The Keynesian Revolution and the Nominal Revolution:
Was There a Paradigm Shift in Economic Policy in the 1930s?[1]

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For most economists, the crowning intellectual achievement of the 1930s was John Maynard Keynes's *General Theory of Employment, Interest, and Money*. Keynes promised, to those willing to wade through his recondite prose and intricate arguments, a new era in which economic policies, especially fiscal policies, would banish the business cycle. The gospel of Keynes was surely one of the cornerstones of the golden age of stability and growth that prevailed for a quarter of a century after World War II.

But was there already a "Keynesian revolution" in economic policy making in the 1930s? Observing the more active use made by certain governments of monetary and fiscal instruments than in the 1920s, some authors would have it be so. Publication of the *General Theory* was not an isolated event; not only had the book been underway for a number of years, allowing drafts to be aired before receptive audiences of Cambridge students and circulated to Keynes's faithful correspondents, but at least some similar ideas had been developed by economists in other countries. And the severity of the slump that started in 1929 did much to erode the legitimacy of the doctrine of balanced budgets and laissez faire, creating fertile ground for experimentation with new approaches to economic policy making.

I argue in this chapter that there was no Keynesian revolution in the 1930s. Arguments

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related to the *General Theory* had little impact on the actual policies of central banks and governments. Fiscal policy in particular made a very limited contribution to recovery from the Depression. Governments ran large budget deficits only where necessary to underwrite substantial increases in military spending that were impossible to finance by other means. Keynesian ideas were invoked, where expedient, to justify these deficits, but the driving force was militarization, not countercyclical stabilization.

Monetary policy, not fiscal policy, was the force behind recovery from the Depression. Whether central banks cut interest rates and stabilized the supply of money and credit was the single most important determinant of the timing and pace of recovery. This is an uncomfortable fact for followers of Keynes. Observing the low level to which interest rates had fallen in the 1930s, *The General Theory* dashed cold water on the idea that interest-rate cuts could be used to jump-start recovery from the Depression. With its concept of the liquidity trap, Keynes's theory was widely seen after World War II as explaining why monetary policy was ineffectual in a slump.

In fact, this was an entirely counterfactual story. There was little evidence of a liquidity trap in the 1930s, either in the United Kingdom, the country that was Keynes's principal concern, or elsewhere. There was little evidence that low interest rates were a binding constraint on expansionary monetary policies, given the other instruments in central banks' arsenals. The constraint was not the ability of central banks and governments to reflate their economies but rather their willingness to do so.

Above all, the fact and ideology of the gold standard stood in the way. So long as the gold standard remained in place, the commitment to defend the central bank's gold reserves and stabilize the gold parity was an insurmountable obstacle to the adoption of expansionary policies.

Indeed, so long as the ideology of the gold standard prevailed, governments and central banks failed to even recognize the need to remove that obstacle. And only when it finally was removed did recovery from the Depression at last commence.

Thus, the fundamental change in policy making in the 1930s was not the Keynesian revolution but the "nominal revolution" — the abandonment of the gold standard for managed money. In fact, the intellectual basis for this revolution was Keynes's own earlier work, in *The Tract on Monetary Reform*, published in 1923, ideas he largely neglected in *The General Theory*.

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To say that the period before World War I was an era of laissez faire, balanced budgets, and monetary automaticity is crude but true. Balanced budgets had been the norm, with exceptions admitted only in wartime. The level of interest rates and the supply of money and credit were dictated by the gold standard statutes under which central banks and treasuries operated. To be sure, governments could and did invoke exceptions to the balanced-budget rule; the large and growing burden of public debts in countries like France is one indication of the disparity between their principles and actions. Anyone who has taken a close look at central bank policy under the gold standard can similarly point to ample evidence of behavior that is difficult to reconcile with "the rules of the game." Trade in this era of free trade was never free, and there were many manifestations of the growing inclination for governments to intervene in the economy, for example the creation of the U.S. Interstate Commerce Commission in 1886. But counterexamples and qualifications notwithstanding, laissez faire remained the norm.

World War I was a sharp shock to this state of affairs. Public spending soared in the

belligerent countries. Using the printing press to finance it meant suspending the gold standard de facto or de jure. Deficits and debts expanded enormously. Between 1914 and 1918, deficits rose to 70 per cent of government spending in the UK, Italy and the United States, 80 per cent in France, and 90 per cent in Germany. Debts adjusted for inflation rose nearly four-fold in the UK and 10 fold in Germany and the United States. The price level doubled in Britain, tripled in France, and quadrupled in Italy.

