

# HISTORY OF ECONOMIC IDEAS



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## KEYNES AND THE CONSTRAINTS ON POLICY\*

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Although Keynes devised economic theory solely for policy purposes he was acutely aware of the constraints on the effectiveness of economic policy. The major set of constraints emanated from the inability of the politicians to comprehend and recommend sound policies and the related domination of policy by the views of a narrow set of "insiders", often to the exclusion of the economists/intelligentsia. Keynes's perception of these issues is examined here in some detail and illustrated with reference to a range of economic events in the 1920s and 1930s. Nevertheless, awareness of these constraints never deterred Keynes from seeking and finding theoretical justifications for the policies he proposed.

### Introduction

Although Keynes developed his short run theory of aggregate demand in the early 1930s in order to provide a rationale for the interventionist policies which he was advocating, he was a proponent of activist policies at a much earlier stage of his career. By demonstrating the possibility that an economy could operate for long periods with high rates of unemployment, in equilibrium at less than full employment, he paved the way for a more forceful promotion of his policy approach. In the 1920s his activist but conventional approach called for an appropriate monetary policy, later for public works programmes and after the development of the *General Theory* for even more energetic state intervention. Thus governments could influence the level of aggregate demand through production enhancing increases in public expenditure; government budgets adjusted according to the state of the economy with a greater reliance on fiscal policy

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than monetary policy; and the shaping through institutional and other state arrangements of a supportive environment in which innovative entrepreneurs could operate. The problem was that the power to initiate such policies lay in the hands of a group of less well qualified and able individuals: the politicians and their civil servants.

Keynes was concerned with how satisfactorily the politicians could fill such a crucial role. His answer reflected his belief about the 'apostolic' mission of the 'intelligentsia' (cf. Skidelsky's clerisy, 1992, p. 5) in influencing directly and/or indirectly the formation of political decisions. The main instrument of the 'intelligentsia' was provided by the professional economists. He strongly supported the direct involvement of professional economists not only in shaping public opinion but also in advising public servants and politicians about appropriate economic measures. Capitalism needed salvation and he aimed to provide the means. Like Alfred Marshall before him and with not much more understanding he rejected the "out of date controversialising" (Skidelsky 1992, p. 520) of Marx. Only through his liberal approach would the general welfare of societies be maximised.

A vast and rich literature exists on most aspects of Keynes's thought, his philosophical leanings and beliefs and his economic policy proposals (see for example Dillard 1946; Lambert 1963; Skidelsky 1988; O'Donnell 1989, chs. 13, 14; Dostaler 1996; Clarke 1998, etc.). The evolution of Keynes's views on economic policies are also well documented while his specific proposals have been endlessly dissected (see for example Patinkin 1982 and 1987; Harris 1947; Moggridge 1975; Peden 1980; Kaldor 1982; Clarke 1988; Millmow 1992). However, there has been much less analysis of Keynes's doubts about the ability of the machinery of state to comprehend and to effectively implement his policy proposals. Such policy implementations were complicated by his stress on the ethical bases of economic policy which he believed would enhance the lives of the "mass of men" (O'Donnell 1989, p. 168).

Keynes's view of the problems of rectifying the malfunctions of capitalist economies forms the main scope of this paper. In section 1 Keynes's arguments are presented for the crucial role of professional economists in devising effective policies and

these are contrasted with his adverse opinions of the abilities of the politicians to form sound policy views. Other factors inhibiting effective policy are also briefly touched on. In section 2 his critical and mainly adverse views of the actual economic policies of government are examined and briefly related to the functions of a mixed economic system.

