

November 1924: Piero Sraffa and Keynes' new theory and social policy

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This paper is focused on the interpretation of a sentence in a letter where, on 6 November 1924, Sraffa expressed very warmly his appreciation for Keynes' new theory of the credit cycle and for the social policy he had illustrated to him few days before. With this discussion we aim at contributing to the preliminary groundwork necessary to the reconstruction of a detailed intellectual biography of Piero Sraffa, but attention will necessarily be devoted also to the relatively unexplored phase of the development of Keynes' thought in the period which marked the early progress of his steps from the Tract on Monetary Reform towards the Treatise on Money.

After introducing Sraffa's letter to Keynes, we will consider the background to Sraffa's statements (Section I), which will lead us to study some unpublished notes on the Tract on Monetary Reform he presumably wrote in December 1923 or in early 1924 (Section II). We will then discuss the content of what Keynes himself, in the second half of 1924, depicted as his new theory of the credit cycle (Sections III and IV),² and of what Sraffa described as the social policy outlined by Keynes (Section V).³ Finally (Section VI), we will face the problem of exploring the grounds of Sraffa's appreciation of Keynes' positions; in this context we will also take into account the political underpinnings to Sraffa's statement.

² With the phrase credit cycle Keynes generally referred to what we now tend to call economic fluctuations, economic cycle, trade cycle, or business cycle. For instance, in the 1924 article *The Speeches of the Bank Chairmen*, "the stability of the internal price level and the damping down of the credit cycle" is presented as synonym of "to keep prices steady and trade on an even keel" (CW IX p.192). In a similar vein, in one of the earliest tables of contents illustrating his path towards the *Treatise on Money*, the heading "The Analysis of the Credit Cycle" was corrected by Keynes in "The Analysis of the Trade Cycle and the Theory of Credit" (JMK/TM/3/2/12). On the other hand, in the *Treatise on Money*, he wrote that a theoretical definition of credit cycle should relate to disturbances due to investment factors, which do not lead to "a passage from one equilibrium price level to another [but to] an oscillation about an approximately unchanged price level" (Keynes 1930 vol.1, p.248).

³ It is important to stress that the nature and the limited amount of the documents dating to the relevant period will only allow for a conjectural basis to our reconstruction.

1. A letter to Keynes

The letter sent by Sraffa to Keynes on 6 November 1924 is one of the few documents where Sraffa expressed an opinion on questions directly relating to the latter's views in the field of economic theory and of economic policy:

The delightful time I had in Cambridge, thanks to your hospitality and to the pleasure of enjoying your conversation, I shall never forget. But above all I was honoured and pleased by being among the first to hear from your own mouth your great new theory of the credit cycle and the outlines of the social policy which, I hope, will direct progress in the near future" (JMK/L/S/18-19).

If we are interested in the development of Sraffa's thought, and if we dismiss the possibility that in this letter Sraffa only meant to thank particularly warmly a famous economist for the attention he had paid him, we may wish to understand why he was so appreciative of Keynes' new theory and of his views on social policy. But, of course, if we wish to answer these questions, we must first clarify the context of Sraffa's statements and understand the content of Keynes' new theory and social policy (and, we must stress it, we should not take for granted that the latter descended from the former).

First of all, we may say that at that time Sraffa had already been in England for some months and that he most probably had already met Keynes on at least another occasion (JMK/PP/41/21/42). We also know that the meeting with Keynes referred to by Sraffa in the letter we are considering took place on 31 October 1924 (JMK/PP/41/21/46), and that Sraffa's enthusiasm was shared by Keynes, who, on that very day, wrote to Lydia Lopokova (who was to become his wife about a year later):

To - day Piero Sraffa, the Italian who has been translating my book, came to lunch. We talked for nearly three hours and I told him the Credit Cycle Theory. He was enthusiastic; so I was satisfied. As usual, I thought him very talented - no!, not because he agreed, but because of the sort of questions he asked [...] The conversation with Sraffa about Credit Cycle has made me very eager to begin writing my book (JMK/PP/45/190/2/39).

Keynes' use of the phrase as usual probably hints at the various occasions he had had to explore Sraffa's abilities since they first met, three years before. But in the period we are considering we may guess that at least two subjects were touched. On one occasion, as suggested by a sheet of paper containing a diagram drawn by Keynes charting marginal utility of money, marginal disutility of labour, wages and marginal utility of income dated by Sraffa J.M.Keynes, estate 1924 Londra (SP D1/11/38), it seems likely that their discussion related to Sraffa's interest in the foundations of Marshallian economics and of economic theory in general. But it is also likely that they discussed questions relating to the content of Keynes' Tract on Monetary Reform and to the publication of its Italian translation, that Sraffa had probably completed during the Spring of 1924 but which he may have wished to revise under Keynes' supervision (a fact which could have concurred to delay publication of the Italian edition of the book, which initially Sraffa seems to have expected to take place in Summer 1924, while it was published in December 1924 - see letters from Sraffa to Keynes, 8 March 1924, 22 December 1924, JMK/MR/1/1/83-5).⁴

If it is likely that the Tract on Monetary Reform was part of the subjects discussed by Keynes and Sraffa in the period we are considering, its importance to the reconstruction of the context and

⁴ We may also add that when they met on 31 October 1924 they certainly talked also of Pantaleoni's death, which had happened just two days before; in fact we know that Keynes asked Sraffa to write an obituary for the Economic Journal (Sraffa 1924b; JMK/L/S/19, 20).

of the object of the discussion which took place on 31 October 1924 is furthered by the fact that Keynes' new theory of the credit cycle was clearly rooted in his Tract, and we may guess that, on that occasion, discussing the content of the Tract naturally led Keynes to introduce Sraffa to the way his ideas had evolved. Therefore, to proceed in our reconstruction, we have to take a short step backward, and consider the content of that book and how Sraffa approached it.

2. Sraffa and Keynes' Tract on Monetary Reform

As we know, Sraffa met Keynes for the first time in 1921-22, when, shortly after graduation at the University of Turin, he spent about a year in England, attending courses at the London School of Economics, doing research at the Labour Research Department, and trying to penetrate British social, political and economic life (Naldi 2005). During one of his meetings with Keynes in 1921-22 we may guess that Sraffa illustrated the views on Italian post-war inflation that he had developed in his tesi di laurea and, in particular, his opinions on the choice between deflation and stabilization of prices, and the reasons why domestic monetary stabilization was to be distinguished from exchange rate stabilization and was to be preferred to the latter (see Roncaglia, 1984, pp.107-8; 1994, p.2; Ginzburg, 1986, p.62). On the same occasion, Keynes certainly asked Sraffa to write an article on the Italian banking system⁵ and, shortly afterwards, he also asked him to translate his Tract on Monetary Reform, first published in England on 11 December 1923.⁶

The fact that Sraffa agreed to translate this book may obviously imply that he shared its main points: in particular the idea that price stabilization was important to counter business fluctuations; Keynes' version of the quantity theory of money [$n = p (k + rk')$], which was at the bottom of his analysis; and the idea that price stabilization could be pursued by a banking policy aimed at expanding money [n] and credit supply or at reducing the bank reserve rate [r] when real balances kept by the public (i. e., money balances [k] and bank deposits [k'], both expressed in terms of consumption units) were increasing (vice versa in the opposite case).