These were not, however, policies that economists and officials regarded acceptable in peacetime. They disrupted international capital flows and foreign trade, the dual foundation stones of the Atlantic Economy of the late 19th century. Inflation and price uncertainty demoralized investors. They arbitrarily redistributed income and property, inciting social conflict and eroding political consensus. For all these reasons, few observers questioned the desirability of restoring the status quo ante.

At the same time, this experience provided powerful precedents for how governments and societies might respond when next confronted with an economic crisis akin to war. Some evidence of this tendency toward more active management of economic conditions was already apparent in the 1920s. There was the attempt to push money supplies up toward the prevailing level of prices as an alternative to pushing prices back down toward prewar levels and thereby depressing output and employment. This was the argument propounded by Keynes, first in the *Tract* and then in *The Economic Consequences of Mr. Churchill*, that using monetary policy to push up prices, or at least to maintain them at prevailing levels, served to reduce labor costs (given the relative inflexibility of money wages), thereby stimulating employment, and to reduce the overhang of inherited debts, thereby stimulating investment. In seeking to make himself

heard, Keynes had to rebut the apostles of the gold standard, who argued that the sanctity of contracts required reestablishing the prewar gold standard parity, which in turn meant pushing price levels back down to prewar levels. “The choice,” as the British economist Ralph Hawtrey put it in 1919, was between “a long and painful deflation and an arbitrary manipulation of the currency, which is hardly consistent with the preservation of public good faith.”

That Keynes failed to convince Churchill to abandon his quest for the prewar parity is commonly cited as evidence of the continuing dominance of a now anachronic 19th century monetary ideology. The reality was more complex. International conferences in Brussels in 1920 and Genoa in 1922 had already addressed the question of how central banks might modify their statutes to permit them to expand their money supplies to limit the deflation associated with the restoration of prewar parities. It is clear from the proceedings of these meetings that delegates were aware of connections between monetary conditions and unemployment, and that they wished to manage the former so as to limit the latter. Countries where inflation had continued to run out of control in the first half of the 1920s did not use stabilization as an occasion to restore the prewar parity; in France, Belgium, Italy and other countries where inflation had been chronic, currencies were stabilized at levels that implied a significant devaluation against gold. In each case those who advocated deflation and the restoration of prewar parities were rebuffed on the grounds that their prescriptions were too disruptive.

Even those who saw the gold standard as the cornerstone of sound economic policies acknowledged the need for more active management of financial conditions to buttress the stability of the international system. Officials of the newly-created Federal Reserve System appreciated their responsibility for helping the Bank of England back onto the gold standard,

cutting interest rates in 1924 in pursuit of that goal. In 1927, the Fed and the Bank of France adjusted their policies to help the Bank of England stay on gold, following a famous meeting of U.S., French, British and German central bankers on Long Island, New York. Central bank cooperation was not unknown before 1913, but the 1920s saw unprecedented efforts, not always successful, to more systematically manage monetary conditions with the stability of the international economy in mind. These attempts to nurture international cooperation were not always successful because there was at the same time a growing desire to tailor monetary policies to domestic needs, which encouraged the unilateral sterilization of gold flows. Sterilization in violation of the rules of the gold-standard game was another practice with ample prewar precedent, but it was, by any measure, more pervasive in the second half of the 1920s than ever before.

This reference to the Federal Reserve System flags the other distinctive feature of the economic policy environment in the 1920s, namely, the establishment of central banks where they had not existed previously. Monetary missionaries like Professor Edwin Kemmerer of Princeton University and Otto Neimeyer, formerly of the British Treasury, brought the gospel of central bank independence to a score of countries in Latin American and Eastern Europe. Kemmerer advised governments to create central banks in the image of the Fed. Adherence to the gold standard being another key ingredient of his recipe, it is not entirely accurate to say that Kemmerer encouraged countries to put in place institutions suited for manipulating monetary conditions. But the creation of central banks where they had not previously existed, in conjunction with steps in various countries to bring them under more direct government control, created the potential, if not always the reality, of more active management of the money supply.

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The unprecedented slump starting in 1929 posed a fundamental challenge to the theory and practice of economic policy making. The failure of officials to adapt to the new reality is therefore a powerful testament to the influence of the prevailing policy paradigm.

