainty, everyone recognizing that it was an exceptionally distinguished thesis’ (JM to RFK, 16 March 1930 in RFK 13/57/3).

It was these months that saw the beginning of the exchange of ideas and series of discussions that, as Kahn recalls in an article entitled ‘The Cambridge “Circus”’ (Kahn, 1985), were to lead up to the publication of the General Theory and, more broadly speaking, to the spread of the ‘Keynesian revolution’. The precise nature of the role played by Kahn and the ‘Circus’ – or in other words the group that included, besides Kahn, James Meade, Piero Sraffa, Joan and Austin Robinson – has come in for sharply contrasting considerations in the literature. Kahn’s essay offers important evidence, being also, chronologically, the last account he left of the discussions fermenting in those months.

On the other hand, there can be little doubt about the importance of the ‘multiplier’ essay, as it was called, ‘The relation of home investment to unemployment’ (1931). It was written between the summer of 1930 – drafting began in August during a holiday in the Tyrol (Kahn 1984: 91) – and the early months of 1931, and published in the June of that year. The importance of the multiplier essay lies in providing the terms for analysis of the conditions that see an increase either in the level of prices or in the quantities (or a combination of the two) in aggregate given an increase in demand (in this particular case public investments in road building). Kahn always insisted that his role was to help Keynes finally shake off from the ‘stranglehold’ of the quantitative theory of money; contributing to the alternative approach with a fundamental tool, namely the aggregate supply curve. Nevertheless, the limitation of that as yet unripe formulation of an approach alternative to the ‘classical’ approach, as Kahn himself subsequently recognized, was the failure to make clear the fundamental implication of the ‘multiplier’, namely the necessary equality of savings and investments (Kahn, 1984, 99). Kahn attributed this difficulty to the fact that the article took as frame of reference the definitions of saving and income adopted in the Treatise on Money; it was only subsequent to the ‘discovery’ of the principle of effective demand that it became clear that these particular definitions had to be ditched.

In the multiplier article Kahn set about studying the effects of an increase in investment on overall production in terms of the supply and demand of consumption goods in aggregate in short-period conditions. Such, in fact, were the appropriate conditions to evaluate the proposal made by Keynes in ‘Can Lloyd George do it?’, dating to 1929, to implement public works policy as a way out of economic depression. If the level of demand is high, then the productive capacity will already be made good use of, and greater use will entail an increase in costs and thus in prices. But if, on the other hand, the level of demand is low, then plant and equipment will be largely idle and production can therefore be stepped up without any appreciable increase in unit costs and prices.

Hence the crucial point is the form costs take for firms in the short period. As we have seen, study of the various types of costs and their trends had taken a central position in the Dissertation analysis. In particular, in seeking to account for the behaviour of the cotton firms, which closed their plant for a number of days in the week while working full-time on the other days, Kahn had taken the average cost curves to have the form of an inverted L. We may therefore reasonably assume that when Kahn was writing the multiplier article he drew on his previously acquired knowledge to determine the right form of cost curves necessary to construct an aggregate supply curve for consumption goods. Nevertheless, although the multiplier article contemplates a considerable interval during which costs are constant, the hypothesis that they take an inverted L shape seems to have disappeared. The abandonment of this hypothesis was probably influenced by Pigou’s critical remarks on it in his Report as a member of the Board for award of the Fellowship, which Kahn was able to read immediately after.

The importance of the inverted L curves lies in the fact that, as we have seen, they had made it necessary for Kahn to introduce the hypothesis of imperfect competition in the Dissertation. If, on the other hand, the hypothesized form of growing cost curves is retained, there is no longer any need to abandon the hypothesis of perfect competition.
Of course, in the General Theory Keynes accepted the traditional hypotheses that the short-term marginal cost curves were rising, that the degree of competition was given, and that the behaviour of the firms was guided by maximization of profits. The most important consequence for application of the Keynesian prescription to unemployment was that every increase in demand -- if the costs are growing and the firms must maximize profits -- calls for an increase in prices. If monetary wages are given, then increased prices mean a reduction in real wages, and higher employment can only be achieved at the cost of a reduction in real wages. In Keynes's approach causality runs in the direction from increasing employment to reducing wages, and not vice versa. And yet, accepting the existence of an inverse relationship between wages and employment exposed Keynes's message to the risk of being distorted and incorporated into a completely different theoretical framework.

