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A METHODOLOGICAL READING OF “THE ECONOMIC CONSEQUENCES OF THE PEACE”

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**A METHODOLOGICAL READING OF
“THE ECONOMIC CONSEQUENCES OF THE PEACE”**

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Abstract

The paper provides a methodological reading of Keynes's “The Economic Consequences of the Peace”. Drawing on the close interdependence between theory and method in Keynes's economics, which he considered as a branch of logic, a correct way of reasoning about a complex economic material, we reconstruct the rationale of Keynes's imaginative solutions for the troubles caused by WWI and the Versailles Treaty. We thereby shed light on a method of thinking out the specific problems of international economic relations that Keynes will be consistently using (though adapting it to changing times and circumstances) in his work of international economics and diplomacy. A method which will have a direct influence on the contents of Keynes's Bretton Woods reform plans, and may be of great importance in directing European policy-makers to a structural reform of the continent's economic architecture.

Keywords: Economic Consequences of the Peace, Europe, John Maynard Keynes, interdependence, complexity, uncertainty, ethics, leadership

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Introduction

When suggesting, in a 1936 BBC broadcast, that the reader who has ‘learnt to read but [has] not yet gained experience ... should live with more books than he reads, with a penumbra of unread pages, of which he knows the general character and content, fluttering round him’ (*The Collected Writings of John Maynard Keynes*, vol. 28, p. 334; hereafter: CW), Keynes did not have in mind the *Economic Consequences of the Peace* (ECP). As many other great, highly influential essay in social disciplines, however, the ECP cannot avoid, in principle, this sort of destiny, that is to be read for the first time or rediscovered many decades after its publication, at some key moments of the recent history of the global and European economies. In the introduction to a new edition of the ECP, published on the eve of the global crisis, Paul Volcker (2007, p. 11) wrote that in reading the book, he was struck ‘not by the felicity of Keynes’s prose and the passion of his concerns but by the relevance to the world in which we live’. Curiously enough, in introducing the 1983 Italian edition of the book, Marcello De Cecco observed that it included an ante litteram criticism of the deflationary programs imposed on developing countries by the International Monetary Fund in the early Eighties, after the sharp reversal of monetary policy in the United States – Volcker was then chairman of the Federal Reserve – had produced a violent debt crisis in Latin America.

In a symposium organized by the history journal ‘Contemporanea’ on the ninetieth anniversary of the ECP, renowned historians have debated on the correctness, influence and legacy of Keynes’s analysis of the Versailles Treaty. Maier, among others, pointed out that while the ECP had for long appeared as ‘obvious wisdom’ (2009, p. 160), this opinion radically changed in the Seventies, when it was argued that Keynes had underestimated Germany’s capacity to pay reparations through economic recovery and export surplus, and after the newly available French official documents of the epoch had revealed that Clemenceau’s (and, more generally, the European Allies’) position about reparations was more nuanced than it had appeared to Keynes in 1919 (see also Keylor 2009), who had in any case undervalued France’s legitimate concerns about Germany’s possible aggressiveness in the future. Nonetheless, Maier himself explains that he is now less critic than he was about Keynes’s arguments – after all, as Moggridge (1992) has observed, many of these criticisms come from the future, and Keynes could not anticipate the climate of tolerance which later permitted a de facto relaxation of both the Treaty’s clauses and the problem of Inter-Allied indebtedness – and admits he recognizes the strength of Keynes’s

economic argument about excessively punitive reparations and perilous debt entanglements. Remarkably, both Asso (2009) and Cohrs (2009) identify one of outstanding contributions of the ECP in the fresh way of looking at international economic relations there proposed by Keynes, in the awareness of the abrupt transition from the pre-war order of the 'first' globalization to a much less safe world of global imbalances and 'bluffs discovered' about capitalist accumulation and income inequality, making the 'future of capitalism' (Maier 2009, p. 163, our translation) appear quite gloomy. In Keynes's view, 'rational' economic reconstruction of Europe and new forms of international cooperation between the continent and the United States to ensure the orderly unwinding of global imbalances were necessary for constructing a workable global order (Asso 2009).

Also in view of this, Eric Bussière (2009) interestingly address the eventual legacy of Keynes's solutions for Europe in 1919 on the actual evolution of the European integration process, and rightly concludes that the 'European project' embedded in the ECP is somewhat ambiguous. In general, Keynes appears to favour, as against both Robert Schumann's 'communitarian model', a form of economic governance which 'aims to take politicians away from decisions regarding the economic future of the continent' (Bussière 2009, p. 200, our translation). He considered the Treaty as a serious threat for the economic solidarity between European countries and repeatedly insisted on the continent's interdependence, but the proposal, in the final pages of the book, of a free trade European area seems a secondary element in an overall strategy which had in the financial involvement of the United States and Britain in the European economic affairs its core aim. After all, Keynes was a thinker of global economic integration, who devoted his whole work of international economist to the reform of the international architecture; he had little interest, if any, in a regionalist perspective.

Yet, although Keynes's book, 'illuminating as concerns 1919, does not help to understand the subsequent evolutions of Europe' (Bussière 2009, p. 201), the revival of interest it is currently enjoying shows that Keynes's analysis of the continent's 'economic problem' at the end of WWI might represent a powerful guide for policy-makers in the times of the European debt impasse. Both Keynesian and Post Keynesian scholars (e.g. Arestis and Sawyer 2012), on one side, and mainstream economists (Summers 2011), on the other, have discerned in the ECP an antidote to today's 'austerity agenda' (Krugman 2012), while Miller and Skidelsky (2012) have directly prompted for a plan of debt reduction (without

austerity) of the kind of the one proposed by Keynes and vetoed by the Americans in 1919. This rediscovery can be regarded as a demonstration that the ECP are more than a simple, however important, precedent of critical thinking about austerity programmes imposed by creditor to debtor countries. The European debt impasse throws light on the crucial novelty represented by Keynes's 'complexity approach' to international economic relations, and on the fundamental role played by the ECP in the construction of this theoretical perspective. In other words, and despite legitimate reservations about Keynes's early 'European project', the rediscovery of the ECP may enable to grasp the revolutionary essence of Keynes's mature plans of global reform, which is in its turn a necessary prerequisite to elaborate a mostly needed, more and more invoked reform of the European architecture (see e.g. Amato and Fantacci 2012).

