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Hobson With a Keynesian Twist

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IT MAY seem like dealing in antiquities to discuss John A. Hobson in relation to Lord Keynes at a time when Keynesianism of some variety has seemingly swept before it all economic thought. After all, Keynes paid his respects to Hobson as one who had "preferred to see the truth obscurely and imperfectly rather than to maintain error" when the more reputable economic pundits chose to remain in outer darkness. Reasonable men would be presumed to allow things to lie in such a rectified state. Hobson has had his day in court! But things are not in a finished state for there is more to be said. The theoretical affinity between Hobson and Keynes is closer than appears at first glance.

I

ALTHOUGH KEYNES RECOGNIZED the Herculean efforts of Hobson, Keynesians have not been any kinder to Hobson than they were before conversion. Alvin Hansen in 1927 wrote that Hobson had "restated the argument of his predecessors, but has contributed little, if any, to their work."[1] In a more recent and post-Keynesian work his evaluation of Hobson remains unchanged.[2] Others have found Hobson lacking in theoretical elegance and have dismissed him on this ground.[3] Presumably this criticism rests on the assumption that one mark of theoretical adequacy is a proliferation of erudition.

The first of these criticisms can best be answered by looking into the second. As to the second, it can be said that unfamiliarity with all of Hobson's work leads to such a statement. Hobson was a prolific writer and, as with Veblen, one must read comprehensively to get a view of the whole system. Any one volume is related to the whole, but, as in the case of an iceberg, there remains much that is not immediately apparent.

Hobson did have a well-worked-out system of economic theory in the traditional sense of what is taken to be a well-worked-out system. He did have a theory of value and distribution which made use of the usual factor analysis in terms of increments, decrements, and margins. In justice it must be said that he did not work within the traditional framework,

[1] Alvin Hansen, *Business-Cycle Theory*, Boston, Ginn, 1927, p. 15.

[2] Alvin Hansen, *Business Cycles and National Income*, New York, Norton, 1951, p. 255.

[3] Robert A. Gordon, *Business Fluctuations*, New York, Harper, 1952, p. 344; Gottfried Haberler, *Prosperity and Depression*, New York, United Nations, 1946, p. 119.

but he certainly did work with the framework. Although he accepts the factor analysis, it is not to the same end that the neo-classicist did. The end-result of Hobson's manipulation of increments and decrements of the factors is to demonstrate the disharmony of what had been used, at least since the Austrians had "saved the day," to demonstrate an essentially harmonious economic universe.

On cursory examination his use of the accepted terminology appears to make Hobson orthodox in theory. There have been those who have intimated that Hobson was orthodox in everything but his underconsumptionism.[4] To hold that he was orthodox in all but his underconsumption apostasy may be true, but true only in the same sense that Marx was orthodox in everything but his concept of surplus value. Hobson's underconsumption position rests on his distribution theory and his concept of the unearned surplus.[5]

Hobson had a rather tight system as systems go. Details of his distribution theory may come under attack by those who are predisposed toward the more orthodox marginalist version. But there is little gained by such attacks, for in these matters of recondite speculation the only ones convinced are those who desire conviction. One theory may serve the purpose as well as another, the only difference being to the particular status group in whose favor the theory may be turned to account. No marginalist has yet convinced a Marxist, and no Marxist has yet convinced a marginalist! Hobson, in so far as theoretical elegance is concerned, comes out as well as can be expected from this sort of endeavor.

But from his theory of the unearned surplus Hobson worked out his underconsumption theory and his theory of imperialism. These three are the cornerstones of Hobson's whole system of economic theory and none stands alone. The unearned surplus results in a maldistribution of income. The maldistribution of income means excess saving. Excess saving leads to overinvestment. Overinvestment, the product of excess saving, means inadequate purchasing power. This leads to economic breakdowns. The latter are temporarily staved off by imperialist freebooting which for a while provides both an outlet for excess saving in foreign investment and for surplus product in foreign markets. This is all too brief an account, but it does serve to show the interconnectedness of Hobson's system of economics. In a sense he had a much more integrated scheme of economic theory than that of the more reputable economists. Certainly his break-

[4] See for instance Joseph Dorfman, *Thorstein Veblen and His America,* New York, Viking, 1934, p. 211.

