

Week 4. The Keynesian Revolution.

What were the major theoretical and practical obstacles to the adoption of Keynesian demand management to cure unemployment in the inter-war years? Would it have been effective?

Was there a ‘Keynesian Revolution’ in economic thought and policy in the 1940s and 1950s?

Readings.

Peden, G. C., ‘The “Treasury View” on Public Works and Employment in the Inter-war Period,’ *Economic History Review* (1984). Outlines the theoretical orthodoxy against which Keynes rebelled.

Middleton, R. C., ‘The Treasury in the 1930s: Political and Administrative Constraints to the Acceptance of the “New” Economics,’ *Oxford Economic Papers* (1982).

McKibbin, R. I., ‘The Economic Policy of the Second Labour Government, 1929-31,’ *Past and Present* (1975). [Number 68, p96-102]. A useful look at the international reception of Keynesian policies.

Floud, R., and D. N. McCloskey, *The Economic History of Britain since 1700*, vol. 2 (1860-1939). (Second edition, 1994). [Chapter 14 (Thomas)]. Quantitative analysis of the impact of plausible Keynesian policies.

Booth, A. R., ‘The “Keynesian Revolution” in Economic Policy-making,’ *Economic History Review* (1983). See also the comment by Tomlinson, *Economic History Review* (1984). Discusses the definition and timing of the Keynesian revolution.

Rollings, N., ‘British Budgetary Policy, 1945-54: a “Keynesian Revolution”?’ *Economic History Review* (1988). A strong rebuttal of Booth.

Note: if you are unsure about the Keynesian model of the labour market then refer to Levacic and Rebmann, p70-5, 86-93.

KEYNESIANISM.

The Central Features Of Keynesianism.

1. The economy was not self-adjusting and the government should use active policy to bring the economy back to full employment in a recession.
2. The government can increase aggregate demand by running a budget deficit in the short term (borrowing from the capital markets). This would be repaid in the medium term from higher tax revenues as the economy expanded ("Act of Faith" argument).
3. Increased spending should be channelled through the capital budget (public works). This increased the long term productive potential of the economy.
- [4. Some Keynesians differed from Keynes in their precise policy prescriptions - Meade (tax) and Kaldor (balance of payments). So was Keynes a Keynesian? Probably: he changed his mind very frequently.

Theoretical Obstacles To Keynesianism.

1. The reigning economic paradigm in the inter-war period was the classical model, which predicted that the economy was self-adjusting in the medium and long term. (Pigou Effect et cetera). The behaviour of the economy in the inter-war period was consistent with this pattern of adjustment (i.e., falling unemployment up to 1929).
2. The classical model was based on the following tenets.
 - a) The only way to permanently alter output and employment was through alterations in *productivity or* investment (the savings ratio). The government was incapable of influencing these factors without using very blunt instruments such as Bank rate.
 - b) Crowding out occurred if the government increased its borrowing. (Whilst idle balances did exist, only a high rate of interest would mobilise them and therefore they would not prevent crowding out as Keynes claimed). Private investment was more efficient than public (Adam Smith) so the net effect would be negative.
 - c) Heavy government borrowing redistributed wealth.
 - d) The government could avoid crowding out and redistribution by borrowing from the central bank. But that would increase high powered money and create inflation (which could in any case be achieved through monetary policy).
 - e) Only in a liquidity trap could public works be effective (these arose very rarely, such

as 1894 and 1932).

f) Keynes ignored the role of confidence in his analysis. The physical increase in output from a budget deficit could be entirely offset by the fall in investment due to a reduction in confidence. (The business world *believed* the classical paradigm).

g) Ricardian Equivalence.

