Interview with Tony Thirlwall

A Keynesian View of the Current Financial and Economic Crisis in the World Economy

Tony Thirlwall is Professor of Applied Economics at the University of Kent at Canterbury, UK. He joined from the University of Leeds in 1966, and has taught there ever since, interspersed with spells at the University of Papua New Guinea, West Virginia University, Princeton University, Cambridge (England), Melbourne and La Trobe Universities. In his early career he made contributions to regional economics, and the analysis of unemployment and inflation, but since the beginning of the 1980s his major research field has been international trade, the balance of payments and economic development. His major intellectual debts are to John Maynard Keynes and to Nicholas Kaldor (whose biography he wrote). His books include: Regional Growth and Unemployment in the UK (with R. Dixon); Balance of Payments Theory and the UK Experience; Inflation, Saving and Growth in Developing Economies; Economic Growth and the Balance of Payments Constraint (with J. McCombie); a best-selling textbook Growth and Development, now in its ninth edition, and his most recent, Trade Liberalisation and The Poverty of Nations (with Penelope Pacheco-Lopez). Between 1972 and 1991, he organised eleven Keynes Seminars at the University of Kent to commemorate the life and work of Keynes (published by Macmillan), and he is now the editor of the series Great Thinkers in Economics, published by Palgrave-Macmillan. Eleven volumes have appeared so far.
John King: What were the deep underlying causes of the recent great financial crash?

Tony Thirlwall: One of the important lessons that the great economist John Maynard Keynes taught us is that capitalist economies are inherently unstable; that there are no automatic mechanisms in an economic system that will maintain economies on a steady full employment growth path, contrary to the assumptions of classical economic theory. Indeed, left to themselves, recessions and expansions can become cumulative. And one of the great contributions of post Keynesian economists, particularly of Hyman Minsky, has been to show how a credit-based economy can exacerbate real fluctuations in economic activity, and there can come a point at which credit has expanded so much, and private and public debt has become so huge relative to income, that an upward cycle reaches a peak and then plunges. This point is sometimes called a 'Minsky moment' (when reality dawns!). Many non-orthodox economists were waiting for it, and it happened.

Indeed, economic historians will probably look back at the great financial crash of 2007-08 with some incredulity because as the Queen of England rather impertinently remarked on a visit to the London School of Economics in 2009 'why did economists not see the crash coming'? Many did, but their voices were drowned by the orthodoxy. In the UK, the signs were everywhere. The ratio of house prices to average earnings were way above their historical trend; banks, such as Northern Rock, were offering high interest rates to savers (a sure sign of high risk-taking) and granting mortgages 125 percent of the value of houses. The level of personal debt reached an all-time high. Even without the sub-prime mortgage fiasco in the United States, Britain was heading for a Minsky moment of ultimate debt deflation. Indeed, there was already evidence of the onset of recession in 2008 which led Danny Blanchflower of the Bank of England's Monetary Policy Committee to argue for cuts in interest rates when all his
colleagues on the Committee were still voting for rate increases to keep inflation at bay.

But what were the institutions doing all this time whose job is to monitor the British economy and the financial system? Basically, they were asleep on the job. The Financial Services Authority (FSA), which was set up when the Bank of England was made independent in 1997 to supervise the banks, failed in its job, and has now been disbanded by the new Conservative-Liberal coalition government. Why did it allow banks to lend to people more than the value of their houses? Why did it not warn about the level of personal debt, and why was it not monitoring the activities of investment banks investing depositors' money in fancy new exotic financial products that no-one really knew the risks attached to, not even the credit-rating agencies?

The Bank of England had its supervisory function taken away, but even so it has a huge staff full of highly trained economists. Could they not see something awry in the economy? Their defense is that their sole remit is to keep inflation below target, but the events of the last three years have exposed one of the fundamental weaknesses of inflation targeting and that is there are other prices to worry about in an economy as well as retail or consumer prices - namely asset prices. One instrument, the interest rate, to control different prices, is not enough. It is handicapped like the one-club golfer.