Kahn accepted the responsibility for having suggested to Keynes the idea that 'in normal conditions the marginal cost curve is rising very steeply' (Kahn, 1984, 87) with all the consequences it entails. As we read in Kahn (1975), the merit of having led Keynes back to the subject of the real wages trend is attributed to the work of two Cambridge research students, J. Dunlop and L. Tarshis, while no mention is made of the findings arrived at by Kalecki, who had always worked with the hypothesis of constant marginal costs in the two years spent at Cambridge, and whose theoretical work had founded the empirical research of Dunlop (1938, 1939) and Tarshis (1939).

Nevertheless, neither on this occasion nor on any other did Kahn lament the fact that Keynes had accepted the hypotheses of perfect competition and maximization of profits. The former he defended, arguing that it was made for the sake of simplicity, and the latter in the conviction that the alternative hypotheses, based on the degree of monopoly or on constant mark-up, were tautologies or assumptions rather than real theoretical explanations.

The collaboration between Kahn and Keynes was very close in the years preceding the publication of the General Theory, but, as we also read in 'Unemployment as seen by the Keynesians' (1976a), Joan Robinson and Richard Kahn -- the very people who were then closest to Keynes -- had from the outset also been following lines that in certain respects did not run in the direction pursued by Keynes. It was clearly Kahn who played the leading role in orienting Keynes's thought in certain significant aspects, but in general it was through the 'Circus' discussions and the debate continuing over the following months that the General Theory took shape.

We may mention the role played in 1932 by the Manifesto of the 'Trumpington Street School', signed by Kahn, Austin and Joan Robinson, containing the suggestion that, to prove the proposition that a variation in investment brings about a variation of the same sign in the level of production, Keynes could more usefully apply 'the demand and supply method' than the profit mechanism method he had hitherto made use of. And in fact, by the end of 1932 we see Keynes beginning to use aggregate demand and supply curves in describing the mechanism of adjustment towards equilibrium (see Marcuzzo, 2002a).

The voluminous correspondence, some of which is still unpublished, between Keynes and Kahn from 1931 to 1935 (the General Theory was completed in the December of that year) shows Kahn insisting on the need for the definitions to be more precise, the demonstrations more stringent. For example, he intervened in the second revise, in September 1935, on the way the necessary quality between savings and investments was demonstrated, and in this case, too, Keynes accepted Kahn's suggestion, as can be seen comparing the final version (CWK VII, 63) with the second revise (CWK XIII, 424). In the essay 'Unemployment as seen by the Keynesians' (1976a), Kahn also expressed dissatisfaction with the way Keynes defined involuntary unemployment, actually going so far as to say that the second chapter of the General Theory always left him very cold. On this particular subject, in fact, his reference is rather to the essays that Joan Robinson wrote at the same time as the General Theory (Robinson, 1937), but waited for Keynes's book to be printed before having it published.

There is a considerable amount of evidence confirming the fact that the atmosphere in those months, when the General Theory was being written, was of great expectations of a groundbreaking theoretical change, the 'young Keynesians' being possibly almost more convinced than Keynes himself. On the actual nature of the 'Keynesian Revolution' that would come about only with the General Theory, Keynes was far more wary; indeed, considering it in relation to the Treatise on Money, in various contexts the drift of his remarks suggested points of continuity.

In these essays and in The Making of the General Theory Kahn took a very clear position in his indications of the points where the General Theory departed from the Treatise, consisting above all in the final abandonment of the quantitative theory of money and an understanding of the causal link between investments and savings. Unlike Robinson, however, he seems to have been more of the persuasion that the importance of the Keynesian approach was not to be seen to lie solely in the General Theory.