The challenge to the received wisdom was most serious in the United States, since it was there, among all the industrial countries, that the downturn was most severe. But notwithstanding mounting evidence of economic and financial distress, those responsible for budgetary decisions, in the Congress and the Hoover administration, continued to approach public financial policy by way of analogy with the balance sheet of a private enterprise. Prudent financial management meant that expenditures should be covered by revenues, no less when business was depressed than at other times. The language of contemporaries hardly suggests that the debate over fiscal policy was infiltrated by proto-Keynesian ideas. The dominant doctrine was liquidationism, according to which business cycle downturns served the Darwinian function of weeding out the weak enterprises least well adapted to a dynamic economy. Herbert Hoover's Treasury Secretary Andrew Mellon put it best when he remarked, "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate, liquidate banks, liquidate businesses...purge the rottenness out of the system." The Harvard economist Joseph Schumpeter used more scholarly terms, but his point was fundamentally the same. The problem with stimulative fiscal policies was that they only "produce additional trouble for the future...[Depressions are] not simply evils, which we might attempt to suppress, but...forms of something which has to be done, namely, adjustment to change." He continued, "most of what would be effective in remedying a depression would be equally effective in preventing this adjustment." This doctrine counciled inaction and cautioned

that departures would be counterproductive for the economy.

For all these reasons, President Hoover, despite an engineering background that predisposed him toward activism, submitted budgets to the Congress in 1929 and 1930 that projected operational surpluses. As activity continued to decline and revenues fell off, he recommended further reductions in public spending and increases in taxes. The Revenue Act of 1932, which raised personal and corporate income taxes and introduced a number of new direct and excise taxes, was the largest peacetime tax increase in U.S. history. Hoover deserves credit for expanding public works spending, increasing emergency grants to the states, and establishing the Reconstruction Finance Corporation, but his initiatives were all taken within the confines of a balanced budget.

Franklin Delano Roosevelt was more of a free thinker, but not on this subject. He campaigned for the presidency on a platform of balanced budgets, actually criticizing the Hoover Administration for fiscal irresponsibility. "Any government, like any family, can for a year, spend a little more than it earns," FDR warned in a radio address. "But you and I know that a continuation of that habit means the poorhouse." Once in office, Roosevelt advocated balanced budgets. Government spending on work relief and public works increased under the New Deal but was for the most part financed out of taxes. Personal and corporate income taxes were again raised in 1935. A new tax on undistributed corporate profits was imposed in 1937. State and local jurisdictions, for which borrowing was particularly difficult, raised taxes even more rapidly than the federal government. Estimates of the constant employment budget balance, whether for the federal government or the consolidated public sector, suggest that fiscal policy remained strongly contractionary except in 1931 and 1936 when large bonuses were paid out to veterans of

World War I over the objections of Presidents Hoover and Roosevelt.

French policy makers were, if anything, more stubborn even than their American counterparts. Their version of liquidationism interpreted the slump as a consequence of policies that had been used to artificially boost demand in the 1920s. Moreover, the French looked back on the country's experience with chronic budget deficits in the first five post-World War I years as an unparalleled disaster. Those deficits had fueled inflation, destroyed savings, redistributed income from creditors to debtors, and created social and political turmoil. One government after another had been brought down by its inability to solve the problem. Finance ministers were regularly appointed and dismissed in the "waltz of the portfolios." Nothing would now do more damage to confidence, the conclusion was drawn, than to allow a repeat of this scenario. The one goal on which all political parties agreed was the maintenance of financial stability. Thus, the new Herriot Government brought to power by the 1932 election proposed to balance the budget by raising taxes and reducing civil service salaries by 5 per cent. Failing to marshal support for these measures, it fell and was succeeded by six Radical-led cabinets in quick succession between June 1932 and February 1934. None was able to break the budgetary deadlock.

In other countries the terminology differed, but the essential doctrine and the results were fundamentally the same. In Britain the received wisdom flew under the banner of the "Treasury view," which should not be understood, notwithstanding its name, as limited to the Treasury Department. Churchill summarized it in his budget speech in 1929 with the statement that "It is orthodox Treasury dogma, steadfastly held, that whatever might be the political or social advantages, very little additional employment can, in fact, and as a general rule, be created by State borrowing and expenditure." Public spending merely crowded out a corresponding amount

of private spending. It did so through both real and psychological channels -- by sopping up limited financial resources and by undermining confidence in the government's fiscal and financial probity. If unemployment was a problem, this reflected the excessively high level of wages, whose adjustment would only be discouraged by public spending designed to artificially support the level of demand.