Then there is the role of the Treasury in the sorry saga. What were all the economists in the Treasury doing as the Titanic was heading for the iceberg. The Treasury should have been warning about levels of debt, fuelling consumption; about unsustainable asset price rises; about levels of bank lending etc.. The immortal words of the Chancellor of the Exchequer, Gordon Brown, of 'no more boom and bust' will haunt him for the rest of his life. He and the Treasury truly believed that the British economy could go on growing above its historical trend rate, fuelled by the growth of personal consumption and government expenditure. They were living in a fool's paradise.

In the United States, the situation was very similar, except the much more
irresponsible bank lending to poor people and the repackaging of risky mortgages (which international banks lapped up and passed on - like a game of pass the parcel with more paper added rather than taken off!), which led ultimately to the so-called sub-prime market crisis and the exposure of major financial institutions which did not have adequate capital to draw on as default took place. At the root of the problem, both in the UK and US, has been the liberalisation of financial markets and the inadequate supervision of banks encouraged by the theoretical orthodoxy taught in economics departments and business schools throughout the world, of efficient market pricing: that is, that the current price of assets reflects all known information and risks, so that, in effect, risk is already factored into prices. But again, one of the great lessons of Keynes in his *General Theory of Employment, Interest and Money* (GT) (1936) was to say that the future is unknowable; risk is one thing, but uncertainty is another, and all economic life is subject to fundamental uncertainty that cannot be insured against. In fact, history is littered with 'black swan' moments which should have always been a warning to those who believe in efficient market pricing.

Both in the UK and in the US, governments gave the financial system virtually free reign to do what it liked with whom it liked. In the UK, it was Thatcher's 'big bang' in the 1980s which freed the City of London from virtually all controls. Reserve requirements were relaxed; retail and investment banking were allowed to get mixed up, giving no protection to depositors. In the US, the Glass-Steagall act was repealed during the Clinton administration which had previously separated retail and investment banking. Traders and dealers were rewarded with huge bonuses for taking risks, but not for making mistakes, and so the merry-go-round was allowed to continue until the Minsky moment finally came with the collapse of Lehman Brothers. The moment itself was not dissimilar to the international debt crisis of the early 1980s when the debt of risky borrowers (mainly developing countries) got so large that it could not be repaid. The exposed banks, mainly in the US and UK, would have gone bust without debt-restructuring, and aided in this case by the IMF and other multilateral institutions.

In the domestic crisis of 2007, some banks did go under, as we know, but others
were deemed 'too big to fail', removing moral hazard, and were bailed out costing governments billions of dollars. Financial greed and lax supervision of the Anglo-Saxon banking model were the fundamental causes of the great financial crash. This can be clearly seen by the fact that several countries managed to avoid a crisis because their banking systems are much more prudent. Countries such as Canada, Australia and New Zealand, for example, and even Italy where banks are much more conservative, have not suffered to the same extent. There are important lessons here for the future of financial systems in the UK and US. In my view, there needs to be a separation of retail and investment banking; investment banks should be allowed to fail, and for retail banks there needs to be close monitoring of lending policies, combined with more prudent reserve requirements and capital adequacy ratios.

**John King:** Why did the great financial crash not produce a deep global recession similar to the 1930s?

**Tony Thirlwall:** The financial crash of 2007-08 was not followed by as deep a recession as the Great Depression of the 1930s because governments learnt the mistakes of the 1930s and intervened promptly. Policy-makers learnt the Keynesian lesson that in times of depression there is a role for government to support overall demand in the economy through both monetary and fiscal policy. The UK, the US and many other countries all launched massive fiscal stimulus packages which have increased their current account deficit to GDP ratios to close to 10 percent and above. Interest rates have been reduced to rock bottom of 0.25 to 0.5 percent. In the UK, there has also been so-called 'quantitative easing' which is just a fancy name for printing money. There is nothing wrong with this if circumstances warrant; it is not Mugabe economics! It just means the Central Bank using money it creates itself to buy up government bonds to keep long term interest rates low and to pump liquidity into the economy, hoping that banks will lend and agents spend.

