**Reverse influences in Keynes’s mode of thought: a discourse analysis of the Keynes-Hayek Debate**

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**Área 1 - História do Pensamento Econômico e Metodologia**

**Resumo**

Historiadores da economia destacam que Keynes e Hayek, além de escreverem diversos outros trabalhos juntos em periódicos, notas em jornais e revisões de livro, trocaram várias cartas entre 1927 e 1944 em que comentavam e respondiam questões relacionadas a seus trabalhos. Se as correspondências trocadas entre Keynes e Hayek de fato influenciaram a visão de cada um deles sobre política, filosofia e economia ainda é uma questão passível de debate. No entanto, uma análise do discurso de seus argumentos naquela correspondência não tem sido realizada por economistas. Este artigo propõe tal análise baseda na ordem do discurso de Michel Foucault, visando explorar as respostas de Keynes a Hayek no que diz respeito à complexidade da realidade econômica e ao papel do Estado. Nossas conclusões se apoiam nas possibilidades de considerar Hayek uma influência reversa às declarações de Keynes sobre os limites da ação estatal e fins socialmente desejados. Defendemos que tal debate teve uma forte influência em Keynes. Os argumentos liberais Hayekianos desempenharam o papel de uma força reversa e descontínua que contribuiu para delimitar e reforçar a racionalidade “middle-way” de Keynes.

**Palavras-chave:** John Maynard Keynes; Friedrich Hayek; Análise do Discurso; Modo de Pensamento; Michel Foucault.

**Classificação JEL:** B31, B49, B50.

**Abstract**

Historiographers of economics have described that Keynes and Hayek exchanged several letters between 1927 and 1944 in which they discussed their own ideas and works, besides writing together journal articles, newspaper notes and book reviews. Whether that correspondence influenced their own views on politics, philosophy and economics still remains a matter of debate. A discourse analysis of their arguments, however, has not been pursued by economists. This article carries out such an analysis based on Michel Foucault’s order of discourse, exploring Keynes’s replies to Hayek on what concerns the complexity of economic reality and the role of the state. Our conclusions are buttressed by the possibilities of considering Hayek as a reverse influence in Keynes’s late beliefs on the limits of state action and socially desired ends. We claim that Hayekian liberal arguments promoted a reverse and discontinuous force that contributed to delimit and strengthen Keynes’s “middle-way” rationale.

**Key Words:** John Maynard Keynes; Friedrich Hayek; Discourse Analysis; Mode of Thought; Michel Foucault.

**JEL Code:** B31, B49, B50.

**Introduction**

Historiographers of economics have described that Keynes and Hayek - besides writing together journal articles, newspaper notes and book reviews - exchanged several letters between 1927 and 1944, in which they discussed their own ideas and works. Whether that correspondence between Keynes and Hayek influenced each intellectual’s own views on politics, philosophy and economics still remains a matter of debate. Historiographers of economics (cf. Ingrao, 2005; Wapshott, 2011) oftenly mention that Keynes and Hayek – besides writing journal articles, newspaper notes and book reviews - exchanged several letters between 1927 and 1944, in which they checked each other’s views and replied to their own comments.

This article proposes a critical discourse analysis to explore the arguments presented in the “Keynes-Hayek debate”, drawing on Michel Foucault’s assertions regarding the complex connections between language, power and ideology (cf. Foucault, 1971). The divergences between Keynes and Hayek’s view of liberalism functioned as a negative influence, or a “reverse influence” to Keynes’s own theoretical reinforcement and the constitution of his mode of thought, according to Dow’s methodology (Dow, 1996, p. 11).

In political terms, Keynes was indeed a liberal, as he explained in his 1925 essay entitled *Am I a Liberal?* (CW IX, 2013b, pp. 295-306). Nevertheless, economically speaking, he cannot be considered a liberal due to his rejection of core liberal ideas: methodological individualism; economic action based on the idea of self-adjustment; and limit the state to political and juridical issues.

It is in this sense that comparing Keynes to Friedrich Hayek’s liberalism sheds light to Keynes’s political view in terms of economic and public action. Hayek was an Austrian economist of the Austrian Institute for Business Cycle Research, later joining the London School of Economics (LSE) faculty in 1931 under the influence of Lionel Robbins. Hayek contributed greatly to the rise and consolidation of the Austrian School in economics, especially regarding business cycles and liberal political theory, which provided him great acknowledgement across social and political theory.

Following Foucault’s analytical method of genealogy, we can consider Hayek both as a discontinuous and reverse influence for the growth and development of Keynes’s thought. Discourse, Foucault (1971, pp. 52-53) stresses, “[i]s not simply that which translates struggles or systems of domination, but is the thing for which and by which there is struggle, discourse is the power which is to be seized”. In *The Order of Discourse* Foucault presented some methodological principles that should unveil and govern a discursive analysis that takes power and ideology into account: reversal; discontinuity; specificity and exteriority (cf. Foucault, 1971, p. 67).

Our concluding arguments emphasize the construction of Keynes’s “middle way” view (cf. Skidelsky, 2010, p. 152) when facing debating arguments about socialism and egoistic/individualistic liberalism, which put him in a very peculiar political position during his time. More specifically, we can define his middle way as a “social philosophy” that conceived politics, economics and society as three institutional spheres that worked together and contributed mutually from an ethical (not moral) sense of action.