In what follows, we outline some key aspects of Keynes's complexity approach by providing a methodological reading of the ECP (the present article further elaborates a previous article by the writers, 2010). Drawing on the close interdependence between theory and method in Keynes's economics, which he considered as a branch of logic, a correct way of reasoning (that is, one which avoids logical fallacies) about a complex economic material, we therefore reconstruct the rationale of Keynes's imaginative solutions for the troubles caused by war and the Treaty. A more ambitious aim is however to shed light on a method of thinking out, to use Keynes's own words, the specific problems of international economic relations which he will be consistently using (though adapting it to changing times and circumstances) in his work of international economics and diplomacy; a method which will have a direct influence on the contents of Keynes's Bretton Woods reform plans, and (although space constraints do not allow us to insist on this point) may be of great importance in directing European policy-makers to a structural reform of the continent's economic architecture.

Keynes's method in the ECP: organic interdependence

The ECP provide a perfect illustration of the difficulty to separate theory and method in Keynes's economics: in a way, it is his own methodological position that prevents the possibility to treat them as independent entities. Keynes made it clear in introducing the Series of Cambridge Economic Handbooks of 1922-23: contrary to economic positivism, 'the theory of economics does not furnish a body of settled conclusions immediately applicable to policy'. Economic theory is rather to be described as a 'method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its possessor to

draw correct conclusions' (CW 12, p. 856). As he put it to Roy Harrod in 1938, economics is to be seen as 'a branch of logic, a way of thinking' (CW 14, p. 296), one which helps economists to avoid logical fallacies in reasoning. In other words, economics is an apparatus of probable reasoning, the term 'probable' referring to the logical conception of probability Keynes had exposed in *A Treatise on Probability* (on which, in general, see Carabelli 1988). Such 'organised and orderly method of thinking out particular problems' (CW 7, p. 297) is therefore the non-demonstrative way of reasoning used in *The General Theory*.

We have elsewhere (Carabelli and Cedrini 2011a) shown that *The General Theory* itself – and surprisingly so, given how Keynes's *magnus opus* has been read by the mainstream of the discipline, and by Keynesians themselves, at least until the rediscovery of *A Treatise on Probability* in the Eighties – is in truth conceived by its author exactly as a guide to the complexity of the economic material under consideration, necessarily requiring readers' involvement. If his theory is more general with respect to the classical counterpart, this is because it does not tacitly introduce into the analysis those assumptions of independence to which the classics had recurred – hence Keynes's famous criticism of 'pseudo-mathematical methods' (CW 7, p. 297) and his explicit denunciation of the limits of the Marshallian *ceteris paribus* hypothesis – and which severely impairs the generality of their theory. According to Keynes (and his *Essay on Edgeworth*, 1926), the economist is 'faced at every turn with the problems of organic unity, of discreteness, of discontinuity – the whole is not equal to the sum of the parts, comparison of quantity fails us, small changes produce large effects, the assumptions of a uniform and homogenous continuum are not satisfied' (CW 10, p. 262). Therefore, in chapter 18 of *The General Theory*, Keynes summarizes the provisional conclusions obtained by isolating factors one by one, that is by tacitly introducing assumptions of independence, in chapters 1-17, with the expressed aim to make this same operation explicit, and open the way for the analysis, in chapters 19 to 21, of the 'probable interactions of the factors amongst themselves' (CW 7, p. 297), that is between variables he had previously taken as independent. The concept of 'independence' used in the book is therefore, in the lexicon of *A Treatise on Probability*, 'independence for knowledge': causal relations used in chapters 1-17 are in truth logical connections between arguments, not material connections between events. In Chapters 19 to 21, Keynes is therefore free to analyse roundabout repercussions between 'independent' variables and the consequences of removing simplifying assumptions.

The interdependence of form and substance, of method and theory in the ECP is made quite evident by the centrally symmetric structure of the book, which seems to reflect Keynes's concern for the organic interdependence of the European economy. The Versailles 'Treaty' (ch. 4, preceded by Keynes's sketch of the 'Conference', ch. 3, and followed by his thoughts on 'Reparations', ch. 5) is the centre of an analysis of the changes, induced by the war, occurred in the economic organization of the continent, with respect to the pre-war 'economic Eldorado' (CW 2, p. 6). In 'Europe before the Treaty' (ch. 2), Keynes paints a highly positive picture of the integrated pre-1914 European economy – 'What an extraordinary episode in the economic progress of man that age was which came to an end in August 1914!' (p. 6) – and ends his analysis of the consequences of peace with a chapter ('Europe after the Treaty', ch. 6) of 'pessimism' (p. 143), entirely devoted to showing that 'The Treaty includes no provisions for the economic rehabilitation of Europe ... nor does it promote in any way a compact of economic solidarity amongst the Allies themselves' (ibid.). The last chapter, with Keynes's 'remedies', is but a list of *desiderata*, of Keynes's 'unanswered appeals' (Markwell 2006, p. 90), all vetoed by the Americans *in primis*, and perfectly matches the introductory section: both chapters are focused on the 'sense of nightmare' ('Introductory', p. 4) hanging over the destiny of Europe ('bankruptcy and decay' in 'Remedies', 188), and both strikingly insists on powerlessness ('events marching on to their fated conclusion uninfluenced and unaffected by the celebrations of statesman in council', p. 3; 'the events of the coming year will not be shaped by the deliberate acts of statesmen, but by the hidden currents, flowing continually beneath the surface of political history, of which no one can predict the outcome', p. 188).