As we know, Keynes fell seriously ill in the April of 1937, almost immediately afterwards to become absorbed in the conditions foreboding war and the eventual flare-up. This marked the beginning of a new stage in their collaboration, given also the new responsibilities that fell upon Kahn's shoulders with Keynes absent from academic life.

4 The economics of welfare

Kahn's logical faculties were particularly keen in the sense in which the mathematician Felix Klein distinguished the 'logical' from the 'formalists' and 'intuitionists' to explain that 'the great strength of people belonging to this category lies in their logical and critical capacities; in their ability to forge precise definitions and derive rigorous deductions from them'.

The two essays 'Some notes on ideal output' (1935) and 'Tariffs and the terms of trade' (1947) reveal -- more, perhaps, than the other essays -- Kahn's
singer logical capacities, although they may also have amounted to a limitation. Unlike Keynes, adept in the use of rhetoric as a technique for persuasion, Kahn invariably favoured the use of deductive reasoning not only to construct his argument, but also to defend it. It was this obsession with precision in minute details that probably held Kahn back from ranging out further and wider.

Joan Robinson, who possibly knew Kahn better than anyone else, accounted thus for his ‘perfectionism’ in the 1976 Preface to the Italian edition of the only collection of Kahn’s essays so far published (Kahn, 1976e): ‘He had great repugnance to the thought that there might be an error attached to his name’ (JVR 1/8/7). This is also largely why Kahn was so exceptionally generous with help to others, and as exceptionally reluctant to publish on his own account. In the September of 1934 Keynes had stepped in, urging Kahn to publish part of his Dissertation findings with words that now sound prophetic:

You must not get into the habit of never doing your own work but always someone else’s for them. In the first place you will get subconsciously (or consciously) badly irked by it yourself and in the second place you will end up by getting the credit for everything of any merit published by anyone during your lifetime!

(JMK to RFK, 13 August 1934, in RFK 13/57/58)

In the essay on the ideal level of output, Kahn’s logical-deductive mastery is applied to demonstrate that it is in fact possible to measure the benefits accruing to the community by re-allocating the resources from the paths they had taken in conditions of laissez-faire, applying the tools of taxation and subsidies. To this end he exploited the entire Marshallian-Pigovian apparatus, which takes both internal and external economies into account, as well as various measurements of the marginal productivity of the factors, to extend it to the case of imperfect competition. Written practically at the same time as the General Theory was being drafted, this essay seems to have pursued the line of research that began with the Dissertation to be taken yet further (albeit subsequently rejected) by Robinson in The Economics of Imperfect Competition, which set out to demonstrate cases of inefficiency with allocation entrusted to the market, and thus the desirable course intervention could take. Submitting the article to Keynes, Kahn explained his intention, which was to demonstrate that Pigou’s findings in the Economics of Welfare are of very limited application, especially in relation to problems of unemployment.26

The essay, too, on tariffs and exchange ratios, although written in completely different conditions, after the experience of wartime controls, is an exercise in measurement of the advantages of intervention on market mechanisms — the introduction of import tariffs in this case. In the meantime Kahn had acquired a great deal of experience as an administrator, and not only deviser, of economic policies designed to address the specific and severely challenging problems raised by the war and subsequent reconstruction.27

5 National and international monetary theory: the role of the institutions

Great Britain declared war on 3 September 1939. It was Keynes’s intention that Kahn should be taken on by the Treasury as a civil servant for the duration of the war, but initially the idea came up against a great deal of resistance, for Kahn seemed to be too close to Keynes, who was viewed with a considerable degree of suspicion at the time (Kahn, 1988, 28). Eventually Kahn was assigned a position on the Board of Trade, where he began work in December 1939.28 As he was later to recall, some months after having been taken on he found out that a Treasury official had agreed to the appointment only on condition that he did not deal with monetary matters: ‘The Treasury (in the shape of an official of the establishment Department — not Sir Horace Wilson) agreed to my appointment only on condition that I had nothing to do with currency questions!’ (RFK to JMK, 30 June 1940, in JMK W/3/302). Keynes responded with cynical irony: ‘Either all questions are currency questions, or none are. So I suggest you adopt the latter interpretation’ (JMK to RFK, 2 July 1940, in RFK papers, 13/57/467).