The next section presents the founding arguments for a critical discourse analysis based on Foucault’s approach to power and language. Section 2 presents some central points for understanding Keynes’s critique of liberalism and his view about the necessity for governmental action. Hayek’s theory of spontaneous order and state limitation is explored throughout Section 3. Section 4 explores Keynes’s political thought and recommendations from a reverse and discontinuous point of view in the sense of a Hayekian “reverse influence”, which can shed some light on both the constitution of a Keynesian theory of state action and how it conceived social and economic interventions from a “middle-way” perspective. Lastly, some concluding remarks are presented.

**1. A Foucauldian approach to discourse analysis**

French philosopher Michel Foucault’s intellectual project was to promote a diagnosis about the leading causes that constitute modern subjects, or how individuals become subjects. He identified three modes of objectification that transform human beings into subjects (cf. Foucault, 1983, p. 208): first, objectivizing the speaking subject of general grammar, linguistics, economics and biology using archaeological investigations that explored the “scientific status” of discourses; secondly, analyzing the “dividing practices” that separate the subject from other individuals, which meant to separate the sane, healthy and good individuals from those who are mad, sick or criminal; and finally, investigating how a human being turns himself/herself into as subject by their own conducts, such as sexuality.

While accomplishing an investigation about forms of knowledge (or *connaissances*), Foucault emphasized how some conditions limited and/or institutionalized certain discursive formations. This meant that understanding the responsible forces that enabled a specific discourse to emerge at a certain time and place was as important as analyzing the macro discourse itself. For Foucault, the role of universal discourses and influences should be decomposed and interpreted microscopically.

Foucault sought for the connections between knowledge, power and truth by reconstructing Friedrich Nietzsche’s genealogical analysis and method found *On the Genealogy of Morality* (1887). According to Foucault (1971, pp. 67-69), genealogy was not a search for a metaphysical origin that neglected all other historical and conjectural aspects. On the contrary, it was an investigation that paid attention to the discontinuous and specific facts of a discourse, thus analyzing its exterior issues.

Foucault’s inaugural lecture at the *Collège de France* in 1970 (entitled *The Order of Discourse*) already demonstrated a clear concern about the production of discourses and how they were affected by power. For Foucault, “discourse” refers to knowledge, or what is “within the true” (Foucault, 1989, p. 78). Discourses are ordered systems of statements (or “enunciations”) that are produced under certain rules of knowledge, whose conditions of existence (or “possibility”) rely on the epistemological and historical conditions of a given time and place. Furthermore, the Foucauldian perspective assumes that discursive rules are correlated to the exercise of power: discourse itself is constituted by (and ensures the reproduction of) the social system through mechanisms of selection, exclusion and domination.

Close to Foucault’s discourse analysis is Fairclough’s approach to discourses as forms of social action and interaction (2003, p. 21-25). Certain texts and discursive structures emerge at a specific historical, economic and social moment, such as those involving “globalization”; and “governance”, which might have causal powers and influence the ways social structures are thought and designed. Noteworthy how Foucault and Fairclough emphasize discourse also as an instrument of performativity: it defines certain potentials, possibilities or forms of inclusion/exclusion.

It is for this reason that a complete discourse analysis must also encompass elements and features beyond the discourse itself, such as other hidden influences, social contexts or negative influences. Foucault’s methodological prescriptions for investigating a discourse include four key principles: reversal; discontinuity; specificity and exteriority (cf. Foucault, 1971, p. 67).

The principle of reversal demonstrates an inverse and negative role of discourses, stressing their emergence and contexts of dominance. For Foucault, we should always try to abandon the fundamental understanding regarding certain discourse and then look for establishing an opposite interpretation, highlighting its possible negativities, controversies and debates.

According to Foucault (1991, p. 56) the idea of discontinuity means a two-step process. First, it means to abandon continuities such as preconceived traditions, influences and habits of thought, making other discursive forms possible and visible. Secondly, it involves leaving aside psychological explanations of change and methodological individualism (the genius of great inventions, crises of conscience, etc.), turning to other transformations that constitute – and not simply provoke – a change.

Thirdly, the principle of specificity indicates substituting general forms, abstract elements and universal effects of discourses for an analysis of transformations in their own causable explanations and conditions (Foucault, 1991, p. 56). Accordingly, specificity does not assume pre-discourses or pre-established symbols that make a statement possible, but it considers a discourse as something specific from its own time and space.

Lastly, the principle of exteriority was extensively used by Foucault in his analyses of micro forms of powers. It aimed to search for exterior elements in the sense of taking into account the conditions of possibility located outside a discourse, such as external facts, forces, actors and power relations.

Then, for Foucault discourse analysis, could be linked to a genealogical approach of theories, language and history in the search for the events, the series, the regularities and conditions of possibility of a form of knowledge to emerge. Genealogy (based on a Nietzschean approach) focuses on details, accidents, forces and events that were responsible for the emergence, instead of simply going after the evolutionary origins of a discourse or practice. For instance, in what concerns economic discourses, we should look for how they emerge, following a process that goes beyond the text itself and rely on other epistemological, historical and social aspects. In that particular case, Lima (2015) argues that the same epistemic context was responsible for the rise of mercantilist and physiocratic theories of value: even though physiocrats criticized mercantilist notions of money, value and trade, the nature of such ideas and their impact on representation remained epistemologically the same.