One in the list of the general characteristics of complexity, as seen, of the economic material, organic interdependence is the crucial theme of the book. 'Europe is solid with herself. France, Germany, Italy, Austria, and Holland, Russia and Roumania and Poland, throb together, and their structure and civilisation are essentially one. They flourished together, they have rocked together in a war ... and they may fall together. In this lies the destructive significance of the Peace of Paris' (p. 2). The leading trade partner of the European allies, a provider of capital and organization for Eastern Europe, Germany was the 'heart' of the European 'body' (p. 2), the rest of the continent depending on the 'prosperity and enterprise' of Berlin (pp. 9-10). Practically all prefaces written by Keynes for the translations of the book draw readers' attention to the fact that the Treaty 'ignores the economic solidarity of Europe, and by aiming at the destruction of the economic life

of Germany, it threatens the health and prosperity of the Allies themselves' (CW 17, p. 58). The French preface, for obvious reasons, is an explicit condemnation of the 'atomic hypothesis' the Treaty negotiators illegitimately applied to international economic relations: 'they overlooked the economic unity of Europe' (p. xix), wrote Keynes, a situation which could be remedied only by seeking 'the recovery and health of Europe *as a whole*' (p. xx, emphasis in the original). He believed that Europe was facing a 'civil war' (p. 2), of the lose-lose kind, wherein winners were 'deeply and inextricably intertwined with their victim by hidden psychic and economic bonds' (ibid.).

In truth, economic (organic) interdependence is a main issue of all Keynes's writing, from *Indian Currency and Finance* ('Every part of the Indian system fits into some other part. It is impossible to say everything at once, and an author must needs sacrifice from time to time the complexity and interdependence of fact in the interest of the clearness of his exposition. But the complexity and the coherence of the system require the constant attention of anyone who would criticize its parts. This is not a peculiarity of Indian finance. It is the characteristic of all monetary problems', CW 1, pp. 181-2) to *The General Theory*, as seen (readers are constantly warned that blind mathematical manipulations of a complex economic material cause economists 'to lose sight of the complexities and interdependencies of the real world', CW 7, p. 298). It is peculiar of the ECP (as well as of *A Treatise on Money* with the 'paradox of saving') that they explore the dark side of interdependence, so to speak, the one which is associated with conflicts, fallacies and paradoxes; that is, with uncertainty and social conflict. Keynes's reasoning about the Treaty dispositions about coal (which Keynes saw as the key factor of the continent's growth and 'organization' but also as a symbol of the economic unity of the continent) and iron is highly revealing in this regard.

Social complexity: dilemmas, conflicts, uncertainty

By establishing the obligation, for Germany, to cede the Saar Basin and Upper Silesia, to compensate France for estimated losses incurred during the war, and to pay part of the reparations in coal or coke, the Reparation Commission de facto assumed the right 'to destroy Germany's commercial and economic organization' (CW 2, p. 49). The sacrifice of her own industrial development was compulsory for Berlin, whereas her creditors had another choice available, being apparently free to exercise magnanimity. It was only an illusion, however: the coal settlement was a 'real dilemma' (p. 58) for European policy-

makers. On one side, also due to the 'desperate' (ibid.) European overall coal position, France and Italy's requests were morally justifiable and possessed 'unanswerable force from a certain point of view' (ibid.), although standing in sharp contrast to Wilson's commitment to a peace of magnanimity. After all, the 'non-surrender' of coal 'will jeopardize French and Italian industry' (pp. 58-59). But its surrender would have deprived Northern Europe and Austria-Hungary of Germany's surpluses. True, Germany's neutral neighbours could have exchanged German coal against materials which Germany regarded as essential to its survival, as long as Berlin were prepared to face the hostility of France and Italy. 'It will be difficult', Keynes observed, 'to weigh against [France and Italy's] claims the possible facts that, while German miners will work for butter, there is no available means of compelling them to get coal, the sale of which will bring in nothing, and that if Germany has no coal to send to her neighbors she may fail to secure imports essential to her economic existence' (p. 60). By pleasing France and Italy, nevertheless, Europe would have put at risk her own 'industrial future' (ibid.).

European policymakers found themselves, therefore, in several dilemmas; more in general, the European situation was to be described, as Keynes did in the opening pages of the book, as an 'impending catastrophe' with 'all the elements of ancient tragedy' (p. 3). As Lepper (2012) has shown, in the ECP Keynes used an unusual range of metaphors, literary sources, allusions with the general aim of suggesting the gravity of Europe's disease, and largely borrowed from classical and modern tragedies (Shakespeare's *Macbeth* in particular). In a letter of 1921 he directly pointed out that he did not want to be 'party to a continuation of a European bloodfeud, however great the past guilt. In Cambridge here, this term, we are performing the Aeschylean trilogy and the theme of that great drama is in our minds. I want to see the Furies turned into Eumenides, clothed in red robes, and pacifically housed under the Acropolis' (CW 17, pp. 219-20). As documented in Carabelli (1998), Keynes's peculiar interest in ancient Greek tragedy and classical drama dates back to his juvenile years: writings of 1904-6 (the essay on Burke, the philosophical papers entitled *Virtue and Happiness* and *Modern Civilisation*) are disseminated with references to tragedy. Tragedy clearly played a role in directing Keynes towards the problems uncertainty raises in the economic environment: the concept of uncertainty he made use of in his works derives from his early interest in rational and moral dilemmas (or tragic choices). There seems to be a *fil rouge* linking Keynes's early attention to the impossibility (which is typical of tragic dilemmas) to weigh down

heterogeneous reasons or contrasting moral claims one against the other on a common scale, to his constant interest in problems of incommensurability and non-comparability of probability (as dealt with in the *Treatise*) and economic magnitudes such as real income, real capital, and the general price level. And tragedy also had an influence on the emphasis Keynes placed on the fallacy of composition. It is in fact the irreducible clash of moral ends or values, of incommensurable or opposite heterogeneous reasons within a single judgement of probability which engenders those situations of radical uncertainty with which such generalized conflicts are generally associated.