With these fiscal and monetary interventions, output has not slumped, and
unemployment has not risen, to the levels it did in the early 1930s in the depths of the Great Depression, but even so, output fell by 4 to 6 percent in many countries between 2007 and 2009, and is only now recovering; and unemployment is hovering around 10 percent in the US and many European countries. The economic patient is still in intensive care and may need more oxygen before full recovery.

But a gap in economic thinking has emerged between the US and virtually the whole of Europe on the need for further fiscal stimulus. The US President and his advisers, as well as influential commentators such as Paul Krugman and Joseph Stiglitz, both Nobel Prize winners in economics, want the stimulus maintained, while European countries, including Britain, want to retrench because they are frightened about whether financial markets will buy their debt at current interest rates. Germany, France, Britain, Spain, Ireland, Portugal and Greece (under pressure) have all announced budget-tightening measures of cuts in government expenditure and tax increases. It remains to be seen what this does to the fragile recoveries of these countries. There is the danger of a so-called 'death spiral' in which cutting deficits ends up increasing them because of the negative impact on output, income and employment, and therefore tax receipts.

My preferred solution for reducing budget deficits without jeopardising recovery is for what is called a balanced budget expansion whereby government expenditure continues to increase (on investment projects) matched by increases in tax revenue. The expansionary effects of expenditure are always greater than the deflationary effects of tax increases so that the economy continues to expand, and, as it does so, tax revenues rise reducing the deficit. This type of approach helps to lay the foundations for future growth and enables vital public services to be maintained - but people have to be persuaded and willing to pay more taxes in the first instance.

**John King**: What is your verdict on the Greek financial crisis and lessons for the eurozone?
**Tony Thirlwall**: The recent economic and financial crisis is a cautionary tale for any weak country thinking of joining a common currency area. Greece entered the eurozone thinking that somehow it would prosper and be shielded from economic turmoil under the coat tails of its stronger partners. Instead, the opposite has transpired. Had Greece not been a member of the eurozone its economic fragility would have been exposed much earlier because there would have been a run on its currency and it would have had to have acted much sooner to cope with its twin deficits on the budget and on the current account of its balance of payments.

The Greek budgetary problem has a simple explanation. The government spends more than its citizens are willing to pay in taxes. In this sense, the nation is profligate and needs to tighten its belt. The financial crisis, however, could have been nipped in the bud much earlier if the stronger euro-partners had been willing to guarantee Greek government bonds while the government put in place measures to reduce the fiscal deficit to a manageable level acceptable to financial markets. The Greeks thought that that is what partners in an economic union are for, but it had perhaps forgotten the 'no bail out' clause in the original Maastricht Treaty establishing monetary union. But the pressures within the eurozone eventually became so great, with the threat of contagion to Spain and Portugal, that now even the European Central Bank (ECB) will buy up Greek government bonds if necessary having said since the start of the crisis that it would not. I think that Greece was right to put pressure on the institutions of the European Union (EU) rather than to default, but I also think that exit from the eurozone would be in Greece's long term interest. Members of a currency union lose all control over their economic policy, but for the maximization of the economic welfare of a country, I believe that economic policy-making needs to be as flexible as possible. In principle and in practice, therefore, I think it is short-sighted for nation states to join currency unions, particularly weak countries. In currency unions and free trade areas the lessons of history are that strong countries always gain at the expense of the weak - as, indeed, Prince Bismark observed in the nineteenth century. It would not be difficult for Greece, or any other country, to leave the
eurozone if it wished. It could simply revert to its old currency; denominate all existing debt in its own currency, and then let the currency find its own level on foreign exchange markets. This would help reduce the debt burden and improve the balance of payments and growth performance all at the same time. I would recommend the same strategy for Spain, Portugal and Ireland. Fortunately, Britain is not in the same economic straightjacket as most of the rest of Europe. I campaigned vigorously against the idea of Britain joining the euro when the debate was active in the late 1990s, and I believe that scepticism of the wisdom of European Monetary Union (EMU) has been vindicated. Cooperation and harmony in Europe, and the single market, never required a common currency. That was a political decision, not one with a sound economic rational. Indeed, the Nobel Prize-winning economist, Robert Mundell, who pioneered work on the economics of monetary unions, frankly admitted some years ago that he didn't believe that the current grouping of countries fulfill the conditions for an optimum currency area.