But if we consider Sraffa's few notes on Keynes' book kept among the Sraffa Papers (SP D1/18/2-5), we see that his attitude was all but uncritical.⁷ In those notes Sraffa concentrated his attention on Keynes' definition and analysis of the two concepts of demand for money by the public [k] and by the banks [rk']. According to Sraffa, explaining the demand for money by the public as a function of wealth or income is meaningless because it has no causal relation to either of those

⁵ In the end, Sraffa's articles on this subject published by Keynes in 1922 turned out to be two: Sraffa 1922a, 1922b.

⁶ Strictly speaking, we do not know if Keynes asked Sraffa to translate the book or if Sraffa asked Keynes permission to do it. We only know that Sraffa planned to finish the translation by April 1924 and that, on Keynes behalf, he was seeking a publisher for the Italian edition of the book (letter from Sraffa to Keynes, 8 March 1924, JMK/MR/1/1/83-4).

⁷ The file in the Sraffa Papers where these notes are kept contains a folder headed "Money" by Sraffa himself and documents relating to different subjects. The first document (D1/18/1/1) is a sheet of paper where Sraffa copied (adding few notes) parts of a draft table of contents of Keynes' Treatise on Money; this table seems to coincide (although in some cases it is more detailed) with a draft table dating to June 1927 (CW XIII, pp.47-9). On the verso of this sheet Sraffa wrote "Silly remarks", it is not clear if this phrase was meant to relate to the content of the whole folder or to a part of it, but it seems rather clear that that phrase was written after the table of contents was copied, possibly at a time when Sraffa reconsidered his older notes - hence, it would not reflect a change in the approach to Keynes' Tract already developed by Sraffa in a period relevant to our present concern. The second document (D1/18/1/2) is a short note on Macleod. The third document (D1/18/1/3) is a diagram drawn using data taken from pages 104 and 119 of Keynes' Tract on Monetary Reform. The fourth document (D1/18/2-5) contains Sraffa's notes on Keynes' Tract that we are going to discuss. The fifth document (D1/18/6) is a list of data on clearing operations in January - October 1923 which also relates to the Tract on Monetary Reform. The sixth document (D1/18/7-8) is a short text on "Circulation of gold coins and sheltered price-level". The seventh document (D1/18/9-13), dated 1921, is a short text on the relationship between loans and deposits probably inspired by Cannan's 1921 article The Meaning of Bank Deposits. The eighth document (D1/18/14-16) is a short text on the quantity theory of money probably relating to an article published on the Manchester Guardian Commercial on 17 November 1921. The last document in the folder (D1/18/17) was probably part of a draft paper on industrial profits and it is not clear why it has been inserted in the folder on Money.

magnitudes.⁸ The fundamental variable singled out by Sraffa to explain the size of the demand for money by the public is the amount of payments that the public expect to make in a given period: in his words, their turnover (SP D1/18/3). Similarly, Sraffa was critical of the use of the concept of reserve rate and of the volume of deposits as determinants of the volume of bank reserves. In his opinion such reserves are till money; i.e., they reflect cash movements expected by bankers, or, again, their turnover (SP D1/18/2, 5). In the latter case, however, his disagreement was less pointed than in the previous one, as he stressed that it may reflect different characteristics of British and Italian banking systems (SP D1/18/2, 5). These criticisms also emerge in Sraffa's tendency to favour Fisher's version of the quantity theory of money against Keynes' version, and to stress the importance of the velocity of circulation as a crucial variable to model money demand (SP D1/18/2-4) against Keynes' analysis of its determinants.⁹

To sum up, we have no reason to believe that Sraffa did not agree with the importance attached by Keynes to price stabilization in order to curb economic fluctuations, nor that he wished to deny the importance of the quantity theory of money, but he certainly objected to the relevance of the variables singled out by Keynes as determinants of the demand for money.

Sraffa's objections to Keynes' analysis are reflected in a curled line he drew in his copy of Keynes' Tract on Monetary Reform on the margin of a passage reading:

"in a depression, when the public are increasing their real balances, a greater amount of credit has to be created to support a given price level (in accordance with the theory explained above in Chapter III, p.84) than is required in a boom, when real balances are being diminished" (Keynes 1923b, p.178).

Most probably that curled line, which is what Sraffa usually pencilled in his books as a sign of disagreement, pointed to the fact that the relation between level of economic activity and real balances envisaged by Keynes was at variance with the determinants of the demand for money singled out by Sraffa. In particular, if Sraffa regarded Fisher's version of the quantity theory of money as more appropriate (SP D1/18/2-4), we may guess that his own stress on the importance of variations of the velocity of circulation might have led him to put forward policy prescriptions (if he would have ever advanced any!) conditional to the interpretation of the role of that magnitude. In this sense, in order to counter price reductions, money and credit supply should be increased, as suggested by Keynes, only if it could be excluded that the effect of an increase in those magnitudes would be a further reduction of the velocity of circulation. But in principle this could not be excluded.¹⁰

⁸ Here Sraffa argued in the sense that the lack of a theoretically well grounded causal relation was crucial to exclude the relevance of the magnitudes even if an empirical correlation could be found: "Questi confronti tra il capitale (o, peggio, il reddito) degli individui e la «frazione» che essi ne tengono in denaro sono quanto mai artificiali. Non sbagliati: ma privi di significato, poiché i due termini non si trovano in nessun rapporto di correlazione o di causa. Dire che il rapporto tra gli anni del capitano e i metri di altezza dell'albero maestro è di 3:1 e che la «media» dei rapporti per tutte le navi e i loro capitani di un paese, in date condizioni, è di 2:1, è una proposizione in cui, a rigore, non si trova nulla da obiettare. Ma, se lo scopo di queste formule è di «riunire ordinatamente le cause principali che determinano il valore del denaro» (Pigou, citato] da Keynes p. 74), protesto. Poiché non esiste maggiore connessione fra ricchezza e denaro tenuto in tasca di quella che sia tra età del capitano e albero" (SP D1/18/3).

⁹ For instance: "i privati tengono in tasca una quantità di denaro proporzionale, non alla ricchezza né al reddito, ma ai pagamenti probabili che debbono fare entro un certo periodo: cioè al loro turnover. E ci avviciniamo alla velocità di circolazione, allontanoci da «la quantità di denaro che si tiene in tasca»" (SP D1/18/3).

¹⁰ This point may be interpreted in terms of the role attributed to speculation on expected reductions of commodity prices: in fact, within Keynes' approach, Keynes' own prescriptions could prove ineffective if - granting speculative real balances - money and credit expansion were absorbed by speculative positions with no positive effect on price stabilization. However, Sraffa's notes contain only a short reference in this sense, where he seems to stress that discussing whether money demand by the public depends on income or capital (or wealth) does not face the core of the problem, which is "sapere se il denaro sono «risorse locked up», che potrebbero essere investite in beni" (SP D1/18/4).