[5] Paul T. Homan, *Contemporary Economic Thought,* New York Harper, 1927, p. 336.

down theory flows more clearly from the rest of his theory than what is now called macro-economics flows from micro-economics. Thus, to accuse Hobson of theoretical inelegance in cycle theory is to fail to see the role his underconsumption theory plays in his complete system of economic thought.

II

THIS VERY FAILURE to see the whole of Hobson has led cycle theorists to treat his underconsumption doctrine distinct from his unearned surplus theory. Yet there is a significant connection between these two theories that puts Hobson closer to Keynes than has usually been conceded. Outside of a passing mention by R. F. Harrod[6] on the interconnection between them, little reference has been made to the complementary nature of the two theories.[7] In fact the theory of the unproductive surplus is not even mentioned in the standard manuals on business cycles.[8] Hobson's underconsumptionism is discussed without linking it in any way with his theory of the economic surplus.

Like Malthus, Hobson contends that saving takes place on such a large scale that effective demand is unable to take the goods produced as a result of the invested savings at a profitable price. This brings on a breakdown, a decrease in investment, income, and employment. The glut (as he calls it) of unsold goods must be eliminated before prosperity can once again be realized. This glut is removed as people, conservative in spending habits, attempt to maintain an earlier-established standard of living despite diminished income. Some live beyond current incomes by dipping into past savings. Eventually the glut is removed, profits begin to rise, investment increases, wages lag making profits seem even higher and a return to prosperity is negotiated. There is one difficulty, however. The very factors that have given rise to the prosperity are the cause of its downfall. Rising profits accompanied by the wage lag once again lead to over-saving and a glut.

Hobson puts much store in what he calls the right proportion between savings and consumption expenditure. There is a correct proportion which

[6] R. F. Harrod, "Preface to Fourth Edition" of J. A. Hobson, *The Science of Wealth*, Home University Library, Oxford University Press, 1950, p. vii.

[7] Paul T. Homan in an essay on Hobson in his *Contemporary Economic Thought*, *op cit.*, does discuss Hobson's theory of the unproductive surplus and his underconsumption theory. He states that the latter arises out of the first, but since he is "not particularly concerned with cycle theories" he does not elaborate the point.

[8] See for example, A. H. Hansen, *Business Cycles and National Income*, pp. 254–8; R. A. Gordon, *Business Fluctuations*, pp. 342–4; J. A. Estey, *Business Cycles*, New York, Prentice-Hall, 1942, pp. 274–80; Asher Achinstein, *Introduction To Business Cycles*, New York, Crowell, 1950, pp. 38–40.

is equated with continued prosperity. That correct proportion is one at which the current consumption expenditure will be sufficient to take off the goods produced at a profit. In the long-run, consumption outlay and savings must rise proportionately so that increased production can be matched by increased consumer spending. This condition maintained, there is no reason for a breakdown.

Unlike Keynes, Hobson clings to the classical role of savings for the most part. All saving is realized in the form of new investment. In fact saving is essential to economic growth and elimination of all saving would bring economic progress to a halt. For, as he says

> Indeed, it must be admitted that upon this natural conservatism of present consumption, strengthened and directed by reasonable regard for future consumption, the economic progress of mankind depends. It is this conservatism that is expressed in saving. The real economic function of saving must be clearly kept in mind. It does not consist in not spending, *i.e.* in putting money income in a bank, or even making an investment. It consists in paying producers to make more non-consumable goods for use as capital, instead of paying them to make more consumable goods and consuming them. This is the vital distinction between spending and saving, so often obscured by dwelling on the merely monetary aspect.[9]

The cause of economic fluctuations in the Hobsonian system is the disproportionality between savings and capital formation and consumer spending. His is then an oversaving or overinvestment theory.

Although Hobson does not specifically tie together his over-saving theory with his theory of unearned surplus incomes in all of his discussions of unemployment, the two are complementary and the latter is important to understand fully Hobson's position.[10] The neglect of the latter can only be ascribed to the more general neglect of Hobson by the orthodox sect of economists. The mild "inspected and approved" endorsement of Hobson's underconsumption position by Keynes enabled it to slip through the main gate, but his unearned surplus position still awaits without. Nevertheless, it is a vital part of Hobson's analysis.