**John King:** What do you think is the role of international economic institutions in promoting a stable world economy and promoting economic development?

**Tony Thirlwall:** Part of the bail-out for Greece has come from the International Monetary Fund (IMF) which was established, along with the World Bank, at the Bretton Woods conference in 1944. The role of the IMF was to lend to countries in short-term balance of payment difficulties to avoid the beggar-thy-neighbour policies practiced in the 1930s. It is doing this with Greece, but the interesting thing is that the IMF (and various European institutions, including the European Commission and OECD) didn't see the crisis coming, just as it didn't see coming the East Asian financial crisis in 1997. Just as there has been a failure of financial supervision within countries, so there has also been a systemic failure by international institutions to forecast country trouble. IMF intervention in Greece will now come with heavy surveillance of its economy and policy-making, just as
the IMF imposes heavy conditionality on poor developing countries when it gives loan support. There is one big difference, however, between Greece and a typical developing country, and that is the IMF cannot tell Greece to devalue its currency. So unless Greece can become more competitive by slashing wages and prices, Greece's problem with uncompetitiveness with the rest of Europe will remain, and the task of economic recovery will be that much harder. In the end, Greece may have to default, or leave the eurozone, notwithstanding IMF support.

One huge failure in the design of the international architecture established at Bretton Woods, and with the rules of the game laid down, was the failure to put in place mechanisms to deal with global imbalances of payments. There has always been an asymmetry in the system because while deficit countries are penalised by having to pay interest on their loans and to deflate their economies, surplus countries pay no penalty on their surpluses and are not forced to expand their economies. So the current system produces a deflationary bias in the world economy, and leads to flows of funds between surplus and deficit countries which have no particular rational and can be destabilizing for the world economy. The most obvious current example is the huge transfer of resources from China and other Asian countries in massive surplus to the US with a massive deficit. Apart from the stupidity of the world transferring resources to the world's richest country, it poses major problems for the US economy itself by encouraging excessive consumption and destroying US domestic industry because the consumption is largely of foreign goods.

This is not how Keynes wanted the international monetary system to work. He wanted a world central bank (an International Clearing Union, he called it) which would have the power to create international money (bancor) for collectively agreed purposes (so the dollar would not be the world's reserve currency), which would also have the power to penalize surplus countries as well as deficit ones. The resources raised from surplus countries could be recycled to poorer countries as a form of international aid, instead of to American consumers. The Keynes Plan, however, was not adopted at Bretton Woods, and the world economy now suffers as a result.
The function of the World Bank was to provide long-term development aid to countries, originally to the war-torn countries of Europe and later to developing countries, but increasingly it has become 'banker to the poor', like the IMF, dispensing short-term balance of payments support as well, under its so-called Structural Adjustment Programmes. The roles of the IMF and World Bank have largely merged, and there is hardly any difference in the programmes they implement in countries in difficulty. Both are harsh and deflationary, and often 'anti-developmental' in that they hurt the poor through cuts in government welfare programmes and the removal of subsidies on basic foods.