3. Keynes' 1924 new theory

With this brief analysis of the content of Keynes' Tract on Monetary Reform and of Sraffa's views on it, we reach the core of our discussion. In fact, although we know very little of Keynes' new theory of the credit cycle approvingly referred to by Sraffa, it is quite clear that it was built on the basis provided by that Tract on Monetary Reform.¹¹

In order to understand what Keynes' new theory consisted of in October 1924, the documents most relevant to our inquiry amount to two draft chapters (CW XIII pp.19-24; the second being almost a fragment) and to a table of contents (CW XIII p.18). Dating these documents is subject to a certain amount of fastidiousness. The table of contents is dated by Keynes himself 30 November 1924 (JMK/TM/3/2/12), and the draft of the first of the two chapters (JMK/TM/3/2/63-71; an introductory chapter published in CW XIII pp.19-22) was probably written on that very day¹² - probably before the table of contents mentioned above.¹³ The draft of the second chapter (JMK/TM/3/2/72-5; four handwritten sheets numbered 18, 19, 22, 23 published in CW XIII pp.22-4) is also broadly consistent with the same table of contents but was probably written between December 1924 and February 1925.¹⁴

From the content of these documents it may be inferred that, in that phase of the development of his thought, Keynes' new theory was formed by two main parts.

One of these parts, as emerges from the draft introductory chapter to the projected new book, was closely derived from the discussion of the equation of the quantity theory of money expressed in terms of demand for real balances and supply of money already developed in the Tract on Monetary Reform:

"Under a credit or bank-money system, such as we have now, prices rise when the ratio of bank money to real balances increases, and prices fall when the ratio of bank money to real balances diminishes. This may come about, either by a change on the side of bank money (up or down) - which is what attention has been generally concentrated upon; or by a change on the side of real balances (down or up) - which may be just as important, particularly over short periods. This

¹¹ Most probably, Keynes conceived the project of preparing a sequel to the Tract on Monetary Reform in January 1924 (letter from Keynes to Lydia Lopokova, 1 February 1924, JMK/PP/45/190/1/69) but it seems that only in the second part of 1924 he set himself seriously at work for presenting his new theory in a new book (see CW XIII pp.15-8; Skidelsky 1992, pp.281-2). The result was to be *The Treatise on Money*, but it was to emerge only in 1930, after a long and difficult gestation. Unfortunately, very little has survived of the work done by Keynes in the early phases of this work.

¹² This view is based upon the fact that in a letter to Lydia Lopokova Keynes quoted the opening sentence of the chapter he had just started: "I have begun the new book! — to-day, and have written one page. This is the first sentence: — 'I begin this book, not in the logical order, but so as to bring before the reader's mind, as soon as possible, what is most significant in what I have to say.'" (letter from Keynes to Lydia Lopokova, 30 November, 1924, JMK/PP/45/190/2/65; see Moggridge 1992 p.436). The sentence in the draft introduction is exactly the same but for the last phrase, which reads "what is most significant for my purpose" (JMK/MK/TM/3/2/63; CW XIII p.19).

¹³ This hypothesis is supported by two facts. First, the original title of the draft introduction was "A short summary of the author's theory about to be expounded" (CW XIII p.18), but it was changed into "Introduction" by Keynes himself, most probably following the table of contents written on the same day. Second, in this draft introduction Keynes stressed the importance to his theory of the concept of circulating capital, while the table of contents refers to working capital (initially, also the table of contents referred to note that the phrase working capital was preferred by Keynes also in his *Treatise on Money*, where he circulating capital, but this expression was corrected by Keynes in working capital). It may be interesting to provided what may be interpreted as an indirect explanation of his preference: "The classical economists emphasized the distinction between fixed capital and what they called 'circulating capital'. But they did not clearly distinguish my third category of capital, namely 'goods in process' or working capital, which is not identical with their 'circulating capital' [...] They did not clearly perceive that the capital to keep labour in employment is found, not in the stocks of goods already available, nor by abstention from the consumption of available income, but by decisions which have the effect (a) of determining what proportions of the goods emerging from the machine of process are in fixed and in liquid form respectively, and (b) of applying the flow of available income in one way instead of in another, namely, by supporting productive consumers instead of unproductive consumers" (Keynes 1930 vol.2, p. 114).

¹⁴ The title and the number of the draft chapter ("4. Working capital in slumps and booms") is slightly different from what appears as Chapter 3 in the table of contents dated 30 November, 1924 ("Fluctuations in the demand for 'working capital' in relation to the trade cycle"), but a letter from Robertson to Keynes (CW XIII pp.24-6) dated 27 February, 1925 commenting on Keynes' draft of a Chapter 3 confirms the consistency between the documents and suggests that the extant fragment was part of an earlier version of the document sent by Keynes to Robertson.

conclusion is the same, though in different words, as the leading tenet to my Tract on Monetary Reform. I shall argue in this book, as I argued in that, that the general price level can be stabilized by giving the Bank of England a control over the volume of bank money created (which has to be done to some extent under any bank-money system), and by using this control to cause the volume of bank money to vary in the same proportion as that in which the volume of real balances varies" (CW XIII p.21).

As Keynes was perfectly justified in stressing that this analysis and this conclusion he had already put forward in his Tract on Monetary Reform, we may presume that Sraffa had no reason to regard it as novel, nor (provided he had not abandoned his previous objections to Keynes approach) of approving it without qualification.

The other part of the theory, on the contrary, as emerges from the same draft introduction, was presented by Keynes as new (CW XIII p.21) and as containing what was most significant for the purpose of his analysis (CW XIII p.19): the distinction between fixed capital¹⁵ and circulating capital, or working capital, and the appreciation of the special importance of the latter in relation to the trade cycle. Hence, we may fairly safely guess that it was to this part of Keynes' theory that Sraffa referred to when he expressed his admiration for his "great new theory of the credit cycle". In fact, the extant tables of contents suggest that Keynes conceived this part of his analysis after 9 October, 1924, when he drafted a table of contents which included no reference to the concept of circulating or working capital (CW XIII pp.16-8). The results of this addition to his own old analysis were singled out by Keynes as follows:

"my second set of conclusions, however, is new; - they seek to explain how and why, under our pre-war monetary system, fluctuations in the demand for circulating capital - however arising, and however inevitable or even desirable - tended to generate the credit cycle; how the supposed remedies which we were accustomed to apply were capable, in certain conditions, of aggravating the disease; and how the credit cycle itself, by causing, in its turn, further fluctuations in the demand for circulating capital, tended to bring about its own repetition. If this analysis of the credit cycle is correct, it makes the nature of the cure fairly obvious" (CW XIII p.21).

Unfortunately, in this draft introductory chapter Keynes did not enlarge any further on these points but it is clear that "fluctuations in the demand for circulating capital" were at the centre of his analysis and that from that analysis a set of policy prescriptions followed.