Even on his home turf, then, acceptance of Keynes's ideas was slow. There is the same evidence for Britain as for the U.S. that the government ran budget deficits for much of the 1930s (when that balance is again calculated on an economically meaningful constant-employment basis). Increased public works spending by the Labour Government in 1930-1 was a short-lived exception, but it was both limited and abandoned as soon as that government collapsed. Little active use was made of fiscal policy before the end of the 1930s, only some slight tendency to hold back public works spending once the economy had begun to recover to ensure that the authorities had a weapon in reserve in the event that the economy again turned down. To the extent that fiscal policy lent impetus to British economic recovery, it did so in the form of loan-financed rearmament expenditure, which was driven by recognition of a growing external threat more than by any new diagnosis or appreciation of the pressing nature of the macroeconomic problem. By the end of the decade, admittedly, Keynesian ideas had begun to seep into the public consciousness and political debate. But while the Treasury recognized that the pressure for deficit-financed public works would prove irresistible in the event of another depression, it was far from happy about the prospect.

Swedish economists, it is asserted, discovered Keynesian ideas before Keynes, making Sweden one country where fiscal policy was actively used to stimulate recovery from the

Depression. Erik Lindahl, Gunnar Myrdal and Bertil Ohlin articulated the case for countercyclical fiscal policy and carried the day over the opposition of the older generation when the Social Democrats came to power in 1933. But the statistics tell another story: Sweden's "crisis policy" of deficit spending was mostly smoke and mirrors. The sway of budgetary orthodoxy remained strong, and Swedish officials worried of the difficulty of financing large budget deficits given the weakened condition of the country's financial system. Since deficits were never more than modest, they could have made at most a minor contribution to the economy's recovery.

This fact is all the more remarkable in light of the relatively advanced development of the Swedish financial system. While the Swedish government could issue bonds, the only available means of financing budget deficits in less developed countries were foreign loans and money creation. Access to foreign finance dried up after the U.S. stopped lending in 1928 and most developing-country debtors were forced to suspend service on their obligations; at the same time, the ideology of the gold standard left governments reluctant to resort to the printing press. Deficit spending could not be used, in other words, if deficit spending could not be financed. Governments had to first solve their economies' monetary and financial problems before they could make aggressive use of fiscal instruments.

Germany and Japan provide proof by counterexample. In both countries fiscal policy was used aggressively to propel the economy's recovery from the slump. The government seized control of the financial system to channel finance toward the public sector. Increasingly stringent control of the labor market was used to suppress the inflationary consequences. But, in both instances, rearmament rather than Keynesian theory provided the motivation. Military spending rather than public works was the driving force for recovery. In Japan, for example, military

spending rose from less than half a billion yen in 1931 to nearly 1 billion yen in 1934, and 3 billion in 1937, its share in GNP more than doubling over the period.

But these were exceptions to the rule. E. Cary Brown's conclusion for the United States applies more generally. "[F]iscal policy...seems to have been an unsuccessful recovery device in the 'thirties--not because it did not work, but because it was not tried."

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The same ideology of inaction pervaded the corridors of central banks. In the United States, Adolph Miller of the Federal Reserve Board and the governors of the Philadelphia and Dallas reserve banks were outspoken advocates of letting nature run its course. Actively expanding the money supply, in their view, threatened to dilute the cleansing effect of the downturn by interfering with "the natural law of supply and demand in the money market" (in the words of one reserve bank governor). For the Fed to inject credit into the economy in disregard of that natural law would encourage an even bigger stock market bubble than had burst in 1929, leading ultimately to a bigger, more damaging crash. The real bills doctrine counseled that the provision of additional credit was appropriate only if there existed a demand by commercial banks prepared to discount commercial paper. Thus, the Fed looked to the supply of commercial paper and the level of free reserves (the surplus cash the banks had on hand over and above that mandated by the reserve requirements imposed on them by the Fed) as guides to the timing and extent of expansionary open market operations. With the commercial paper market becalmed and the banks sitting on a mountain of reserves due to the dearth of attractive lending opportunities, Federal Reserve officials concluded that no new monetary initiatives were justified. To the extent

that gold reserves provided a further guide for policy, their decline starting in the final months of 1931 reinforced this conviction. The power of these ideological blinkers should not be underestimated, given the otherwise impressive evidence of the damage wrought on the American financial system and economy by this inaction. How else are we to understand the Fed's willingness to stand idly by as the banking system and the economy collapsed around its ears?

