

No.19

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desertion and integration

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April 2000

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**Key Words** : Henderson, Keynes, Lloyd George, the General Election in 1929,  
a managed economy, public works, the Welfare State.

**JEL Classification** (*Journal of Economic Literature*)

(a)primary: B31 History of Thought: Individuals

B Methodology and History of Economic Thought

(b)secondary: N14 Europe: 1913-71, N1 Macroeconomics and Monetary  
Economics; Growth and Fluctuations, N Economic History

**Abstract**

It is difficult to judge their collaboration and division appropriately, unless we trace Henderson's basic idea. Previous studies have paid little attention to the idea and his original writings.

We will develop the next two viewpoints. Firstly, before 1929, is it certain that their views coincided, and can we really call their work co-operative research? Secondly, if breakdowns really occurred between the two men, when, why, and to what extent were Henderson and Keynes divided? The latter question implies doubts as to whether or not Henderson's experience of public office was the only true reason for their division.

We can summarise this paper into the following four points. Firstly, we assert that, before 1929, Henderson and Keynes shared the same logical steps: three elements (bad monetary policy, the unemployment problem, and the capital plan) are naturally joined into one ring. Secondly, we should consider primarily the impact of the general election in June 1929, and secondarily the impact of his inauguration as secretary in the Economic Advisory Council in January 1930. Thirdly, we can claim that the fears and warnings of Henderson stem from his consistent doubt about the dole type Welfare State. Fourthly, we can arrive at the conclusion that they share the same idea, "managed economy", on the grounds of the concept of "entrepreneur-in-chief".

## Henderson and Keynes on the Welfare State: desertion and integration

Atsushi Komine\*

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## Section 1 Introduction

The goal of this paper is to investigate both the meaning and the extent of the collaboration between H. D. Henderson (1890-1952) and J. M. Keynes (1883-1946). As a fervent supporter of the Liberal Party, Henderson was the chief editor of *the Nation and Athenaeum*, which could at that time be regarded as the instrument of the Party. In addition, he was so close to Keynes that they worked together. For example, they co-authored such writings as the article "Can Lloyd George do it?" (1929) and the book *Britain's Industrial Future* (1928). However, their collaboration suddenly came to an end around 1930. Some studies tried to clarify the reason for this. According to them, Henderson's making public office in January 1930 was a crucial event. He became a secretary of the Economic Advisory Council and a member of its treasury side. However, those studies, which emphasised his experience as a public officer, did not mention his own writings, thus overlooking his consistent economic thought. The question of how to weigh up the similarities and differences between the two famous economists is still open.

This paper distinguishes itself from previous research by focusing specifically on Henderson's own papers, leading articles, and memoranda, as well as on his 1929 joint article with Keynes. Furthermore, in order to elucidate points at issue, a full comparison is made between Henderson and Keynes. After that, the following two aspects or questions are addressed: firstly, before 1929, did their views really coincide, allowing us to call their work co-operative research? Secondly, if they disagreed, when, why, and to what extent were Henderson and Keynes divided?

This paper is organised as follows. Section 2 gives a short biography of Henderson. Section 3, which is regarded as the research proper, presents a survey of their contemporaries' and researchers' judgement on the collaborative or divided nature of their relationship. Section 4 analyses "Can Lloyd George do it?" in detail in order to bring out the key points of the article, and compares it with his own economic thought before and after 1929. Sections 5 to 8 constitute the core of the paper. In accordance with central points indicated, Section 5 considers his analysis, prior to 1929, of unemployment. The comparison with Keynes' is also made. Section 6 traces the change of Henderson's claim, which was made around

1930, on the causes of unemployment and its remedies. Section 7 concentrates on the discussion of unemployment benefit. Section 8 focuses on Henderson's economic thought as a background to his assertion. Finally, Section 9 summarises this paper in order to clarify the most important claim, and draws the conclusion.

## Section 2 A brief biography<sup>1</sup>

Hubert Douglas Henderson (1890-1952) was born in Beckenham, Kent on 20 October 1890. He was the youngest of six brothers, his father was a Scottish banker<sup>2</sup>, and his mother was descended from an Edinburgh ship-owner.

While he was being educated at Aberdeen Grammar School and then at Rugby Public School, his interest gradually shifted from classics to mathematics. He was selected to study at Emmanuel College<sup>3</sup>, Cambridge in 1909. During his college life, a movement of social reform, which later came to be known as the Liberal Reforms<sup>4</sup>, was organised by the Liberal Party Governments (1905-1915). In addition to this political background, because he only attained a Third Class in the first part of the Mathematical Tripos, Henderson changed to read the second part of the Economics Tripos. This time he was awarded a First Class in 1912. At that time, Dennis Holme Robertson<sup>5</sup> was his classmate. His college life was so active that he

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<sup>1</sup> This section relies mainly on Clay [1955], Robinson [1987], and Wilson ? [1953].

<sup>2</sup> At first, his office was in the North of Scotland Bank in Aberdeen. He later moved to Cydesdale Bank in Glasgow.

<sup>3</sup> Richard Valentine Nind Hopkins (1880-1955) graduated from the same college. Hopkins and Henderson later worked together in the Treasury.

<sup>4</sup> The Chancellor of the Exchequer was Lloyd George. Examples of the reforms abound: the Administrative Provisions (1907), the Old Age Pensions Act (1908), the Labour Exchange Act (1909), the National Insurance Act (1911), and so on. He also established the "People's Budget" (1909), in which new taxes were imposed on the rich.

<sup>5</sup> Robertson changed from classics to economics (Skidelsky [1983] p.213). F. Lavington, who is famous for his theory of trade cycles, took the Tripos in 1911. After working in the Board of Trade, he returned to Emmanuel College as a teaching fellow.

became President of the Union, as Keynes did in 1904<sup>6</sup>. In those days in Cambridge, young teachers - not only Professor Pigou, but also Keynes, Charles Ryle Fay, and Walter Thomas Layton<sup>7</sup> - played both an active and an attractive part.

The First World War broke out in 1914. Though he applied for military service, Henderson was refused on medical grounds. Then, after graduating, he was recruited by the statistics division - organised by Layton - of the Board of Trade. For the first time, he had experience as a government officer. He was dispatched to Manchester as Secretary of the Cotton Control Board in 1917. After observing practical aspects of industrial management, he recognised himself to be a specialist who could afterwards publish the pamphlet on the Board. During the War<sup>8</sup>, he married Faith Bagenal.

After the end of the War, in 1919, Henderson was employed as a teaching fellow at Clare College, Cambridge. He published a textbook, *Supply and Demand* (1922), although he was busy with classes and tests. The textbook was volume one<sup>9</sup> of the Cambridge Economic Handbooks of which Keynes was general editor. For the next three decades, *Supply and Demand* was used as an introductory book to economics<sup>10</sup>. In 1922, he also published the Cotton Control Board.

The first turning point for him was in 1923, when he was invited - on Keynes' powerful recommendation - to become editor of *The Nation and Athenaeum*, which was to change its character<sup>11</sup>. Keynes was chairman of the Board of Directors. Writing leading articles and so on, Henderson played an important role as chief editor, and the magazine spread Liberal Party views to the masses. Additionally, he published *Inheritance and Inequality: A Practical Proposal* in 1926. This was one of "The New Way" Series<sup>12</sup>, which were the outcome of discussions among

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<sup>6</sup> Harrod [1982(1951)] p.97.

<sup>7</sup> A Liberal economist (1884-1964), Editor of *The Economist*. Moggridge [1992] p.888.

<sup>8</sup> He shared a flat with Robertson, see Clay [1953] p.27, preface.

<sup>9</sup> Volume two is Robertson's *Money* (1922).

<sup>10</sup> Robinson [1987] p.639.

<sup>11</sup> H. W. Massingham, the previous editor, had resigned and decided to join the Labour Party. Moggridge [1992] p.391.

<sup>12</sup> The pamphlets were designed as a contribution to the clarification of post-war confusion.

members of the Committee and the Council of the Liberal Summer Schools. Members included Keynes, Layton, and Henry Clay. Moreover, Henderson participated in the writing of Britain's Industrial Future in 1928, later known as the Yellow Book. This book was also a product of the Liberal Summer Schools, and was written by the executive committee of the Liberal Industrial Inquiry. Naturally, Henderson was also one of the writers<sup>13</sup>, though his contribution cannot be disentangled from the book as a whole. To sum up, in the 1920s, he was positively concerned with the ideals of the Liberal Party and liberalism.

The year 1929 was important for Henderson. Taking the coming general election into consideration, Lloyd George - whose Party was out of office - officially announced a pledge in March, in the pamphlet "We can conquer unemployment". This pledge caused a great dispute in the Conservative Party and in Whitehall. In May, in support of his policy, Henderson and Keynes published together "Can Lloyd George do it?: the pledge examined". What is more, as a Liberal candidate<sup>14</sup>, Henderson stood for Cambridge University. The Party was defeated completely in the general election on 30 May. He himself was one of the failures<sup>15</sup>. For Henderson, this was closely associated with actual political action. After that, the McDonald's Labour Party administration took office on 5 June.

The second turning point came in 1930. Under the Labour Party Cabinet, a new national conference on industry was organised. It was the Economic Advisory Council. In January, Henderson<sup>16</sup>, who left *the Nation*, took part in the Council as an assistant secretary, and later as joint secretary. This was his second time as a civil servant. However, since this national committee did not function at all, other segmented multiple sub-committees were set up as advisory organs. One of them was the committee of economists, appointed in May 1930. Keynes became chairman, and Henderson participated on the side of the Treasury.

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<sup>13</sup> There were thirteen members, including Layton (chairman), Lloyd George, B. S. Rowntree, and Keynes.

<sup>14</sup> Keynes had once refused to contest. See CW19 p.816.

<sup>15</sup> Clarke [1988] p.101.

<sup>16</sup> He did not accept to be a professor at the London School of Economics.

Clarke [1988] p.142.

Now the two men seemed to be divided. Almost at the same time, a committee organised by Lord Stamp was also set up. As a member of the committee, Henderson explained the current economic situation to the Prime Minister every month. This continued until the next World War broke out. Over and above, in 1935 he became chairman<sup>17</sup> of a sub-committee that examined the unemployment insurance act. In short, Henderson was a public servant during the first half of the 1930s.

Finally, he reached a third turning point in 1934. Henderson took up the position of lecturer at All Souls, Oxford University. He became engaged in managing university administration. For example, he formed an economist research group<sup>18</sup> to investigate businessmen's actual behaviour, and in 1938 he founded an academic magazine, Oxford Economic Papers. Though he entered a scientific environment, he remained in contact with the government office. For instance, in 1938 and 1939, he took a trip to the West Indies in order to study its economic situation, as a member of the Morne Commission<sup>19</sup>. On the eve of the War, in 1939, the investigation department - organised by Lord Stamp - was again set up in Whitehall. Henderson also took part in it. However, he moved to the Treasury during the War as an advisor on economic policy. He was chosen as a member of the Royal Commission on Population in 1944, and later took over the chairmanship.

In 1945, Henderson was elected as Drummond Professor<sup>20</sup> of Political Economy at Oxford University. Outside Oxford, he became President of the Royal Economic Society in 1950. Although his colleagues elected him to the post of Warden in 1951, that is, President of the college in the symbolic sense, he was unable to perform the job because of his disease. Henderson died on 22 February 1952.

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<sup>17</sup> See Debenham [1953] p.42.