The fragment of the other draft chapter dating to the same period (Working capital in slumps and booms) gives us some additional elements. First of all, Keynes linked working capital to savings in the sense that it could not be increased but through increased current savings:

"during the period of recovery, we require not only an optimism on the part of the entrepreneurs, which disposes them to start more goods into process, but also a steady accretion to current savings in liquid form to furnish the working capital which will enable them to carry their inclinations into action" (CW XIII p.23; see also p.22).

Secondly, the role of working capital in a recovery after a slump is depicted in terms which suggest that Keynes conceived that part of capital as regulated by objectively measurable production coefficients and that precisely for this characteristic it was bound to influence the path of fluctuations in prices and quantities produced:

¹⁵ Here, Keynes' definition of this concept is slightly ambiguous, because he refers to "finished goods, awaiting use or in the course of use" (CW XIII p.19), which may include both fixed capital and stocks of goods (liquid capital, as they will be called in the second extant draft chapter - CW XIII p.23).

"once a slump has been allowed to develop, with prevalent unemployment and a corresponding impairment of working capital, it will be impossible to bring about a rapid increase of employment merely through a recovery in business sentiment or by the expenditure of public money. Such influences may raise prices, but they cannot enter a greater volume of goods into process, unless the wages fund is being adequately replenished out of current savings [...] The expenditure, on the production of fixed capital, of public money which has been raised by borrowing, can do nothing in itself to improve matters; and it may do actual harm if it diverts existing working capital away from the production of goods in a liquid form, which unlike fixed capital will be available for the further replenishment of working capital at a later date. The fall from boom to slump [...] may be rapid; because any amount of goods can become available in excess of what is being fed back. But the rise from slump to boom must be more gradual; because goods can't be fed back in excess of what is becoming available" (CW XIII pp.22-3).¹⁶

If we consider the emphasis Sraffa was placing and was to place on the importance of building an approach to economic theory based upon objective (as opposed to subjective) magnitudes,¹⁷ we may presume that he felt that Keynes' attention to technical aspects of production processes as a basis for the explanation of the cyclical movements of the economy was in tune with his own views of how theoretical work should be done.

4. Seeking additional information on Keynes' new theory

All in all, we may say that the draft chapters just considered provide us with a bare sketch of Keynes' new theory and we may wonder which were more precisely its content, its origins and the policy prescriptions it implied. As to the second question, the answer may be relatively simple, but, again, it gives us no additional detail on the stage of development Keynes' analysis had reached in late 1924. Following Donald Moggridge's suggestion (CW XIII p.1), its origin may be traced to the evolution of ideas Keynes had first elaborated in a paper written in late 1913 (CW XIII pp.1-14). That paper, inspired by the reading of an early draft of Robertson's book *A Study of Industrial Fluctuation*, hinged on a discussion of the relations between banking policy (i.e., expansion or restriction of credit) and the trade cycle, but the crucial concepts in the analysis were investment decisions and the distinction between decisions to deposit money in banks and decisions to save. The latter two sets of decisions, combined with banking policy, could lead to divergences between savings and investment - and these divergences, in turn, would lead to economic fluctuations aggravated by ensuing banking policies. In the 1913 paper the investment decisions relevant to these movements were generally singled out by Keynes as concerning capital works (i.e., fixed capital), but initially he had also hinted at investment in stock of consumption goods and in goods in process (CW XIII p.5) - i.e., to liquid capital and working capital. In this paper, liquid and working capital soon fell out of focus. But as the latter concepts re-emerged in the November 1924 draft chapters, it may be stated that the 1913 paper not only provided a broad substratum, although chronologically remote, to the general development of the train of thought which, after the publication of the *Tract on Monetary Reform*, led Keynes towards the *Treatise on Money*, but that it

¹⁶ We may note that the concept of wages fund was used by Keynes also in his *Treatise on Money*, where a paragraph is devoted to the true wages fund (Keynes 1930, vol.2 pp.113-5). A sentence in Robertson's comments on the draft he had received by Keynes in early 1925 suggests that the idea put forward in that paragraph that that fund should include the income of all factors of production and not just of labour was also part of that draft (CW XIII pp.25-6; see also p.122).

¹⁷ Sraffa placed great emphasis on such an approach from 1927 onward, but it emerges very clearly also in papers dating to the years 1923-27.

also provided a broad connection to the particular point concerning the role of working capital in business cycle that we are focusing upon.

In order to answer the other questions listed above; that is to say, to get a more detailed picture of the content of what Keynes regarded as the novelty of his late 1924 business cycle theory and of the policy prescriptions it implied, we can rely on no other documents from the period, and we have to turn to documents written a good many years later: to the text of a draft chapter dating to late 1928 - early 1929 (The part played by the banking system [within the credit cycle]; CW XIII pp.83-113), which was not to survive in the published book, and to the final outcome of the process; i.e., to the *Treatise on Money* itself. In fact, although the length of time which separates them from the 1924 discussion between Keynes and Sraffa is considerable, the 1928 draft chapter and some chapters of the *Treatise on Money* may be interpreted as stemming directly from what in 1924 Keynes presented as his new view of the crucial role played by the demand for working capital. More precisely, in order to extend - although very tentatively - our understanding of the train of thought which was being pursued by Keynes in late 1924, we would point primarily to Chapters 18 and 27 - 29 of his *Treatise on Money*;¹⁸ while the extant draft chapter *The part played by the banking system* dating to late 1928 does not add to what can be gathered from the text of Keynes' 1930 book.

The text of Chapters 18 and 27 - 29 of the *Treatise on Money* confirms our previous statement that Keynes' analysis of business cycles was centred on the distinction between the various categories of capital necessary to production. But it also adds new elements on the special position of working capital in the ascending phase of the business cycle, on how this position, joined with technical aspects of the production process and with the trend of demand, would put an end to the boom and turn it into a slump, and, finally, on how ordinary banking policy tends to amplify these movements by facilitating lending in the upswing and by restricting it in the downswing, while it could curb them if directed at preventing the rise and fall of the price level. Variations of the price level should be taken by the banking system as an index to direct banking policy. To counter business fluctuations, broadly speaking, credit should be restricted when prices are rising and facilitated when prices are falling. But this prescription did not simply repeat what was said by Keynes in *Tract on Monetary Reform*; it could now rely upon the new understanding of the importance of technical characteristics of production processes and in particular of the role of working capital.