The global financial crisis has hit poor countries largely through the slow-down of world trade, but year in and year out they suffer adverse economic forces operating in the world economy. For example, there is a long-run deterioration of the terms of trade of primary commodities which poor developing countries tend to specialize in which means that for a lot of countries, particularly in Africa, their real income decreases because they have to give up more and more exports to pay for a given quantity of imports. Even more serious is the extreme volatility of primary product prices around the declining trend of the terms of trade. A 10 percent decline in the average price of all primary commodities can wipe out the total value of official aid to developing countries, equivalent to nearly $100 billion a year.

This is also something that particularly concerned Keynes, but his proposal for a 'Commod Control' scheme to stabilize the price of primary commodities never even got to the drawing board at Bretton Woods. It was regarded as too radical and too 'interventionist'. But the world is still plagued with primary product price fluctuations as it was in the 1930s, which play havoc with the economies of poor countries, and makes the world economy much more unstable than it need be. Today, multilaterally managed price schemes for storable commodities could be financed through the use of Special Drawing Rights (SDRs) which the IMF created in 1969, but which have never been put to any socially useful purpose. When prices of commodities are falling below an agreed price, SDRs could be used to buy them up and store them, and when prices rise above an agreed price, stocks
of the commodities could be released. Keynes believed that his scheme would make a major contribution towards curing the international trade cycle.

Apart from the IMF and the World Bank, the other major institution that affects the functioning of the world economy is the World Trade Organisation (WTO), formerly the General Agreement on Tariffs and Trade (GATT) which itself was created after the Bretton Woods institutions because the Conference could not agree at the time on how a new international trade organisation would function. The purpose of GATT (set up in 1947) was to free trade, but it also allowed 'policy space' for poor countries. Now, however, the WTO (set up in 1995) pursues free trade relentlessly, regardless of circumstances, as an end itself, with almost a religious fervor holding out the promise that if poor countries pursue free trade they will somehow reach the promised land of sustained growth without impediments. The reality, however, has been very different from the rhetoric. The sudden freeing of trade, often under pressure from the IMF and World Bank, and the poor sequencing of trade reforms, has been a disaster for many developing countries. Their balance of payments has worsened, economic growth has deteriorated, and domestic poverty and income inequality have increased. The problem with the exaggerated promises of the free trade doctrine, based on Ricardo's famous law of comparative advantage, is that the gains are static and the balance of payments and employment consequences of freeing trade are ignored. But the growth of an economy depends on the types of goods produced and traded - whether they are goods subject to diminishing returns and have a low income elasticity of demand in world markets or whether they are goods subject to increasing returns with a high income elasticity of demand in world markets. What developing countries need to do is to move out of old areas of comparative advantage, which makes them poor, and to acquire new dynamic comparative advantage in non-traditional products. This can only be done in the first instance by various types of protection, such as tariffs, subsidies, preferential credit for new investment, and so on. This is what the historical evidence shows and the contemporary experience of the successful countries of South East Asia (and now China) which from the 1950s onwards pursued a combined industrial
policy of import substitution and export promotion using a variety of protective devices, including directed credit by the government to key sectors.

The recent Doha trade negotiations largely broke down because some of the major developing countries objected to the WTO proposal that in return for developed countries reducing their agricultural subsidies, they should allow freer access to their industrial and service sectors: a very bad bargain, however, as far as the poorer developing countries are concerned. There is no hope for slow growing developing countries locked into the production and export of primary commodities without structural change.

John King: You are well known for your work on balance of payments constrained growth models. What inspired this work?

Tony Thirlwall: It is true that one of my main contributions to thinking in the field of growth and development economics has been the focus on the balance of payments consequences of trade and to argue that in the long run the balance of payments may be the ultimate constraint on the growth performance of countries. No country in the long run can grow faster than that rate consistent with balance of payments equilibrium on current account unless it can finance ever-growing deficits which in general it cannot. There is a limit to the deficit to GDP ratio, and the international debt to GDP ratio, beyond which financial markets get nervous. The question is what determines the crucial balance of payments equilibrium growth rate?