The situation in Britain was different; there it was over the conduct of monetary policy, ironically, that the impact of Keynesian ideas was greatest. The preoccupation of adherents to the "Treasury view" with the crowding out of private investment predisposed them toward policies which promised to put downward pressure on interest rates. In addition, Treasury officials, concerned about the politicization of budgetary policy, were more confident that decisions regarding interest rates, having been delegated to an independent Bank of England, could be kept out of the political realm. Low interest rates, insofar as they translated into a weak exchange rate and hence improved international competitiveness, also promised a solution to the chronic British problem of high labor costs.

But this reorientation of policy, in virtually every country, had to await the loosening of the gold standard constraints. Scholars continue to debate whether the need to protect the nation's gold reserves was a significant constraint on Federal Reserve monetary policy, given the overwhelming size of the U.S. economy and its possession of a third of the world's monetary gold. Some insist that the continued pursuit of expansionary open market operations like those with which the Fed experimented between March and June of 1932 (under pressure from members of a Congress preparing for a hotly-contested electoral campaign) would have pushed U.S. gold reserves down to levels dangerously close to the statutory minimum. This

interpretation is supported by the fact that the Fed, concerned over the volume of gold losses, abandoned its experiment with open market operations as soon as the Congress adjourned for the campaign season. Others counter that the injection of a little additional domestic credit could have gone a long way toward stabilizing the U.S. banking system, stabilizing the economy and, by raising the demand for money as well as the supply, limiting gold outflows.

Be that as it may, the point is not in dispute for other countries. Everywhere else, except possibly in France before 1934, the gold standard constraint was binding. (France was in the enviable position of possessing, like the United States, nearly a third of the world's gold supply.) But the constraint on reflation was more than simply a rigid backing rule that more insightful governments would have had the wherewithal to change. At a more fundamental level, the problem was one of confidence. Technically, Britain possessed the option of loosening the gold standard constraints; it could simply increase the fiduciary issue (that portion of the note circulation that did not have to be backed with gold). But doing so would signal that the authorities had other priorities besides the maintenance of convertibility and that they were less than fully committed to defending the prevailing rate of exchange. Tampering with the provisions of the gold standard law, by undermining confidence, might precipitate an outflow of gold that reduced reserves more quickly than the authorities' efforts at financial engineering freed them up. Indeed, this is what the British authorities learned to their chagrin when they increased the fiduciary issue in the summer of 1931. Similarly, the General Council of the German Reichsbank had the option of reducing the gold cover ratio below 40 per cent if it was prepared to pay a tax on the deficiency, but was reluctant to do so for fear of damaging confidence and provoking capital flight. As Reichsbank head Hans Luther put it to Chancellor Bruning's ministers, the

psychological effect "would [have been] absolutely fearful." The U.S. Congress passed the Glass-Steagall Act in early 1932, eliminating the Fed's obligation to back with gold all monetary liabilities that were not backed with commercial paper (the latter, of course, being in short supply), but by casting doubt on the country's commitment to gold convertibility, the measure did more to undermine confidence than to restore it.

Freeing up monetary policy therefore required cutting loose from the gold standard and resolving the confidence problem. Maintaining confidence meant articulating an alternative operating strategy for monetary policy and reassuring investors that once the golden anchor was raised, policy would still be framed in a sound, stable and coherent way. The Bank of England and British Treasury did so by keeping interest rates high for the first six months following sterling's departure from gold, thereby signaling the market that it would not succumb to the siren song of inflation. It then adopted an explicit policy of cheap money in 1932, reducing interest rates to two per cent but resisting the temptation to more pro-actively expand the money supply. Interest-rate sensitive sectors led Britain's recovery from the slump, testifying to the dominant influence of the monetary impulse. The Swedish Riksbank articulated a policy of stabilizing the price level in what may have been the first such policy ever adopted by a central bank. It imparted credibility to the policy by taking advice from experts like Gustav Cassel, David Davidson and Eli Heckscher and by constructing a weekly consumer price index to provide an explicit, independently verifiable monetary target. In Sweden as in Britain it was primarily interest-rate sensitive sectors producing for the home market that led the recovery.

