I. Introduction

Tradition has placed David Ricardo and J. M. Keynes at opposite poles in the history of monetary theory. In the *General Theory*, Keynes focused much of his criticism of classical economics on Ricardo, because the Ricardian tradition had dominated theory and policy for over a century [Keynes, 1936, VIII, p. 32; henceforth cited as JMK]: "Ricardo conquered England as completely as the Holy Inquisition conquered Spain." The *General Theory* was written during the Great Depression, when economists were primarily concerned with the problems of massive unemployment and idle industrial capacity. However, Ricardo's ideas were formed during the Napoleonic Wars, when inflation and the size of the government deficit were the principal problems. At the start of World War II, however, when Keynes expected massive government deficits and wanted to avoid excessive inflation, his position was much closer to Ricardo's.

The views of Ricardo and Keynes on war finance may properly be said to represent the Classical and Keynesian positions on the problems of inflation and deficits. Since many economists consider themselves to be either Classical or Keynesian economists today, the theories and policies of Ricardo and Keynes are not merely a matter of history but are of contemporary interest—especially in light of recent experience with deficits and inflation.

Ricardo and Keynes both argued that inflation was the most serious problem during wartime, because it tended to redistribute income and wealth in an arbitrary and unjust manner. Ricardo concluded his first publication, a letter to the *Morning Chronicle* in 1809, by chastizing the Bank of England for causing inflation [Ricardo, 1809, III, p. 21; henceforth cited as DR]:

"It would then be evident that the evils in our currency were owing to the over-issue of the Bank, to the dangerous power with which it was entrusted of diminishing at its will, the value of every monied man's property, and by enhancing the price of provisions, and every necessary of life, injuring the public annuitant, and all those persons whose incomes were fixed, and who were consequently not enabled to shift any part of the burden from their shoulders."

And Keynes began one of his many notes on the war budget with a warning about inflation [JMK, 1940, XXII, p. 218]:

"The importance of a war Budget is not because it will "finance" the war. The goods ordered by the supply departments will be financed anyway. Its importance is social: to prevent the evils of inflation now and later; to do this in a way which satisfies the popular sense of social justice; whilst maintaining adequate incentive to work and economy."

Thus, their policy objective was the same, eliminating the evils of inflation, even though they explained the causes of inflation in antithetical and polemical terms.

II. The Inflationary Process

Ricardo maintained that inflation was caused by an increase in the quantity of money, whereas Keynes attributed rising prices to an increase in aggregate demand. At the same time, each explicitly denied that the other theory was valid. In his controversy with William Blake, who had argued that inflation during the Napoleonic period had been caused by wartime expenditure, Ricardo denied that such a thing as an excessive aggregate demand could exist, much less cause inflation. Since production determines the level of real income and expenditure at full employment, any increase in demand in one direction will be

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*University of Saskatchewan—Canada. An earlier draft of this paper was presented at the universities of Padua, Venice, Western Ontario, and Saskatchewan. The author is particularly grateful for the comments and criticisms of Ferdinando Meacci, Geoff Harcourt, David Laidler, Shiela Dow, and an anonymous referee, who are not responsible for any remaining errors or omissions.

1World War I is not relevant to Keynes' criticisms of Ricardo, because at that time Keynes was still within the quantity theory tradition and often agreed with Ricardo. Patinkin [1976] argues that Keynes remained a quantity theorist until after the publication of his *Treatise*. 
matched by a decrease in demand in another, so that [DR, 1823, IV, p. 355; III, pp. 301-15] "the aggregate of demand must be precisely the same." In contrast, Keynes argued that the Bank of England could pursue an expansive monetary policy during World War II without contributing to inflation.

The inflation theories of Ricardo and Keynes are illustrated in Figure I: Aggregate Supply and Demand. The Ricardian aggregate supply curve (RAS) is drawn on the assumption that the economy is in a static equilibrium without capital accumulation or population growth. Since Ricardo argued that unemployment is a transitory phenomenon, the quantity of labor supplied equals the quantity demanded ($L_s = L_d$), so that his aggregate supply curve is perfectly inelastic. The Keynesian aggregate supply curve (KAS) consists of two segments: (1) An elastic segment that reflects the aggregate marginal cost of production; that is, a predetermined nominal money wage divided by the marginal product of labor; and (2) A perfectly inelastic segment that coincides

**FIGURE I**

**AGGREGATE SUPPLY AND DEMAND**