Indeed, such approach opens up a broader perspective for exploring other theories within the history of economic thought and how they actually constitute themselves as discourses. Foucault (2010, p. 176) argues about “discursive ruptures” that may occasionally happen within certain discourse. Even though theories and statements may emerge as a critique on other theories, they still remain at the hypercritical level where a new statement contains elements of the old statement to settle itself.

Mirowski’s idea of “vortex” (cf. Mirwoski, 1987, p. 1004) illustrates the particular case of economic institutionalism and mainstream Keynesianism in the postwar. Even though the Keynesians and institutionalists had divergent sources of inspiration and validation for their own concepts, they resembled one another on the ways each school conceived social and natural knowledge once they were immersed in the same historical-epistemic context. A discourse analysis reveals that opposing discourses can also work as influences in the reverse and discontinuous sense of the word: scholars must strengthen their discourses – sometimes using the opponent’s language or method – to reinforce their own argument.

Following Foucault’s core ideas concerning discursive representation and emergence, we explore Keynes’s arguments on economic reality, liberalism and the limits of state action in the next section. This aims to provide elements to consider whether his debate with Hayek constituted itself as a fundamental influence.

**2. Keynes’s “middle-way” view and a critique to economic liberalism**

Thinking about Keynes’s political view demands an accurate investigation regarding his social context and professional evolution. Keynes’s biographer Robert Skidelsky (2003, p. 73 and 77) stresses that, as an undergraduate, Keynes was not as much as interested in politics as he was in philosophy and formal logic. However, his interests seemed to have changed after the First World War. For instance, in Keynes’s *Essays in Persuasion* (CW IX, 2013b) [1931], we can see that he dedicated himself to discuss several political issues during the late 1920s and early 1930s.

For Keynes (CW IX, 2013b, p. 285), socialism had lost its capacity to deal with real problems due to its ideological dependence. Furthermore, it is noteworthy that in the same work Keynes did not separate socialism and liberalism in two complete opposites. He actually claimed that both socialism and liberalism emerged from the same historical and theoretical origins (or “conditions of possibility”, if we use here Foucault’s own expression), thus emphasizing their acceptance or denial of the utilitarian character.

Keynes was a liberal, but not in the traditional, economic sense of the term. He believed in the liberal view of doing politics and had an open mind to many social issues. However, he criticized economic liberalism and its assumption regarding a complete rejection of state intervention, especially in times of economic crises. Keynes addressed a direct critique to *laissez-faire* liberalism and to Russian communism in four of his *Essays in Persuasion* (CW IX, 2013b), which constituted a separate section entitled “Politics”: *A Short View of Russia* [1925]; *The End of Laissez-Faire* [1926]; *Am I a Liberal?* [1925]; and *Liberalism and Labor* [1926].

In the second essay[[1]](#footnote-1) (see Keynes, 1926), Keynes investigated the origins and metaphysical foundations of the idea of *laissez-faire* liberalism, which he attributed to an intellectual agreement in the 18th and 19th century concerning the ideas of “natural liberty” of economic activities and “enlightened” self-interest. For Keynes, those philosophical ideas accorded with the practical notions of conservative politicians and lawyers in the sense that they provided a satisfactory intellectual foundation to the rights of property and to the liberty of individuals to act freely. That is the reason why liberal ideas became so popular and effective in the 18th and 19th centuries.

Historically *laissez-faire* and individualism emerged as a suitable ideology for that particular time. For instance, Keynes (1926, pp. 2 and 8) emphasizes how 18th century governments were corrupt and incompetent, besides stressing that from 1750 to 1850 material progress came largely from individual initiative and private enterprises, what endorsed individualism and *laissez-faire* as an acceptable philosophy for business, conservative men.

Nevertheless, when considering economic thought, Keynes deconstructs some myths about associating British classical political economy to markets deregulation. Quoting Keynes (1926, p. 4): “The phrase of *laissez-faire* is not to be found in the works of Adam Smith, of Ricardo, or of Malthus. Even the idea is not present in a dogmatic form in any of these authors.” Actually, aside from French physiocrats, only Jeremy Bentham mentioned the idea of *laissez-faire* in his late writings, but presenting it from his Utilitarian perspective that affected social and economic life in an intense way (Keynes, 1926, p. 4).

Economists played an active role in spreading the notion of *laissez-faire* to the public arena during the end of the 19th century, which demonstrated a narrow connection between the theoretical field of ideas and the public, practical sphere of public policies. Keynes (1926, p. 7) mentions two ideological assumptions that transcended from the ideological context of *laissez-faire* to the practical world of norms and rules: first, that individualism and self-interest led to a social selection norm that there must be no mercy or protection for those who were bankrupt or less efficient; secondly, how *laissez-faire* led to the institutionalization of the love for money in the sense that liberalism created a necessity for unlimited private money-making and enabled a system that put first those skillful or fortunate individuals.

Keynes criticized this form of individualistic capitalism. In his third essay *Am I a Liberal?* (CW IX, 2013b, pp. 295-306) [1925], he stresses his concerns with a liberal program not in the historic sense of the analysis, but how it affects current political and economic issues pragmatically. Interestingly, Keynes returned to Bentham’s nomenclature of a political *Agenda* (see Bentham, 1843, vol. 3) to describe where the state should and should not interfere[[2]](#footnote-2). Keynes advocated that the ideal size for the unit of control and organization is somewhere in between the individual and the state: on semi-autonomous bodies within the state that use the criteria of public good as their guide of action, such as Universities or Central Banks. In this sense, Keynes’s “middle way” proposal did not exclude the individual nor the institution of the state (see Keynes, CW IX, 2013b, p. 288-289).