### 1. The role of professional economists and the politicians

After June 1919 following his inability to persuade the parties at the Paris Peace Conference, Keynes left Paris and the 'official' world returning to the fuller pursuit of his academic activities. According to Harrod (1951, p. 283) the target which Keynes set for himself was "to devise remedies which would enable [... the free exchange...] system to survive by curing it of its main defects" (brackets added). Although his ideas continued to develop his interest in issues of unemployment was already visible (Robinson 1947, p. 123) in *The Economic Consequences of the Peace* (1919). Keynes's optimism about the capabilities of a 'select' group of humans drove him to seek for solutions to pressing economic problems and in particular, to find a cure for high unemployment<sup>1</sup>. His demeanour apparently exuded an extraordinary self confidence which was reinforced by his careful preparations for meetings where there was a discussion of policy. Following his "prophesies" in his "The Economic Consequences of Mr Churchill" (1925), he observed with a superior, almost smug, style: "... I, who opposed our return to the gold standard and can claim, unfortunately, that my Cassandra utterances have been partly fulfilled, believe that our exchange position should be relentlessly defended today..." (1931c, p. 236)<sup>2</sup>. He made the effort to moderate his language and to soften what often appeared as a polemical stance. With the detachment

1. Keynes stressed the significance of an optimistic outlook: "For if we consistently act on the optimistic hypothesis, this hypothesis will tend to be realised; whilst by acting on the pessimistic hypothesis we can keep ourselves for ever in the pit of want" (1931b, p. xviii). Cf. "He was [...] profoundly an optimist and profoundly an idealist." (ROBINSON 1947, p. 22).

2. Elsewhere Keynes wrote (1931c, p. 236): "I have thought twice, and the following are my conclusions".

brought with the passing of time he wrote in the Preface to his collected *Essays in Persuasion* that his aim had been "... to influence opinion...". Consequently, "...[I] was constantly on my guard - as I well remember, looking back - to be as moderate as my convictions and the argument would permit" (1931b, p. xvii).

Surprisingly, for someone with Keynes's academic and intellectual background he aimed to win "...public interest in the practical application of economics on critical occasions" (*The Times*, 1946, p. xix). And allowing for Harrod's tendency to idealise (1947, p. 71) he suggested that "Few men in history can have had so great an influence as Keynes in moving the minds of men on social and economic questions". Similarly, Austin Robinson (1947, p. 85) maintained that Keynes as a civil servant "...had two God-given weapons - a voice and a pen..." that could persuade not only his superiors but also the ordinary people<sup>3</sup>. Despite his powerful intellect he never came across as single-minded or obsessive in his policy suggestions. On occasions he listened to and even took into account the views of other writers on economic issues. When he wrote a series of articles for publication in *The Times* (1933, p. 357) he claimed that "After private discussion and borrowing the ideas of others, I am convinced that the following scheme is the best one. If other variants command more support, that would be a reason for preferring them".

In Keynes's view economics should always be directed towards problem solving and he constructed theories based on "vigilant observation" (Skidelsky 1992, p. 221) for the purposes of policy formation. Such policies would then be promoted to those who had the power to implement them<sup>4</sup>. He believed that economic advisers should be very well versed in economics, and

3. For Keynes's feelings and ability to persuade his audience by using an economy of 'utterance', see Harrod (1951, pp. 207, 286). However, Keynes, as Schumpeter comments (1946, p. 75) "...had no taste for politics, but he had less than no taste for patient routine work and for breaking in, by gentle arts, that refractory wild beast, the politician".

4. Keynes approached all problems, as problems of government, and strongly subscribed to the view that economics should guide policy. As Robinson observed (1947, p. 23) "...never, so far as I remember, did Keynes in late life devise an economic tool purely for its own sake rather than to solve an immediate practical

not beholden to any political party or ideology. This led him to one of his most famous pronouncements: "If economists could manage to get themselves thought of as humble, competent people, on a level with dentists, that would be splendid" (1930, p. 332). Political decisions would then be informed by these modest and competent advisors. At the same time he enumerated the following special 'gifts' of the professional economists which represented an ideal not necessarily achievable:

"the master-economists must possess a rare combination of gifts. He must reach a high standard in several different directions and must combine talents not often found together. He must be mathematician, historian, statesman, philosopher - in some degree. He must understand symbols and speak words. He must contemplate the particular in terms of the general, and touch abstract and concrete in the same flight of thought. He must study the present in the light of the past for the purposes of the future. No part of man's nature or his institutions must lie entirely outside his regard. He must be purposeful and disinterested in a simultaneous mood; as aloof and incorruptible as an artist, yet sometimes as near the earth as a politician".