The importance of working capital in the business cycle and its role in turning a boom into a slump emerges in Chapter 18 of the *Treatise on Money*. Here Keynes, considering that the most frequent case of economic expansion is that triggered by "an additional production of capital goods being superimposed on the existing output" due to the fact that entrepreneurs had seen "advantageous opportunities for increased activity in particular directions" (Keynes 1930, vol.1 p.252, 8), stressed that, after this primary phase of the cycle, prices of consumption goods and of working capital tend to rise. In the secondary phase the stocks of those goods are reduced and their production increased in order to obtain the unusually high profits that their prices allow to gain. This stimulus to increase production adds up to the first one and raises costs of production substantially. Hence, demand for money and credit due to industrial circulation is increased, and "surplus bank resources fade away" (Keynes 1930, vol.1 p.258). But, even if the latter element were not sufficient to put the boom to an end, the secondary phase, according to Keynes, contains the

¹⁸ The titles of these chapters are the following: Chapter 18, Changes [in the price level] due to investment factors; Chapter 27, Fluctuations in the rate of investment - I. Fixed capital; Chapter 28, Fluctuations in the rate of investment - II. Working capital; Chapter 29, Fluctuations in the rate of investment - III. Liquid capital.

seeds of a reaction which turns the boom into a slump: increased costs of production reduce the incentive to invest in fixed capital; increased supply of working capital and consumption goods reduce their prices.

The role of the distinction between fixed capital and working capital to the study of the business cycle is discussed in greater detail in Chapters 27 - 29 (i.e., in the second volume of the *Treatise on Money*), where the same point is also discussed with an eye at showing the statistical importance of fluctuations of demand and production of working capital, and where the fact that production takes time is highlighted as a crucial part of the role that production of working capital plays in fostering a boom and laying the seeds of a subsequent slump (Keynes 1930, vol.2 p.106). In particular, in Chapter 28, Keynes argued that, normally, investment in fixed capital absorbs the whole current savings and that when, in the ascending phase of the cycle, "the time comes for the replenishment of working capital, it may be impossible to effect this rapidly without rupturing the equilibrium of prices and incomes" (Keynes 1930, vol.2 p.100).

5. New theory and social policy

Having reached this stage in our reconstruction of what Keynes, in late 1924, regarded as the novelty of his trade cycle theory, we may turn to the problem of formulating an hypothesis on the content of the social policy he illustrated to Sraffa and of understanding if and how it related to the policy prescriptions Keynes derived from his own new theory.

To this effect we may consider that the general horizon of the views on policy put forward by Keynes in several papers in 1923-25 was not restricted to specific economic measures. It encompassed prescriptions on the conduct of banking policy clearly connected to the analysis developed in the *Tract on Monetary Reform*, but it may be accurately described as the design of State intervention in economic life carefully engineered to avoid suppression of individual liberties - an approach obviously consistent with Keynes' philosophical views (dating to his youth) on the foundations of ethical behavior and on the scope for active intervention aimed at the improvement of practical affairs (see Carabelli - De Vecchi 1998, pp.76-80).

In the period we are considering - i.e., in 1923-25 - this strand in Keynes' thought first developed as perception of the importance of monetary reform (i.e., State intervention in the management of money) as a means to attain price stability and avoid cyclical unemployment. The focus on unemployment, which in post war Britain reached a dimension inducing to approach it as a permanent rather than a cyclical problem,¹⁹ extended Keynes' analysis into a discussion of the peculiar position that foreign investments had been assuming in Britain in those years and of the opportunity of diverting them towards home investments which, again, because of the peculiar conditions of Britain (Keynes 1924c, pp.229-30), should have been led by State intervention. These arguments - deeply rooted in precise historical premises - tended to combine with Keynes' more general views on the functioning of capitalism.

To show how these different points emerged in the relevant period we may refer to some papers (not always published in his lifetime) Keynes wrote approximately between Summer 1923

¹⁹ "It seems very optimistic to assume [...] that the figures [on unemployment] will cure themselves if we merely sit by smiling and avoid gross errors of policy [...] there is no place or time here for *laissez-faire*" (Keynes 1924b pp.219-20; see also 1924c p.231). It may be worth noting that just two months before Keynes had written: "I believe that not many months will elapse before I shall be in favour of dear money again. In the ordinary course the present slump will come to its final conclusion, and, just as on previous occasions, a boom will begin" (Keynes 1924a pp.193).

and Autumn 1925: his address to the Liberal Summer School in August 1923 (Keynes 1923a); his December 1923 lecture at the National Liberal Club (Keynes 1923c); his contributions to the debate on the economic situation of Great Britain which followed the letter sent by David Lloyd George to The Nation in April 1924 (Keynes 1924b, c); the lecture The End of Laissez-Faire that he delivered on that very 6th of November, 1924, when Sraffa was writing the letter we have studied (Keynes 1926);²⁰ his August 1925 address to the Liberal Summer School Am I a Liberal? (Keynes 1925a); and his October 1925 articles A Short View of Russia (Keynes 1925b).

In these writings Keynes broadly outlined the possibility that the State intervened in economic life introducing "wise controls and workable interferences" (Keynes 1923c, p.159) with the aim of improving the technical efficiency of capitalism ("improvements in the technique of modern capitalism by the agency of collective action" Keynes 1926, pp.292-3). These interventions should have avoided the suppression of individual liberties and the creation of a socialist society (i.e., protecting "society against the attacks and criticisms of Socialist and Communist innovators" - Keynes 1923a, p.117 - and leaving "private initiative and enterprise unhindered" - Keynes 1926, pp.292).

Keynes' starting point was the problem of unemployment:

"it may be inevitable that the average real wages of labour cannot, with the resources of nature, of invention, and of industry at our command, be raised to so high a figure as we should like. But the absurdity of labour being from time totally unemployed, in spite of everyone wanting more goods, can only be due to a muddle, which should be remediable if we could think and act clearly. The most serious charge which can be brought against the system of private enterprise in business and of capitalistic investment as it exists to-day, is that it has failed, so far, to deal with this muddle. As time goes on things seem to get worse rather than better" (Keynes 1923a, p.113);

and he saw price fluctuations, and in particular price deflation, or the fear of it, as responsible of this state of things:

"I argue, therefore, in the first place, that our existing industrial system is singularly ill-adapted to a policy of deliberate deflation, and that unemployment to-day is due to a very considerable extent not to the absence of markets or to the impoverishment of customers, but to a lack of confidence, arising out of many causes, in the existing level of prices" (Keynes 1923a, p.116).

From this diagnosis stemmed his proposal, which of course followed the lines also put forward in the Tract on Monetary Reform, for a State regulated currency:

"we must free ourselves from the deep distrust which exists against allowing the value of the currency to be the subject of voluntary decision. Only by wisely regulating the creation of currency and credit along new lines, can we protect society against the attacks and criticisms of Socialist and Communist innovators" (Keynes 1923a, p.117).

The same point he reasserted in December 1923:

"It is not true that individuals acting separately in their own economic interest always produce the best results. It is obvious that an individualist society left to itself does not work well or even tolerably. Here I agree with Labour. I differ from them not in the desirability of state action in the common interest, but as to the forms which such interference should take. Their proposals are out of date and contrary to human nature. But it is not safe or right just to leave things alone. It is our duty

²⁰ The published version of this lecture was revised in 1926 (see CW IX p.272).

to think out wise controls and workable interferences. Now there is no part of our economic system which works so badly as our monetary and credit arrangements; none where the results of bad working are so disastrous socially; and none where it is easier to propose a scientific solution" (Keynes 1923c, pp.158-9).