<sup>18</sup> Empirical interviews made it clear that the form of actual business behaviour was not the maximum principle as to price and interest. One product of the group is Hall and Hitch [1939].

<sup>19</sup> Royal Commission of Enquiry into the economic problems of the West Indies.

<sup>20</sup> His successor was John Richard Hicks.



### Section 3 The relation between the two men

No papers or books brought out Henderson's own economic thought, treating him as a protagonist. He was only referred to in his own obituaries, memorial writings, and in the context of researches on Keynes. This section begins by listing quotations about him. Those references then come to be summarised in two parts: collaboration and estrangement.

#### 3-1 Collaboration

First of all, we will show the very close relationship between the two economists. Many related contemporaries and present researchers have testified along the following lines.

Few knew about their exact relationship better than Henderson's wife, Faith. Remembering the day when Keynes came and asked him to be the editor of *the Nation*, she testified that "for the next seven years Hubert worked in the closest collaboration with Keynes"<sup>21</sup>. As to the joint pamphlet (1929), she regarded it as " ... a true work of collaboration about which there was never any question as to who gave the most"<sup>22</sup>.

Henry Clay<sup>23</sup>, who had left the University of Manchester and come to the Bank of England, reviewed the Yellow Book (1928) as follows: "Henderson's part in conducting the inquiry and drafting the report was considerable, though it cannot be disentangled from a large co-operative work"<sup>24</sup>.

We naturally introduce Keynes' own words. When Henderson ran for general election in 1929, as mentioned above, Keynes expressed his support for him, stating:

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<sup>21</sup> F. Henderson [1953] p.8.

<sup>22</sup> F. Henderson [1953] p.8. See also CW9 p.86.

<sup>23</sup> A specialist on Rationalization of Industry. Later, he edited a book of collected writings of Henderson, *The Inter-War Years and other Papers* (1953).

<sup>24</sup> Clay [1953] p.7, preface.

in the two causes of international peace and disarmament, and of national development as a remedy for unemployment<sup>25</sup>, which look like being the two principal issues of this Election. For Mr Henderson has played a prominent part in forming the opinion and policy of the Party on these questions. (CW19 p.816)

Moreover, special acknowledgement was made<sup>26</sup> to him in Keynes' *The Treatise on Money* (1930):

Amongst several others who have helped at different stages, I would particularly like to mention Mr H. D. Henderson. (CW5 p.14, preface)

Thus, we can conclude that Lady Henderson, Clay, and Keynes himself considered it natural that there was surely a strong co-operation between the two men. We now turn to present studies.

Today, the most famous view is taken by the editor of the Collected Writings of John Maynard Keynes (hereafter referred to as CW) as follows:

It has not proved possible to apportion the pamphlet between its joint authors ... As editor-in-chief of *the Nation* and chairman of its advisory board, Henderson and Keynes worked closely together, and both men had taken a major part through the years leading up to the election in framing the Liberal plans. (CW9 p.86)

Moggridge later recorded that "by 1930, Henderson had a long record of collaboration with Keynes on campaigns to influence economic policy, if not of success in achieving that influence"<sup>27</sup>. Two things are clear. Firstly, the editors, especially Moggridge, shared the same view as Lady Henderson, quoting the above sentences in footnote 22. Secondly, it is necessary here to emphasise the fact that such professional editors as E. A. Robinson, Elizabeth Johnson, and Donald

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<sup>25</sup> Keynes himself had tackled the unemployment problem since 1924. See CW19 p.182.

<sup>26</sup> The others are Robertson and R. Kahn.

<sup>27</sup> Moggridge [1992] p.502.

Moggridge could not find any drafts of "Lloyd George". Therefore, we cannot directly decide on which part of the article Henderson really wrote.

Peter Clarke described it from a different angle. According to Clarke [1988]:

He and Keynes shared a schooling in the Marshallian tradition in economics and in politics an outlook shaped by the New Liberalism of the Edwardian period. (Clarke [1988] p.78)

New Liberalism consists of four elements: the end of laissez-faire, the rejection of class war or nationalisation, a remodelled Liberalism or the managed economy, and co-operation with Labour<sup>28</sup>.

From the above quotations, we can conclude that both their contemporaries and themselves and present researchers recognised them to be close, in thought and in theory. In addition, as Skidelsky [1992] made it clear<sup>29</sup>, the Hendersons were on friendly terms with the Keynes, at least in the 1920s.

### 3-2 Estrangement

Secondly, we will discuss their estrangement in theory and in thought, if it existed at all. A final conclusion can be drawn from Keynes' conscious statement about the 1941 budget, later called "the first Keynesian budget"<sup>30</sup>.

The critics are now all content except Hubert. (CW22 p.347)<sup>31</sup>

Indeed we were a wonderfully united team. The opposition which has given me trouble and worn down my nerves was mainly from Hubert Henderson.

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<sup>28</sup> Clarke [1988] pp.79-80.

<sup>29</sup> For example, see Skidelsky [1992] p.145, p.217, and p.339.

<sup>30</sup> The budget includes national income account and inflation-gap analysis whose target point is full employment. Keynes appreciated the budget as follows: "the logical structure, and method of a wartime Budget which, together with the new White Paper, is really a revolution in public finance" (CW22 pp.353-354).

<sup>31</sup> A letter to James Meade, 28 March 1941.

(CW22 p.354)<sup>32</sup>

Researchers share the view that, around 1930, when Henderson left the Nation, the two men differed in many respects. Take five quotations, for example. As Clarke [1997] pointed out: "Henderson was thus one of the first and one of the most persistent critics of Keynesianism, both in theory and in practice"<sup>33</sup>. The editor of CW said: "Keynes retained an intermittent exchange of memorandum with Sir Hubert Henderson, in many ways the White Paper's strongest critic"<sup>34</sup>. As Middleton [1998] demonstrated: "Indeed, the case of Henderson illustrates how an essentially radical and optimistic spirit can be broken by experience of government service ... "<sup>35</sup>. As Clay [1955] stated: "The changes in his attitude to particular projects or policies were the fruit of experience"<sup>36</sup>. To quote Harrod [1953], "Henderson had been deeply impressed with all those practical difficulties which damp the zeal of the most ardent reformer when he finds himself in Whitehall"<sup>37</sup>. We need to pay attention to the fact that they focused on Henderson's experience of civil service.

Then, when and why did his change in opinion occur? Three scholars tried to answer this question. Firstly, as Skidelsky [1992] put it: "The change in Henderson's views was partly the result of a change in position: Henderson was now inside the government machine, Keynes outside it"<sup>38</sup>. Then, Skidelsky pointed out that his defection was signalled in a letter from May 1930. We will deal with this letter in Section 6. Secondly, as Howson and Winch [1977] said:

After their collaboration in the latter half of the 1920s, a gap opened up between Henderson and Keynes on a variety of issues - a gap which widened with time and the deterioration of the economic situation. This divergence of

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<sup>32</sup> A letter to his mother, 14 April 1941.

<sup>33</sup> Clarke [1997] p.147.

<sup>34</sup> CW27 p.372.

<sup>35</sup> Middleton [1998] p.82.

<sup>36</sup> Clay [1955] p.15, preface.

<sup>37</sup> Harrod [1955] p.59.

<sup>38</sup> Skidelsky [1992] p.365.

opinion can perhaps be partly attributed to the differences in their official positions, with Henderson becoming increasingly associated with the problems of government seen from inside, while Keynes remained a privileged outsider ... (Howson and Winch [1977] p.66)

They continued to state that "as early as March 1930 Henderson had expressed doubts to Keynes"<sup>39</sup>. Thirdly, Moggridge [1992] completely approved of this study, stating that "a gap opened up between the two .... Their differences may have reflected a difference in their official positions, and hence sense of responsibility"<sup>40</sup>.

Austin Robinson [1987] looked at another aspect of the estrangement.

It was not Henderson's fault that, despite the ingenuities of Keynes and the debates of countless committees, they failed to do so. It was the fault of a generation of politicians who could not be persuaded to grasp the nettle. But these years of frustration had turned Henderson into a different man. He was no longer the crusading optimist. (Robinson [1987] p.639)

As mentioned above, their opinions almost coincided. To put it briefly, for a long time - especially for the seven years following Henderson's coming to *the Nation* - he and Keynes shared a political and theoretical style in common. However, the two men seemed to be thoroughly divided when the Economic Advisory Council was held in January 1930. According to past studies, the reason was quite clear. Henderson's experience of public service had been influential. In consequence, he became a drastic and persistent critic of Keynesianism.

This paper will distinguish itself from previous studies by criticising their over-simplification, and by focusing on Henderson's own economic thought. To make the question at issue evident, we will develop the next viewpoints. Firstly, before 1929, is it certain that their views coincided, and can we really call their

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<sup>39</sup> Howson and Winch [1977] p.66.

<sup>40</sup> Moggridge [1992] p.502.

work co-operative research? Secondly, if breakdowns really occurred between the two men, when, why, and to what extent were Henderson and Keynes divided? The latter question implies doubts as to whether or not Henderson's experience of public office was the only true reason for their division.

In order to answer this question, we need to examine Henderson's own writings. Before describing them in detail, however, it is useful to address the question raised by the article "Lloyd George" (1929) in Section 4. It is necessary here to sum up and to highlight the key points of the joint paper.

#### Section 4 The pledge examined

As for the coming general election in 1929, the issue in those days was a remedy for unemployment. Since 1920, the rate of unemployment in Britain had reached the level of one million<sup>41</sup>. Some of the Liberal Party camps such as Keynes's were convinced that public works were a solution to cut down unemployment, and pressed the Government to carry them out. Their claim was symbolised by Lloyd George's pledge, "We can conquer unemployment" (March 1929). The government reacted to his pledge immediately. In April 1929, the Treasury View was stipulated for the first time in a budget speech by Winston Churchill, the Chancellor of the Exchequer. The central point of this view was the following: "Borrowing money by the government should crowd out private investment. Therefore, public works by national debts do not bring additional employment." In May, a pamphlet, "Can Lloyd George do it? --- The pledge examined," was published by the co-signatories Keynes and Henderson in support of the pledge. The following day, only Chapter 7 was printed again in the Nation by the co-signatories. Keynes later edited Chapters 3, 9, 10, and 11 in his Essays in Persuasion (1931). In May, the Treasury in turn announced a White Paper, "Memoranda on certain proposals relating to unemployment". It was just a

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<sup>41</sup> According to Feinstein [1972] pp.T126-T127, Table 57, the figure for unemployment in 1929 was 1500000, and the rate was 7.3 %. However, there is still a dispute about the figures from inter-war Britain.

declaration of war that would be called an "economic dispute" between the two camps.

#### 4-1 Summary

The co-signatory pamphlet consisted of 11 chapters. In this section, after each chapter is introduced, it is summarised in five important points.

In Chapter 1, "Mr Lloyd George's pledge," they were wholeheartedly supporting the pledge, and appealed to public opinion for the carrying out of national programmes. They reproached people for being pessimistic, stating that "the cumulative effect of renewed prosperity will surpass expectations"<sup>42</sup>. A crucial point to emphasise here is that they rightly recognised that the vital point, which generated arguments for and against, lay in the "transfer problem". This phrase meant "shifting men from industries where they are permanently redundant and settling them in their new work"<sup>43</sup>. This difficulty, however, was only of secondary importance to them.