In orthodox trade and growth theory this question does not arise. Firstly, there is a divorce between real trade theory and its monetary consequences. The balance of payments is either assumed to look after itself (as under the old gold standard or flexible exchange rate system) or is regarded as a form of consumption smoothing and nothing to worry about. Secondly, mainstream growth models (such as the Solow neoclassical growth model) tend to be closed economy models
in which the balance of payments ad constraints on demand do not matter. These are supply-oriented models in which long run growth is determined by the rate of growth of the labour supply and productivity growth (determined by technical progress), both exogenously given. The contribution of my balance of payments constrained growth model is to argue that the growth of an economy may have to be constrained by demand long before the supply potential of the economy is reached because the growth of imports exceeds the growth of exports, which is unsustainable. Moreover, if a country can grow at its potential without balance of payments difficulties arising, demand may generate its own supply by encouraging new entrants into the workforce (including immigrants) and stimulate productivity growth. Thus growth is demand-driven to which supply can adapt within limits. There are not many developing countries in the world that could not grow faster given the greater availability of foreign exchange.

What can then be shown is that if the real terms of trade or real exchange rate don't change very much in the long term, or that the price elasticities of demand for exports and imports are low, the long-run growth of an economy can be approximated by the simple rule of the ratio of the growth of exports to the income elasticity of demand for imports. Sir Roy Harrod, one of Keynes's inner circle, showed a static version of this model in 1933, and the famous Argentinian economist, Raul Prebisch, produced a similar theory in 1950, but neither gave the empirical evidence to support it, which I did in 1979. Since then, there have been a multitude of studies supporting the rule (or 'law') for both developed and developing countries. The theory has become attractive to post Keynesian economists because it puts effective demand into growth theory as a driving force in contrast to the unsatisfactory nature of neoclassical growth theory which treats the differential growth of factor supplies between countries as exogenous.

John King: What do you think is the relevance of Keynesian and post Keynesian thinking today?
Tony Thirlwall: The prolific Canadian economist, Harry Johnson, once said that the greatest disservice Keynes did to economics was to cast his *General Theory of Employment, Interest and Money* in the context of a closed economy. In a sense, he was right because at least today, it is not possible to explain the fortunes of countries without reference to their trading performance and balance of payments. We all live in open economies. But Keynes was not oblivious to open economy issues. Before the GT, in his evidence to the Macmillan Committee in 1931, he referred to the dilemma of there being only one interest rate for both internal and external balance, and the interest for external balance may be too high to secure internal equilibrium. That is why in the GT he has a section (chapter 23) defending mercantilism because balance of payments surpluses allow the interest rate to be kept low to stimulate enough investment to match planned full employment saving for internal equilibrium. Mercantilists were not the 'imbeciles' as portrayed by later classical economists who argued that money (foreign exchange) is not wealth. This issue also relates to his views on free trade. He vacillated on the issue, but in the 1930s, at least, he came out against arguing that it all depends on whether full employment is maintained. As he put it: "free trade assumes that if you throw men out of work in one direction you re-employ them in another. As soon as that link in the chain is broken the whole of the free trade argument breaks down".

Despite Keynes's relative neglect of the open economy in the GT, I describe myself as a Keynesian economist because I still believe that the model he presents of the workings of a capitalist economy, and of the fundamental causes of fluctuations in income, employment and unemployment is the best there is. The reasons it came under attack in the 1960s, largely from Americans, are fourfold: Firstly, many economists never read Keynes in the original but only textbook versions, so they know none of the subtleties that cannot be mathematised (the Harvard economist, Gregory Mankiw, once said that he lost interest in Keynesian economics when he realised he couldn't put it into maths!); secondly, orthodoxy could not grasp the idea that price adjustments in the economic system may not bring about appropriate quantity adjustments to produce full employment;
thirdly, it was argued that the GT could not explain the combination of unemployment and inflation (stagflation) that arose in the late 1960s and 1970s, and fourthly, those on the right of the political spectrum didn't like the policy implications that suggested a big role for government in the workings of the market place (an anathema to conservatives).