Starting from 1924, the same view that State intervention was necessary to cure unemployment tended to focus on the idea of financing public works and emerged from Keynes' attention to the way current regulations tended to direct Britain's savings towards foreign rather than home investments; but it also touched upon the deeper note of the necessity of seeking a new equilibrium between the State and the individuals. A hint to this effect can be found in the Spring 1924 debate on the remedies for unemployment, when Keynes wrote:

"The next developments of politico-economic evolution may be found in co-operation between private initiative and the public exchequer. The true socialism of the future will emerge, I think, from an endless variety of experiments directed towards discovering the respective appropriate spheres of the individual and of the social, and the terms of fruitful alliance between these sister instincts" (Keynes 1924b, p.222; see also 1924c, p.229);

"I look, then, for the ultimate cure of unemployment, and for the stimulus which shall initiate a cumulative prosperity, to monetary reform - which will remove fear - and to the diversion of national savings from relatively barren foreign investment into state-encouraged constructive enterprises at home" (Keynes 1924b, p.223); and "The main purpose of my article [...] was to ask whether it might not be in the national interest that the State should intervene to direct a larger part of our savings into capital enterprises at home" (Keynes 1924c, p.225).²¹

The same broader theme emerges in the November 1924 (revised in 1926) lecture *The End of Laissez-Faire*, where Keynes illustrated his view that:

"we must aim at separating those services which are technically social from those which are technically individual. The most important Agenda of the State relate not to those activities which private individuals are already fulfilling, but to those functions which fall outside the sphere of the individual [...] the important thing for the government is [...] to do those things which at present are not done at all" (Keynes 1926, p.291).

In this case, Keynes provided three examples (Keynes 1926, pp.291-2). First, the possibility of reducing "risk, uncertainty, and ignorance" by means of "deliberate control of the currency and of credit by a central institution" and by means of "collection and dissemination on a great scale of data relating to the business situation", involving "society in exercising directive intelligence [while leaving] private initiative and enterprise unhindered". Second, the possibility of coordinating savings and investments, in their national and foreign destination. Third, the possibility of pursuing a policy aimed at attaining the size of population deemed to be "most expedient" (see note 22 below).

Similarly, in his August 1925 address to the Liberal Summer School, Keynes referred to the fact that:

"the transition from economic anarchy [the era of abundance experienced in XVIII and XIX century] to a régime which deliberately aims at controlling and directing economic forces in the interest of social justice and social stability, will present enormous difficulties both technical and political. I suggest, nevertheless, that the true destiny of New Liberalism is to seek their solution" (Keynes 1925a, p.305).

²¹ The same theme is discussed by Keynes also in his address to the Liberal Summer School held in Oxford in August 1924 (Keynes 1924d).

These themes provide the background to the reflections Keynes put forward in his October 1925 articles on Soviet Russia. Here his concern for the shortcomings of modern capitalism emerges through his fear that a socialist system could outperform it by combining a tolerable economic inefficiency with a strong religious appeal; while capitalism would combine no religious appeal with weak economic efficiency (Keynes 1925b, pp.266-7).

It is in this context that we may understand Keynes' emphasis on the importance of reducing the prominence of the money making motive in capitalist societies. He saw how the technical muddles of capitalism combined with its unsatisfactory spiritual dimension could foster communist revolutionary movements and how he considered that both those spheres should be taken into account to counter them:

"we used to believe that modern capitalism was capable, not merely of maintaining the existing standards of life, but of leading us gradually into an economic paradise where we should be comparatively free from economic cares. Now we doubt whether the business man is leading us to a destination far better than our present place. Regarded as a means he is tolerable; regarded as an end he is not so satisfactory" (Keynes 1925b, p.268);

"a time may be coming when we shall get clearer than at present as to when we are talking about capitalism as an efficient or inefficient technique, and when we are talking about it as desirable or objectionable in itself. For my part I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life" (Keynes 1926, p.294);

"a revolution in our ways of thinking and feeling about money may become the growing purpose of contemporary embodiments of the ideal. Perhaps, therefore, Russian Communism does represent the first confused stirrings of a great religion" (Keynes 1925b, p.269).

To sum up, the core of the social policy depicted by Keynes to Sraffa in Autumn 1924 and that the latter wished would "direct progress in the near future" could lie in the idea that State intervention in monetary management and in directing investment through a programme of public works could remedy the most dissatisfying features of a capitalist economy and was supported by a broader philosophical and political approach which justified that intervention and stressed the possibility of reforming the basis of capitalist society without yielding to a suppression of individual liberties.

It may be interesting to note that the same two basic strands of thought were to appear also in the Treatise on Money as a more specific economic prescription and as a broader quasi-moral appeal to counter unemployment. The first aspect emerges from Keynes' discussion of the trade cycle in the first volume of his book, where all the emphasis fell on the role that banking policy might play in keeping savings and investment constantly equal, so as to prevent price movements and economic fluctuations (Keynes 1930, vol.1 pp.261-2) and on the fact that a moderate price inflation followed by price stabilization (not by deflation, of course) could bring general advantages in terms of economic growth (Keynes 1930, vol.1 pp.267-8). The second aspect emerges in the second volume of the Treatise on Money, where Keynes drew conclusions which, to a certain extent, went beyond the analysis of the trade cycle and implicitly invoked an external intervention on the economy:

"an increase in working capital due to increased employment does not involve an equal abstention from, or a reduction of, current consumption by the community as a whole, as does an

increase in fixed capital, but mainly a redistribution of consumption from the rest of the community to the newly employed. Investment, which requires a redistribution of current consumption but no reduction in its aggregate, may be said to substitute productive consumption for unproductive consumption [...] At any time, therefore, a community has two sets of decisions to make - the one as to what proportion of future income shall be available for consumption and what proportion shall consist of fixed capital, the other as to what proportion of present income shall be consumed productively and what proportion shall be consumed unproductively [...] it is on the second set that employment and unemployment depend. Full employment of the factors of production requires a redistribution, not a reduction, of the aggregate of consumption. [...] So long as unemployment and unproductive consumption are allowed to exist side by side, present total net income and future available income are less than they might be; and nothing is required to mend the situation except a method of transferring consumption from one set of individuals to another" (Keynes 1930, vol.2 p.111-3).²²

6. The basis of Sraffa's enthusiasm for Keynes' views on trade cycle and social policy

Our reconstruction allows us to circumscribe four areas which may be more usefully considered in order to understand the origin and meaning of Sraffa's enthusiasm for Keynes' analysis of economic fluctuations and for his views on social policy. Two of them relate to the first subject; two to the latter.

First of all, we may say that it is rather unlikely that Sraffa's enthusiasm for Keynes' new theory of the credit cycle and for his views on social policy - as expressed in the 6 November 1924 letter to Keynes which has triggered our research - may have been raised by Keynes' old real balances analysis and by any policy prescription directly stemming from it (i.e., by the idea of introducing and using forms of control over bank money "to cause the volume of bank money to vary in the same proportion as that in which the volume of real balances varies" - CW XIII p.21). In fact, although it is probably true that Sraffa shared from the beginning Keynes' broad idea that price movements should be taken as an index of progressing economic fluctuations and as a rough guide to monetary policy, we have seen that Sraffa was critic of the way Keynes had modelled the relationship between money demand and money supply in his Tract on Monetary Reform.