The essay ‘Some notes on the liquidity preference’ written in 1954 shows that the Treasury had seen aright, for the positions Kahn took were so extraordinarily original and radical as to mark him out entirely from monetary orthodoxy. A few years later the whole business was to become clearer when he gave evidence to the Radcliffe Committee, the Keynesian monetary approach emerging in all its complexity and originality.

Marco Dardi (1990, 1994) offered a particularly lucid interpretation of the monetary theory set out in this essay in the light of Kahn’s conception of uncertainty and the role of opinion in decision-making mechanisms. As we have seen, as in the description of entrepreneurial behaviour, defined as pursuit of maximum profit, Kahn always stressed the aspect of rationality which found expression in the ‘trial and error’ method, rather than identification as optimizing choice between possible and known alternatives. This ‘rationality’ pursued through trial and error works on the basis of the ‘rewards’ and ‘punishments’ of the competitive mechanism in more or less perfect markets.

In the case of the money market we seem to be faced with an even more complex situation, for the individual investor always has two opinions — let us distinguish them as first degree (best guess) and second degree (conviction) — on buying, selling or keeping securities as an alternative to money. While the first degree opinion, that is whether to be bullish or bearish according to the kind of forecast on the future trend in security prices, may be taken to point to the path to follow, the second degree opinion is the doubt that shrouds the forecast in uncertainty. As Dardi put it:

In Kahn’s approach the chosen position, although — one may assume — maximal in the individual preferences, does not necessarily dominate all the non-maximal positions that are feasible in the circumstances... the fact that
individuals, from the position they are in, do not find other feasible positions interesting, does not mean that if they were in one of these positions they would want to move forwards the position where they in fact are. What we may say is that they prefer to retain the asset composition they have, not that they have the asset composition they prefer. (Dardi, 1994, 96)²⁹

Essentially, Kahn’s monetary theory is not one of (optimizing) choice of positions on the basis of identification of certain behaviour (or utility) functions, but represents individuals ‘as divided best guess and uncertainty’ (ibid.). More generally speaking, Kahn’s approach to the liquidity preference theory²⁶ was perhaps to a more radical extent than Keynes’s¹¹ based on the difficulty experienced in monetary policy in actually bringing about the state of affairs corresponding to the desired goal.

Kahn was also involved in international monetary issues to which he contributed with important papers, reconstructing the design and implementation of the new international monetary system that came into being in the aftermath of the Second World War. His essays ‘The historical origins of the International Monetary Fund’ (1976b), ‘International regulation of trade and exchanges’ (1952b) and ‘The International Monetary System’ (1973) offer examples of how Kahn assessed the capacities of these institutions to perform their task, generating virtuous behaviours and opinions in the markets, as in matters of money and trade (but also, as we will see, in the labour market), where individual optimizing behaviour functions are not directly involved. The role of the institutions in these markets should be to create the right conditions for decisions to be arrived at proving ‘virtuous’ from the point of view of the community, given that the individual pursuit of a hypothetical maximum profit or utility is not always able to generate the optimal outcome for society, nor indeed, over the long period, for the individual.

Kahn’s vision of politics and the institutions was developed in the relatively secure seclusion of academia, but it was also forged through concrete experience as economic adviser to and executive director of big organizations.

In the October of 1941 Kahn moved to Cairo to take up a position, first as Economic Adviser and subsequently as Deputy Director General, with the Middle East Supply Centre. The task of this Centre was to collect information and propose solutions for import priorities in that area, in collaboration with a score of governments of the Middle East that had different administrative structures and independent monetary systems.²⁸ On his return to London in January 1943 Kahn spent a year working for the Ministry of Supply, with the task of studying the post-war conditions of raw materials in terms of their prices and volume. In this final period collaboration with Keynes was once again very close, and both worked on a buffer stocks scheme for raw materials and on problems affecting the sterling area.