Believers in orthodox price theory labeled themselves as 'new Keynesians', arguing that the Keynesian conclusion of the possibility of long-run unemployment equilibrium depended on the assumption of rigid money wages and prices, and if only there was wage and price flexibility economies can achieve full employment. A whole array of explanations was given of why wages and prices may be rigid. But this is a fundamental mis-reading (or non-reading) of Keynes because he explicitly states in Chapter 19 that his conclusions do not depend on wages and prices being rigid. Even if they were flexible in conditions of unemployment, the effect of falling wages and prices would depend on how they affected the components of aggregate demand - consumption, investment and the foreign balance. No, the major source of unemployment lies in the 'peculiar properties of money' ; that if people switch from buying goods to holding money there is a net diminution of the demand for labour ('zero elasticity of production') and even if the prices of goods fall, people still want to hold money ('zero elasticity of substitution'). In other words, a monetary-production economy is fundamentally different from a barter economy, or a model of general equilibrium in which money is just another good and the theorem of gross substitution holds.

Those who argued that Keynesian economics could not explain stagflation called themselves the 'new classical macroeconomists'. These were the second generation monetarists who not only believed in the quantity theory of money but also that economies are always at their natural rate of employment determined solely by real forces, and that inflation must always be associated with excess demand. Rising prices and growing unemployment are impossible. They may have been heavily influenced in their youth by Samuelson's depiction of Keynes's GT using the famous 45-degree line diagram which fails to include an
aggregate supply function. But Keynes's own analysis in chapter 3 includes both an aggregate supply schedule (or necessary receipts schedule, as he called it, partly determined by wage costs) and an aggregate demand schedule (or expected receipts schedule). Aggregate employment is determined where the two curves cross. If the necessary receipts schedule shifts upwards because wage costs rise, this reduces employment and raises prices at the same time. Stagflation is perfectly explicable within a Keynesian framework.

But perhaps the most important explanation of all for the rejection of Keynesian economics was the influence of Milton Friedman and the Chicago school whose underlying philosophy was the same as Adam Smith's that 'governments are rarely more effective than when they are negative'. The state is the root of all evil. Keynes's use of the phrase 'the socialisation of investment' didn't help, but he went on to say "beyond this (i.e. government expenditure) no obvious case is made out for State socialism which would embrace most of the economic life of the community". Keynes was a Liberal not a socialist.

In the wake of the current financial and economic crisis, people are re-reading Keynes. Keynes is becoming fashionable again much to the delight of post Keynesians, who never lost the faith, but much to the chagrin of the Chicago school whose silence these last three years speaks volumes. Two of Americas foremost and youngest Nobel prize winners in economics - Paul Krugman and Joseph Stiglitz - have become fundamental Keynesians. Two of the top economic journalists on the Financial Times - Martin Wolf and Sam Brittan - have turned Keynesian. It seems 'we are all Keynesians now'!

What we originally learned from Keynes, and should never have forgotten, is: fundamental uncertainty in a money-production economy; money is different from other goods and the desire for liquidity preference can have profound consequences; the role of future expectations in determining the present, and how volatile expectations can be, and last, but not least, it is demand that determines output, employment and unemployment in an economy, not supply. Economies become depressed because demand is depressed. Demand depends
on consumption, investment and net exports. The current economic difficulties of western capitalist economies will continue as long as finance is allowed to dominate the real economy, and until the confidence of investors is restored. Ultimately it is the 'animal spirits' (as Keynes put it) of entrepreneurs that drives the economic system; if animal spirits are dimmed 'enterprise will fade and die'.