Practical Obstacles To Keynesianism.

a) The government accounted for only 30% of UK investment and it was difficult to make substantial changes (in absolute terms). Hence the post-war Keynesians relied on tax changes.

b) Lack of direct government control hindered speed and efficiency of intervention. (Local authorities versus the Liberal manifesto; central government spending would only serve to *displace* local authority spending).

c) The supply of certain types of labour and investment goods was constrained, so that excessive acceleration would merely create inflation.

d) The Banks would not have lent the government the money (Australia). The national debt was already large.

e) Unilateral reflation would cause a balance of payments problem which could only be solved by tight money, tariffs or devaluation. (Essential interdependence of monetary and fiscal policy; deflation required to lower price level; parallel Reagan).

f) Once the balanced budget orthodoxy was broken there would be few constraints on fiscal irresponsibility. The constraints were already weak, given the state of national accounting.

g) Fiscal expansion was already large during the inter-war period (measured by the elasticity of government spending to GDP) and the government was already window-dressing the accounts.

The Efficacy Of Keynesianism.

1. Adverse calculations by Thomas and Howson (based on generous assumptions).
2. Dual economy problem would have emasculated Keynesian reflation (Glynn and Booth; Walcott).

The Keynesian Revolution.

1. Competing definitions of "Keynesian Revolution" (from a simple belief that markets do not always clear to advocating the use of persistent budget deficits).
2. There was a great diffusion of Keynesian theory in the 1930s (in the late 1930s the Treasury accepted in principle the efficacy of budget deficits on the capital account).
3. Further movement towards Keynesian policies during the war (for example, the Beveridge Report, econometrics, deflation in 1947 pursued via demand management).
4. But Rollings has emphasised the Treasury's strong desire to rely on traditional policies to reduce inflation, such as raising productivity and wage controls.
5. More fundamentally, only a budget deficit can definitely establish the Treasury's Keynesian credentials - but there was never any need for one, so we shall never know (Tomlinson)!

**MIDDLETON, "The Treasury In The 1930s:
Political And Administrative Constraints To The Acceptance Of
The 'New' Economics," *Oxford Economic Papers* (1982).**

1. The traditional view of the Keynesian Revolution suggests that after Keynes developed the *General Theory* he and his disciples battled with the Treasury until the later was overcome by intellectual argument and converted to Keynesian fiscal policies. (p48).

2. Middleton wants to emphasise the political realities of the situation - how difficult it was implement expansionary policies in the 1930s and how social and political attitudes changes during the war to make them more receptive to Keynesian theory. (p48).

3. The Treasury was a very powerful voice in government circles for various historical reasons (for example, the Permanent Secretary to the Treasury was also Head of the Civil Service and therefore very powerful; the Treasury had constant access to the Chancellor). (p49). Although the Treasury is usually portrayed as excessively conservative and short-sighted, such an interpretation ignores the role of the Treasury in reconciling (in an politically acceptable manner) the various claims that were made on the public purse. It was widely held by business, unions and government that balanced budgets were a highly desirable goal. Therefore the Treasury was loath to endorse risky plans such as cutting taxes in the hope that the expansion in output would raise the value of tax returns and bring the budget back into balance. It is not realised by many that fiscal expansion in the inter-war period was already relatively high - the elasticity of expenditure growth to GDP growth was already 1.6 (compared to 1.2 from 1960 to 1976). (p50).

4. The balanced budget rule which the Treasury inherited from its nineteenth century predecessors (and to which the government and public held) can be summarised as follows.

One: the budget must balance unless there is a war on or unless an investment project can be shown in advance to be remunerative (in the usual accounting sense).

Two: since taxes were a burden on industry - the productive sector of the economy - they should be kept to a minimum.

Three: government borrowing would crowd out private sector investment. (p51).

5. The balanced budget rule can be defended on several grounds:

One: it is consistent with the tenets of Adam Smith and the other classical economists (i.e. it was defensible on theoretical grounds).

Two: it prevents the government from fiscal irresponsibility stemming from political expediency. (p52, 59 onwards). Even during the inter-war period there was already

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evidence of "political business cycles", such as the tax cuts of Churchill's 1925 budget and also the 1935 budget. (p63 onwards). Parallel to the gold standard debate.

Three: it offered a clear public control mechanism when accounting techniques were very imprecise and open to abuse.