Although not making this point clear, Keynes indicates that what he called as a “self-adjusting” economic approach (see Keynes, CW VII, 2013a, p. 339) actually had some issues in common with the *laissez-faire* ideology. His critique is similar to both approaches in the sense that they insisted on the role of market forces to solve economic problems and maladjustments, besides leaving economic institutions on their own without a proper control. Actually, Keynes’s critique of economic thought and discourse has two main targets: Say’s Law, whose approach denied the role of demand as a relevant economic force, and Benthamian Utilitarianism, which sought to limit state actions.

Following Skidelsky’s terminology (2010, p. 152), we can say that Keynes’s view about the world offered both a “new way” and a “middle way’. The new way refers to his macroeconomic theory, which identified the problems in an insufficient aggregate demand to solve the 1929 economic crisis. The middle way represented his political view that deviated from both Marxism and Liberalism, in which Keynes attempted to propose a social philosophy that would be a compromise between capital and labor, thus rejecting socialist forms of total control, liberal *laissez-faire* and individualism.

Keynes’s philosophical thought influenced on the rationale of his policy proposals in two possible ways: the need for rules in policy-making under uncertainty; and the ethical end of politics.

First, Keynes defended that in face of risk and uncertainty the government should act to promote social contentment that not only involved strict political and economic tools, but broader social actions including the expansion of schools and universities, leisure centers for the population and supporting the arts.

As Davidson (2003, p. 228) claims, under uncertainty a *laissez-faire* market system cannot ensure an effective level of aggregate demand that makes profitable for firms to employ fully. In this case it is highly unlikely that, in the absence of active government policy, full employment can be achieved. Hence governments should act as a guide to economic activity both directly and indirectly: directly in the sense that governments can actually act as an economic entity that hires employees and controls capital flows via fiscal policies and investments; and indirectly in the sense that the state may affect economic reality via monetary policy, interest rates, taxes and international trade that result in incentives to production and employment (see Keynes, CW XX, 2013c, p. 328).

Secondly, politics for Keynes represented a form of practical ethics. Indeed, Keynesian politics did not rule out ethics; on the contrary, politics was a branch of practical ethics for Keynes insofar as it was the science of how governments should act and behave (see Skidelsky, 2010, p. 155). Accordingly, Keynes also criticized liberalism from an ethical point of view in the sense that he rejected the ideology of private money-making as an end and the love of money. In fact, both politics and economics were practical means of action to achieve the ethical end of good life in the sense that it was the government’s duty to facilitate the pursuit of such goods by members of the community. For that, society demands a coordinated action of institutions that have that specific end of social contentment.

Skidelsky (1989, p. 151) and Davis (1994a, p. 158) underpin Keynes’s growing interest in fostering the development of a persuasive public-spiritedness in economic life, which overcame a traditional political expansion of the state. We can see that when he advocated that self-autonomous bodies should be encouraged by state action, he also included the social role of universities, leisure centers and the arts (see Keynes, CW XXVII, 2013d, p. 270), reaching a point where he also considered sex, population and drug issues as a relevant agenda (see Keynes, CW IX, 2013b, p. 301).

If we could summarize Keynes’s view of the role of the state, Peacock’s (1993, p. 15) classifies Keynes as an *end-state liberal* in the sense that he saw the state as a crucial institution for expanding confidence, promoting public policies and achieving its social ends – particularly under contexts of high uncertainty –, but he remained a “liberal” in an ethical-philosophical sense that diverged from contractarian liberals (such as Locke or Rousseau).

For Peacock (1993, p. 26) Keynes’s liberalism might have seemed “naïve” for contractarian liberals, whose assumptions put great weight on institutions that assure equal political rights and legal recognition. Actually, Keynes was more pragmatic as he considered ethics and the power of ideas as the great persuasive forces for practical governmental action. He did not seek to understand the formal means of the state legally and politically speaking, but he focused on real economic and political concerns of a historical period in which the state had a crucial role for promoting economic and social solutions, hence an *end-state liberal*.

Nevertheless, one cannot ignore the critics of Keynesian theory and economic policies that emerged in the decades of 1920 and 1930, particularly from free-market liberal economists. At that time, we could point out the London School of Economics (LSE) as a liberal *locus* that diverged from the Cambridge school of economics (for this terminology, see Harcourt and Kerr, 2009), particularly because of its free-market and individualistic notion that derived from Lionel Robbins and Friedrich Hayek.

Conceptualizing Keynes’s arguments from a reverse perspective reinforces the strength and persuasion of his arguments, especially in that particular of a liberal critique. The Keynes-Hayek debate suits this reverse approach well in the sense that we can grasp Keynes’s arguments about the need of state intervention in economics from a clear, critical point of view when replying to Hayek. For that, the next section focuses on Hayek’s liberal arguments and the defense for a spontaneous order, followed by a presentation of their intellectual debate from a discourse analysis perspective.