It is useless to try to tackle the "transfer problem" seriously until the jobs have first been created elsewhere, and employers are crying out for men. ... It is useless to transfer men until there is something to transfer them to. (CW9 p.90)

According to Keynes and Henderson, the government should start by carrying out large-scale investment plans, and go on to tackle the transfer problem. The converse was not true. In other words, priority was given to the macroeconomic area, not to the microeconomic one. The former meant raising demand in general, whereas the latter indicated the transfer problem between individual industries.

In Chapter 2, "the common sense of the problem," they criticised the policies of the Prime Minister, Baldwin. They declared that, in the pamphlet, they would justify the claim that: "if new forms of employment are offered more men will be

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<sup>42</sup> CW9 p.89.

<sup>43</sup> CW9 p.89.

employed"<sup>44</sup>. In Chapter 3, "the facts of unemployment," the loss due to unemployment in the 1920s was outlined. In Britain, one-tenth or more of the population had had no jobs for eight years. The number of insured workers had never been under one million. For this reason, the unemployed took in cash a sum of £500 millions. It was, nevertheless, in vain. Added to this, there was also the loss in profits to employers and in taxation to the Treasury. There had been a total loss of £2000 millions since 1921, estimated from the annual output per capita. In contrast, the pledge of the Liberal Party was a plan ensuring 500,000 returns to employment for £100 millions a year. The cost of the plan was only 5% compared to the loss hitherto shown - "it is a *very modest programme*"<sup>45</sup>. This chapter had unique characteristics, as the economic situation was analysed using newly-developed macro-statistics of unemployment<sup>46</sup>, and the cost of unemployment was too high because the "opportunity cost" of unemployment was also too high. What needs to be emphasised here is that there was no reference to the cause of unemployment.

In Chapter 4, "the Liberal programme", concrete National Development plans were presented. Such plans included the national transport system --- roads, railways, and bridges ---, national housing, and other developments --- telephone and electrical development, and drainage ---. Their argument in this chapter was in fact a summary of Britain's Industrial Future. In Chapter 5, "the Government's case", they accused the Conservative administration of overlooking remedies to unemployment, owing to temporality and inefficiency.

In Chapter 6, "How much employment will the Liberal plan provide?", they examined the quality and quantity of employment created by the plan. They claimed that each million pounds spent annually on roads would employ 5,000 workers. Not only did this have a direct effect, but it also had an indirect one. It is valuable to point out that Keynes and Henderson realised the importance of indirect employment and a cumulative force. For example, these phenomena indicated that "the construction of the road entails a demand for labour and also for other

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<sup>44</sup> CW9 p.92.

<sup>45</sup> CW9 p.93, italics in original.

<sup>46</sup> It was started by the Ministry of Labour in 1923, see CW9 p.92.



commodities, which, in their turn, entail a demand for labour"<sup>47</sup>. For them, a policy of development "would mean an increase in effective purchasing power which would give general stimulus to trade"<sup>48</sup>.

the indirect employment which schemes of capital expenditure would entail is far larger than the direct employment. (CW9 p.106)

It is not possible to measure effects of this character with any sort of precision .... (CW9 p.107)

These quotations were very important, because they pointed out that starting by developing aggregate demand benefited employment. They also showed that there was a cumulative positive effect for the economy as a whole. Moreover, a concept similar to effective demand was used. Again, macroeconomic scope took priority. Simultaneously, the sum of the total effect by the cumulative process could not be identified; that is, it is not yet the perfect multiplier analysis. Besides, the above quotations were very important in the light of the quality of employment. Objections against the policy of development were: "the unemployed can not suit the new jobs". According to the co-authors, these objections missed out the indirect employment factor. Taking this factor into consideration, the demand for new workers would grow in the whole of industry if aggregate demand expanded.

Chapter 7, "What will it cost?", was reproduced in the Nation. According to their calculation, nearly half of the cost of the Liberal plan "would be recovered *at the time*"<sup>49</sup>. The reasons for this were that some programmes would pay for themselves, that the reduction of the number of unemployed people would lead to the creation of the Unemployment Fund, and that revenues were expected to go up with the increase in national income. In Chapter 8, "Is it socialism?" the question was asked, "why must the government play a part itself?"<sup>50</sup> The answer was the following: it was a fact that a large part of capital programmes "have fallen under

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<sup>47</sup> CW9 p.105.

<sup>48</sup> CW9 p.106.

<sup>49</sup> CW9 p.112, italics in original.

<sup>50</sup> CW9 p.113.

the influence or the control of governmental departments"<sup>51</sup>. This attempt was not a socialist one, because the government did not deprive private companies of their means of production.

Chapter 9, "Will it merely divert employment from other enterprises?", was a direct objection to the Treasury View. According to the Chancellor's budget speech, the issue of public bonds must reduce the amount of money available for private companies. Therefore, new employment on state plans was a mere substitute for ordinary employment. For Keynes and Henderson, this argument was false, as well as unfounded. To begin with, if this inference was applied to private enterprises, a fallacy of composition was clearly revealed. It never happens that a new plant scheme by some motor company would derive the capital of some other chemical firm<sup>52</sup>. Secondly, this argument did not take the main sources of the new investment into account. In fact, there were three sources: firstly, the savings to pay the unemployed; secondly, the savings wasted through lack of credit; and finally, a decrease in the amount of foreign lending or bonds. Regarding the second point, the claim that credit expansion brought about inflation was fallacious, because inflation occurred when everyone was already employed and when all savings were being used up. The next sentence will be a conclusion.

It is precisely *with* our unemployed productive resources that we shall make the new investments. (CW9 p.120, italics in original)

Chapter 9 was a good mirror for Keynes' economic thought. This is why it was also reproduced in *Essays in Persuasion*. Let us point out three features. Firstly, they recognised that savings did not bear fruit to investment, even though they did not use the specific word, hoarding. In those days, Keynes frequently argued on this point with D. H. Robertson. Secondly, their analysis implied the macroeconomic saving-investment technique. The crucial proposition in *Treatise on Money* (1930) was that inequalities between saving and investment should generate trade cycles, in the manner of Knut Wicksell. Thirdly, Keynes' economic thought was reflected

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<sup>51</sup> CW9 p.113.

<sup>52</sup> See CW9 p.115.

in the pamphlet in the sense that it contained an original idea<sup>53</sup> to be called "the priority-of-the-internal-equilibrium principle". These features meant that the authors regarded it as natural that human, material, and financial resources had been left unused in Britain.

In Chapter 10, "the policy of negation", the attitude of the Treasury was criticised. The Treasury had blocked the outlets and purposes of savings by curtailing all capital expenditure. It turned out that huge amounts of savings flowed abroad. Consequently, the bank rate had to be raised due to a loss of gold. Needless to say, this policy was not desirable for the economic situation. In Chapter 11, "the breath of life", they impeached the government for its watchwords --- negation, restriction, and inactivity. It was now necessary "to be bold, to be open, to experiment, to take action, to try the possibilities of things"<sup>54</sup>.

#### 4-2 Five points at issue

Let us bring out the main five points, summing up the co-authored article.

The first point is the cause of unemployment. Strange as it may seem, this cause was not clearly dealt with in the article. They only criticised the Treasury for being frightened by the national development programmes; that is, for making the reduction of public bonds their number one priority. For example, they did not consider that a high bank rate led to unemployment, as Keynes argued in other papers<sup>55</sup>. In connection with this point at issue, let us also refer to the "transfer problem". They realised that this problem was important. It was so important that it could be the object of the most powerful criticism of their pamphlet. However, it was not the basic "cause" of unemployment but a "difficulty" which was reduced by the extension of general effective demand. The second point concerns the countermeasures to unemployment. The pamphlet consistently advocated large-scale national investment plans. The reasons lie in the third and fourth points. The

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<sup>53</sup> Hawtrey shares this view in common. The point is argued by Komine [1996].

<sup>54</sup> CW9 p.125.

<sup>55</sup> For instance, "The Economic Consequences of Mr Churchill" (1925) and "The Industrial Crisis" (1930). See CW9 p.220 and CW20 p.345.

third point is the importance of indirect employment and of the cumulative process. The large-scale capital plan was approved because it would create the two elements as well as direct employment. The fourth point is the cost of the plan. They pointed out the existence of an idle balance and the decrease in unemployment benefit. Using these funds, the Liberal plan would cost much less and work a lot better. The fifth point is the background to this plan. It was neither socialism nor Laissez-faire. They became aware of the real economic world. Managed economy had been an inevitable trend. Therefore, they envisaged a third solution.

#### 4-3 Economic thought reflected

To what extent then did the pamphlet reflect Henderson's economic thought? Let us examine his leading articles in the Nation from January to May 1929, just before the pamphlet was published. It will be summarised in five parts.

First of all, Henderson recognised<sup>56</sup> that, in 1929, the most urgent economic problem was finding a solution to unemployment, and that the means to solve it was the National Development Policy. In addition, this plan was only practicable under Liberal administration. The acknowledgement of these facts corresponded to Chapter 1 of the joint article. Secondly, he stressed the importance of indirect employment, especially in road construction. As he put it:

When you build a road, not only do you employ men directly on the road, but also many others indirectly in supplying the materials of which the road is built. The greater part of the expenditure (though, of course, by no means all) is translated in one form or another into a demand for labour.

(Henderson [1929d] p.710)<sup>57</sup>

This logic was quite similar to that of Chapter 6 of the pamphlet. Thirdly, he

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<sup>56</sup> "The Conversion to National Development" (26 January 1929), Henderson [1929a] p.574.

<sup>57</sup> "The Objections to Capital Expenditure" (23 February 1929). A similar claim is seen in "Is there any Unemployment?" (4 May 1929), Henderson [1929m] p.150.

considered that even a large-scale capital expenditure plan would be payable, since he noticed that the costliest thing was to let the unemployed be unemployed. The reason was that "many workpeople who are now employed would be receiving wages instead of unemployment pay, and would increase accordingly their consumption of commodities"<sup>58</sup>. This part corresponded to Chapter 7. Fourthly, the crowding-out phenomenon was denied. In other words, the Treasury View was discarded as an old doctrine. The view that work by public authorities simply diverted one from the ordinary industry was "the old and obsolete dogma"<sup>59</sup>. The dogma was as stupid as the claim that banks "can only grant manufacturer Paul an advance by taking it away from manufacturer Peter"<sup>60</sup>. This metaphor was used in Chapter 9. Fifthly, the following sentences were important:

We are wasting at present in idleness not only a substantial portion of our labour power, but a substantial portion of our savings as well.

(Henderson [1929d] p.711)

We conclude, therefore, that a policy of capital expenditure ... would serve mainly to divert to home development savings which now find their way abroad ... (Henderson [1929d] p.711)

This acknowledgement was also identical to that of Chapter 9 of the joint article.

As mentioned above, it was proved that Henderson's economic thought was reflected perfectly in "Can Lloyd George do it?", precisely because of this core acknowledgement. For instance, Henderson powerfully supported the importance of indirect employment and the rejection of the Treasury View. In that sense, we can conclude that his collaboration with Keynes worked completely. They only disagreed on the fundamental cause of unemployment.

The next problem is how their collaboration changed with time. On the basis of the above summary, we will investigate how Henderson's claim about economy was changing. We will compare his thought before 1930 with that after 1930 with

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<sup>58</sup> Henderson [1929m] p.151.

<sup>59</sup> "The Government Decision" (20 April 1929), Henderson [1929l] p.66.

<sup>60</sup> Henderson [1929a] p.575. The same metaphor appeared in Henderson [1929d] p.710.

respect to the five points in this section.