In this regard, Keynes's 1926 essay against laissez-faire appears as a methodological guide to the reading of his major works in economics. In the essay, Keynes describes fallacies of composition as situations of interdependence among economic actors wherein individuals take initiatives which would benefit her/him only if they do not become shared, and rather benefit no one if every one pursue them: 'The world is *not* so governed from above that private and social interest always coincide. It is **not** so managed here below that in practice they coincide. It is **not** a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally *is* enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these' (CW 9, p. 288; emphases in the original). Keynes's well-known paradox of wages and paradox of saving apply this logic to show that in an organically interdependent world, the logical ('atomic') hypothesis of independence does not hold, to the extent that the producer loses on the demand side what s/he had gained on the supply side by reducing wages, after widespread adoption of her/his initiative. Uncertainty and ignorance are often the first link of these chains of events and a primary cause of social conflict, since they induce individuals to shape conventional rather than reasonable expectations. This produces a state of affairs where 'it may even be the interest of individuals to aggravate the disease' (pp. 290-1), lastly to their own disadvantage (as in the paradox of saving of *A Treatise on Money*).

In the ECP, Keynes portrayed the 'true dilemma' of reparations as 'a case where particular interests and particular claims, however well founded in sentiment or in justice, must yield to sovereign expediency' (CW 2, p. 60). Organic interdependence accounts for the fact that 'if the European Civil War is to end with France and Italy abusing their momentary victorious power to destroy Germany and Austria-Hungary now prostrate, they invite their own destruction also, being so deeply and inextricably intertwined with

their victims by hidden psychic and economic bonds (p. 2). More in general, however, the whole discussion of the rational dilemma of the coal settlement, with the moral dilemma of reparations in the background, centres around a notion of fallacy of composition which follows closely Keynes's reasoning in *The End of Laissez-Faire*. 'Men have devised ways to impoverish themselves and one another and prefer collective animosities to individual happiness' (p. 62), he commented in analysing the 'particular interests and particular claims' (p. 60) put forward by the Allies. Describing the confusion of the Conference, he referred to the Tower of Babel (p. 20), 'to demonstrate how competing self-interest and the worship of nationalism and imperialism are major impediments to the restoration of property' (Lepper 2012, p. 39). As he wrote in the first draft of the preface to the Rumanian edition, 'economically [the group of countries which won the war] gave way to passion and greed, and became blinded to the real facts of the economic structure of Europe and even to their own self-interest' (CW 2, p. xxv). As this quote makes clear, it was for Keynes a mixture of greed and political interests, but also of ignorance and fundamental uncertainty about the immediate future that could explain why the European Allies were determined to 'demand the impossible' (p. xix).

Note that the Treaty did not quantify the 'impossible'. It simply established that Germany should pay the whole cost of the war, and left the task of determining the exact amount of reparations to the newborn Commission. That of fixing reparation was for Keynes another 'dilemma' (p. 100) resulting from the political impossibility to fix, and weigh down ones against the others, figures relative to the two 'false statements' (p. 99) on which the enemy's capacity to pay and justice for the Allies were based; the 'safest course' (p. 100) of mentioning no figure at all prevailed. But even in this case, the author of a fundamental treaty on probability as the most general form of knowledge and a guide for action under uncertainty, an essay where he analysed the validity conditions of induction and analogy as the most important types of reasonable arguments of probability, Keynes could not fail to remark that reparations had been established on the basis of two tacit assumptions, and more precisely of two 'false analogies': that between Germany's export potential before and after the war – the false assumption 'that she is in a position to conduct in the future a vastly greater trade than she ever has had in the past' (p. 118) – and that between the pre-war order, linking the Old World to the New one by means of self-liquidating American loans, and the post-1914 system of global relationships.

Yet uncertainty was both a result and a cause of 'impossible' reparations. As to uncertainty

as a result of them, Keynes observed that France and Italy's budgetary position was 'nearly hopeless' (p. 93): the prospect of bankruptcy could only be concealed, 'by holding out the expectation of vast receipts from the enemy' (ibid.). Remarkably, Keynes is here using the same theoretical apparatus he had used in his 1910 lectures on speculation, which we have elsewhere (Carabelli and Cedrini 2012) described as a most relevant antecedent of Keynes's reasoning in *The General Theory* about, in particular, speculation and financial markets, but more in general decision-making under radical uncertainty and the formation of conventions. As said, Keynes saw these latter as the result of 'the necessity for action and for decision' (CW 14: 114) even under conditions of ignorance and extreme uncertainty, that is situations characterized, following *A Treatise on Probability*, by lack of reasons or evidence which may ground reasonable judgments. He evidently recognized the practical importance of conventions, but never yielded to the temptation of transforming them into agents of social stability. He rather emphasized their intrinsic precariousness, and insisted on the possibility of reasonable judgment as the only available means of counteracting the harmful effect of the dominance of conventional (rather than reasonable, that is grounded on some reasons) expectations.

In the ECP, Keynes is somehow accusing the Allied governments of behaving like those speculators – professional speculators, possessing 'superior knowledge' (Keynes MSS 1910, UA/6/3, p. 93), whereas that of 'gamblers' is an 'ignorant' mass, lacking adequate knowledge – who manipulate markets to their own benefit by voluntarily inducing market fluctuations, that is by spreading 'unreal' judgments (as in Keynes's beauty context metaphor in *The General Theory*), 'false rumours' and 'possible wisdom of acting on a rumour, which one does not himself believe, if one thinks it will be generally believed' (p. 109). The French and Italian governments (the same for Britain's Prime Minister Lloyd George, but Britain had 'not based [her] financial arrangements on any expectation of an indemnity', p. 93) had voluntarily adopted such strategy, with the final result of impeding the fixing of reparations: 'The expectations which the exigencies of politics had made it necessary to raise were so very remote from the truth that a slight distortion of figures was no use, and it was necessary to ignore the facts entirely. The resulting unverity was fundamental. On a basis of so much falsehood it became impossible to erect any constructive financial policy which was workable' (p. 94).