Secondly, we may presume that Sraffa found particularly interesting and akin to his own approach to economic theorizing Keynes' new ideas on the role of working capital in generating cyclical upswings and downturns. On the one hand, he probably believed that Keynes' new attention to variations in the demand for working capital significantly improved the foundations of the idea that price movements should be taken as an index of progressing economic fluctuations and as a rough guide to monetary policy. On the other hand, those ideas seem to have been formed by a set of propositions characterized by a marked attention to the technical features of production processes. Having in mind the emphasis he was already placing, as his manuscripts prove, on the importance of building an approach to economic theory based upon objective (as opposed to subjective) magnitudes, we may suggest that Sraffa felt that Keynes' attention to the technical

²² It may be noted that it is not altogether unlikely that the basic structure of this argument was touched upon by Keynes also during his October 1924 meeting with Sraffa. In fact, although the concepts of productive and unproductive consumption do not appear in the 1924 draft chapters, in a letter to Robertson dated 28 May 1925 Keynes referred to those very concepts as if they were a consolidated part of his approach: "a transference of consumption of such a kind that productive consumption (in my sense of the word) is substituted for unproductive consumption does increase saving [...] If you transfer purchasing power from retired widows to the unemployed, on condition that the unemployed work, then there is increased [saving]" (JMK/TM/1/2/20, CW XIII p.35).

aspects of production processes was in tune with his own views of how theoretical work should be done.

Considering the third area that we may circumscribe, we come to Sraffa's enthusiasm for Keynes' policy prescriptions - or, more precisely, for the social policy he had outlined. With regard to economic policy, we have seen that Keynes' views in the years 1923-25 amounted to the suggestion that constantly pursuing price stability would have avoided the necessity of reducing unemployment by means of inflationary policies. But he also maintained that diverting private investment from foreign to domestic destinations and a programme of public works were essential to facing persistent unemployment in specific British conditions. Considering Keynes' broader approach to social policy, on the other hand, we may state that his views hinged on the idea that a certain amount of government intervention in economic activity was necessary. The principles which were to guide this intervention were those of "controlling and directing economic forces in the interest of social justice and social stability" (Keynes 1925a, p.305). But this approach stretched towards favouring a wide process of social and moral reform, to the extent that Keynes dwelt on the possibility of a general move towards a revision of the importance of the money making motive in the working of capitalist societies and was ready to acknowledge the presence of interesting aspects in Soviet Russia and to adopt he himself the phrase true socialism - just as he was doing with the phrase new liberalism - to describe his own positions (Keynes 1924b, p.222, and 1925a, p.305, quoted above). In this context, we may also note that we are never led to suppose that within this process Keynes was ready to favour a form of dictatorship and sacrifice the basic principles of individual freedom or of what he simply referred to as society (Keynes 1923a, p.117).²³

Finally, we come to the fourth area singled out in order to assess the bases of Sraffa's appreciation of Keynes' positions. What we have indicated as the content of Keynes' views on economic policy and social policy lead us to consider also the political background of Sraffa's statement. To start with, we may conjecture that the defeat of both Labour and Liberal parties in the 29 October, 1924, general elections radicalized Keynes' attitude towards the necessity of a deep rethinking of social policy and that this broader approach was the main ground of his discussion with Sraffa.²⁴ But we may also wonder to what extent Sraffa was serious in his expressions of admiration for Keynes' social policy. On the one hand, the general elections had returned a Conservative majority after a Labour government supported by the Liberals: how could Sraffa seriously expect that Keynes' social policy, as described above, could "direct progress in the near future"?²⁵ On the other hand, as is well known that Sraffa's political sympathies were with the Communist left, it needs to be explained how he could have expressed the hope that a social policy aimed at extending the life of the capitalist system were soon to be applied. The latter point deserves to be discussed more deeply, and to this effect we may consider at least two possibilities, which are not necessarily excluding one another.

First of all, we may suggest that Sraffa's approval of Keynes' approach to social policy reflected an inclination on Sraffa's part to regard as generally important and desirable any improvement in the general conditions of the working class (in this sense we could interpret also his

²³ In principle, Keynes did not regard influencing the rules of social and economic games as an unacceptable interference by the State in the freedom of the individuals. But we may wonder if it was not an unacceptable interference that was approvingly referred to by Keynes in the case of population policies: "The time may arrive [...] when the community as a whole must pay attention to the innate quality as well as to the mere numbers of its future members" (Keynes 1926, p.292).

²⁴ In fact, the very letter where he informed Lydia Lopokova of the meeting he had had with Sraffa, was opened by Keynes with these words: "I am still rather depressed about the Election. The poor Liberals are simply cut to pieces. But I console myself that it makes a good time to think matter out better than they have been thought out lately" (JMK/PP/45/190/2/39, Hill - Keynes 1989 p.245).

²⁵ Of course, much would depend on what Sraffa meant by near future, and on the importance he attributed to differences between a Labour or a Liberal government and a Conservative government.

work, in 1922, as Direttore of the Labour Office of the province of Milan - see Naldi 1998 pp.498-9). Secondly, we may consider a more complex explanation rooted in how, in the early 1920s, Sraffa viewed the nature and causes of Fascism and the possibility of accomplishing a Socialist revolution in Italy or in other European countries. In this context two documents are particularly interesting: a manuscript in Sraffa's hand, probably dating to 1921-22, kept among Dobb's papers and bearing the title British Empire (DP DD 2),²⁶ and a letter sent by Sraffa to Antonio Gramsci probably in early 1924 and published by Gramsci with a comment in L'Ordine Nuovo shortly afterwards.

From the first document we may gather that according to Sraffa any capitalist country was facing the risk of a Fascist involution as a result of economic difficulties. In particular, Sraffa, following Engels (and Rajani Palme Dutt), considered the case of Great Britain and the effects which could follow from the partial collapse of some parts of the trade with the countries belonging to the British Empire or from the total loss of the Empire. Sraffa did not believe that a strong Socialist movement or a Socialist revolution would immediately follow such a crisis:

"Dutt, Engels: «When [British] Emp[ire] crumbles [the British working class] will turn socialists» Well, I don't believe it will be as direct and as simple as that - although it will be the ultimate result. In the first place, when the eng[lish] w[orking]-c[lass] feels seriously the pinch of the break up of the empire, i.e. brit[ish] com[mercial] supremacy, (and this will in the first instance be the collapse of the dole, when it will be impossible to continue on present scale without curtailing the incomes of the capitalist to a point they will regard as intolerable, i.e. the so-called «discouraging of enterprise»).