## Section 5 Causes of unemployment and countermeasures

Let us examine some of the leading articles from the Nation, as they are a good reflection of Henderson's economic thought before 1929. The following paragraphs sum up his representative leading articles from 1923 to 1927. Afterwards, we will reconstitute his economic thought at that time, and compare it with that of Keynes.

### 5-1 Leading articles

In a leading article from November 1923, he opposed the policy of the Conservative Party. According to him, the abolition of the deflationary policy was completely different from protective trade. The effect of the latter only reached a limited number of industries. On the other hand, the abandonment of the deflationary policy removed an obstacle. There was "the home market at the expense of the export trades, which account for the greater part of our unemployment"<sup>61</sup>. Putting forward protection and a high exchange rate as a solution to unemployment was "the most extreme instance of false political diagnosis in our modern history"<sup>62</sup>.

In "Will unemployment increase?" (4 April 1925), he asserted that<sup>63</sup>: the main explanation of large unemployment is the decline in foreign trade. This is a factor which it is not in our power to correct. It is necessary to secure a diversion of labour power to new industry. There are two answers. First, to decrease unemployment in the metallurgical industries, what is needed is the undertaking of capital development at home, which calls for this type of industry. Second, "the situation calls for the greatest possible mobility of labour"<sup>64</sup>, mobility between

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<sup>61</sup> From F. Henderson [1953] p.16.

<sup>62</sup> From F. Henderson [1953] p.16.

<sup>63</sup> Henderson [1925a] p.15.

<sup>64</sup> Henderson [1925a] p.15.

different occupations and between different districts in the same occupation. It was then summarised as follows:

Capital development and greater mobility are two essential conditions of a reduction of unemployment substantially below the figure of a million; and Mr. Lloyd George is, we believe, entirely right in the persistence with which he stresses both these points. (Henderson [1925a] p.16)

Moreover, according to him, a much more important problem was hidden in the background. Our "monetary policy is of critical importance ... a return to gold this year cannot be achieved without terrible risk of trade depression and a serious aggravation of unemployment"<sup>65</sup>. As Keynes pointed out, due to a considerably overvalued sterling, the export industry had been largely damaged.

"Diagnosis and remedy" (9 May 1925) criticised Churchill's policy. In particular, the return to the gold standard was carried out at an unduly high parity. Therefore, "the cotton trade will suffer ... from a high Bank Rate and diminished credit"<sup>66</sup>.

In "the new industrial revolution" (27 November 1926), the difference between regions and industries was taken up. If one drew a line across the map of England, the line divided Great Britain into two parts. To the left (to the north and west), "unemployment is almost exactly double what it is on the right"<sup>67</sup> (to the south and east). The west and the north were occupied in coal, iron, steel, cotton fabric, and shipbuilding industries. All of these industries were declining. On the other hand, the east and the south were developing; new industries such as automobiles, chemistry, and electricity were growing<sup>68</sup>. In short, the degree of difficulty varied with occupations and regions. As he put it:

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<sup>65</sup> Henderson [1925a] p.16.

<sup>66</sup> Henderson [1925b] p.19.

<sup>67</sup> Henderson [1926a] p.29.

<sup>68</sup> Similar recognition is seen in "The Industrial Transition" (23 July 1927), Henderson [1927] p.538.

Our economic life is shifting, we believe, from one sort of equilibrium to another. Our unemployment and our labour troubles represent essentially the difficulties and the pains of the transition ... To organise and to direct that transition is today the central task of economic statesmanship.

(Henderson [1926a] pp.31-32)

Further Capital plans were explained in "Economy or development" (30 July 1927). Roads, bridges, electricity, housing, and urban planning were necessary to national development. They "all depend upon State Policy"<sup>69</sup>.

It would provide employment for many workpeople directly, and, by the fillip it would give to almost every economic activity, indirectly for many more. It would, by absorbing our savings in greater degree in home investment, and thus diminishing the quantity seeking outlets abroad, provide the most efficient form of safeguard against ... an adverse balance of payment ...

(Henderson [1927] p.566)

Henderson asked himself, "which are we to place first: economy or development?"<sup>70</sup> At that time, the whole trend of Government policy was to subordinate development to economy. This drift was based on "a widespread but baseless belief that our high level of national taxation is a major cause of our industrial troubles"<sup>71</sup>. It was high time that people stopped encouraging this notion.

To sum up, from the middle stage to the latter half of the 1920s, Henderson acknowledged the following: on the one hand, the key industries which had shown an initiative in export trade declined; on the other hand, new industries such as automobiles and chemicals were now rising. The State must carry out a policy of national development<sup>72</sup>, because the mobility of labour from old to new was

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<sup>69</sup> Henderson [1927b] p.566.

<sup>70</sup> Henderson [1927b] p.567.

<sup>71</sup> Henderson [1927b] p.567.

<sup>72</sup> Capital expenditure on roads is insufficient in particular. See Henderson [1929i] p.903.



lacking - this was the transfer problem. A policy of capital expenditure clearly ranked above a reduction of fiscal spending. Since only the rich disliked and rejected a high income-tax, the possibility of imposing extra tax revenue still existed.

## 5-2 The logic of both sides

The logical steps taken by Henderson were as follows. The basic cause of the difficult situation in the United Kingdom was a depression of export industry. This predicament deteriorated because of a mistaken financial policy; the return to gold at the pre-war parity. It was the export price in the United Kingdom being made to rise by an unduly high pound, which killed her international competitive power. In addition, a policy of dear money and credit squeeze had led to more deflationary effects. In contrast with the traditional export industries, the new industries became prevalent. This gap (the transfer problem) was the origin of mass unemployment. One was excess demand for labour, whereas the other was excess supply. Economic intervention by the State was necessary to solve this difficult question. As for the means, a large-scale capital programme was suitable. There were two reasons why this plan was useful. Firstly, it was possible to convert savings, which had flowed abroad, into funds at home. Secondly, public works could employ people both directly and indirectly by stimulating the economy as a whole. As discussed above, an erred financial policy, the unemployment problem, and capital plans were linked with each other in Henderson's logic.

The logical steps taken by Keynes<sup>73</sup> were the following: by erred means of the high bank rate policy, the United Kingdom had suffered from mass unemployment. Two management systems needed to be executed in order to save the situation. The first was a managed currency system which replaced the gold standard. Under this system, investment had to be promoted by lowering interest and easy credit. The second system was large-scale capital development programmes. Both labour and savings were being idle. Therefore, it was possible for the government to find outlets of investment at home. Mistaken monetary policies

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<sup>73</sup> For further details on this, see Komine [1998] pp.66-70.

resulted in an unemployment problem, and investment promotion by credit relaxation had been required for its solution.

Let us compare the two different logics. There are common points as a whole, but emphatically different points in detail. In those days, they naturally shared the view that a bad monetary policy (failure of the policy), the unemployment problem (current recognition), and a national development plan (solution) were all connected. In that sense, Henderson and Keynes almost shared the same economic thought in the 1920s.

However, we should not overlook their difference in detail. It did not lie in the remedy to unemployment but in its fundamental cause. Indeed, the two economists justified a policy of national development as a solution, because they shared the same point of view on macroeconomics, as mentioned above. Again, they both opposed the return to gold for the reason that the pre-war parity was unduly high. With regard to these points, almost nothing could be added by Henderson. He seemed to be strongly influenced by Keynes in these respects. Nevertheless, differences revealed themselves on the true cause of unemployment. For Henderson, the failed monetary policy was a "factor" --- or one of the factors --- which worsened the predicament of the export industry. In any case, the basic "cause" of mass unemployment was the downfall of the export industry itself. What is more, the reason why the unemployed had not decreased in spite of new industries was the "transfer problem". It was the very problem that Henderson regarded as the "essence" of the unemployment question. In contrast, Keynes looked upon the mistake of the deflationary policy as the "essence" and "cause" of unemployment. He seemed to regard the transfer problem in the labour market as the "factor" which caused the unemployment situation to deteriorate. That is to say, the microeconomic scope, such as each industry or each region, strayed from Keynes' central concern.

The elaborate logic of the three linked elements, however, already seemed to involve the germination of their division. In particular, the thought that Henderson emphasised every region and industry might not be compatible with that of Keynes' emphasis on national economy --- or macroeconomics ---. Nonetheless, they were satisfied with their mutual agreement in the outline at that

time, thus they could not think of the possibility of dividing them (the unawareness theory). Otherwise, we should not miss the fact that Henderson stood as a Liberal candidate. The joint paper with Keynes was a powerful manifestation to approve the pledge (the Orange Book) of the Liberal Party. We can also interpret his thought as the attitude that he dared to ignore different points in detail, and set up his election as the first priority (the consciousness theory). We cannot yet be sure which is correct. Here, we only marshal the two theories equally.

## Section 6 The cataclysm from 1930

The Economic Advisory Council was formed in January 1930. After the Council started functioning, Henderson's claim clearly changed. In the process of changing, the link which connected the three elements mentioned above had been destroyed. Within his logic which cut the chain, we will consider in particular the classification of unemployment and defects of public works.

### 6-1 Classification of unemployment

Firstly, his view on the problem of unemployment radically changed. Evidence can be found in the following material from 1930: A letter to Keynes (May) and a memorandum, "the present unemployment" (July). Henderson consciously declared to Keynes how he had changed from what he had been. As he put it:

My first shifting of opinion from my position a year or so ago, is that I am less disposed to regard (I don't say our 2 million unemployment) but our 1,200,000 unemployment as a short period transitional problem, yielding to the treatment of a pure temporary stimulus. (CW20 p.358) <sup>74</sup>

In short, he asserted that 60% of unemployment could not be saved by temporary public works. How then was the remaining 40% treated?

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<sup>74</sup> A letter to Keynes, 30 May 1930.

His approach in this stage was to classify unemployment into three types. He tried to classify it in a memorandum "the present unemployment" (July 1930) for the first time. The first category, called "minimum unemployment", was the one that "would exist even if industry were in a healthy and prosperous condition"<sup>75</sup>. This phenomenon had a seasonal character, and resulted from the unemployed being in the process of finding other jobs. The second category was unemployment "arising from the post-war difficulties"<sup>76</sup> in British industries. The third was the unemployment "attributable to the present world-wide trade depression"<sup>77</sup>. Although the first was estimated at about 600,000 persons, "there is no real *unemployment* problem"<sup>78</sup>. The third was about 750,000, owing to a cyclical and temporary phenomenon. Again, it was not important simply because recovery will certainly come sooner or later. Therefore, the real problem lay with the second category, to which about 500,000 persons belonged. "The heart of this problem is the long-continued depression of some of our leading exporting industries"<sup>79</sup>. While a large surplus of labour existed in old industries like cotton and coal, which were of a highly localised character, it was not yet possible to absorb it in other new industries. Briefly, for Henderson, the second type ranked above the first and the third one. Incidentally, the second and the third type were later named in 1936. The second being named "transfer unemployment", and the third "cyclical unemployment". Transfer unemployment was solved only when labour was transferred to other districts or to other industries. Cyclical unemployment was "an expression of a deficiency of effective demand, but not a chronic deficiency"<sup>80</sup>.

## 6-2 Weak points of public works

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<sup>75</sup> Henderson [1930c] p.56.

<sup>76</sup> Henderson [1930c] p.56.

<sup>77</sup> Henderson [1930c] p.56.

<sup>78</sup> Henderson [1930c] p.58, italics in original.

<sup>79</sup> Henderson [1930c] p.60.

<sup>80</sup> Henderson [1936b] p.166.