(1924, pp. 173-174).

These were the exacting, almost superhuman qualities and technical skills which he expected the economic advisors to bear in government to help to solve pressing economic problems. Although they may be construed as the ideal and dismissed as 'Keynes's vision' his sincerity can not be doubted.

In a less guarded address to a Liberal Summer School he proclaimed: "I believe that in the future, more than ever, questions about the economic framework of society will be far and away the most important of political issues. I believe that the right solution will involve intellectual and scientific elements which must be above the heads of the vast mass of more or less illiterate voters" (1926b, p.295). Toward the end of his life (in a speech proposing a toast to the Royal Economic Society in 1945) he proclaimed that economists

problem in the application to government of the methods of economic analysis-

should be "...the trustees, not of civilisation, but of the possibility of civilisation." (quoted in Harrod 1951, p. 194)<sup>5</sup>.

The experienced economic advisers would provide advice, informed by well constructed and appropriate statistical measures. Unfortunately, there was another complication, as he commented, "Every government since the last war has been unscientific and obscurantist, and has regarded the collection of essential facts as a waste of money" (1939-1940, p. 381). Nevertheless, an even more acute problem was the quality of those who received the advice. He rarely described any politician in glowing colours and he tended to pass quickly over their strengths to focus on their weaknesses. These weaknesses were detected with a devastating accuracy and insight. As early as 1919 he wrote of President Woodrow Wilson that he was: "a [...] man, with many of the weaknesses of other human beings, and lacking that dominating intellectual equipment which would have been necessary to cope with the subtle and dangerous spellbinders whom a tremendous clash of forces and personalities had brought to the top as triumphant masters in the swift game of give and take" (1919, pp. 24-25). Furthermore, "His mind was too slow and unresourceful to be ready with any alternatives" and he was "...far too slow-minded and bewildered" (1919, pp. 27-28). Clearly he did not rank politicians among the individuals who could fill the role of "philosopher-king" (1919, p. 26). Keynes's expectations of politicians were so low that he saw no prospect that they would be able to effectively direct the economy and improve the welfare of their citizens<sup>6</sup>.

From his earliest days in the India Office Keynes developed an adverse view of the operation of government policy. His perception of the politicians was that they were rather full of words and few actions. The opening comments in *A Revision of the Treaty* scathingly noted that "It is the method of modern statesmen to talk as much folly as the public demand and to practise no more of it than is compatible with what they have said, trust-

5. Harrod commented that Keynes presupposed that "Britain was and would continue to be in the hands of an intellectual aristocracy using the method of persuasion" (1951, pp. 192-193). This is a view which in practice can not hold true in a democracy (see BUCHANAN and WAGNER, 1978, pp. 16-17).

6. Cf. Adam Smith (1776, p. 456) who famously espoused a similar

ing that such folly in action as must wait on folly in word will soon disclose itself as such, and furnish an opportunity for slipping back into wisdom" (1922, p. 1). As Harrod noted (1951, p. 191), for Keynes "...those concerned with government were a lesser breed of men, whose role was essentially a subordinate one

Keynes forthright, almost disparaging comments on the economic policies of such an astute politician as Winston Churchill are noteworthy:

"[Mr Churchill] ... was committing himself to force down money wages and all money values, without any idea how it was to be done. Why did he do such a silly thing? Partly, perhaps, because he has no instinctive judgment to prevent him from making mistakes; partly because, lacking this instinctive judgment, he was deafened by the clamorous voices of conventional finance; and, most of all, because he was gravely misled by his experts. His experts made, I think, two serious mistakes. In the first place I suspect that they miscalculated the degree of the maladjustment of money values, [...] also misunderstood and underrated the technical difficulty of bringing about a general reduction of internal money values".

(1925, pp. 212-213)

These negative views date from Keynes earliest employment experience as a civil servant in the India Office. He joined the India Office in 1906 and in less than a year he was writing to Lytton Strachey (Skidelsky 1983, p.181) "I'm thoroughly sick of this place and would like to resign [...]. It's maddening to have thirty people who can reduce you to impotence when you're quite certain you're right [...]. Then the preoccupation, which seems characteristic of officials, to save their own skin, is fatal". Although he was in the India Office for just 20 months his early experiences left an indelible mark. In October, 1911 he wrote to Duncan Grant: "You have not, I suppose, ever mixed with politicians at close quarters. They are awful. I think some of these must have been dregs anyhow, but I have discovered, what previously I didn't believe possible, that politicians behave in private life and say exactly the same things as they do in public.