In the 1950s, Kahn started a monograph on buffer stocks, which was never completed,²⁹ in which he advocated the establishment of an international buffer stock agency to prevent price fluctuations of primary commodities. The agency was to be managed by experts so that price determination of raw materials, unlike under the quota system, would be ‘not a matter of bargaining strength, but of judgement based on scientific enquiry and expert experience’ (RFK/2/12.3; see Marcuzzo and Rosselli, 2008).

Kahn was to return to the institutional aspects of the international payments system extensively years later, working from 1965 to 1969 as a member of the UNCTAD team of experts. He took a hand in the drafting of the four reports, which entailed work on reform of the interpretation monetary system to cope with the economic growth needs of both the developing and the developed countries.

6 Wages and inflation

In the 1970s Kahn found himself duty-bound to reconsider Keynes’s contribution and the characteristics of the Keynesian approach in order to deploy all the defences he could muster against both monetarism and what we might define as the excesses of Keynesianism.

His essays ‘Thoughts on the behaviour of wages and monetarism’ (1976d), ‘Mr Ellys and the Keynesians’ (1977) and ‘Inflation – a Keynesian view’ (1976c), were written when the tide was turning in the hegemony of Keynesian thought and the Western economies hit by levels of inflation such as had never been reached in the post-war period. Kahn’s polemic – at times waxing fierce and scathing – was levelled against politicians and trade unionists, on the one hand, both held guilty of ‘irresponsible’ behaviour in failing to check the increase in monetary wages, and on the other hand, against the new dominant theory, ‘monetarism’, which to all intents and purposes amounted to the restoration of a pre-Keynesian approach. Nor did Keynes himself altogether escape censure, blamed for not having given due weight to the prospect – in economies that had gone through over twenty-five years of high levels of employment – of monetary wages growing uncontrollably, implying the need to create institutional architecture able to hold the upward pressure in check.

If we are to place these essays in their historical context we must bear in mind certain characteristics of the system that Kahn was faced with. In the mid-1960s the institutional mechanism for the determination of wages and salaries consisted of three tools. The first, and most important, was collective bargaining between representatives of the workers and representatives of the employers. This applied to virtually the whole of industry and the professional organizations.³² The Trades Union Congress (TUC) was responsible for political representation. The second tool, instituted with the Wages Council Acts of 1945, consisted in legislative regulation, with application mainly to agriculture, catering and various particular sectors. The Wages Board or Wages Council was made up of an equal number of representatives of workers and employers, together with a certain number of ‘impartial’ members, described as independent (Wootton, 1964, 82). The third tool was the ruling of the arbitration tribunals set up by the Ministry of Labour, which had the task of performing ‘last resort arbitration’ when collective
bargaining broke down. By the end of the 1970s collective bargaining extended to about 80 per cent of the blue-collar workers and about 50 per cent of the white-collar workers. The Wages Council and other such systems for 'quasi'-collective bargaining covered a substantial part of the other white-collar workers. In practice, wages in the non-unionized white-collar segment were in fact determined collectively (Nickell and Andrews, 1983, 183). And yet, throughout the post-war period the role of national bargaining in determining the wages effectively paid by firms, or at the level of individual departments, had shown a steady decline. In fact, 'wage drift' – that is the differential between wage actually paid and wage negotiated at the national level – eventually undermined the incomes policy of the Harold Wilson governments between 1964 and 1970. When the general election of June 1970 brought the Conservatives back to power, they stated the firm intention not to apply an incomes policy. This determination was endorsed by the subsequent Labour government, which, once elected in 1974, declared it would only contemplate an incomes policy as a solution favoured by the social parts (Dawkins, 1980, 60). Thus arrived what was known as the 'social contract' of the mid-1970s, to which Kahn refers. Essentially, this was an agreement between the trade union leaders (Jack Jones of the Transport and General Workers Union played a particularly crucial role) and the Labour government, help in curbing the wage trend being negotiated in exchange for social policies favoured by the trade unions.