The second logical structure was his claim that public works have many defects. He pointed out four characteristics.

First and foremost, the large-scale capital plan would worsen the financial situation in Great Britain:

it is important that nothing should be done in the meantime which would be likely to check business enterprises or to disturb confidence. There is a danger both in Great Britain and elsewhere that Budget deficits and consequential increased taxation may enter into the vicious circle ...; in the case of Great Britain the danger is increased by a growing nervousness as to the soundness of our financial situation ... (Henderson [1930c] p.59)

If a large capital plan was announced, taxation was likely to be increased year by year indefinitely<sup>81</sup>. The effect does not fully appear in the course of execution.

Secondly, public works could not solve most unemployment in relation to the classification of unemployment. He regarded most unemployment as minimum and transfer unemployment.

Our present unemployment is mainly a matter of the depression of our export trade ... More shortly, public works cannot hope to improve our export trade ... (Henderson [1935] p.156)

The third point was the inefficiency of public works<sup>82</sup>.

The idea of using public works as a trade-cycle tap is a very old one. ... In principle I think the idea is uncontroversial and unobjectionable. But in practice I think that experience has shown that the idea is barren. Regarded as a tap public works are a most unwieldy and inefficient instrument.  
(Henderson [1935] p.155)

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<sup>81</sup> CW20 p.359.

<sup>82</sup> See also the following phrase. "I am frankly disillusioned with public works from the practical standpoint" (Henderson [1935] p.155).

The reasons why they are inefficient are that most public works are in the hands of local authorities, not directly controlled by the central government, and that there is "inevitably an immense time-lag between preparation and execution"<sup>83</sup>.

The fourth point was the crowding-out phenomenon. The following lines are some comments to the drafts of Keynes' *The means to prosperity* (1933):

Take, for example, your £100 millions "to be spent under the auspices of a National Housing Board". Obviously to a considerable extent your Board would build houses which private enterprise would build otherwise. (CW21 p.164)<sup>84</sup>

Similar claims were shown in his comments to the drafts of the White Paper on *Employment Policy* (1944):

I do urge that the possibility that the stimulation of public investment may react adversely on the volume of private investment is a major difficulty which ought not to be ignored. (Henderson [1944] p.320)

The other type of classification is worth a mention here in passing. These were three categories related to time. The first was a short-term remedy. Public works might be advocated "as a means of evening out the trade cycle"<sup>85</sup>. The second was a longer but limited period. They might be advocated "as a means of facilitating a large readjustment of the national economy"<sup>86</sup>. The third type of public works might be advocated "as a permanent policy to check a chronic tendency to disequilibrium"<sup>87</sup>. According to Henderson, the emphasis had shifted from the first category to the second, and then to the third. At the beginning of the 1920s just after the war, the first category was argued. When the great depression struck in

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<sup>83</sup> Henderson [1935] p.155.

<sup>84</sup> A letter to Keynes, 28 February 1933.

<sup>85</sup> Henderson [1935] p.152.

<sup>86</sup> Henderson [1935] p.152.

<sup>87</sup> Henderson [1935] p.153.

1929, the main discussions were the second. Now in 1935, however, the third type had gradually come into the spotlight --- though it was confined to academic circles. What was important here was that "they may be largely irreconcilable with one another"<sup>88</sup>. In particular, the first was incompatible with the others. A short-term counter-cyclical policy was incompatible with a long-term capital programme, since the former must be changed immediately and drastically when a short-term business trend was changing.

How did Henderson understand the advantages of public works once mentioned in 1929? The advantages were the diversion of idle savings from abroad to home, and the cumulative effect to the economy in general. We will consider three aspects.

Now, these merits did disappear for him. Firstly, as to tax revenue, he came to ignore idle balance. Using only the available resources would naturally cause budget deficits, and consequently increased taxation. Secondly, in the matter of cumulative process, he rejected the effect, or regarded it as very restricted.

Now undoubtedly a strong condition of effective demand helps to promote the process of transfer; ... provided it is not made so strong relatively to existing supply as to cause prices to rise ... / But this proviso is in my judgement essential. (Henderson [1936b] p.166)

Increasing effective demand would cause a boom. Since profits were abnormally high, the level of unemployment would temporarily reduce. However, this condition would not continue, simply because rising prices and wages "lead on to a crisis followed by a depression"<sup>89</sup>. He concluded that "I do not believe therefore the development of boom conditions is likely to be helpful in the long run to the reduction of unemployment"<sup>90</sup>. Thirdly, regarding the multiplier principle, he completely denied it. Based on Richard Kahn's multiplier, Keynes used the idea to support public works in the draft of the report in the Committee of Economists

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<sup>88</sup> Henderson [1935] p.154.

<sup>89</sup> Henderson [1936b] p.166.

<sup>90</sup> Henderson [1936b] p.166.

(1930). Henderson opposed this immediately<sup>91</sup>, and played a role so as to make the committee break up. His standpoint did not change in 1933 nor even in 1944:

I think that the beneficial repercussions of [public works] ... would probably be fully as great as you claim. Nonetheless, I don't like the approach of the Kahn calculations ... (CW21 p.164)<sup>92</sup>

This doctrine as formulated is far too static ... It ignores the vital time factor. Behind the doctrine there is the important element of truth that trade movements, both boom and slump, are cumulative. But it is of the essence of the problem that these cumulative forces take time ... (Henderson [1944] p.320)

### 6-3 Cutting of the link

Let us summarise Henderson's assertion after 1930. The major reason why he seemed to divert from his past position was to classify the unemployment issue into the transfer problem. Today, this is named "structural unemployment"<sup>93</sup>. It is true that the possibility has remained that discretionary public works is surely effective in cyclical unemployment. However, this was not a main problem of the United Kingdom, though the return to gold was one of the factors of the export depression<sup>94</sup>. By setting up three classes of unemployment, Henderson severely confined the range of unemployment on which public works had an effect. Additionally, he pointed out that the defects overwhelmed the advantages of public works itself. The most noteworthy defect was the adverse effect on financial deficits. Public works also led to increasing import trade, consequently turning out to deteriorate balance of payments. Both expected increased taxation and fragility of the exchange position discouraged the business community. Public works were not effective, had a large time-lag, and only replaced private investment. The

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<sup>91</sup> Howson and Winch [1977] p.69.

<sup>92</sup> A letter to Keynes, 28 February 1933.

<sup>93</sup> The minimum unemployment corresponds to the frictional plus the voluntary one in present terms.

<sup>94</sup> See Henderson [1944] p.318.



advantage he shared with Keynes by 1929 had also faded away. Some ideas also disappeared, the idea of utilising fiscal resources from idle balance, savings of the unemployment insurance, and diversion from funds abroad. Future tax increase became inevitable, because it was only covered in present financial deficit (public bonds). The multiplier was refused owing to static and unrealistic respects. Finally, general cumulative effect was restricted in the case that prices did not rise.

As for current recognition and countermeasures, the above-mentioned link had been perfectly broken in pieces. Now the unemployment problem was loosely connected with public works. Compared with a few positive points, there were overwhelmingly negative ones. In addition, criticism of an erred monetary policy disappeared. It could be judged that a macroeconomic scope such as general cumulative impulse was out of sight and that microeconomic eyes were generating, in which the difficulty lay in a change of occupation in every industry and region.

This microeconomic perspective, however, was already present in Henderson's writings before 1929. That is to say, this perspective was born not after, but before 1929. The next question then, is why his emphasis has shifted. Past studies emphasised his experience of public service. It is one interpretation that he came to recognise the administrative difficulty of public works. We will show in the next section whether or not it is fair to understand his conversion on the grounds of this reasoning exclusively.

## Section 7 The unemployment allowance

First of all, we write a conclusion of this section. The reason why Henderson came to oppose public works was the adverse effect of financial deficits. Another reason was that he opposed increased social security expenditure, especially through an unemployment allowance. This is why he emphasised the importance of budget deficits both practically and ideally. In order to verify the above conclusion, we will put it forward as a hypothesis: since the middle stage in the 1920s, there had been his fear of the "dole" type expenditure. However, the establishment of the Labour Party administration in June 1929 turned his fear into a warning. Consequentially, the event filled him with strong distrust, which finally made his

economic thought divert. It is necessary to examine the two stages of his conversion around January 1930.

### 7-1 From scepticism to unemployment allowance

Indeed, the fear of an increase in social security expenditure (especially through an unemployment allowance) already existed before 1930. Henderson particularly opposed the current qualification to receive unemployment. He thought that it was not until one paid the insurance premium fully that he or she had a right to receive the insurance benefits. Let us examine his statements from 1925 and 1929.

One of his earliest scepticisms was laid out in a leading article, "diagnosis and remedy" (9 May 1925), which criticised Churchill's budget bill. Henderson stated that:

At the present time industry has to pay, through insurance contributions, not only for the benefits which are rightly on a contributory basis, but also for uncovenanted unemployment benefit. ... It really is ... a "dole" and there is no justification, even in principle, for throwing this charge mainly on industry. ... these insurance contributions ... tend in the direction of aggravating unemployment. (Henderson [1925b] pp.20-21)

It is a bad tax which damages industry. This sentence expressed his scepticism towards the unemployment allowance and his warning against deficit finance.

Let us explain "uncovenanted unemployment benefit" as quoted above. In the Unemployment Insurance Act of 1920, three benefit conditions were defined. Firstly, one qualified for benefit only if one had paid at least twelve weeks contributions. This was the first statute. Secondly, one would have a right to receive one week's salary if one had paid six weeks contributions. This was the "one in six" rule. Thirdly, annual benefits were limited to a maximum period of fifteen weeks. However, the first statute had been loosened by the successive post-war cabinets. Part of this easing process was the introduction of "uncovenanted

unemployment benefit". This was payment to people who did not formally qualify for benefit. Of course, payment was not made unreservedly. The person was required to take two tests. The first revealed the income of a household. The second was the "genuinely-seeking-work test". It was a test revealing whether he or she had seriously carried out a job search. The first test became unnecessary from April 1928. The second was also abolished in March 1930, after the Labour administration founded the investigation committee in July 1929, and amended the Act on the basis of its advice<sup>95</sup>.

In the context of criticism of the Conservative Party administration, Henderson wrote a revision of the Unemployment Insurance Act in March 1919. The Baldwin Cabinet accepted an estimation of the Blanesburgh Committee without criticism. They assumed that the level of unemployment might immediately return to normal without any efforts. He criticised it as follows:

They introduced the "thirty contributions" rule in the Unemployment Insurance Act on the strength of this assumption; and even now they have only postponed the operation of this rule for a single year. They are allowing the Unemployment Fund to pile up debt ... In short, Ministers still affect to believe that unemployment may fall to normal proportions within a single year.  
(Henderson [1929i] p.903)

The "thirty contributions" rule meant the entitlement to unemployment benefit. The unemployed qualified for benefit thanks to over thirty contributions. The post-war cabinets, however, did not enforce this rule strictly. For example, the rules changed to thirty contributions in a period longer than a year, less than thirty contributions within a year, and so on. If trade got better by itself, even such an easing process had no effect. Nonetheless, the administration had not provided any effective remedies for unemployment. The rate of unemployment was therefore high, and the Unemployment Fund accumulated debts.

## 7-2 The establishment of the Labour Party administration

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<sup>95</sup> This paragraph is much indebted to Ohsawa [1986] pp.269-172.