As a consequence, the reparation commission would have had a 'duty ... to extract from Germany year after year the maximum sum obtainable' (p. 105). Keynes knew perfectly

well that 'There is a great difference between fixing a definite sum, which though large is within Germany's capacity to pay and yet to retain a little for herself, and fixing a sum far beyond her capacity, which is then to be reduced at the discretion of a foreign Commission acting with the object of obtaining each year the maximum which the circumstances of that year permit'. The first, in fact, 'still leaves her with some slight incentive for enterprise, energy, and hope', three key factors for recovery and relaunch which he will group together under the term 'animal spirits' in *The General Theory*. The latter, conversely 'skins her alive year by year in perpetuity, and however skillfully and discreetly the operation is performed, with whatever regard for not killing the patient in the process, it would represent a policy which, if it were really entertained and deliberately practised, the judgment of men would soon pronounce to be one of the most outrageous acts of a cruel victor in civilized history' (pp. 105-6).

But Keynes correctly saw uncertainty as a cause, too, of impossible reparations. Another reason for France and Italy's ungenerosity was fundamental uncertainty about their own economic destiny. In a note reinforcing the case for a revision of the Treaty and magnanimous financial policy, Keynes mentioned a conversation he had with 'Frenchmen who were private persons and quite unaffected by political considerations ... You might persuade them that some current estimates as to the amount to be got out of Germany were quite fantastic. Yet at the end they would come back to where they had started: 'But Germany *must* pay; for, otherwise, what is to happen to France?'' (p. 94n1). It was also for this specific reason, wrote Keynes, that Europe should have adopted a 'magnanimous financial policy' towards Germany. For in truth, uncertainty was a generalized condition for the continent as a whole: Europe should face a reduction in productivity and a great limitation of its ability to import supplies from overseas. Lowered coal production was accompanied by 'the breakdown of transport and exchange by means of which its products could be conveyed where they were most wanted' (p. 146), while persistent inflation was a direct attack on 'confidence in the equity of the existing distribution of wealth' (p. 149) and a serious danger for debtors/creditors relationships. As to France, she should find means of covering her trade deficit without Britain's assistance, while Italy was faced with the collapse of Austria, historically a relevant market for her exports, and raising prices of imported raw materials. Russia, Hungary and Austria were already 'experiencing the actuality of what for the rest of Europe is still in the realm of prediction' (p. 158).

Inter-Allied debts, a neglected ‘relevant cause’ of the catastrophe

Writing about France and Italy's problems, Keynes observed that their ‘financial position ... was so bad that it was impossible to make them listen to reason on the subject of the German Indemnity, unless one could at the same time point out to them some alternative mode of escape from their troubles’ (p. 94). In other words, the European zero-sum game opposing winners and losers in conditions of radical uncertainty about the future was an irreducible generalized conflict, a fallacy of composition nurtured by irresolvable moral and rational dilemmas. To avoid the ‘impending catastrophe’ where all these ‘elements of ancient tragedy’ were leading to, an ‘alternative’ way out of the impasse was absolutely required. Remarkably, a thinker of the complexity of international economic relations, Keynes opened the chapter devoted to *Remedies* by stressing that ‘in so complex a phenomenon the prognostics do not all point one way; and we may make the error of expecting consequences to follow too swiftly and too inevitably from what perhaps are not *all* the relevant causes’ (p. 160).

In so doing, Keynes admits that up to this point of the analysis, he had left out relevant causes of the ‘the condition and the prospect of Europe’ (ibid.), and one in particular, Inter-Allied debts. After calling for a revision of reparations and a relaxation of the coal clauses, he claimed that the proposed changes ‘would not be enough by themselves’: ‘fairness requires’ to supplement them by ‘a readjustment of its apportionment between the Allies themselves’ (p. 170). In particular, Britain should waive her claims for cash payments in favour of Belgium, Serbia and France. Then, she should approach the United States with two proposals: the entire cancellation of Inter-Allied debts and a scheme of international loan. Keynes believed that it was also, and mainly, because of Inter-Ally indebtedness, that European claimants caught in the dilemma could not recede from asking for impossible reparations. Only the United States had ended the war as a net lender, since Britain had lent twice the amount she had borrowed; the other Allies were net borrowers only. The United States should have surrendered approximately £2,000 million (Inter-Allied debts amounted as a whole to £5,000 million). Britain would have ceded £900 million; France would have gained £700 million and Italy £800 million.

Readers might fail to notice it, but Keynes had concluded his analysis of the troubles of France and Italy, in the chapter of reparations, by pointing out that he believed ‘the representatives of the United States’ to be ‘greatly at fault, in my judgment, for having no

constructive proposals whatever to offer to a suffering and distracted Europe' (p. 94). The reason why Keynes felt the necessity to invoke the 'generosity' (p. 93) of the United States and Britain is to be found exactly in what Bussière (2009) sees as the weak link of Keynes's reasoning about Europe. Both the United States, obviously, and Britain herself were actors lying outside the European continent, or better, outside the European conflict. 'Europe is apart and England is not of her flesh and body' (CW 2, p. 2), and her problems were 'of a different kind altogether from those impending on Europe' (pp. 160-1). The same for her share of Inter-Allied Debts, since the argument for the cancellation of her American debt was the 'not chiefly economic' origin of such liabilities (CW 17, p. 277). In *The End of Laissez-faire*, Keynes maintains that the solution for social conflicts (fallacies of composition) brought about by social complexity and uncertainty lies 'outside the operations of individuals' (CW 9, p. 291). It rather has a social character, and must come from public institutions concerned with long-term perspectives and capable, through 'public action grounded upon deliberate and reasonable ... judgment' (Carabelli and De Vecchi 2001, p. 234), to favour the general welfare. For sure, actors caught in the impasse cannot by themselves provide the required cure.