Kahn wrote these essays against a background that saw the waning of incomes policy, and indeed of full employment, as government objectives. In fact, when Margaret Thatcher became Prime Minister in 1979, for the first time since the war the government ceased to proclaim the goal of full employment for, according to the monetarist philosophy behind government policy, it was not an objective which the government could pursue directly with policies to support demand. What the government was aiming at were cuts in public spending, in the tax burden and in the needs of the public sector, and restoration of the market mechanisms. It was these mechanisms that were supposed to boost employment indirectly. Through reduction of the money supply growth rate, in addition to the above aims the goal of reduced inflation was also to be achieved.

And, to the end of his life, Kahn was to dedicate his efforts as a theoretical economist, academic and member of the House of Lords to demolishing the 'mystique' of monetarism and building an alternative institutional framework on 'Keynesian' foundations. In the current economic crisis, his arguments have become topical again, appearing as enduring and forceful as ever.

Notes

- This paper is a revised version, with a new title, of Marcuzzo (1999). I have updated it in the light of the more recent literature. References to unpublished material are given according to their archival records: JMK (John Maynard Keynes), JVR (Joan Robinson), RFK (Richard Kahn), King's College and PS (Piero Sraffa), Trinity College, Cambridge. The quote in the title is attributed to Samuelson by Joan Robinson in her Introduction to the Italian edition of Kahn (1976c, JVR i/8/1).


2 The evidence left of Shove's course are the notes taken by one of his students, John Saltmarsh, in the academic year 1928-9. They are kept among Kahn's papers. For an assessment of Shove's contribution see Rosselli 2005a.

3 The Dissertation was published first in Italian, in 1983, with an Introduction by M. Dardi, and subsequently in English in 1989. Aslanbegi and Oakes (2011) put forward the doubtful explanation that 'due to the intervention of Robinson and the subsequent proliferation of research in the field, Kahn's thesis became unpublishable as an original monograph'.

4 For a detailed and scholastic reconstruction of the collaboration between RFK and JVR in the writing of The Economics of Imperfect Competition, see Rosselli (2005b); a provocative reconstruction is provided by Aslanbegi and Oakes (2010).

5 See the letters by E. Chamberlin to RFK of 3 August 1930 (RFK 1/13/19-24) and 12 September 1930 (RFK 1/13/25), and E. Chamberlin (1961, 513 n).

6 RFK to JVR, 9 February 1933: 'I am having lunch with Chamberlin, whose book on Monopolistic Competition is just about to come out, in fact in two days' in RFK/13/90/1/100. Interesting, too, is the letter by JVR to RFK, of 3 March 1933, referring to the coincidence of the 'discoveries' of imperfect competition in these years: Chamberlin's book has turned up. Very competitively monopolistic as Piero Sraffa says. I find myself enjoying the coincidences without any base emotions, but I must not read it thoroughly or the temptation to put in [that is in The Economics of Imperfect Competition] footnotes will be too great.

(RFK/13/90/1/169)

7 The text refers to J. Robinson's book with the title The Theory of Monopoly, it was only in January 1933 that the title was changed to the definitive The Economics of Imperfect Competition. See the letter by JVR to RFK of 23 January 1933, in RFK/13/90/1/74.

8 The Dissertation was completed in December 1929, and immediately afterwards Kahn began his collaboration with Keynes on the Treatise on Money, which was published in October 1930. In the months following publication Kahn was preoccupied with discussion and close consideration of the issues raised by Keynes not only in the Treatise on Money, but also in 'Can Lloyd George do it?'. In the same months Kahn began work on a book he had planned with the same title as the Dissertation; however, it remained unfinished. The article in question was elaborated on the basis of what was to have been chapter 7 of the unfinished book. See Marcuzzo (1996).