Their stupidity is inhuman" (quoted in Harrod 1951, p. 157)<sup>7</sup>.

These views led him to argue that economic policy measures should never be the sole prerogative of the politicians for the effects would often be deleterious to the common good<sup>8</sup>. Some of the strongest language he ever used, laced with a tone of indignation was reserved for the Churchillian policies associated with the return to the gold standard in the mid-1920s. For example, he stressed that "... this policy [...] will leave much injustice behind it on account of the inequality of the changes it will effect, the stronger groups gaining at the expense of the weaker" (1925, p. 224). Although Keynes was never a socialist he was at his most progressive and outspoken at this time. The adjustments which would be a consequence of a return to the gold standard would be severe: "Some people may contemplate this forecast with equanimity. I do not. It involves a great loss of social income, whilst it is going on, and will leave behind much social injustice when it is finished" (1925, p. 225).

Although Keynes chose to make Marshall one of his whipping boys in the promotion of the *General Theory*, in many respects he was greatly influenced by him, and not just in terms of methodology. Echoes of Marshall are visible in Keynes's emphasis on social justice and his emphasis on the important role to be played by the 'intelligentsia'<sup>9</sup>. The qualities of the professional economist would compensate for the deficiencies of the politicians and the inability of the public to comprehend. Writing in 1931 about Britain's attempts to maintain the gold standard he commented: "The point is that the Cabinet and the public seem to have no clear idea as to what has to be done to implement its own decision" (1931c, p. 241). For Keynes the professional economist was the philosopher advisor to the king and thus he strongly supported and encouraged the formation of

7. E.A.G. ROBINSON (1947, p.110) wrote about Keynes that "he hated stupidity, not only with aesthetic but also with a moral hatred". Robinson justified Keynes's attitude by suggesting he believed "stupidity prevented the accomplishment of what was best for the world".

8. For Keynes's dissatisfaction with the various political parties and the existing politico-economic system see SKIDELSKY (1975).

9. Keynes recognized that policy "was significantly philosophy-dependent" (O'DONNELL 1996, p. 215).

various committees of specialists, including economists to provide the government with advice on current problems before and during the second World War (see Coats 1981).

## 2. Government's detrimental decisions

Keynes was at his most combative and trenchant in the 1920s after he had been freed from the constraints of the civil service and as his popular and academic writing focused to an increasing extent on the unemployment problem<sup>10</sup>. At first it was his writing on monetary theory and policy which he directed to the unemployment issue. In the early 1930s it was the development of the *General Theory* as a vehicle for the promotion of his policy recommendations which provided the impetus. His objective was to help to eliminate wrong or inappropriate policy actions by governments. The deleterious effects on the welfare of the community were most evident in the misery and other costs associated with high unemployment.

After the first World War the British economy suffered from persistently high unemployment which has been linked to a rise in real wages and the wrong-headed deflationary policies of government. Keynes's comments were usually directed towards the deflationary policies of the British Government. His comments on such policies exemplify his views, which were not always consistent, as his biographers and most commentators have noted<sup>11</sup>. His iconoclasm and polemicism resulted in some aggressive and colourful language. After Britain's return to the Gold Standard in 1925 referring to the principal economic ministers' opinions he wrote: "These statements are of the feather-

10. Although many of Keynes's adverse views of politicians and bureaucrats were shaped by his experiences in the India office and as a temporary civil servant in the Treasury during the first World War, his most critical views of government policy did not emerge until the 1920s. For a review of Keynes' work in the Treasury see MOGGRIDGE (1992).