Henderson's economic thought was forced to change drastically when the Labour administration was established in June 1929. In order to investigate the change that led to estrangement, it is useful and necessary to divide it into two stages: from June 1929 to January 1930, and afterwards.

In the first stage, we will study a leading article, "the problems of the new government". This paper was announced just after the general election and the foundation of the new administration on 8 June 1929.

the Labour Party has committed itself definitely to raising the level of unemployment pay ... / Now we do not know whether a general raising of unemployment benefits will be popular or not. We are sure that it represents a thoroughly wrong policy ... It is immeasurably better to spend money on training the unemployed and absorbing them in useful work than on increasing the dole. (Henderson [1929r] p.328)

Note that increasing unemployment benefits was strongly criticised as "a thoroughly wrong policy". These statements stemmed from his deep distrust of the Labour Party and of a system which gave unemployment benefits without requiring self-help. According to Henderson, the previous Labour Government (1924) had achieved an increase in unemployment benefits, which were stabilised at that level. However, Labour was again planning to raise the level of benefits under a catchy but old slogan, "Work or Maintenance."

His fear of increased taxation first manifested itself in "How much taxation" (20 July 1929). Labour's policy "would entail an immense increase in the national expenditure, and a correspondingly immense increase in the level of taxation"<sup>96</sup>. The adverse effects of increased taxation were especially felt in the business community. One of the effects was a general state of apprehension to see money go out of Great Britain. The policy should eventually result in "flight from the pound"<sup>97</sup>. In fact, this was not an opposition to "increasing expenditure on a

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<sup>96</sup> Henderson [1929w] p.526.

<sup>97</sup> Henderson [1929w] p.527.

moderate scale for clearly desirable purposes". However, beyond the scale of £20 to £40 millions, the scale of £100 to £200 millions that the present cabinet planned to spend was not admissible for him. In short, in this article Henderson worried about the Government expenditure plan which drastically exceeded an appropriate scale.

The problem of unemployment benefit payment was taken up several times in leading articles. In "the coming deficit" (23 November 1929), he opposed the modification of the genuinely-seeking-work clause, and predicted that "there will be a huge deficit on the *current* financial year"<sup>98</sup>. In "the limits of insular socialism" (30 November 1929), he criticised the Labour Party for being under the illusion that tax revenue was infinite. It was dangerous to believe that Labour was able to accomplish the twofold policy of graduated tax payment on the one hand, and the provision of social services on the other. The reason was that an increase in the rate of graduated tax would give people a powerful motive for the practice of evading and avoiding tax. In other words, people could send their money abroad as well as move abroad to escape taxation. "The national income is reduced thereby"<sup>99</sup>. Labour should "modify the ideas about future social expenditure"<sup>100</sup>. In "the revolt of the commons" (14 December 1929), the problem of easier entitlement to unemployment benefits was again discussed. The financial situation in 1929 was different from that in 1924. In 1924, it was possible for the Treasury to sanction new investment plans, thanks to huge automatic reductions of war expenditure. Today, on the other hand, new expenditure only means the burden of new taxation. "Every millions spent on unemployment benefit increases the difficulty of finding money for other purposes, however constructive or urgent"<sup>101</sup>.

"The other purposes" were still large-scale capital expenditure programmes. In June 1929<sup>102</sup>, Henderson's focus was on an adequate programme for roads as well as railways. It was not merely the distribution of existing jobs. In July, he

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<sup>98</sup> Henderson [1929ab] p.274, italics in original.

<sup>99</sup> Henderson [1929ac] p.36.

<sup>100</sup> Henderson [1929ac] p.37.

<sup>101</sup> Henderson [1929ad] p.502.

<sup>102</sup> "The background of trade and prices" (29 June 1929), Henderson [1929t].

denounced the Treasury View's "confusions of thought"<sup>103</sup>. In October, he pointed out new economic situations which confronted the United Kingdom. On the one hand, high money rates were needed for Britain to be an international financial centre. On the other hand, national development was also necessary. "A large-scale capital programme, promoted by the State, supplies the readiest means of reconciling these two objectives"<sup>104</sup>. The enforcement of the plan was urgent. The country needed all kinds of plans on all kinds of railways, roads, housing, and so on. In January 1930, he summarised his assertions as follows:

It remains true ... that a vigorous policy of national development is one of our great needs ... / But the time has gone by when we can safely indulge in expenditure of the "dole" type. (Henderson [1930a] p.503)

From the statements mentioned above, we can summarise his thoughts from June 1929 to January 1930 in a few sentences: under the Labour Party administration, there was further easing of entitlement to benefits. This policy was quite unproductive, and deficits only piled up. Instead, as well as his claim before the general election, the most important and urgent action was to carry out a large-scale capital plan. Our analysis shows that at this stage (the first step), the national development programme and his fear of budget deficit were almost equally important and compatible with each other in Henderson's thought --- although, strictly speaking, there could be a contradiction between the two elements.

### 7-3 Qualitative alteration after 1930

At the second stage, however, the fear of budget deficit grew, and it eventually resulted in the abandonment of capital plans. This time, Henderson had again started work as a government official. Now we will first focus on discussions in

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<sup>103</sup> "Can Mr. Thomas conquer unemployment?" (27 July 1929), Henderson [1929x]p.555.

<sup>104</sup> "Unemployment, Thomas, and the Bank" (12 October 1929), Henderson [1929z] p.39.

the "Committee of the Economic Outlook"<sup>105</sup>, which was one of the sub-committees of the Economic Advisory Council. According to him<sup>106</sup>, a large-scale capital plan surely entailed the belief among businessmen that increased taxation would result from it. Regardless of whether this plan succeeded or not, one must worry about the dangerous situation created by financial deficit. He said in his letter to Keynes:

Essentially my position is that I am scared by the Budget position quite apart from whether capital programmes are pushed forward or not, and I want to force your attention to that question. (CW20 p.362)<sup>107</sup>

It seems to me extraordinarily dangerous. The cost of unemployment pay is mounting up very rapidly, much more so than the numbers of unemployed. The whole system of unemployment benefit under last year's Act shows signs of developing into a scandal of the grand order. (CW20 p.362)

Note the expression "last year's Act". This referred to Labour's bill easing entitlement to benefit. Henderson was badly shocked by this easing process.

In July and September, the question was further examined. According to "the present unemployment" in July, minimum unemployment consisted of a job search, seasonal and daily variations, interruptions in the continuity of work, and work-people of poor industrial quality. Ironically, the system of unemployment insurance tended to increase unemployment itself. The reasons were that temporary breaks which would not have been recognised as unemployment before now entitled people to receive benefit, and that such people as married women, who had withdrawn from the job market, could "register and draw benefits as unemployed"<sup>108</sup>. Thus, unemployment figures swelled. As it turned out, "Budget

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<sup>105</sup> Keynes as chairman, Henderson as secretary. The committee was founded in February 1930, and gave reports by May. See Howson and Winch [1977] p.356.

<sup>106</sup> A letter to Keynes, 30 May 1939, CW20 p.359.

<sup>107</sup> A letter to Keynes, 5 June 1930.

<sup>108</sup> Henderson [1930c] pp.56-57.

deficits and consequential increased taxation may enter into the vicious circle"<sup>109</sup>. In September, according to a memorandum circulated to the Committee of Economists - which was one of the special sub-committees of the Economic Advisory Council, Henderson drew attention to both the heavier burden of public debt and the fact that direct taxation was much higher than in other countries<sup>110</sup>. The memorandum, "the background of the problem", said:

I am strongly of the opinion that the broad question of the present system of unemployment pay is one which we ought not to neglect ... It represents a phenomenon essentially new ... (Henderson [1930d] p.70)

Again, note the phrase "a phenomenon essentially new". This surely meant that, during the last year or so, he had rapidly become afraid of an accumulation of unemployment pay.

This standpoint did not change until his final years. We will quote some statements from 1931 and 1944. In the context of his comment on the May Committee<sup>111</sup>'s report in 1931, he recommended "considerable cuts in unemployment benefit"<sup>112</sup>. Afterwards, Henderson discussed the post-war economic policy with Keynes; they were in the process of publishing a White Paper on *the Employment Policy*.

But it is a dangerous exaggeration to suppose that full employment or "aggregate demand" can be maintained by the instrument of financial profligacy ... Under conditions of great external weakness, such as we must

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<sup>109</sup> Henderson [1930c] p.59.

<sup>110</sup> Henderson [1930d] p.68.

<sup>111</sup> The Committee on National Expenditure recommended that the Government drastically cut unemployment benefit and the salaries of public officers. As well as the report of the Macmillan Committee, the May report made the financial and monetary situations in Britain open to everyone. Ironically, this information forced the gold standard to stop in June 1930 due to outflow in gold.

<sup>112</sup> Henderson [1931a] p.77.



expect, the more probable result of such a policy would be a currency collapse.  
(Henderson [1944] pp.317-318)

This is an excerpt from the paper "Lord Keynes and employment policy" (1944). In short, budget deficit was not desirable for four reasons. Firstly, "the deficits may easily become very large"<sup>113</sup>. Secondly, "as a remedy for unemployment, the policy is fundamentally inappropriate"<sup>114</sup>. If productive resources were left unused, "that indicates a defect of economic organisation, not of financial policy"<sup>115</sup>. Thirdly, the effects of the policy were much more limited than expected, because the unemployed were localised in specific areas, and because increasing the flow of effective demand in general was ineffective. Fourthly, from the latter half of the 1930s, Henderson also became more and more interested in the population problem<sup>116</sup>. The growing figure of old age pensioners was one of Britain's main problems. Accordingly, the cost of the social services would grow rapidly<sup>117</sup>.

At the second stage, Henderson abandoned capital plans at last. The weak points of public works in the 1940s were his strong fear of budget deficit or, strictly speaking, of the rising cost of unemployment payment. What can be said at least is that the fear was so powerful that the attractiveness of capital plans disappeared after 1929. For that reason, we can assert that the direct clue to "treachery" in Henderson's economic thought was the establishment of the Labour Party administration in June 1929. However, the problem remained. What made him hate the indiscreet unemployment allowance?

#### 7-4 Henderson's objection to the idea

As we have discussed above, his anxiety about budget deficit did not date

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<sup>113</sup> Henderson [1944] p.322.

<sup>114</sup> Henderson [1944] p.322.

<sup>115</sup> Henderson [1944] p.322.

<sup>116</sup> The clue is his research visit to the West Indies. See Debenham [1953] p.45.

<sup>117</sup> See Worwick [1953] p.76. For details of the Royal Commission on Population, see Winter [1990].

back to 1930, but to the time when he was chief editor of the Nation. If his fear was not attributable to his diversion from Keynes around 1930, what should we identify as the basic cause of his fear? It is necessary here to read *Inheritance and Inequality: A practical Proposal* (1926) and "the principle of the Beveridge plan" (August 1942). The former is a pamphlet which should be called Henderson's only academic book. The latter is a paper in which he and Keynes discussed drafts of the famous Beveridge Report (1942). Although both writings have never been examined before, they suggest how he viewed "equality".