Four: it was felt that the rate of interest and the price level were not entirely within government control (i.e. they could be subject to outside pressure from the international economy) and this could make debt servicing very difficult if a large national debt were built up. (p52).

Five: running deficits would create inflation. (p53, 56). The reflationary effects of deficits could in any case be achieved by monetary policy, which would be more politically neutral. (p62).

Six: deficits undermined confidence in business circles and could cause an offsetting contraction in activity. (p53, 55, 56). The Treasury argument verges on Ricardian Equivalence when they discuss whether a deficit has to be preceded by a surplus. (p60).

Seven: the fact that government debt was held by certain sections of the public would tend to redistribute wealth regressively. (p54).

6. The government was already "window-dressing" the budget throughout the late 1920s and early 1930s in order to disguise a secret deficit. (p57). [But nowadays we would use the concept of Full Employment Balanced Budget].

7. Political constraints prevented the government from further unbalancing the budget, but administrative constraints were equally important. The central government undertook only 3% of gross domestic fixed capital formation, the local authorities another 27%. The latter were given grants in order to provide social overhead capital such as roads, sewerage et cetera. Merely raising the level of grants would not have increased investment because the local authority would have taken the opportunity to reduce local rates and cut back on their own expenditure. (p66). The political step of over-riding or constraining the freedom of local authorities would have been widely denounced in the 1930s, particularly given the administrative reorganisation being undertaken by Hitler in Germany. Even proponents of increased spending such as Oswald Mosely and the Liberal Party admitted this fact in 1930 (the latter with regard to their road building programme outlined in "We Can Conquer Unemployment"). (p68). The required long term planning began to be undertaken after 1937 when the central government required local authorities to set out five-year plans of investment projects which could be undertaken during a downturn. (p69).

8. Alternative methods of inducing deficits (i.e. lowering taxes) were not favoured by *either* side in the debate. Firstly, the multipliers are smaller. Secondly, the increase in spending is rarely directed towards investment (and higher consumption merely raises

imports). (p70). Thirdly, tax changes can only be made in the budget (and inter-war governments avoided mini-budgets because they implied a crisis).

Although on the whole tax changes were perceived to be inferior to changes in investment, they certainly offered some advantages. Tax changes work faster, they can be made to work automatically without political interference and have fewer adverse effects on confidence. (p71). In fact, the automatic element in fiscal policy was as pronounced in the inter-war period as it is today, which was one factor which made it so difficult for governments to balance their budgets in the 1920s and 1930s. (p72). If Keynes had been as keen on automatic stabilisation as Meade then some of the Treasury fears might have been allayed.

9. Middleton concludes that the influence of Keynes was limited in the 1930s largely because he failed to effectively address the political constraints which the government and Treasury faced. He also hindered the acceptance of his ideas by associating himself with a morally and politically bankrupt Lloyd George (who was the only one with enough originality - or desperation - to embrace Keynes' arguments wholeheartedly). (p73). Keynes was also facing an uphill struggle because fundamental questions had to be asked about the role of central government and the way it should operate - but this was only possible under the pressures created by the war. Hence Middleton can explain the reluctance to embrace Keynesianism and follows a different path from other authors (such as Howson and Winch) who attempt to back-date the acceptance of the "New" economics. (p74).

**BOOTH, "The 'Keynesian Revolution' In Economic Policy-making,"
Economic History Review (1983).**

1. Booth addresses the issue of exactly *when* Treasury officials became converted to demand management techniques. That is the question on which most of the Keynesian Revolution debate has centred. (p103).

2. Keynesians are defined as those people who were employed as temporary civil servants in the War Office Secretariat and who were followers of Keynes. They wanted to promote full employment by adjusting aggregate demand. (p103). Booth does not use the term "Keynesian" to refer to those who shared Keynes' analytical tools but called for a different policy agenda (for example, they were more willing to tolerate inflation or felt that the external balance should be the primary objective). It is questionable, however, whether there was really such a divergence between these groups as has been previously argued. (p104).