### 3. Hayek’s individualism and spontaneous order

Friedrich Hayek was a major influence for the 20th century schools of liberal economic thought, especially the Austrian school of economics, besides influencing some emerging principles of German ordoliberalism and American neoliberalism. Hayek was an important part of neoliberal think-tanks: the Walter Lippmann Colloquium in 1938 and the Mont Pèlerin Society in 1947 (see Plehwe and Mirowski, 2009). Furthermore, he was a key influence to nascent forms of neoliberal thought in Great Britain (as a lecturer of the London School of Economics) and in the United States (as a member of the University of Chicago), both notably known for its liberal influence.

Hayek developed a unique economic theory in the sense that he approached two domains of expertise: business cycles and political economic theory. One of Hayek’s famous works is *The Road to Serfdom* (2001) [1944], which analyzes the possibilities and risks of emerging totalitarian regimes from government control and centralized decision-making, particularly because it suppresses the individual and its intrinsic freedom. He directed his critique to totalitarian regimes, such as communism, and to intervener modes of governance, such as Keynesian economic and social policies.

Regarding Hayek’s theoretical background and political proposals, he was not a *laissez-faire* economist in the classical sense of the term that presupposed free trade. Actually, as Feser (2006, p. 6) argues, Hayek did not believe in free trade and self-interest as feasible economic principles. Indeed, Hayek was careful not to identify economic liberalism with *laissez-faire*, a mistake made by 19th century liberals. For instance, if one takes Bentham’s utilitarian thoughts about the state, one will see a theory that defends a self-limitation of state action, whose core action relies on “doing nothing”.

On the contrary, as Skidelsky (2006, p. 100) stresses, Hayek did not defend an exclusion or the rejection of state action. Actually, he saw the need of the state for multiple purposes, including the provision and enforcement of a legal framework for competition. More specifically, governments should guarantee a liberal order through fixed rules to entrench economic liberalism intentionally. This is essentially different from a *laissez-faire* approach that defends the rejection of governmental action.

The conception of Hayekian liberalism is a response to socialism and centralized forms of government, mainly because socialism is incompatible with individual freedom, which is a central feature for Hayek’s theory (see Kukathas, 2006, p. 183). True individualism, for Hayek (1948, p. 4), emerged with John Locke, Bernard Mandeville and David Hume, and it was later improved by Adam Smith and Edmund Burke. Hayek considers individualism[[3]](#footnote-3) a theory of society in which one presupposes the individual as the first ontological instance to understand the social processes. As Hayek (1948, p. 6) claims: “there is no other way toward an understanding of social phenomena but through our understanding of individual actions directed toward other people and guided by their expected behavior.”

Without conceptualizing the individual, it would be impossible to understand our social dynamics. Individualism provides conditions of possibility to the constitution of spontaneous social events, which are the basis of Hayek’s economic and political principles. With individualism also comes a limitation for coercive and interventionist powers, thus representing the Hayekian solution to avoid totalitarian powers in the sense that the state should only interfere through the principle of law. Therefore, Hayek’s two main political principles that involve state action were based on spontaneous order and the Rule of Law.

First, Hayek considered the principle of spontaneous order as the basis for his libertarian system. For him (1982, p. 36-37), one can conceive the notion of “order” in two complete different senses: as an authoritarian, artificial, exogenously created system; or as a free, self-generating, endogenous force, such as the market force. Actually, he compared the latter form of order to a biological system that emerged from natural forces: “[a]ll that is necessary to preserve such an abstract order is that a certain structure of relationships be maintained, or that elements of a certain kind (…) continue to be related in a certain manner.” (Hayek, 1982, p. 39). Therefore, a spontaneous order is a product of forces or systems that interact (such as human), but are not created from a pre-calculated and intended design.

Given that an order does not emerge with a specific purpose, but from a spontaneous process, institutions should not change its nature. This is why Hayek believed that society should rely on that principle of spontaneous order to limit the powers to control: those forms of control are created by society, which are not as effective as those institutions that emerge spontaneously. Hence in social contexts the economic order of the market would suit better the arrangements and organization of public action than an “artificial” governmental action over the economy.

Despite that rejection of direct state intervention on markets, Hayekian theory relied on the state to ensure that the spontaneous forces would be respected by society and individuals. Hayek (1990, p. 108) emphasized the role of the state and other formal institutions in freeing the spontaneous forces of the economic system, such as assuring that the market competition system has its necessary conditions to function well. This liberal approach did not assume a natural force that would drive and select the individual interests, but rather there should be an institutional framework to enable that process (Boettke and Leeson, 2009, p. 448).

Although Hayek is against the neoclassical premises of perfect competition theory and competitive equilibrium (see Hayek, 1948, pp. 95-96), he believed that competition is a natural force of the market, and therefore it should not be suppressed. Actually, Hayek’s thoughts about competition start from the context of individual behavior, which emphasized Hayek’s methodological individualism. He assumed the notion of enterprise to understand the decisions and actions of economic agents (see Hayek, 1948, pp. 96-97), in which the entrepreneur is the driving force of the market process that ensures the good functioning of the economy.

In order for the entrepreneur to carry out his decisions and activities, he/she must rely on an institutional basis that ensures the rules of the market. Hayek underpins the necessity of rules and principles for a proper and limited intervention of the state in the economy, and this demands a critical analysis of his political view.

First, Hayek (1990, p. 10) links the issues of spontaneous order of the market and rules of law. Considering his theory of how that specific order emerges – it is not the result of a miracle, but a combination of unintended rules of conduct that constituted a system of repeated activities – the rules created with the aim of regulating the market order should actually improve and maintain the order, without annulling its influences and forces.