Despite the newborn League of Nations, which Keynes clearly supported, the international environment was at the epoch (and still is) a fundamentally anarchic world. Keynes will learn how difficult it is to shape a consensus on the need of global economic institutions, but he was not so naïve to overlook the possibilities a responsible international leadership could open for a rational management of global economic relations. While therefore, in his 1926 essay, Keynes required the state to implement the agenda required to remedy fallacies of composition and the harmful effects of uncertainty, his proposal for an international cure for the world slump of the early Thirties rested on a public-spirited global leadership of Britain. In Keynes's view, the slump was the result of a 'competitive struggle for liquidity' (CW 21, p. 42) which in its turn owed much to the uncooperative attitude of creditor countries towards the problems of international equilibrium. Having described it as 'an extreme example of the *disharmony* of general and particular interest' (p. 52, emphasis in the original) at the international level – in the attempt to improve their relative position, countries were launching a beggar-thy-neighbour game which easily caused each of them to 'suffer more from similar action by its neighbours than it gains by such action itself' (ibid.) – Keynes appealed to the renewed leadership of Britain. Possessing the 'experience or the public spirit' (CW 9, p. 236), which

is typical of social institutions, Britain 'should regain its liberty of action and its power of international initiative' (CW 21, p. 57) and 'set the example' (p. 62): acting as 'a reasonable creditor who moderates his claim in view of so great a change in the situation as the recent catastrophic fall in commodity prices' (CW 9, p. 247), London only could perform what was in truth 'a high social duty today for everyone' (whereas creditor countries had contributed to spread a tendency to curtail or postpone expenditures, which Keynes considered as 'an anti-social act', CW 21, p. 53), by 'us[ing her] influence, whatever it may be, in private and in public, in favour of every kind of expansion and expenditure, which is financially possible to those who incur in it, and which in better terms would be generally admitted to be legitimate and useful' (p. 60).

Believing that 'leadership in the achievement of human progress had to be accepted as a responsibility by those who had the capacity to provide it' (Goodwin 2006, p. 231), Keynes wanted from the United States in 1919 'an act of farseeing statesmanship' (CW 2, p. 93), making 'expediency and generosity agree together', destined to 'promote immediate friendship between nations' (p. 179). Only the voluntarism of a responsible leadership (note Keynes's condemnation of the inactive attitude of the United States, having nothing to offer to Europe), that is courageous initiative on the part of a public-spirited player, willing to act boldly when no one else is disposed or able to take this risk, could counteract the prevalence of passive attitudes and conventional thinking, and 'redirect ... the fundamental economic tendencies which underlie the events of the hour, so that they promote the re-establishment of prosperity and order, instead of leading us deeper into misfortune' (p. 162).

True, from a strictly economic point of view, the appeal was 'inevitable' (p. 92). By focusing on the methodological outlook of the volume, however, it becomes evident that in Keynes's 'complexity approach' to the European impasse, the cancellation of Inter-Allied debts was the necessary precondition to solve the problems generated by the war, and the sole possibility to reconcile European countries' claims with the declared aim of a peace of magnanimity and the continent's interest in reconstruction and stability. The two Anglo-Saxon powers should truly 'set the example'. In discussing his proposal of debt cancellation, Keynes famously (a strategic mistake) made a comparison of relative sacrifices, only to demonstrate that Europe was entitled, at least, to ask for debt forgiveness. But he added that Europe could ask for American generosity provided she 'is making an honourable attempt in other directions, not to continue war, economic or

otherwise, but to achieve the economic reconstitution of the whole Continent' (p. 173).

This sounds surprising, for readers would expect European magnanimity towards Germany to be the result, rather than a premise, of American generosity. Keynes himself had presented debt cancellation as 'an indispensable preliminary to the peoples of the allied countries facing with other than a maddened and exasperated heart the inevitable truth about the prospects of an indemnity from the enemy' (CW 16, p. 422). Yet, in the ECP, he made clear that 'the financial problems which were about to exercise Europe could not be solved by greed. The possibility of *their* cure lay in magnanimity. Europe, if she is to survive her troubles, will need so much magnanimity from America, that she must herself practice it. It is useless for the Allies, hot from stripping Germany and one another, to turn for help to the United States to put the States of Europe, including Germany, on to their feet again' (CW 2, p. 92; emphasis in the original). The apparent confusion between premises and consequences of American generosity is to be explained by the use Keynes makes of the complex concept of gift as mechanism of international adjustment. Keynes's proposal of a 'grand scheme for the rehabilitation of Europe' (CW 16, p. 428), an international loan involving winners, losers and even neutral countries (Britain and the United States providing interest-bearing credit allowing Germany to issue bonds to be used for reparations and purchases of food and raw materials; interest payments were to be guaranteed by the Allies, some neutral countries and Germany itself) was presented as an alternative scheme (in April 1919) after the rejection of his suggestion for debt cancellation (Keynes's proposal dates back to November 1918). Yet, in the ECP, where Keynes revised and re-edited as an outsider the proposals he had suggested as an insider, the international loan becomes a supplementary plan of action, finding in the cancellation of Inter-Allied debts its necessary precondition.