3. Prior to Howson and Winch (1977) the advent of Keynesianism was viewed as a victory of a new form of academic economics over the established orthodoxy. However, Howson and Winch pointed out that throughout the inter-war period the two parties had a

fair amount of common ground (at least in terms of policy) and whilst both believed that public works had a role in stimulating demand they were both wary of the inflationary effects created by supply constraints. Hence there was intellectual osmosis between the two camps - via intermediaries such as Hopkins - which paved the way for explicit Keynesian policies from 1941 onwards.

Peden (1980) offers a more conservative view and points out that there were still substantial differences between the two groups in terms of how they actually thought the economy functioned. He rejects argument by Hutchison (1977) that Keynes and the Treasury had very similar views in the 1930s. (p105).

4. Booth believes that the heart of the revolution is to be found in the *wartime* economic debates, rather than earlier. [He also argues that what Keynes read gives a better idea of his views than what he wrote. Is this bloke serious?]. (p106).

Booth argues that the importance of the 1941 budget has been overstated by Howson and Winch. The emphasis on controlling demand in 1941 was widely seen as a special case created by the needs of the wartime economy - it does not signify the conversion of the Treasury to peacetime interference. Otherwise we could equally well date the Keynesian revolution as June 1940 (when Keynes was asked to join the Chancellor's Consultative Committee) or October 1939, when Keynes began a campaign to make the Treasury see the potential of the budget as a policy instrument to control inflation. (p107). If the Treasury were not truly converted to Keynesianism in 1941 (as Booth suggests) then it is easier to explain their later opposition to demand management in the plans for reconversion.

5. Meade and others believed that the path of the economy after the war would be similar to that experienced after the Great War (i.e. boom and bust). Hence he believed that the government should permit a moderate rise in prices after the war - if necessary stimulating demand through public works, lax monetary policy to encourage private investment, tax reductions and social security payments - but a tight rein should be kept on inflation through incomes policies linked to increases in productivity. It was hoped that this would avoid the necessity of severe deflation and permit the post-war boom to continue. (p108, 111). However, the Treasury expected the economy would operate below full employment after the war and therefore feared that budget deficits to stimulate demand would expand out of control. Instead they proposed to keep a balanced budget and only stimulate demand by some expansion of unfunded debt. (p109, 112).

Keynes was close to Meade. He wanted demand to be stimulated when necessary by capital investment and he also favoured automatic stabilisers (such as a sliding scale of social security contributions which fell as unemployment rose). (p109, 112). He thought that unemployment would average 5% after the war, considerably below the 8.5% which Beveridge had assumed in his calculations of how much social security the country could afford. Hence Keynes was thoroughly out of touch with the Treasury, who were working on the assumption that unemployment would be *higher* than Beveridge had allowed for.

They were using his own earlier arguments against him by suggesting that only very precise demand stimulation was desirable because some sectors would reach full capacity ahead of the others. (p110).

6. The Steering Committee on Employment Policy was established by Anderson. In order to represent the two camps the committee itself was loaded with Treasury men but their remit was to examine ways of controlling aggregate consumption and investment. The subsequent report (not surprisingly) echoed the Treasury's view from the 1930s. Public works were thought to be beneficial but the report warned against persistent budget deficits. The report placed some emphasis on investment demand but did not admit that the level of unemployment could be altered through the use of *aggregate demand* - much to the annoyance of the Keynesian Economic Section. (p112, 113).

The report noted that if varying the level of aggregate demand were the objective of the government then this could best be served by adjusting social security payments rather than investment. The extent to which social security could be adjusted was between 50% and 100% higher than investment. The overall impact was likely to amount to around 10% of GDP - but only because Keynes vastly overestimated the multiplier. The true level of government leverage was quite small. (p113).

As well as overestimating the benefits of intervention the report also underestimated the costs. The incomes policy proposed by Meade was dropped after objections from the Labour Ministry and as a result any expansion was likely to create higher inflation. (p114).