In brief, he contends that productive payment to the factors of production consists of the cost of maintenance (subsistence and replacement)

[9] J. A. Hobson, *The Economics of Unemployment,* London, Allen & Unwin, 1922, p. 34.

[10] He does have a short note on some aspects of the subject in *The Science of Wealth* in Chapter VII, "Other Surpluses." This is the note Harrod refers to. He also alludes to the unearned surplus in his discussion of the business cycle as, for instance when in discussing public policy he advocates full taxation of the unearned surplus and redistribution of this to low income receivers. In his *Economics of Unemployment* he mentions the unearned surplus in reference to taxation only. He does definitely join the two in *The Industrial System* in Chapter 18, "Unemploymnt."

and the cost of growth. This latter may provide for growth in two ways: (1) by a more intensive use of the factor and (2) "by calling into use new supplies of these factors."[11] Anything paid over these costs he calls an unproductive surplus. Hobson claims that this unproductive surplus can be received by any of the factors, but is mainly found in the rent of land and in monopoly earnings of capital.

III

As has been seen, in his underconsumption argument, Hobson contends that oversaving results from a disproportion between consumption and saving which causes failure of effective demand. The relation of his "unproductive surplus" to his over-saving doctrine is revealed in the following passage.

> But as regards cost of growth there is no such security for adequate provision. The surplus of wealth remaining after costs of maintenance are defrayed does not automatically distribute itself among the owners of the several factors of production in such proportions as to stimulate the new productive energies required to promote the maximum growth of production. Instead of disposing itself in these proper proportions, the surplus may be so divided as to furnish excessive stimuli to some factors and defective stimuli to others, thus retarding that full progress of industry which requires a proportionate growth of all the factors.[12]

The real difficulty would appear to lie in the unproductive surplus and primarily in that paid to capital. In a period of business expansion, profits rise, wages lag, and the unproductive surplus paid to capital increases. This condition results in a rise in capital investment disproportionate to the rise in wages. The disproportionality is aggravated by credit expansion. The result is the deluge. In the contraction, the proportionality is changed, wage decreases continue to lag, profit declines and distribution of the unproductive surplus shifts from capital to labor. However, labor spends it for consumer goods, which reduces the time-period necessary to remove the glut. Thus, ultimately in the Hobson system the causes of fluctuation are to be found in shifts in income proportionality and the distribution of the unearned surplus.

Now, at the time Hobson was writing, the classical concept of savings was still held in much esteem. All savings were realized in some form of investment. The only difference between Hobson and the classicist was over the matter of savings being excessive. Since the classicist was a true believer in Say's law of markets, savings could never be excessive.

[11] Hobson, *The Science of Wealth*, p. 59.
[12] *Ibid.*, p. 60.

But no real violence is done to Hobson's system by a slight modernization in that part which pertains to the identity of saving and investing. Since Hobson developed his system at a time when no one questioned the identity of the saving operation with the investment operation it would seem nothing more than charitable to allow Hobson's system to undergo renovation on this point.[13] It should be kept in mind that Hobson did not have the advantage of Keynes as Keynes did of Hobson.

The results of revising Hobson's concept of saving are startling in their effect. If one is allowed to inject the idea of saving as a residual of income rather than as automatic investment, the result is an underconsumption argument with a Keynesian twist. Using Hobson's unproductive surplus argument in conjunction with the Keynesian concept of the passive role of savings, it becomes apparent that all wage costs represent largely consumption expenditure, while cost of subsistence and the cost of growth of capital represent depreciation expenditure and new investment outlays, while unearned surplus income represents saving not realized or abortive attempts to save not offset by investment expenditure. By this revision Hobson becomes Keynesian but Keynesian with an underconsumption accent.

IV

According to Hobson, then, shifts in the distribution of income or in the ratio between capital and labor have different effects on the economy. An increase in the unproductive surplus to capital results in abortive attempts to save and a decline in income. A shift in the unproductive surplus to labor leads to an increased consumption expenditure with a multiplier effect on investment. In the first case a shift in the unproductive surplus results in a failure to close the savings gap by investment expenditure. In the second case a large increase in consumer spending has a multiplier effect on investment and income.