But European countries' commitment to reconstruct Europe rather than continue war under other forms, which one would normally regard as the desired result of Inter-Allied debts cancellation, is also a necessary counterpart of the expected American assistance: debt forgiveness is therefore the precondition for the 'shared responsibilities' scheme for European reconstruction devised by Keynes, triggered off by a starting gift. As illustrated by the anthropological-sociological literature on gift-giving, starting with Marcel Mauss's (1923-24) seminal essay, only a gift, with the gamble on mutual trust which accompanies it, can create the preconditions of an agreement between actors that are otherwise destined to remain prisoners of irreducible conflicts. To borrow words written by

Marcuzzo (2008, p. 16) with regard to Keynes's proposal of an American gift to Britain in 1945 (on the affinity between these two episodes of Keynes's diplomacy, see Carabelli and Cedrini 2010), Keynes opted for a gift in order to change 'the environment within which individuals operate', inducing 'behaviour to conform to goals which were attainable only bypassing individualistic motivation or utilitarian calculations'. A gift, a principle of 'something for nothing' (Gouldner 1973) acting as a 'strange attractor' (see Godbout 2000), was the required ignition key, to use Gouldner's metaphor, allowing a spiral movement of 'magnanimity' to spread along the chain of countries disposed to take part in Keynes's plan for the reconstruction of Europe. Only a gift could trigger off the 'shared responsibilities' principle lying behind the 'grand scheme' and help it to work properly, as indirectly confirmed by Keynes's sceptical comments on the Dawes Plan.

Keynes's proposal gained support from international (European and American) bankers at the meeting of Amsterdam in November 1919, not from the American administration, which remained itself prisoner of a 'dilemma' (CW 16, p. 439): the Americans pointed out, 'with some justice, that our reparation proposals will take away from Germany her working capital, and that we are in effect asking them to restore the working capital to Germany which we have thus unnecessarily taken away'. Yet it was in their interest to show magnanimity: after all, 'if the loans are to be met, a serious obstacle will exist to future trade relations between the Allies' (p. 424). To exact payment, America should have 'scrapped her export industries, and diverted to other uses the capital now employed in them', in the hope that 'the former European associates decided to meet their obligations at whatever cost to themselves', which was 'utterly chimerical' (CW 17, p. 274) to Keynes's eyes. America's position was 'exactly parallel to that of German reparation' (p. 276): she 'will not see through the repayment of Allied debt any more than the Allies will see through the collection of their present reparations demands' (p. 277). 'Vainly trying to solve the problem of assisting Germany without assisting us', Keynes observed, the Americans could not 'alight on any method of doing this' (CW 16, pp. 439-40), for they were not disposed to consider reparations and Inter-Allied debts as parts of a unique question and solve them as such.

Ethics, leadership, knowledge

When asking for debt cancellation, Keynes did make use of moral arguments. Critics of the ECP have generally emphasized the instrumental character of such arguments, or have

identified the weak point of Keynes's reasoning exactly in this presumed propensity to substitute the ambiguity of ethics for the cogency of finance. Keynes polemicized for years with the United States over the question of Inter-Allied debts. His view was that they should not be treated 'just like any ordinary commercial debt for goods sold and delivered' (CW 18, p. 264). He considered the American view of such debts as a logical mistake, the result of false economicist analogies. Britain's share of Inter-Ally indebtedness was the consequence of her 'greater eagerness' in the 'common cause' (p. 384) against Germany. Clearly a strategic mistake, in the light of both the economicism of the American attitude towards war debts, and above all of the tormented wartime relationships between the two financial leaders of the common cause, Keynes presented a comparison of relative sacrifices (controversies over this issue would be 'very barren and very foolish also', he wrote, p. 174), but was aware that they could not produce 'any compelling argument' (p. 175); at most, they could demonstrate, as in the case of Britain with respect to desired American generosity, that a country proposing Inter-Allied debt cancellation was not seeking to free ride on the costs of war.

Rather, the proposal aimed at reconstructing Europe with the general purpose of reviving global trade, which was in the interest of the United States itself. To strengthen the case of debt cancellation, Keynes set out three reasons why such debts should not be treated as commercial liabilities. The above-mentioned not chiefly economic 'origin of the debts', which (as shown by the polemics raised by the publication of Keynes's talk 'A London view of war debts' in the American magazine 'New Republic' in 1928; see CW 18, p. 296) Keynes's critics saw as an unduly attempt to veil a controversy on purely financial matters; second, 'the evils which would follow on an attempt to exact them', and third, 'the practical impossibility of collection' (p. 264). Contrary to how Keynes's reasoning has been traditionally interpreted, the three arguments were highly interrelated, as a closer inspection at his general positions on ethics and economics in relation to ethics helps to understand (see Carabelli and Cedrini 201b).

In ethics, Keynes distinguished between 'speculative ethics', which he defined as 'one's attitude towards oneself and the ultimate', and 'practical ethics', 'one's attitude towards the outside world and the intermediate' (CW 10, p. 436). Economics and politics belong to practical ethics; they are means to create the material preconditions required to experience a good and happy life of Aristotelian flavour (whole ends are those of speculative ethics: universally and intrinsically desirable ends and values such as love,

friendship, beauty, truth, and knowledge). The ‘economic problem,’ even at the international level, ‘is nothing but a frightful muddle, a transitory and an *unnecessary* muddle’ (CW 9, p. xvii), whose end will enable men to actively consider those not-material ends whose pursuit is indispensable to express authentic human qualities, and to choose deliberately what specific kind of life they want to live. Keynes’s critique of the American refusal to recognize the linkage between ‘the circumstances out of which the debt arose’ and ‘the desirability of clearing up the future situation’ (p. 302) is therefore to be read in the light of this general anti-utilitarian perspective.