7. The resulting White Paper was (inevitably) a compromise version. It was broadly Keynesian but peppered with warnings about persistent deficits. Keynes noted particularly that the paper failed to give sufficient emphasis to the capital budget. (p114). He thought that the post-war boom would probably last five years and that investment demand could then be manipulated in order to maintain growth for another ten years. It was only then that he feared a depression. (This is in contrast to the Treasury, who were more fearful of an earlier set-back). (p115). As a result the paper should be seen as a milestone on the road to Keynesianism but not a signal that the revolution had occurred. (p116).

8. Keynes' own preoccupation with investment spending was to set him apart from his post-war disciples. Although Keynes was prepared to tolerate a deficit on current account (i.e. consumption spending) he primarily expected reflationary policy to work through capital investment. Hence he persuaded the government to restructure the accounts with separate sections for current and capital spending. (p115).

Yet the divergence between Keynes and his followers should not be predated. Up to 1950 they were of one mind, agreeing on a preference for capital spending and incomes policies. (p117). It was only later that tax changes became popular - and Keynes was the first to admit that he might well change his mind when faced with a new situation.

9. Over time more Treasury officials were won over to Keynesian (particularly the

younger ones) and many opponents were moved or retired. The Economic Section managed to establish itself in Whitehall and undertook econometric analysis of the economy in order to formulate more accurate predictions and policies. The head of the Section (Meade) was given a seat on the Chancellor's budget committee. (p118).

10. The Labour government was generally receptive the Keynesians but suffered from a lack of understanding of economic analysis. Hence they retained for politician reasons various idiosyncrasies which inhibited effective demand management (for example, statistics based on the calendar year and budgets based on the financial year). (p119).

In addition, the reconversion process required some fairly direct intervention such as increasing output in the export industries by inducing a wage differential in their favour. (p120). Ironically, the Keynesian revolution was no longer being blocked by an orthodox Treasury but instead by a government pursuing radical forms of economic planning. (p121).

11. Keynesians finally asserted their dominance in the inflation/balance of payments crisis of 1947. Meade was invited to make proposals to curb inflation and the plan he suggested was to remove food subsidies and allow prices to rise (thereby reducing aggregate demand and reining back inflation).

The Treasury initially rejected this approach but as 1947 progressed the situation became urgent and the Treasury finally capitulated. (p122). [Booth also interprets this as evidence that Keynesians were sensitive to the problems of inflation, just as much as Keynes himself. Hence the notion of a split between them is overstated. But one swallow does not make a summer].

12. Hence Booth is keen to emphasise the gradual nature of the transition to Keynesianism. It was still not complete in 1947 - demand management was still primitive and the higher echelons of the Treasury were sadly lacking formal economic training. (p123).

Booth also concludes that Keynes and the Keynesians were at one, at least in this period.

The final inference to be drawn from this study is that there *was* a Keynesian revolution. This is in contrast to Tomlinson (1980) who claims that Keynesianism was never really accepted in government circles. (p123).

ROLLINGS, "British Budgetary Policy 1945-54: A 'Keynesian Revolution'?"
Economic History Review (1988).

1. The test of whether or not Keynesianism was accepted is the use of demand

management to achieve full employment. But Rollings believes that only the existence of a budget deficit can reveal whether the Treasury was truly converted (since a surplus is equally consistent with orthodoxy) and since a deficit was never required in the 1950s and 1960s there is no way of establishing the existence of a Keynesian revolution. In addition, the permeation of broadly Keynesian ideas in the treasury was so slow that any concept of a "revolution" is meaningless. (p283).

2. Booth defines Keynesianism broadly, stressing "the universal acceptance of the Keynesian formulation and the existence of Keynesian arithmetic". Hence he pinpoints 1941 and 1947 as crucial years. But Rollings points out that 1947 saw the use of a budget surplus to reduce aggregate demand, which is not a sufficient test of Keynesian credentials (although the *use of aggregate demand to combat inflation* was certainly an innovation in Treasury thinking). Hence Tomlinson argues that there was never a Keynesian revolution, since it was never deemed legitimate in Treasury circles to unbalance the budget to raise aggregate demand. (p284).