As suggested by the title *Inheritance and Inequality*, Henderson paid attention to inequality in the distribution of wealth. Workers were always under the shadow of unemployment and unsanitary housing conditions. It is true that nineteenth century liberalism had made splendid achievements in many fields. On the other hand, economic inequality became dominant and prevailing. Inequality in the present distribution of wealth was so great that it could not be justified from the viewpoint of democracy and social justice. If we are to build up a good and harmonious society, "we can not afford to neglect the unequal distribution of wealth"<sup>118</sup>. The pre-war Liberal administrations recognised this question, and achieved some kind of social legislation and administrative reform, such as Old Age Pensions, Unemployment and Health Insurance, and Trade Boards. "But it was no part of that idea to diminish inequality as such"<sup>119</sup>. For the purpose of increased revenue, indeed, it tended in that direction in practice. However, it did not mean a planned decrease of inequality as an idea. It was not due to social services but to armaments that led to death duties and the supertax. The latter being a system of graduated tax imposed on the higher part of ones income, in addition to ordinary income tax.

The idea was to make the poor, especially the very poor, richer; not to make the rich, not even the very rich, poorer. (Henderson [1926a] p.6)

For Henderson, the means to reduce inequality was not Nationalisation, such as the

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<sup>118</sup> Henderson [1926a] p.6.

<sup>119</sup> Henderson [1926a] p.7.

Labour Party claimed. Instead, he advocated practical death duties.

This citation clarifies the fact that Henderson preferred the "taxation type"<sup>120</sup> to the "social security type". The former was a solution which took extremely rich people to pieces in view of redistribution. The latter was a means which let the poor become richer. As discussed in Section 5-1, in a leading article "economy or development" (July 1927), he judged<sup>121</sup> that it was a baseless belief that industry was badly damaged by heavy taxation. Even before 1929, he consistently disliked the dole type; that is, social services.

As economic adviser to the Treasury, Henderson entirely disagreed with the famous "Beveridge plan"<sup>122</sup>, whose goals were to achieve the "abolition of want" and to secure the minimum income for people as a whole. In contrast, Keynes thought this plan "a vast constructive reform of real importance"<sup>123</sup>. Thus, he tried to let the drafts be revised again and again to make it less costly. At the same time, he tried to persuade politicians and bureaucrats to accept and approve the plan. What then caused the two to be divided in this respect?

Most of all, Henderson disagreed with Clause 4 (adequacy of benefit) of the six features in the plan. It is possible to summarise the principle of this plan into the following six points. Firstly, flat rate of subsistence benefit. Secondly, flat rate of contribution. Thirdly, unified social insurance. Fourthly, adequacy of benefit. Fifthly, comprehensiveness. Sixthly, classification. For Beveridge, each individual had a right to enjoy the minimum income. Furthermore, the State had a duty to guarantee the right. Therefore, there was no necessity to give any types of the means test, that is to say, the tests to check people's wealth and income in order to give appropriate benefits as was done since the Poor Law. It was simply because each person, however high or low an income he or she had, was given the same benefit as one's right. Henderson severely criticised this idea. To be sure, the principle of "abolition of want" was estimable. The six features, however, were incompatible with the goal of the Beveridge plan. A means test was associated with

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<sup>120</sup> Except for taxation on ordinary industry (i.e. employment tax).

<sup>121</sup> Henderson [1927b] p.567.

<sup>122</sup> The formal title is Social Insurance and Allied Services (1942).

<sup>123</sup> CW27 p.204.

the method, however unpopular it was. Likewise, the idea of abolition of want through the redistribution of income was related to the result. For him, the two ideas were fundamentally similar, and two sides of the same fact.

If we are to redistribute income more fairly or more equally, we must first ascertain how much different people have. This implies an inquiry into means. (Henderson [1942] p.194)

To secure the minimum income in turn meant that the State must not give the upper level of it. A means test was inevitable for that reason<sup>124</sup>.

Henderson also opposed Clause 5 (comprehensiveness). It indicated the principle in which the social insurance system covered the whole nation. However, the extension of social insurance would cause new administrative difficulties<sup>125</sup>. For example, since "interruption of earnings" varied from occupation to occupation, a clear-cut definition could not be applied to every occupation. The benefits proposed by the plan were too small for the more higher-income people in particular to cover their contingencies. Instead, they relied on voluntary insurance and personal savings. Burden and benefit varied between classes in society. It "seems unrealistic to proceed as though these differences did not exist"<sup>126</sup>. In brief, the comprehensiveness principle did not fit the facts of social life, and increased the new administrative difficulties.

In short, Henderson criticised the point that all six features contradicted --- or were independent of --- the principle of abolition of want. He concluded that it would cost more<sup>127</sup> and would do otherwise.

Judging from *Inheritance and Inequality* and "the principle of the Beveridge plan", we notice his extreme scepticism about the "dole type Welfare State". Here the term "dole type Welfare State" can be defined for now as the social security system that dated from the Liberal Reform in the beginning of the twentieth

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<sup>124</sup> See Henderson [1942] p.196.

<sup>125</sup> See Henderson [1942] p.201.

<sup>126</sup> Henderson [1942] p.205.

<sup>127</sup> See Henderson [1942] p.208.

century, and has developed into the Beveridge plan as its summit. The original system only included a limited old age pension or unemployment and health insurance. Now, in the 1940s, the comprehensive social insurance system was under deliberation in Parliament. The whole nation had one's own right to the minimum income on the grounds that the system has the principle of flat rate of both subsistence benefit and contribution. According to Henderson, such social security treats a nation uniformly, though one's income and wealth could differ as well as it gives rights (benefits) indiscreetly. There is no duty that is a price of right. As examples of duties, those with higher-incomes must depend on voluntary insurance and personal savings, and a nation must have taken a means test to ascertain how he or she differs from the minimum income. Both cases show a minimum of self-responsibility. Additionally, to eradicate want, enormous new administrative difficulties were also anticipated. Besides, comprehensive benefits needed an enormous national budget. The Beveridge plan (the dole type Welfare State), Henderson claims, leads to dissipation both for an individual and for a State. Based on such economic thought or ideas, he has continuously given warnings of the adverse effect of budget deficits.

The final question then, is what was the ideal economy for Henderson?

## Section 8 The entrepreneur-in-chief

Finally, we will investigate Henderson's economic thought directly. Let us examine three fields: economics, price mechanism, and managed economy.

### 8-1 Abstraction of economics

As Harrod rightly stated, "he was not interested in the more abstract developments of economic theory"<sup>128</sup>. This was reflected well in "the state of economics" (October 1930). The application of scientific methods to economic phenomena must involve three processes: firstly, the extraction of generalisations from gathering facts. Secondly, the testing of the assumptions on the basis of a

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<sup>128</sup> Harrod [1953] p.61.

wider range of facts. Thirdly, the reconstruction of the revised generalisations. In short, the scientific methods needed "study, hypothesis, verification"<sup>129</sup>. Nevertheless, economics did not develop at that point. According to him, this was partly due to the philosophical and logical characteristics, and partly due to the inevitable association with politics. He said at the beginning of his paper:

The most conspicuous defect of the present state of economics is the lack of adequate contact between the work of theoretical analysis on the one hand and realistic study on the other. (Henderson [1931b] p.78)

In recent years, both camps have developed rapidly. Nonetheless, theoretical economists are only concerned with a highly abstract logical system. They pay special attention not to generalisations of the fact but to logical possibilities as a base of analysis. Moreover, some economists stick fast to an old-fashioned doctrine. Others intend to rebel against the authority<sup>130</sup>. Both will, Henderson asserted, be easily influenced by polemical emotions which weaken the soul of scientific inquiry. During a dispute, advocates and opponents would do better to enlist the co-operation of others, not hold fast to their own doctrine. It is necessary to organise research institutes<sup>131</sup>, to define the terms clearly, and to investigate on the basis of the available facts.

The above attitude did not even change in "Lord Keynes and employment policy" (March 1944).

Such [abstract economic] analysis cannot justify sweeping conclusions upon the concrete problems of the actual economic world. ... it can prove nothing ... In my opinion these [Keynes'] doctrines are unhistorical, unimaginative, and unscientific. (Henderson [1944] pp.316-317)

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<sup>129</sup> See Henderson [1931b] p.78.

<sup>130</sup> See Henderson [1931b] p.79. He seems to predict Keynes' rebellion in 1936 against "the Classics".

<sup>131</sup> Later in Oxford, he himself organised a research group. See Harrod [1953] p.60.

From this passage, we can tell that Henderson denied all extreme abstraction of economics, including Keynes's theory. He was not only blaming the General Theory, but also criticising a whole trend of economics. We can add his distrust of economics to the reasons why he "diverted" from his previous position.

## 8-2 The price mechanism

Next, let us examine his paper "controls and the price system" (March 1950) concerning the price mechanism, which was written during his final years. Henderson expressed doubts on two sides:

The forces of the price system are too indirect, too erratic, too slow, and too weak to accomplish large readjustments by themselves. Controls are much more immediately effective. (Henderson [1950] p.419)

Of course, the effect of controls diminishes if the forces of price are in the opposite direction. Controls and the price mechanism are not then alternatives, but to be used "in harmonious combination"<sup>132</sup>. Organised speculation before 1914 was said to stabilise the forces of the price system. It was simply because equilibrium and general confidence existed. However, after the 1920s, when confidence disappeared and serious disequilibrium appeared, "speculation serves to intensify instability, and to accentuate price movements, sometimes to the point of chaos"<sup>133</sup>. Though the price mechanism is weak in this respect, "controls have many disadvantages"<sup>134</sup>. Execution involves much time and labour in the government authorities and even in business. Controls also involve uncertainty, delay, and crude and clumsy instruments. It is no use expecting more elaborate controls with time. The reason why we need controls is merely that "the alternative of no control

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<sup>132</sup> Henderson [1950] p.419.

<sup>133</sup> This recognition is very similar to that of Keynes. In fact, as Worswick [1953] stated, "This is odd, since that mode of thinking seems very suited to focusing attention upon questions of disequilibrium" (Worswick [1953] p.71).

<sup>134</sup> Henderson [1950] p.421.

would be worse"<sup>135</sup>. Eventually, it is desirable to avoid both unnecessary controls and purely private (market) forces.

Beyond that, his original thought on the price mechanism is shown in "the function of exchange rates" (January 1949). Here Henderson argued that free exchange-rate flexibility did not serve equilibrium of balance of payment. Adversely, foreign exchange rates must remain fixed:

The true function of exchange rates is to provide a constant factor round which the more variable elements may move, and by reference to which they can be adjusted; in other words, to provide a focus of stability in an orderly price system. (Henderson [1949] p.373)

For him, something fixed is needed for the price system. In the pre-1914 era, it was the gold-standard system. The confidence and stability that the fixation of exchange rates gave, caused the splendid development of economic life. "The economic failure of the inter-war period was due less to the imperfections of the monetary system"<sup>136</sup>. Rather, it was owing to the policies. The authorities relied on and supported the price system too much. That power is too small to readjust resources. His special position is at last revealed here. Except for the one point, free forces (i.e. the market mechanism) are indispensable for the economy to work well. However, the focus point (for example, the gold standard) is also necessary. The fixed point stabilises the system as a whole. What then builds confidence?

### 8-3 Managed economy

Finally, we will show that his standpoint on the necessity of discretionary policies has been consistent from the 1920s to the 1940s. In 1926 he judged: "There are many weaknesses in the present organisation of our industrial system, and there is much that might be done by a deliberate policy of industrial

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<sup>135</sup> Henderson [1950] p.421.