On one side, Inter-Allied debts derived from America’s late entry into war and her inability to help the Allies in any other way than by financial contributions (‘We often gave assistance in the form of money, precisely because we were less able to assist with men or ships,’ CW 9, p. 48); since there ‘never were any profitable assets corresponding to the sums borrowed,’ war debts were rather ‘a case of pure usury’ (CW 18, p. 382), all the more so since debtors were ‘friends’ engaged in a ‘common cause’ with creditors. In the ECP, Keynes motivated his much criticized pro-German attitude as regards reparation by expressing his belief that ‘the prosperity and happiness of one country promotes that of others, that the solidarity of man is not a fiction, and that nations can still afford to treat other nations as fellow-creatures’ (CW 2, p. 170). More in general, reparations and Inter-Allied debts were both economically and morally objectionable, exactly because they would have imposed an unnecessary stop to European countries’ freedom to march towards economic progress and to choose their own path towards the end of the economic problem (Keynes wrote, with regard to Germany, that ‘nations are not authorised, by religion or by natural morals, to visit on the children of their enemies the misdoings of parents or of rulers,’ p. 222; and argued that Europe ‘will not pinch herself in order that the fruit of her daily labor may go elsewhere,’ CW 16, p. 427).

In this sense, the ECP represent a fundamental step in the construction of a vision of economic history as a permanent struggle between creditors and debtors (see De Cecco 2001), wherein arguments of chiefly economic nature reflect in truth ethical considerations of a superior order. Another ‘false analogy’ (CW 9, p. 40) invalidated the American reasoning about reparations and war debts. The pre-1914 order had ‘only survived because its burden on the paying countries has not so far been oppressive, because this burden is represented by real assets and is bound up with the property system generally, and because the sums already lent are not unduly large in relation to

those which it is still hoped to borrow' (CW 2, pp. 178-9). 'In the highest degree artificial, misleading, and vexatious' (p. 178), Inter-Ally indebtedness was conversely 'a serious obstacle' for future trade relations between the Allies: 'creditor nations may soon find their interest inconveniently bound up with the maintenance of a particular type of government or economic organization in the debtor countries. Entangling alliances or entangling leagues are nothing to the entanglements of cash owing' (p. 177).

Above all, as Keynes argued going back to the issue in 1932, the sanctity of contract, even with regard to debts which do not derive from military confrontation, is not 'an immutable law of nature', and cannot be preserved 'except by the reasonableness of the creditor': 'debtors are only honourable in countries where creditors are reasonable. If creditors stand on the letter of the law, debtors can usually show them how little the law avails. Internationally, contract has nothing to support it except the self-respect and self-interest of the debtor. A loan, the claims of which are supported by neither, will not be paid for long' (CW 18, p. 384). It was rather a specific 'duty of the creditor not to frustrate payment': debtors cannot be asked to sacrifice their 'self-respect and self-interest' in favour of 'narrow calculations of financial self-interest' on the part of the creditor (p. 385). This brings us back to the question of the leadership. As Markwell (1995: 209) argues, Keynes knew that 'interdependence required management, and that a 'leader' was a great asset (if not an essential one) in doing this'. Hence the attempt to 'imbue the new hegemonic centre, the United States, with the behaviour and ethics which pertain to the world creditor power' (Ferrari Bravo 1990, p. 407; our translation); the behaviour and ethics of the 'reasonable' creditor Keynes will invoke to counteract the global slump of the early Thirties. The behaviour and ethics of a veritable global leader, which the United States in 1919, having a too 'strong desire to clear out of European *responsibility* (without even realising what this will mean to Europe)' (CW 16, p. 440; emphasis added), was certainly not. Wilson was not the 'philosopher-king' (CW 2, p. 26) Keynes had hoped for to persuade France of the virtues of magnanimity; rather, metaphors and allusions to the classical world used by Keynes in the ECP with regards to Wilson all express the economist's disappointment for the impotence of the leadership (see Lepper 2012). The President had 'no plan, no scheme, no constructive ideas' (CW 2, p. 39) to offer. There remained only one possibility to avoid the 'bankruptcy and decay of Europe' (p. 188). The methodological reading we have here provided of Keynes's book helps to notice that the ECP end exactly as they began, that is by stressing, on one side, the complex

nature of the economic material and, on the other, the ‘Humean’ attitude with which we normally look at it. European economic organization before the war was of an ‘intensely unusual, unstable, complicated, unreliable, temporary nature’, but ‘very few of us realise [it] with conviction’, since we tend to ‘assume some of the most peculiar and temporary of our late advantages as natural, permanent, and to be depended on, and we lay our plans accordingly’ (p. 1). On ‘sandy and false foundations’ (of the kind of those analysed by Keynes in *A Treatise on Probability*), therefore, we form our judgements, statesmen included – ‘political unwisdom’ (p. 94) follows without difficulty. A ‘philosopher-king’ could restore economic prosperity after the war, but did nothing in the end to achieve this result. For the reasons just outlined, Keynes admitted that ‘the near destiny of Europe is no longer in the hands of any man. The events of the coming year will not be shaped by the deliberate acts of statesmen, but by hidden currents, flowing continually beneath the surface of political history, of which no one can predict the outcome’ (ibid.).

The only possibility to redress the situation was therefore to offer ‘light, even if it is partial and uncertain’, to a world which wants to ‘understand its destiny’, ‘on the complex struggle of human will and purpose, not yet finished, which, concentrated in the persons of four individuals in a manner never paralleled, made them, in the first months of 1919, the microcosm of mankind’ (p. 17). At least, this is what Keynes did, by unveiling the remote causes of war and the dangerous consequences of the Carthaginian peace; by reducing the ignorance and uncertainty which nurture passions like fear; by appealing beyond politicians ‘to the intelligence’ (p. xxii) of citizens. It is only ‘by setting in motion those forces of instruction and imagination which change *opinion*’ that one can influence events: by asserting ‘truth’, unveiling ‘illusion’, dissipating ‘hate’ (p. 188). If we think that the ECP is still relevant to the world we live in, it is because Keynes has succeeded in ‘enlarging and instructing men’s hearts and minds’ (ibid.).

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