Countries which borrowed abroad in the 1920s had the additional problem that reducing interest rates and depreciating the currency threatened to increase the domestic-currency cost of

servicing their foreign debts, thereby neutralizing the benefits of a looser monetary policy. For most of the countries of Latin America, suspending service on their foreign debts was therefore a precondition for relaxing monetary policy. Germany and Austria slapped on exchange controls to halt capital flight and give their central banks more room for maneuver. In effect, they disposed of the confidence problem by disposing of the need for confidence, cutting themselves off from international capital markets.

The monetary consequences of these alternative strategies were profound. Between 1931 and 1934, the M1 money supply rose by 5 per cent in the sterling area countries and by fully 34 per cent in other countries with depreciated currencies. In the members of the gold bloc (France, the Netherlands, Poland and Switzerland), it fell by 14 per cent over the same period. The constraints of the gold standard thus dictated fundamentally different monetary policies. The impact on recovery was plain to see. By 1936, industrial production had surpassed 1929 levels by more than 27 per cent in both the sterling area and in other countries with depreciated currencies while remaining 14 per cent below 1929 levels in the members of the gold bloc. Had the liquidity trap been operative, the change in money supplies would have produced no change in economic activity. That it did, and that the most pronounced change was typically in interest-rate sensitive sectors, is evidence that even at the 2 per cent levels to which rates had declined in the UK, monetary impulses had an effect.

The United States might be thought to provide an exception to the rule. Its recovery starting in 1933 was slower than the average behavior of countries with comparably depreciated currencies would have led one to predict. Maybe, then, there is evidence of a liquidity trap neutralizing the benefits of an expansionary monetary policy after all. In fact, the problem was

not that currency depreciation and monetary expansion were impotent but than the U.S. authorities failed to articulate an alternative monetary strategy upon abandoning the gold standard in 1933. Roosevelt initiated a gold-buying program to depreciate the dollar and inject additional credit into the economy, which succeeded in pushing up prices and reducing real interest rates. But he failed to articulate the rationale for the policy or to indicate how long it would be pursued. This uncertainty rendered interest rates exceptionally volatile in the last three quarters of 1933, depressing investment spending and inadvertently slowing the recovery of the economy. Only when the U.S. repegged the dollar to gold in 1934 did the climate of uncertainty begin to change. Gold flowed in from abroad in considerable quantities, but concerned that excessive liquidity might reignite inflation, the Fed raised reserve requirements by 50 per cent in August 1936 and by another 50 per cent in early 1937, while the Treasury for its part stepped up its sterilization of gold inflows. The problem in the U.S. was not that monetary policy could not work but that it was not pursued in a coherent way.

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Looking back on the monetary and fiscal policies of the 1930s from the end of millennium suggests too many parallels for comfort. The Japanese economy remains becalmed in what is now a decade-long depression. For much of the 1990s, Japanese policy makers were reluctant to act for fear of creating another bubble economy like that which Japan had experienced in the 1980s. Better to liquidate stocks, liquidate real estate, and purge the rottenness out of the system. There was, moreover, the worry that deficit spending would drive up interest rates and crowd out more productive investment, given the weakness of the Japanese financial system and the banks'

reluctance to lend. Shades of the Treasury view! And there was even the fear that an expansionary monetary policy would unleash inflation, this in the face of the most pronounced deflation experienced by a major industrial country in the second half of the 20th century. Shades of gold standard orthodoxy!

This recent experience is thus another reminder that entrenched views change only slowly. This is also the lesson of the interwar years. There was no Keynesian revolution in the 1930s in the sense of sharply expansionary fiscal policies adopted with the purpose of propelling economies out of the slump. Expansionary monetary policies were pursued, but abandoning the gold standard was an indispensable prerequisite for their adoption. Although Keynes provided justification for this policy as well, this was not the Keynes of the *General Theory* as much as the Keynes of the *Tract*, in which he had argued that monetary policy could be used to target exchange rate stability or to target price stability, but that there was no guarantee that the former would imply the latter. Governments forced to choose were well advised to opt for stabilizing the level of prices. In Keynes's own words, "when stability of the internal price level and stability of the external exchanges are incompatible, the former is generally preferable; and...on occasions when the dilemma is acute, the preservation of the former at the expense of the latter is, fortunately perhaps, the line of least resistance." Although it took some time to sink in, by the mid-1930s this once iconoclastic point had almost become conventional wisdom.

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