3. There was a noticeable lack of Keynesian revolution up to 1947. Demand management was not employed to check inflation, and instead the government relied on wage controls and raising productivity (the latter is rather reminiscent of inter-war governments). (p285).

4. As mentioned above, the surplus budget of 1947 does not prove that Keynesianism had been adopted. Gilbert (the Second Secretary to the Treasury and a fundamentalist orthodox believer) noted that a surplus was entirely consistent "all our past training and experience". (p286).

The Treasury supported the surplus for a variety of reasons. In particular, it wanted to maintain confidence by taking a resolute stand against inflation; and it was keen to cut down on government out-goings in order to conserve funds. (p287). Given these goals, the events which occurred between the spring and autumn of 1947 can explain the Treasury's apparent change of heart in that period. The constant upward revision of inflation figures persuaded the Treasury that a more severe deflation was required than was thought necessary heretofore. At the same time the change in the composition of the cost of living index allowed the government to reduce the level of food subsidies without adversely affecting the index and forcing up wages. (p288).

Consequently, we do not need to resort to a sudden Keynesian revolution in order to explain the apparent Treasury volte face. Furthermore, the Treasury attempted to persuade the Chancellor to cut the inflationary gap further by reducing food subsidies but the Chancellor refused. But the fact that the Treasury did not try to increase the budget surplus (cut the inflationary gap) by other means suggests that they were ultimately concerned with costly food subsidies rather than the inflationary gap per se. (p289).

5. Treasury opposition to subsidies continued into the 1950s. (p290). Rollings rationalises this by arguing that the Treasury wanted to reduce public spending, even if some of it were switched to private spending through tax cuts. This was in line with the orthodox view that the market is the most efficient allocator of resources. (p291). The Treasury

were prepared to do this even if it risked increasing wage inflation - whereas the Keynesians in the Economic Section were far more concerned about the wage inflation.

6. The reluctance of governments to cut subsidies because of wage inflation also reveals that the government did not believe that demand management was a sufficient tool to control inflation. Hence their confidence in Keynesianism was not whole-hearted. (p292).

7. Further evidence of opposition to Keynesian analysis is offered by the saga surrounding the national accounts. The budget accounts needed to be changed to the format of the national income accounts if demand management were to be accurate and effective. (p292). This adjustment was a gradual one under the Labour government (p293) - and just as it was completed the Conservatives won the election and consigned the new form of accounts to internal use only. (They did this in order that they could more easily obscure changes in government policy). (p294). The Treasury also put up great resistance to the new format using many specious arguments (such as the fact that the change in format might undermine confidence in the government). (p295). This demonstrates the breadth of opposition to Keynesianism in government circles.

**PEDEN, "The 'Treasury View' On Public Works And Employment
In The Inter-war Period", *Economic History Review* (1984).**

1. The key figure for economic analysis inside the Treasury was Ralph Hawtrey. He believed that the quantity theory of money was a valid concept and that the only way in which income and employment could be changed in the long run was through alterations in savings and productivity. (p168).

2. Peden examines whether there was a substantial change in the economic perceptions of the Treasury in the inter-war period (as Howson and Winch have claimed that there was). If there was indeed a shift in theoretical beliefs - but the Treasury continued to oppose public works in the 1930s - then this must be due to the political and administrative constraints which the government faced. This evidence would strengthen the arguments of Middleton and Tomlinson who concentrate on the political and administrative constraints as determinants of policy. (p169).

3. The 'Treasury view' was not necessarily held universally within the Treasury nor was it constant over time. But the basic tenets were as follows.

4. Crowding out occurred if the government increased its borrowing because the supply of funds was limited to the quantity of savings (which the government felt largely unable to influence except by substantial shifts in monetary policy). Since the private sector was more efficient at investment (a belief descended from Adam Smith) the optimal policy was to minimise government borrowing. (p170).