Their reaction must be a desperate attempt to hold on to the past conditions which are slipping out of their hands - it will take some time before the privileged sections of the w[orking]-c[lass] make up their minds that what is lost cannot be recovered, and that the only way to make it good is to turn against the capitalist. This is seems to be [sic] happening in Lancas[hire], where the shrinking of the Indian trade seems so far to have had more effect in uniting the T[rade] U[nion]s with the employers in their protests at the weakness of Ind[ian] Gov[ernment] which raised tariff and fails to put down the boycott rather than in radicalising the masses" (DP DD 2/11).

In particular, if the working class would react blindly and unconsciously to the events (DP DD 2/14), Sraffa feared the reaction of the middle class hit by unemployment:

"but when: foreign and col[onial] bonds repudiated Col[onial] c[ivil] s[ervants] are turned out of the colonies and perm[anent] decline of foreign trade leads, on the one hand to the unemployment in the City offices, and in the commercial employees abroad.

Then fascism. (Tariff, means this)" (DP DD 2/11).²⁷

And he also noted:

"fascism: why: dispossessed middle class (by war or by inflation) is the raw material of F." (DP DD 2/12).

²⁶ Several elements in this undated manuscript suggest that it was written during the months Sraffa spent in Britain in 1921-22 (see Auletta 2004), but some parts might have been added later. In particular, from Sraffa's diary for the academic year 1930-31 (SP E 4) it appears that he brought this paper back from Italy to England in Winter 1930-1, and on that occasion he might have added some passages to the old text. As it seems likely that Sraffa attended the Summer School held at Herne Bay by the Labour Research Department in 1921 (Page Arnot 1976, pp.467-8; letters from Sraffa to Keynes, 5 August 1921, JMK/L/S/4, and from Sraffa to Luigi Einaudi, 2 September 1921, AFLE), we may wonder if this paper had any relation to that event. Unfortunately, we know of no document which could illuminate this point.

²⁷ We read the phrase "Tariff, means this" in the sense that Sraffa meant to indicate that fascism was based on a nationalist alliance of working class, middle class and higher bourgeoisie.

If we apply these views to the economic depression Britain was facing in 1924, we find a reason why Sraffa could have appreciated Keynes' approach to social policy as a means of avoiding the danger of a Fascist involution in that country. Furthermore, the idea that Sraffa, in Autumn 1924, could have regarded as real such a danger is also supported by the fact that the political climate in Britain may have appeared to him as subject to artful manipulation aimed at fostering nationalist and anti-socialist sentiments: the fall of the Labour government, in early October 1924, had been caused by a vote of censure on the so called Campbell affair (the government decision that the prosecution for sedition of John Campbell, the editor of a British Communist weekly, was to be withdrawn); and on October 25, shortly before the general elections, a letter urging the Communist Party of Great Britain to stir up the British proletariat in preparation for eventual armed insurrection, supposedly addressed to the Central Committee of that party by Grigori Zinoviev, President of the Executive Committee of the Comintern (the Third Communist International), was published in the British press.²⁸

In the same sense, it is also important to stress that in Spring 1924 (that is to say, shortly before the meeting with Keynes we are discussing) Sraffa's political views appears to have been marked by a deep awareness of the role that different classes and parties could have exerted in a fight against Italian Fascism. This is brought out by a letter he sent to Gramsci in early 1924. In that letter he wrote that in Italy it was not the Communist Party that could lead a political initiative against the Fascist pressure, but that it was:

"the time for democratic opposition [...] First of all we need a «bourgeois revolution», which will then allow the development of a worker-oriented politics [...] for better or worse it is [bourgeois «freedom»] which the workers most strongly feel they need today and it is a prerequisite to any further conquest" (Sraffa 1924a, p.107).

Also in this occasion Sraffa expressed his support towards a Socialist revolution,²⁹ nevertheless, he also favoured a bourgeois revolution. The latter fact is clearly consistent with his warm approval of Keynes' bourgeois social policy. The foundation of this approval may lie in the idea that to be able to avoid a Fascist outcome to an economic crisis the working class must not be blind nor unconscious; i.e., it must be well guided and directed. But could Sraffa see such a good guide at hand? Reacting to Sraffa's letter Gramsci himself admitted that in Italy such a guide was lacking: the Communist Party was not adequate to its task (see Naldi 2000 pp.85-6). In Britain, in 1921, on the other hand, Sraffa had directly witnessed the failure of the Trade Unions and of the Labour Party as a revolutionary leadership of the working class (see Sraffa 1921a, b, c), and we may doubt Sraffa could see such a leadership in Britain in 1924. In those circumstances, the danger of a Fascist involution could explain Sraffa's approval of Keynes' social policy: it could be the way an enlightened bourgeoisie could save Britain from a Fascist outcome of the economic crisis. This perspective could have led Sraffa to seek allies within Socialist parties, which was where his political militancy had began. In fact, we know from the correspondence between the Italian Socialist leaders Anna Kuliscioff and Filippo Turati that in June 1924 Sraffa was involved in a group of young socialists projecting to found a centre for economic research (Turati-Kuliscioff 1977, pp.280, 284), and letters and notes kept in the Sraffa Papers and at the Fondazione Luigi Einaudi show that during the months he spent in London in 1924 Sraffa was a member of the 1917 Club: a lunch club founded by Ramsay MacDonald (who became prime minister in January 1924)

²⁸ Our knowledge of these episodes mainly rests upon Bennett 1999 and MacIntyre 1980.

²⁹ "My political opinions remain unchanged - worse, I have become fixed in them, fixed as I was, until 1917, in the pacifist socialism of 1914-15, from which I was shaken out when I made the discovery, after Caporetto and the Russian revolution of November, that it was precisely the worker-soldiers whose hands held the guns. Unfortunately, the analogy does not carry through that far [...] I dont think my position is irreconcilable with being a Communist, even though an undisciplined one" (Sraffa 1924a, p.107).

and possibly closer to the left wing of the Labour Party than to the Communist Party of Great Britain.³⁰

Conclusions

If we accept the idea that in his 6 November 1924 letter to Keynes Sraffa expressed a genuine appreciation of Keynes' new approach to credit cycle theory and of the social policy he was delineating, we may state that that letter may enriches our understanding of both Sraffa's views on economic theory and of his approach to politics in the first years of the Italian Fascist government.

Our attempt to understand the content of the views presented by Keynes to Sraffa in that period has allowed us to explore the stage reached by Keynes' analysis in the early phases of his path from the Tract on Monetary Reform towards the Treatse on Money and the way Keynes' thought evolved in front of the concrete condition facing the British economy in the early 1920s.

In order to understand Sraffa's reaction to these views we have discussed his manuscript notes on Keynes' Tract on Monetary Reform and we have formulated some conjectures on the bases of the enthusiasm he showed during his meeting with Keynes and in the subsequent letter that has triggered our research. These conjectures mainly refer to the objective nature of Keynes' attention to the role of working capital in the trade cycle and to the relationship between his views on social policy, the experience of Fascist involution witnessed by Sraffa in Italy and Sraffa's perception that a similar danger could be generated in any country faced with critical economic conditions.

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³⁰ Information on the 1917 Club have been provided to me by Francis Becket and by the late Roger Simon.

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