In *The Road to Serfdom* (2001, p. 75-76) Hayek claims the Rule of Law[[4]](#footnote-4) is what distinguishes free countries from totalitarian regimes. If a state only governs through the instrument of law, it avoids arbitrary decisions from statesmen and certain groups of power. In the case of the economy, governments should fix the laws that determine the conditions under which the available resources may be used, leaving to the individuals the decision for what ends they are to be used. Accordingly, economic planning should be avoided because it is unable to provide as many desired results as a free economy.

Thus we can define the limits of governmental action in the Hayekian conception as a recommendation that does not exclude the state, but imposes some rules of action. For Hayek, keeping the state from acting coercively does not restrain it from providing some services and designing laws for individuals under certain conditions, such as supplying services that otherwise would not be supplied at all. In that sense, Hayek (1990, p. 111 and 2011, pp. 329-335) establishes an agenda that defines three principles in which government services are compatible with his liberal principles, as long as:

1. Government does not claim a monopoly for providing services, such as social insurance, and/or does not restrain the market to provide them;
2. the means are raised by taxation on uniform principles, and taxation is not used as an instrument for the distribution of income;
3. The wants satisfied are collective wants of the community as a whole and not merely wants of particular groups of interest.

Hayek’s agenda to the state excluded the possibility of governments creating monopolies or other means that could interfere in markets or economic competition. Moreover, it disregarded the use of public means to promote income distribution and to promote group interests that did not coincide with collective interest. For Hayek, the state must not interfere in the economic agenda (inequality, earnings, prices, consumption patterns) as a mean to achieve social ends. In this case, the state should only interfere through legal-formal terms, thus defining a framework within which economic agents can make their own decisions freely.

For scholars such as Caldwell (2010, p. 9), Hayek’s early political arguments were not against the welfare state and welfare policies, but against socialist modes of governance. In the *Road to Serfdom*,Hayek criticized economic planning, which he understood as a regime of nationalization of the means of production – which is something different from the welfare state. Nevertheless, in his later works (see Hayek, 2011, pp. 374-376) he also pointed out the dangers of transforming the welfare state in a coercive and controlling system that restricts our liberties, only more slowly.

As Caldwell (2010, p. 13) also claims, Hayek had a fear of the gradual encroachments of the welfare state in the economy and society, especially under the argument of social justice as a justification for interventions in the economy. Under the Hayekian logic, those arguments favoring social justice and income distribution may actually reflect the interests of some groups, and not the society as a whole. In this sense, welfare policies could present adverse results that sometimes do not promote real, collective welfare for all social spheres.

The ideological and theoretical differences between Hayek and Keynes about involving politics and economic policies are indeed striking, despite their shared epistemological position about the nature and effects of uncertainty (see Skidelsky, 2010, p. 159). Their intellectual debate between 1927 and 1944 demands a separate investigation based on a discursive perspective, underpinning their arguments and replies about the limits of state action.

### 4. A discourse analysis of Keynes’s reply to Hayek: constituting a Keynesian theory for the role of the state

This section aims to explore and analyze the main arguments that constituted Keynes’s reply to Hayek’s critique in the light of discursive formations and ruptures, focusing mainly on the limits of state action. More specifically, we turn to the arguments that Keynes used to confront Hayek in regard to the following topics: (1) economic dynamics and the nature of economic problems; (2) to what extent should governments act to solve or to minimize them, and how to do so; (3) the ethical limits of state action towards the individual or the collective. Those arguments illustrate a refinement and a delimitation of Keynes’s discourse in reply to Hayek, which characterized a “reverse influence” to Keynesian theory.

The intellectual clash[[5]](#footnote-5) between Keynes and Hayek has dominated several academic and nonacademic publications, particularly after the 2008 economic crises when Keynesianism re-arose as an alternative to neoliberalism and markets superiority (for instance, see Shearmur, 1997; Cochran and Glahe, 1999; Steele, 2001; Ingrao, 2005; Skidelsky, 2006; Wapshott, 2011 to name a few). Keynes’s and Hayek’s views about the state and their prescriptions toward economic policies became increasingly popular insofar as they led to a broader debate concerning the limits of state action, power relations, public participation in the economy and individual liberty.

Indeed, re-analyzing their main arguments about governmental intervention, the nature of economic problems, and their possible solutions demands a critical reading of their original manuscripts in the light of their debate. Noteworthy how Keynes’s arguments in his reply to Hayek helped to shape and strengthen his own theory. As Steele (2001, p. 12-14) stresses, their controversy was not just about the political interventions of the state, but also about other issues that involved the role of money and monetary policy, inflation, interest rates and investment levels.

Taking primary sources of their debate into account, Ingrao (2005, p. 237-239) establishes three main periods to investigate the correspondence between Keynes and Hayek: the first, between 1927-1929, which are of mainly biographical interest; the second, between 1931-1932, which addressed their main theoretical observations and critiques in private letters and public notes; and the third group, between 1933-1935, which handled broader issues such as social contacts and academic affairs.

Besides their correspondence, their public comments and notes on economic journals and newspapers are also worth of analysis, such as their public letter exchange in *The Times* in October, 1932[[6]](#footnote-6), and their mutual book reviews, such as Hayek’s 1931 review of Keynes’s *Treatise on Money* and Keynes’s reply (see Hayek, 1995, pp. 121-146) and Keynes’s review of Hayek’s *The Road to Serfdom* in 1944 (see Wapshott, 2011, pp. 198-200).