In the cycle it would follow that as profits rise from an increase in consumer spending, and wages lag, a shift in the distribution of the unproductive surplus from labor to capital takes place. The result is a rise in

[13] There is all the more reason for this in the light of R. G. Hawtrey's slight revisions of his works on this score. See for instance the fourth edition of Hawtrey's *Currency and Credit*, London, Longmans Green, 1950. "In the previous edition I took for granted too readily that money saved would be invested and that money invested would be spent. . . That was still accepted doctrine when I wrote." p. vi. In a long footnote in his *Confessions of An Economic Heretic*, London, Allen and Unwin, 1938, pp. 192–3, Hobson apparently came around to this point of view, which would put him in the under- instead of over-investment category. Unfortunately he never got around to amending any of his works on this front.

savings which, not being offset by increased investment, results in a fall in income. The result is a shift of the unproductive surplus from capital to labor, which provides income to remove the glut and bring on the conditions that lead to recovery.

The result of such a transformation in Hobson is to make his system compatible with present day concepts of saving and investment without doing any major damage to his system. In this way the main advance on underemployment would seem to call for a frontal assault via underconsumption rather than a flanking attack via underinvestment.

Keynes states that Hobson's error was in assuming that all saving did result in investment outlay.

In the last sentence of this passage there appears the root of Hobson's mistake, namely, his supposing that it is a case of excessive saving causing the *actual* accumulation of capital in excess of what is required, which is, in fact, a secondary evil which only occurs through mistakes of foresight; whereas the primary evil is a propensity to save in conditions of full employment more than the equivalent of the capital which is required, thus preventing full employment except when there is a mistake of foresight.[14]

By making the substitution of passive savings for active savings in Hobson's system this "root of Hobson's mistake" would appear to have been successfully grubbed. By such grubbing it would also appear that underconsumption theory and under-investment theory are brought more closely together. The main problem in either case is what is now notorious as the savings gap. How to close the gap! The major difference between Keynesians and underconsumptionists would appear not to be in theory, but in predilections about how to close the breach. Nevertheless, it would be fatuous to assume that this *rapprochement* would satisfy Keynesians even though it might have satisfied Keynes.

Keynesians are confirmed under-investment advocates. The more timid variety favor this approach because it indicates to them an indirect approach to the problem of stability that will leave the status quo untouched. As with monetary theorists such as Hawtrey, chief reliance would be placed on bank rate manipulation. Through low interest rates, in periods of a low marginal efficiency of capital, investment would be encouraged. Resort to more direct methods would be had only on the occasion of what Hawtrey has called a "credit deadlock." Even in this eventuality public investment would be on a moderate scale in line with what has been called traditionally a public works program. Greater re-

[14] J. M. Keynes, *The General Theory of Employment Interest and Money*, London, Macmillan, 1936, p. 367–8.

liance would be put on moral exhortation and blandishment of the reluctant captains of industry.

To this group of Keynesians any suggestion of underconsumption is morally repugnant. Underconsumption is correctable by alteration of the pattern of income distribution. But this also means an alteration in a system of status and reputable expenditure that would reduce the standard of living from that level to which the more reputable elements have become accustomed and raise that to which the less worthy elements would have to become accustomed. To gentlemen of sensibility it is noxious to view simultaneously decayed gentlefolk and splurging on the part of the common run of man. It is this precise state of affairs in England at the present time that is the source of so much alarm in the United States about the wretched condition to which the English have been reduced. The upgrading of the standard of living of the lowest third of the population is viewed in silence.

To the more venturesome variety of Keynesians, underinvestment is compatible with their habitual way of viewing things. Traditional economic theories, both the classical and neo-classical as well as Marxian, have been theories of capital accumulation. By doing without today, the lot of the common man will be raised tomorrow when there will be more to go around. When this argument is used again tomorrow to justify further sacrifice by the common run of man, the argument begins to get a little threadbare. All too frequently the argument has also been turned to an account of the accumulation of money funds which by some mystic process are identified with machines and means of production.[15] But putting all of this aside, the penchant for underinvestment on the part of Keynesians of this stripe stems largely from predilections on the source of human welfare and its enlargement on the morrow. To this way of thinking the enlargement of consumption would encroach on the rate of growth of capital and reduce the speed of economic development.

Further, Keynesians of all variety put much stock in what is called autonomous investment. Keynes himself does not give to consumption much of a role as a determinant of investment. It is notorious that Keynes put little emphasis on the accelerator.[16] But he does in his discussion of

[15] For discussion of this point see C. E. Ayres, *The Divine Right of Capital*, New York, Houghton-Mifflin, 1946, Part I.