11. His comments on "wrong" policies of government are taken from the 1920s and early 1930s. After the *General Theory* was published Keynes was much less strident in stating his views and even saw merit in some of the policy actions of governments. This may be a measure of his powers of persuasion. For a range of opinions on this see ROBINSON (1947); HOWSON and WINCH (1977); MOMMSEN (1981); HALL (1989); SKIDELSKY (1992).

brained order". "While the Treasury experts advising the Ministers presented arguments which were "...vague and jejune meditations..." (1925, p. 210 and p. 214). The credit restrictions accompanying the return to the Gold Standard were especially objectionable: "Deflation does not reduce wages 'automatically'. It reduces them by causing unemployment. The proper object of dear money is to check an incipient boom. Woe to those whose faith leads them to use it to aggravate a depression!" (1925, p. 220)

By the mid-1920s as he was proclaiming the end of *laissez-faire*, contemplating the nature of Liberalism and whether he was a Liberal, he rejected the opportunity to stand for parliament while continuing to write disapprovingly about the policy-makers. Together with Hubert Henderson he published a pamphlet *Can Lloyd George Do It?* (1929) which evaluated the Liberal pledge to drastically reduce unemployment. The Liberal policy closely followed the reflation via public expenditure approach which Keynes advocated through most of the decade. Public expenditure on housing, transport and other infrastructure would directly and indirectly create employment. Increased employment would result in savings to the government revenue and the increases in purchasing power would stimulate external as well as internal trade. Hints of the multiplier and the deflationary impact of reducing unemployment benefits and encouraging private saving are also distinguishable in his analysis. With political licence he described the Conservatives' "...belief [...] that it is financially 'sound' to maintain a tenth of the population in idleness [...] as crazily improbable" (1929, pp. 90-91) and with irony "There are mysterious, unintelligible reasons of high finance and economic theory why this (a reduction in unemployment) is impossible. It will be most rash. It would probably ruin the country" (1929, p. 91).

In the early 1930s Keynes continued to fault government policies. The budget and the Economy Bill were preceded in 1931 by the Report of the government's Economy Committee. Each of them was heavily criticised, for their deflationary bias and the inequitable wage policies which were involved. The

12. KEYNES (1931e, pp. 367-373) was in the early stages of working out his theory of wages for the *General Theory*.

Economy Report raised the issue of transmitting international deflation to domestic wages and prices "...though if this is our intention, it would be absurd to pretend that the process can stop with schoolteachers and policemen" (1931a, p. 141)<sup>13</sup>. From Keynes's perspective "The budget and the Economy Bill are replete with folly and injustice. It is a tragedy that the moral energies and enthusiasm of many truly self-sacrificing and well-wishing people should be so misdirected" (1931a, p. 145). While "...the government's programme is as foolish as it is wrong" (1931a, p. 147). Of the inequity of wage cuts of 2.5 to 3.5 per cent for the 'well-to-do' and 15 per cent for schoolteachers he wrote: "The Prime Minister has offered no defense, except that some of his former colleagues, who have since recovered their heads, were temporarily frightened into considering something of the same kind" (1931a, p. 146). He believed that political imperatives overrode sound economic advice.

Keynes was acutely aware of the impact of the 'climate' of opinion around which economic policy decisions were taken by the government and the civil servants. The decision to return to the Gold Standard had been "...taken in a spirit of hysteria and without a calm consideration of the alternative before us" (1931c, p. 240). Similarly the suspension of the Gold Standard was accompanied by inappropriate deflationary policies influenced by misguided views about the state of confidence: "Our authorities made a great mistake in allowing sterling to open so high, because the inevitable gradual fall towards a truer level must sap confidence and produce on the ignorant the impression of a slide which cannot be stayed" (1931d, p. 246).

Among the ignorant who had an adverse effect on policy decisions were the members of various groups of influential opinion makers. He first expressed awareness of them in the frustrating period around the signing of the Paris Peace treaty when he wrote: "...there are [...] two opinions; not, as in former ages, the true and the false, but the outside and the inside; the opinion of the public voiced by the politician and the newspa-

13. He wrote (1931a, p. 146) "It is a monstrous thing to single out this class and discriminate against them, merely because they happen to be employees of the government... That the schoolteachers should have been singled out for sacrifice as an offering to the Moloch of finance is a sufficient proof of the state of hysteria and irresponsibility into which cabinet ministers have worked themselves".

pers, and the opinion of the politicians, the journalists and the civil servants, upstairs and backstairs and behind stairs, expressed in limited circles" (1922, p. 3).