Regarding the first element about economic dynamics and reality, both economists had a similar epistemological perspective about the existence of uncertainty in reality, particularly in the economic context (Skidelsky, 2010, p. 159). Whereas Hayek was concerned about governmental uncertainty – and its incapacity to know exactly what society needs –, Keynes focused on the harmful economic effects of uncertainty, and how governments could act as a direct collective leader that should take precautions against it.

Hayek believed in the perspective of business cycles as a consistent theory to describe economic reality. For him, understanding the cycles demanded an “equilibrium theory” perspective in which economic dynamics would work from a self-adjusting process in the forces of supply and demand in a free market until they are equalized (Caldwell, 1995, p. 14). Although Hayek did not see money as completely neutral, he saw money as a limited element in the economy in the sense that he defended a neutral and stable money supply (thereby a limited monetary policy and gold standard), emphasizing other elements such as prices and interest rates (see Hayek, 1967, p. 131), mainly influenced by Knut Wicksell.

Both central banks and household consumption decisions can affect the cycle. An increase in household savings for future consumption lowers the interest rates in the present and pushes credit up, probably led by a change in intertemporal consumption plans. This causes an increase in credit supply, what induces firms to borrow with lower interest rates. With that newly created purchasing power, firms begin to lengthen their processes of production by taking into account only the future levels of consumption, forcing consumers to reduce their real desired consumption level at the present. This unmet demand for current consumption goods pushes the prices up, leading to higher market interest rates (see Hayek, 1967, pp. 62-65).

Similarly, if central banks inject newly created money in the economy, banks expand credit and cause a lowering in the market interest rate. However, in this case there is not an actual change in time preferences. When banks expand credit they induce higher levels of spending in the present, such as consumption, investments and loans, which leads to an unbalance between savings and investment and to a boom in the economy. The Hayekian (1967, pp. 90-93) solution is a “neutral” monetary policy that equals savings and investment levels again through an increase on the interest rates, not money expansion.

Almost needless to say that Keynes had a different understanding from Hayek’s conception of economic reality. Keynes investigated a monetary theory of production in which money represents a non-neutral asset that influences individual and collective economic decisions and liquidity preferences. Additionally, Keynes saw a prominent role of non-economic elements and their possible effects in the economy, such as expectations, ontological uncertainty, social conventions and the role of confidence.

Keynes’s revival of the Malthusian notion of effective demand demonstrated how prior capitalist decision-making to invest affects current levels of employment, wages, prices and consumption in the sense that today’s expectations of what will happen in the future are crucial to what indeed will occur in economic reality. This is the reason why the state are important for economic activity and recovery in times of a crisis – it acts as a guider of expectations and as a direct economic agent.

The 1929 crash can offer us a better understanding of Hayek’s and Keynes’s view of economic problems and the limits and the ways of state action to solve these issues. Indeed, they both offered divergent diagnoses about its causes (see Caldwell, 1995, pp. 16-17 and Steele, 2001, pp. 10-20): whereas Hayek believed that low interest rates caused low savings level and overinvestment in securities and real estate, leading to a boom and later to a bust, Keynes attributed the crisis to negative expectations of future profits from investors, leading to low levels of consumption and underinvestment. If a fall in consumption appears to be long-term, businessmen will lower their expectations to invest and to hire, causing an aggregate demand crisis.

As for the second topic that confronts Keynes’s and Hayek’s views about the limits of state action in the economy, the Great Depression offers a historical case study to enlighten their thoughts and proposals. Due to their different backgrounds and temperaments (for that terminology, see Skidelsky, 2006, p. 83), they presented opposite views of how to solve the crisis, besides conceiving economic agents and institutions in very divergent ways.

As Backhouse (2006, p. 35) summarizes, whereas Keynes argued that interest rate policy and public works expenditure (and at one stage even tariffs to protect industry) could be used to alleviate depression and to promote recovery, Hayek considered these precisely the opposite of what was required. Actually, for Hayek they would only serve to prolong an expansion that was unsustainable and was bound, eventually, to collapse. To follow such a course would not just postpone something that was inevitable: the longer the maladjustment continued, the worse would be the ensuing crisis.

Hayek’s biggest critiques to the Keynesian theory included the attempts to stimulate the economy through injections of money and governmental intervention as an economic subject, which would only prolong the crisis. Accordingly, fomenting consumption demand would also be ineffective as a solution to the crisis. Inasmuch consumption was an intrinsic characteristic of Hayek’s business cycle, it should not be artificially stimulated through temporary policies.

In their letter exchange for *The Times* (October, 1932), they diverged about the motives of economic activity; more specifically, the role of spending, savings and private investments in that troubled economic scenario. Hayek’s (and his LSE colleagues) first comment on October 10th defended a rise in savings and the relevance of private investments as the solution for the crisis, which indicated a direct defense for liberalizing policies that involved free trade, fluctuating prices and private investments.

In Keynes’s (and his Cambridge and Oxford associates) reply on October 17th, they stressed the potential dangers of an increase in savings level, particularly because savings tend not to be spent on production or consumption goods during a recessive context, thus emphasizing the economic role of consumption for aggregate demand. Indeed, Keynes’s comment derives from his core theoretical difference between savings and investment because of their magnitude and secondary economic impacts (albeit they are equal in amount, their nature and economic impacts are different). Furthermore, his comments become more clear and refined when underpinning the problems of encouraging private investments without adequate policies: in such case, a depressive scenario would block private investments due to lack of confidence and pessimistic expectations, therefore resulting in no real stimulus for the economy to recover.