<sup>136</sup> Henderson [1949] p.376.



reconstruction to remove those weaknesses"<sup>137</sup>. In 1935 he realised that public works are inevitable because an economic function of the State has been enlarged. In 1949 "deliberate policy ... is not only indispensable for the time being, but will remain indispensable in my judgement for many years to come"<sup>138</sup>. Let us pay attention to his words in 1944 in particular:

In order to secure full and steady employment, it is the economic *laissez-faire* rather than the financial orthodoxy that *chiefly* needs to be altered. The latter calls only for minor modifications; the former for more radical changes. (Henderson [1944] p.318, italics in original)

This is his declaration of rejecting *laissez-faire*. However, that does not mean that it is desirable to thoughtlessly seek public works by budget deficits. Rather, it means other discretionary policies<sup>139</sup> are indispensable. If so, how should the government demonstrate the deliberate policies?

There is an answer, imperfect though it is, in "note on the problem of maintaining employment" (May 1943). Henderson concludes with confidence that there will be no cyclical unemployment in the post-war period<sup>140</sup>. Thus he opposed Keynes' plan of strengthening capital goods. Since capital goods had been excessive during the War, it was most urgent that productive resources should be diverted to consumer goods. It was essential for maintaining full employment in the long run to balance the proportion between the two goods<sup>141</sup>. This transition involved a great difficulty. It was so difficult that what was needed was to "let the State place the orders"<sup>142</sup>. The State acts as if she was a wholesale dealer to take "the risks of accumulating unsold stocks"<sup>143</sup>. Furthermore, Henderson considered

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<sup>137</sup> Henderson [1926a] p.9.

<sup>138</sup> Henderson [1949] p.375.

<sup>139</sup> Faith Henderson named it "the idea of a 'controlled economy'" (F. Henderson [1953] p.27).

<sup>140</sup> Henderson [1943] p.221.

<sup>141</sup> Henderson [1943] p.222.

<sup>142</sup> Henderson [1943] p.230.

<sup>143</sup> Henderson [1943] p.230. Note the other paper, "the government's decision" (20 April 1929).

other roles:

it was suggested that the State should assume ... the role of a wholesale dealer. But this phrase does not bring out the essential idea. What I really suggest is that the State should assume the role of entrepreneur-in-chief, directing the flow of productive resources to the employments in which they can best serve human needs. In our economic system at present that post is vacant. ... / ... Might we not conceivably find a modus vivendi for the next decade or so in an arrangement under which the State would fill the vacant post of entrepreneur-in-chief ... (Henderson [1943] p.234)

Perhaps employment, like happiness, will come most readily when it is not sought for for its own sake. The real problem is to use our productive powers to secure the greatest human welfare. ... Let us think in terms of organising and directing our productive resources, so as to meet these changing needs; and we shall be less likely to waste them. (Henderson [1943] pp.234-235)

It is not useful to believe that maintaining employment should be our sole or our first objective. Rather, we should pay attention to the new role of managing the flow of productive resources. Inducing the flow will lie in consumer goods and services, not in capital goods as Keynes asserted. The State organises and manages the usage of productive resources, and lets the usage meet the human welfare. The state as entrepreneur-in-chief can generate confidence. Confidence stabilises the economic world. This is a new role of the government. Interestingly, Keynes quoted the above two paragraphs and ended his own paper, stating that they "seem to me to embody much wisdom"<sup>144</sup>. This fact suggests that they share the same economic thought in common, at least regarding the role of the government as a whole. In other words, we can conclude that they shared the idea of a managed

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"The Government, in short, has become, in effect, an *entrepreneur* on an enormous scale; and the influence of its policy ... on the trend of trade is correspondingly enormous" (Henderson [1929] p.67, italics in original).

<sup>144</sup> CW27 p.324.

economy, --- though in the concrete direction of management, for example, consumer goods or capital goods, they differed from one other.

## Section 9 Conclusion

We want to arrive at the conclusion in the form of answers to the two questions raised in Section 1. The first point is whether or not Henderson shared Keynes's views, and whether their work can be referred to as co-operative research. The second point is when, why, and to what extent they were divided if the conversion on the side of Henderson existed. Attached to this second point, we will investigate whether the main reason for their estrangement derived solely from Henderson's experience of public service after 1930.

Firstly, before 1929, their differences were hidden by the influence of "Keynes' optimism", though we cannot tell whether it was intentional or unconscious. In the sense that the differences did not become tangible, we can safely conclude that they held the same views in common. Here "Keynes' optimism" means a claim that the transfer problem could be overcome through national development programmes. To explain further, there was a belief that the "transfer problem", the lack mobility of labour between each industry or each region, could be overcome by the "capital expenditure plans", meaning a stimulus of macroeconomic aggregate demand. As long as this belief remained, Henderson supported promotion of the large-scale capital expenditure in the Yellow Book (1928) and in the joint article "Lloyd George" (1929). We note here that in "Lloyd George" there is no clear-cut claim of the fundamental cause of unemployment. Keynes' emphasis lay in the "failure of the post-war monetary policy", whereas Henderson's point is found in "downfall of the export industry". We can infer that in "Lloyd George" the true cause of unemployment is obscure, on the grounds of their hesitation in having the differences revealed. As a result, they easily accepted a theory of the link which connected three elements: a bad monetary policy (failure of the policy), the unemployment problem (current recognition), and a national development programme (solution).

Secondly, when and why did Henderson lose this conviction? It is because

after the general election, he rapidly came to recognise the danger of budget deficit, and realised that there was no surplus in the budget to finance capital programmes. The word "recognise" is used here to indicate that his sense of crisis, which until then had been concealed, was revealed at last. In the first phase (from June 1929 to January 1930), however, he enthusiastically continued to advocate the large-scale capital plan, in spite of a sense of crisis. Nevertheless, in the second period (after January 1930), he gave up pointing out the three merits of the capital plan: indirect employment, general spin-off benefit, and diverting financial resources from idle savings at home. That is to say, the basis (effectiveness of the capital plan) which supports the above optimism had been overturned from the foundation. Thereupon, the link connecting the three elements was cut. The reason for this has two levels. Firstly, the cost of actual social security (especially unemployment allowance) swelled rapidly after 1919. The fear of increased cost already existed, even in the middle of the 1920s. Soon after the Labour Party administration commenced in June 1929, the fear turned to a warning. Secondly, he disliked the "dole" type of social security. The basis of the dole is that benefits are given to the whole nation as a right. There is no self-responsibility principle here that one must pay contributions to meet one's own benefits. Henderson thoroughly and consistently opposed this. For instance, in 1925 he did not accept "uncovenanted unemployment benefit". In 1926 he preferred enlargement of death duties and the supertax, to that of social services which Labour liked. It is because he preferred a means to redistribute the wealth and income of the rich, rather than measures to make the poor richer. Immediately after the general election of 1929, he strongly opposed the Labour pledge to increase unemployment allowance.

What is immediately apparent here is that even before 1930, Henderson already had a sense of crisis over the increased cost of social security. In this sense, it is a misleading inference that his "treachery" is attributed only to his experience of being a government official. Instead, it was important that entitlement to benefit was further relaxed after the Labour Cabinet formed in June 1929. It is true that the position of policy advisor to the Treasury seemed to facilitate access to financial issues, both in human relations and in data. It is an indisputable factor of his "treachery" that Henderson became secretary and/or

member of the Economic Advisory Council in January 1930. However, it is of restrictive importance, in the sense that the event caused him to recall his old doubt about the dole type Welfare State, and resulted in crushing Keynes' optimism. Therefore, we can regard his experience of public service as one of the strengthening factors of his "treachery".

All this may be enough to explain when they arrived at different points, both in theory and in thought: one of the possible answers is "just after the general election in June 1929". Henderson stood as a Liberal candidate, only to be a failure. This shock might have been sufficient to cool his enthusiasm for realising the proposals in the Yellow Book. Similarly, regarding Keynes, who also faced the downfall of the Liberal Party, this "marked the end of Keynes' active life as a party politician"<sup>145</sup>. Nevertheless, even after facing the same experience, they still found their own way apart from one another. On the one hand, Henderson abandoned his position as a spokesman for the Liberal Party, and was on the inside of the government. As a "policy advisor", he continued to hold the negative view of the Beveridge type Welfare State. On the other hand, in order to establish the general theory of employment, Keynes at first began to persuade his colleagues and economists<sup>146</sup>. He linked macroeconomic discretionary policy with the social security system without difficulty. Their contrast is exaggerated by contrary approaches to the theory. One separating from the theory, the other constructing a new one. For Henderson, the first shocking impact was not the Economic Advisory Council, but a defeat in the general election.

Did they, then, remain completely divided in thought? The answer is no. A clue to the answer is Henderson's concept of "entrepreneur-in-chief". They both regard "the automatic adjustment mechanism in economy", whose nucleus is the price mechanism, as extremely powerless. It is discretionary policy that is a supplement to this power, though that is not a complete substitution. There is surely a difference between the two, whether the force is suitable for capital goods at first (public works) or for consumer goods such as utility articles (order as a wholesaler dealer). Moreover, let us use the term "Modern Welfare State" to refer

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<sup>145</sup> Harrod [1982(1951)] p.396.

<sup>146</sup> See Moggridge [1992] p.506.

to a mixture of the Beveridge type social security system and the Keynes type managed economy. Admittedly, Henderson showed a doubt about the former idea, while Keynes approved of a blend of the two systems. Nonetheless, both share the basic idea of controlling and managing productive resources for the sake of human welfare. They entrust leadership, under which both the unemployment problem and the transfer problem should be solved, to Government. We can conclude that they have worked together to establish the idea of a managed economy, that is, "economy must be appropriately managed".

Let us enumerate the new points in this paper. Previous studies have paid little attention to these. Firstly, we assert that, before 1929, Henderson and Keynes shared the same logical steps: three elements (bad monetary policy, the unemployment problem, and the capital plan) are naturally joined into one ring. Secondly, we should consider primarily the impact of the general election in June 1929, and secondarily the impact of his inauguration as secretary in the Economic Advisory Council in January 1930. Thirdly, we can claim that the fears and warnings of Henderson stem from his consistent doubt about the dole type Welfare State. Fourthly, we can arrive at the conclusion that they share the same idea, "managed economy", on the grounds of the concept of "entrepreneur-in-chief".

It is difficult to judge their collaboration and division appropriately, unless we trace Henderson's basic idea. Eventually, Keynes takes the long route to *the General Theory*, confirming the distance between his previous colleagues such as D. H. Robertson, R. G. Hawtrey<sup>147</sup>, and H. D. Henderson, with whom he once had much closer relationships.

### Acknowledgements

I would like to thank Sir Nicholas Henderson, one of Sir Hubert Henderson's sons and a copyright holder, for allowing me (22 September 1999) to cite documents from the Henderson Papers at Nuffield College, Oxford. I am also indebted to Nuffield College Library staff, and especially Mrs. Eleanor Vallis, the

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<sup>147</sup> For further details on Hawtrey and Keynes, see Komine [1994].

Archive Assistant. My thanks are also due to the Public Records Office, London, for letting me consult government documents.

The quotations from the Nation and Athenaeum are from the Institute of Economic Research's microfilm, Hitotsubashi University, Tokyo, except for leading articles which were reprinted in Clay [1955].

My colleagues Hiroyuki Shimodaira (Yamagata University), Hidetaka Ohara (Meiji University), and Atsuyuki Naito (Hitotsubashi University) helped me in collecting some of my references. I benefited greatly from reading an earlier version of this paper in the annual conference of the Society for the History of Economic Thought at Kumamoto Gakuen University, Kumamoto on 6 November 1999. I wish to express my gratitude to Professor Takashi Negishi (Aoyama Gakuin University), who was the coordinator of my report to the conference, and also to the attendants.

I am, of course, entirely responsible for any errors.

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