The Treasury modified its view through the 1920s and began to argue that although not all savings were being used for investment at any one time, the government was unable to mobilise the rest by persuading savers to buy bonds. This is because the remaining savings were held by firms and overseas investors in order to ensure their short term liquidity; hence a very high rate of interest would have been needed to alter their liquidity preference. (p172). Thus, although the supply of investment funds was not fully exhausted the result of government borrowing would still have been crowding out.

5. Hawtrey admitted in 1925 that crowding out might be avoided in the depth of a depression. In a recession some balances were genuinely idle because the owners could not find a profitable outlet and in that case public investment might offer a good solution. But in general a reduction in interest rates was thought to be sufficient to persuade people to reduce savings (i.e. raise consumption) and increase investment, thereby stimulating employment and output. This would have the *same effect* as public works. Occasionally (as in 1894) the reduction in Bank rate was not enough (even when it fell to 2%) and there was room for intervention - which was promptly taken. This situation was reached again in 1932 and the Treasury's adoption of public works can be seen as a continuation of normal Treasury policy (rather than as a Keynesian turn-around as it has been portrayed by Howson and Winch). (p172).

6. The Treasury also believed that nominal wages were not sticky upwards (i.e. an increase in the price level would not lower real wages because the nominal wage would rise). Hence Keynesian inflation policy would not raise employment, it would merely lower it by raising the domestic price level in the face of a fixed exchange rate. (p170).

7. Because the burden of servicing the national debt was large after the war it was felt that no further increases in government debt were possible without *undermining confidence* in the government's ability to service it. (If the government found it difficult to service the debt then it might be tempted to sell more bonds in order to provide liquidity. Such a policy would force down the bond price and inflict a capital loss on bond holders. Indeed, fear of further decline might spread so that bonds would not be held at almost any price). The adverse consequences of a reduction in confidence (capital flight, lower exchange rate and higher interest rate) might completely offset the beneficial effects of mobilising idle balances, increasing output and reducing unemployment relief. (p173).

8. Any public works which the government undertook had to be remunerative investments (i.e. would recoup the capital and interest). Merely spending extra money to achieve the same result in a shorter time span (which is what the Liberal road-building programme amounted to in 1929) was not deemed to be permissible. It would merely create bottlenecks and excess profits. (p173). [It would also upset the local authorities. p174.]

9. But although the preceding arguments are internally consistent and economically rational, it seems clear that in reality the Treasury were basically worried that if deficit financing were permitted then politicians would abuse their power for political advantage.

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(p174). Hence the Treasury marshalled both theoretical arguments and administrative arguments against deficit spending (and thereby demand management). And as it became more difficult to uphold the theoretical arguments the Treasury relied more heavily on the administrative objections (see Peden (1983) for evidence on the machinations of Sir John Hopkins).

10. The Treasury were in any case confident for most of the 1920s and 1930s that private enterprise could lead Britain back to full employment, if only rationalisation could be implemented and other supply constraints such as real wages could be eased. (p176).

11. Over time the Treasury came closer to the Keynesian view. For example, in 1937 they accepted that increases in investment expenditure would help to smooth out the coming downturn. Although they still believed that the effect would only be temporary by the time it wore off the economy ought to have picked up again. (p177). Ultimately, however, primary reliance was still placed on monetary policy to combat a downturn.

12. The Treasury were not entirely unreceptive to new currents of economic thought. Nor were they always entirely at odds with Keynes. (Keynes had worked in the Treasury for several years and at the time happily accepted many Treasury tenets - such as the notion that savings determined investment rather than vice versa). (p180).

The Treasury economic arguments were not as unreasonable as has been suggested. In addition, many of them were deployed at various times simply in order to bolster departmental opposition to political fiscal irresponsibility. As Keynes gradually wore the Treasury down they came to rely more and more on administrative arguments in order to constrain Macchiavellian politicians such as Lloyd George.