[16] This is not to ignore the fact that latter-day Keynesians seem singluarly bent on rectifying this neglect. They have found the accelerator of great advantage in building what they rather euphoniously call models of the trade cycle. See for instance J. R. Hicks, *The Trade Cycle*, London, Oxford University Press, 1950; Alvin Hansen, *op. cit.*, Chap. 11.

Hobson give strong intimation that there is some connection between consumption outlay and investment outlay. In commenting on Hobson's argument he states

> The subsequent argument is, admittedly, incomplete. But it is the first explicit statement of the fact that capital is brought into existence not by the propensity to save but in response to the demand resulting from actual and prospective consumption.[17]

V

BUT KEYNESIANS in letting so-called autonomous investment rest on technological innovation, population growth, frontiers and wars as independent variables, are leaving much to be answered.[18] Technological innovations replace some other technology for which there is already consumption outlay. Certainly it is true that the railroad into the west made possible cash crop agriculture which meant demand for the railroad. But to look at it in this fashion only is to ignore that the movement west had been underway on foot, on horseback, and in the covered wagon long before the rails were laid across the prairie.[19] Likewise, man was quite a mobile creature before the automobile. The Studebaker wagons were a cause of consumer outlay for many years before the Studebaker automobile was such. Similarly, people were habituated to gathering in their homes before a box designed to pickup and amplify radio sound waves before television came into vogue.

As to population growth, there is no other way this can manifest itself on investment except through increased consumer outlay. Malthus was as astute in pointing this out as he was in seeing the weakness in the argument of J. B. Say.[20] New frontiers as a source of investment outlay find Keynesians and Hobson on common ground. Keynesians are more discreet in naming what Hobson bluntly called imperialism.[21] This source of closing the savings gap can take the form of investment and consumption outlay. In calling it foreign investment its consumption aspect is obscured. But foreign markets for the domestic surplus are a long-tried if not true means of closing the gap. As for wars, there is no more rapid means of consumption. Autonomous investment may be independent to those who

[17] Keynes, *op. cit.*, p. 368.

[18] For a more complete discussion of the relationship between consumption and investment outlay see H. G. Moulton, *The Formation of Capital,* Washington, Brookings, 1935, Chap. IV.

[19] Francis Parkinson, *The Oregon Trail,* New York, New American Library edition, 1950.

[20] T. R. Malthus, *Principles of Political Economy,* New York, Kelley, 1951, pp. 311–4.

[21] J. A. Hobson, *Imperialism,* London, Allen and Unwin, 1948, Chaps. VI, VII.

do not care to look beyond it, but its consumption roots are apparent to those who care to grub a little further. Keynes may have noted this and thus it may account for his more charitable treatment of Hobson.

Underconsumptionists, however, approach the problem of economic stability from the consumption side because of other predilections just as strong as those of the Keynesians. Underconsumption has largely been the stock in trade of trade unionists, social reformers, and heretics with a strong penchant for elevating the lot of the common man. With these leanings, the answer to the savings gap would also seem to be cut out for solving the problem of abject poverty. From the standpoint of economic stability, blessed are the poor, for they shall have their reward on earth instead of heaven!

When all is said and done, whether Hobson is held to possess an advantage over Keynes or Keynes an advantage over Hobson would seem to rest on the value placed on a more or less permanent closing of the savings gap. An under-investment approach would call for an almost permanent anti-cyclical policy. An underconsumption approach would get at the "root of the error" and close the gap once and for all. The answer one takes rests on predilections which in turn rest upon background training and experience. Theoretical elegance would appear to have little to do with the issue.

Whether it can be said that Hobson failed to add anything to what had already been said by Malthus depends upon how narrowly one looks at Hobson. If one looks only at the disproportion between savings and consumption argument, the contention that nothing new has been added is valid. If one looks at Hobson's explanation of the origin of the disproportion, its consequences, and its correction, then it must be concluded that something has been added. But in so adding, Hobson becomes compatible with Keynes more so than is Malthus.

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On the labors of the countryman depend the whole strength and health, nay, the very existence of society, yet, in almost every country, politics, economics and social reform are urban products, and the countryman gets only the crumbs which fall from the political table.

A. E.