9 It was in connection with this article that JVR wrote to RFK, in a letter of 11 February 1933: 'Austin [Robinson], who has yet only just glanced at it, is very keen that it should be published as the first manifesto of the Trumpington Street School [After reading it he repeats this view]'. See RFK/13/90/1/116.

10 'The condition of tangency between the demand curve and the average-cost curve of a profit-maximizing firm that just breaks even, Schumpeter in his 1930s Harvard lectures used to refer to as "Kahn's Theorem"' (Samuelson, 1994, 54 n).

11 RFK to JVR, 3 March 1933: 'Taussig's refusal of my article on "Imperfect Competition and the Marginal Principle" was conducted with great candour, which I did all I could to encourage' (RFK/2/2/43-4).

12 Combining the idea of a "trial and error" method with that of rationality to describe entrepreneurial behaviour has been defined as 'benign marginalism' (see Mongin, 1991).
13 The components of the Board, chaired by Keynes, were Austin Robinson, Kahn, Kalecki, Champenowone and Sraffa.

14 Letter by M. Kalecki to RFK of 9 June 1939 in RFK papers, 5/1/146-7. See also the editorial notes in Kalecki (1991, 524) and Marcuzzo and Sanfilippo (2007).

15 It is interesting to compare J. Robinson’s subsequent remarks on the superiority of Kalecki’s price formation theory over Keynes’s with the position revealed in her Memorandum of July 1939, with some very critical remarks on usefulness of Kalecki’s degree of monopoly:

The degree of monopoly is not “a thing in itself”. It depends on e.g. (1) imperfection of the market; (2) number of firms in the market, which may alter (a) technical conditions (probably important in the steel industry); (6) with immediate past history of the industry; (3) deliberate monopoly agreements; (4) tacit agreement and custom of the trade, which may alter with boom and slump; (5) recent exchange rate changes; (6) state of demand for a commodity as a whole. Thus it is not possible to say that there has been a “change in the degree of monopoly” is never a final account of what has happened, and it is often unreasonable to expect a constant degree of monopoly in face of other changes, e.g. a change in demand.

(RFK, 5/1/138)

16 To take a couple of examples: in the margin of an essay by Kahn of 4 November 1927, Keynes wrote: ‘I think you have a real aptitude for economics’ (RFK 3/3/343); similarly, on 27 April 1928 he wrote: ‘Very good – almost a perfect answer’ (RFK 3/3/331).

17 On the role of the ‘Circus’, see, for example, Pasinetti (1991); E. A. G. Robinson (1994); Marcuzzo (2002a); Skidelsky (1992); Moggridge (1992, 1994).

18 Amongst Kahn’s papers is an extract from the article, with dedication to an unidentified Edgar: ‘With the author’s heartfelt thanks for the cooperation and stimulus received in the Tyrol, Austria, 1930 and Surrey, March 1931’ (RFK 13/127).

19 See RFK to R. Murray, 2 May 1937, in Murray (1991, 26), and Murray (1937). The key idea derived from me the idea of thinking in terms of the supply curves of capital goods and consumption goods’. See also the letter by Kahn to D. Patinkin, 11 October 1978: ‘I claim I brought the theory of value into the General Theory in the form of a concept of the supply curve as a whole and that this was a major contribution’ (Patinkin, 1993, 659).

20 The suggestion is that we may reasonably suppose the short-period supply curve of a typical firm to be such that, for all quantity of output (above a small initial quantity) the average prime cost per unit is substantially the same until a so-called ‘capacity output’ is attained, and that no output in excess of this can be secured in a short period at any cost, however high. Now Kahn’s discussion does not, so far as I can see, support this conclusion. Moreover, the conclusion itself is patently out of keeping with the facts. It may well be, indeed, that in many industries there is, for a typical firm, a considerable range of output, in respect of which average prime cost per unit is approximately constant. But it is ridiculous to suppose that there suddenly comes a point at which this cost bounds up to infinity. If by ‘capacity output’ we mean maximum possible output, then it is certain that average prime costs will have risen steeply for some time before that output is reached: if we mean optimum output, in the sense of that output at which average prime plus overhead costs are a minimum, it is certain that average prime cost does not rise to infinity immediately that output is exceeded. In several letters Kahns shows himself quite conscious that his J shaped supply curves are not often realized in fact, andfortunately the main drift in his argument holds good apart from them. But nevertheless it is I think unfortunate that he should assign to them, as he does, a central place in his formal analysis.