Worse still, the opinions of the public which might influence politicians rarely showed the benefit of having been informed by the experts in economics. He observed that "...we live in a curious age when utterances in the press are deliberately designed to be in conformity with the worst informed, instead of with the best informed opinion, because the former is the wider spread; so that for comparatively long periods there can be discrepancies, laughable or monstrous, between the written and the spoken word" (1922, pp. 113-114). Therefore, he felt at liberty to ostentatiously offer some advice which was intended to serve as a warning: "It is the business of the modern politician to be accurately aware of all three degrees (of opinion); he must have enough intellect to understand the inside opinion [i.e. of the politicians], enough sympathy to detect the inner outside opinion [i.e. of the journalists and civil servants], and enough brass to express the outer outside opinion [i.e. of the public]" (1922, p. 4; brackets added).

Although Keynes principal focus was on short run economic policy his attitudes about the most appropriate and desirable economic system were unequivocal. In order to maximise investment activity it was necessary to recognise that: "...economic prosperity is excessively dependent on a political and social atmosphere which is congenial to the average business man" (1936, p. 162). For Keynes the choice was posed as one between the system operating in Britain and that operating in the Soviet Republics. When he wasn't despairing at the deficiencies of the policymakers he expressed optimism (1931b, p. xviii) at the efficiency of human institutions, strategies for the promotion of general welfare and the 'abolition' of the economic problem<sup>14</sup>.

For Keynes writing with Henderson about the Liberal Party pledge to reduce unemployment this begged the question:

14. Keynes did not wish to change the mechanics of the existing capitalist system, but as Harrod claimed "...his lifelong effort to understand what is wrong with the machine implies an interest in the machine, implies that he wanted us to continue to use the machine, implies, in fact, that he was at bottom an individualist" (1947, p. 72).

"Why must the government play a part itself? Why is it not enough to offer facilities and encouragement to private enterprise?" (1929, p. 113). Their answer was that "A very large part of those economic enterprises which absorb substantial amounts of capital have fallen under the influence or the control of government departments" (1929, p. 113). The role of the State was seen as that of a facilitator. It was also clear that the production and enlargement of public utility services needed enormous amounts of capital which entrepreneurs were not able or willing to invest, since, incontrovertibly, "...it is a fact that the rate of capital development in the transport system, the public utilities and the housing of this country largely depends on the policy of the Treasury and the government of the day" (1929, p. 113). Keynes had some doubts about the efficiency of public control of private enterprises, particularly of investment activities. He was at pains to stress that: "...the object is not to develop state enterprise as such" (1929, p. 114). Rather "The object is to develop and equip the country through the instrumentality of such forms of organisation as already exist and lie ready to hand" (1929, p. 114).

This left a wide scope for governments to devise appropriate economic policy measures which encouraged private investment and reduced unemployment. His optimistic opinion was that "...capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life" (1926a, p. 294). The role of the economist was paramount for such persons might develop a "copybook wisdom" for the statesmen to follow, and to "...find new policies and new instruments to adapt and control the working of economic forces..." (1926b, pp. 305-306). Only then would it be possible to establish "...social stability and social justice". This is what he believed he had accomplished in the *General Theory*.

### 3. Conclusion

By 1936 Keynes had achieved his objective to provide a the-

oretical underpinning for the pursuit of interventionist policies. From the time of his earliest experiences as a civil servant onwards he was under no illusions about the difficulties of successfully implementing such policies. This paper has concentrated mainly on his view of two sets of issues: those relating to the limited abilities of the politicians to comprehend the policies generated by the 'superior' analysis of the economists; and the actual failings of the policies which were implemented by the politicians who, Keynes believed, were most influenced by a narrow range of insider views. Keynes's views were not entirely negative and critical. At times he saw merit in some government policies. Despite his perception of the frequent failings of economic policy he did not waver from the view that there was a role for the public sector in maximizing economic welfare.

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