(RFK papers, 2/8/4)

21 As we know, Keynes attributed the responsibility for retention of this hypothesis to Kahn (Keynes, 1939 in CWK VII, 399–400). On Keynes’s departure from the neoclassical explanation of the decreasing marginal productivity of labour, see Marcuzzo (1993, 445–6).

22 In a letter to Keynes of October 1935, Kahn wrote:

| income = value of output = consumption + investment |
| also income = consumption + saving |

23 Joan Robinson went as far as admitting, subsequently: ‘there were moments when we had some troubles in getting Keynes see what the point of his revolution really was’ (Robinson, 1979b, 170).

24 As an example, suffice the following quotation from the General Theory:

In my Treatise on Money the concept of changes in the excess of investment over saving, as there defined, was a way of handling changes in profit, though I did not in that book distinguish clearly between expected and realized results. (Footnote: ‘My method there was to regard the current realized profit as determining the current expectation of profit’) I there argued that a change in the excess of investment over saving was the motive force governing change in the volume of output. Thus the new argument, though (as I now think) much more accurate and instructive, is no more than a development of the old.

(Keynes, 1971–89, CWK VII, 77–8)

25 On the continuity issue between the Treatise and the General Theory, see Marcuzzo (2002b), and for a slightly different interpretation (Pasinetti, 2004).

26 The “formalists” are the mathematicians endowed with exceptional ability to work out a given problem from the formal point of view, finding the algorithm. Finally, the “intuitionists” are those who attribute particular importance to geometric intuition . . . in all the branches of mathematics” (Weintraub, 1958, 1841–2).

27 There might possibly also be a short article on the sense in which unemployment invalidates the methods of the Economics of Welfare, that is in what sense the existence of unemployed labour differs from the existence of unemployed land” (RFK to JMK, 9 August 1934, JMK L/77/8).

28 It was precisely these two essays by Kahn, as well as his meticulous supervision and advice (as the author states in the preface), that constituted the starting point of the classical monograph by De Graaf (1957), written in Cambridge as a doctorate thesis and subsequently published. On Kahn’s contribution to the economics of welfare, see Pasinetti (1991) and Samuelson (1964).
and articles of clothing. Kahn was one of the architects of the rationing scheme adopted applying a system of points; the idea came to him reading the German press (see Kahn, 1988, 38-40).

29 Dardi's more general thesis is that the order of preferences for asset positions implicit in Kahn's analysis is only a partial, and not complete, order.

30 For a recent assessment of Kahn's position, see Cadam de Carvalho (2010).

31 See, however, also Carabelli (1995) for a reconstruction of Keynes' thought on the behaviour of speculators on the financial markets.

32 The Middle East Supply Centre has been described as 'one of the most ambitious and successful of the British War time experiments' (Beherens, 1953, 227).

33 Kahn's papers include both a monograph and some unpublished essays on buffer stocks, written in the immediate post-war period, in which Kahn calls for the coordinated intervention of national and international institutions for regulation of raw materials. For a detailed analysis, see Fantacci, Marcuzzo, Rosselli and Sanfilippo (forthcoming).

34 This reconstruction is drawn from my editorial notes in Kahn (1988).

35 In 1959 Great Britain had no fewer than 651 trade unions, although the number gradually dwindled over the following years (in 1976, for example, they numbered 493; see Smith, 1980, 96).

References


CWK XIX, Essays in Persuasion.
CWK XIX, (1929) ‘Can Lloyd George do it?’ reprinted in CWK XIX.