It is possible to investigate how each intellectual conceived the existence and the active role of the state as a policy-maker from their proposals and possible answers to the crisis. As noted in Hayek’s writings, he did not reject the existence or the legitimacy of governmental intervention. Nevertheless, Hayek thought about the state not as an active economic subject, but rather as rule-maker that contributes indirectly to economic actions. For instance, in Hayek’s reply to Keynes’s letter on October 19th, he affirms:

If the Government wish to help revival, the right way for them to proceed is, not to revert to their old habits of lavish expenditure, but to abolish those restrictions on trade and the free movement of capital (including restrictions on new issues) which are at present impeding even the beginning of recovery. (Hayek, 1932).

Hayek believed in the role of private investments as the way to get out of the crisis: “We, on the contrary, believe that one of the main difficulties of the world to-day [sic] is a deficiency of investment – a depression of the industries making for capital extension, rather than of the industries making directly for consumption.” (Hayek, 1932). Together with stimulus to private investments, Hayek and his LSE associates suggested a formal role of the state in the sense of creating and imposing rules and conditions to stimulate those private investments, rather than being economically active and increasing public expenditure. Indeed, the Hayekian view becomes refined and presents a clear political recommendation during the letter exchange.

Two years before, in 1930, Keynes presented his economic policies in an attempt to mitigate the effects of the crisis. In his essay *The Great Slump of 1930* (see Keynes, CW IX, 2013b), as well as in several of his letters to British statesmen and public radio broadcasts (see Keynes, CW XX, 2013c, pp. 312-401), he discussed unemployment and social policies, industrial incentives, international financial assistance and foreign trade. For Keynes, the biggest issue of that moment was the lack of investment and enterprise at home, together with an expansion of investments abroad, leading to a loss of gold, higher interest rates and credit reduction.

Consequently, this discouraged investment and enterprise at home, causing unemployment and low profits. As a solution, in his 1930 BBC radio broadcast Keynes (CW XX, 2013c, p. 323) says he had been “in favour for a good long time of a large programme of capital expenditure at home that would employ men and would give an outlet for our savings without putting pressure on the gold reserves of the Bank of England”.

Indeed, Keynes’s plan required a direct guidance from the state in controlling public spending and reorganizing the expectations and confidence of the agents. As we can see, this reflected a continuity of Keynes’s ethical-philosophical view of economic reality and method, emphasizing the role of the state as an entity that could change the future of society as a collective, organic entity. In his writings about solving economic issues, Keynes deliberately brings the normative role of the state back, stressing other realistic elements of the economy, such as uncertainty and expectations.

Wapshott (2011, pp. 198-201) returns to an unpublished letter from Keynes to Hayek in April 4th, 1944[[7]](#footnote-7) in which Keynes made some comments about *The Road to Serfdom*. There, Keynes defends a middle course of ideas and governmental action, criticizing Hayek’s theory that socialism and other planned modes of production might lead to totalitarianism. Keynes stresses:

[W]hat we want is not no planning, […] [b]ut the planning should take place in a community in which as many people as possible, both leaders and followers, wholly share your moral position. Moderate planning will be safe if those carrying it out are rightly orientated in their own minds and hearts to the moral issue. […] What we need is the restoration of right moral thinking – a return to proper moral values in our social philosophy. (Keynes, 1944, *apud* Wapshott, 2011, p. 198).

In his letter to Hayek, Keynes advocates a moderate governmental planning of domestic activities, particularly those that involve economic and social issues based on an ethical conduct. Keynes believed in public-spirited people that worked for the collective good, emphasizing the social role of public action. Indeed, for Keynes ethics could not be separated from practical political and economic activities, such as policy-making, and he makes this point clear when elaborating a discourse to criticize Hayek. Even though both intellectuals have strong philosophical backgrounds, their discursive strategies and arguments towards the concepts of “liberalism”, “ethics” and “individual” are distinct.

Following Skidelsky’s (2006, p. 102) claim that Hayek was a utilitarian, his theory of liberty is bounded by the law, and his justification of liberty is instrumental: the central planner has less knowledge than exists, hence the market forces work as a better guide to individuals in the sense of an “entrepreneur of the self” than state-driven or social-driven forces. Individuals take into account the impersonal market signals in their decision process within a legal framework to decide about economic and non-economic aspects of life that will result in relative remunerations (see Hayek, 1948, p. 21). Then, the institution of the state is left out of the decision-making process, which is now guided by the market.

As the Post-Keynesian view demonstrates, however, Keynes’s ethical-political view was more complex in the sense that he incorporated ontological uncertainty, holism and ethics with some traditional aspects of liberal politics that conceived both society and individuals as two mutual-influencing entities. Even though Keynes did not put all efforts in the forces of markets, he combined state intervention in the economy and society with a public ethic that did not annulled the individual. His discourse makes those elements clear, and it is possible to grasp clearer and more refined notions from Keynes’s replies to Hayek. Once Keynes’s replies clearly define his rationale towards state action – and how his view differed from the Hayekian approach – one can see Hayek as a reverse influence to Keynes’s thoughts.

**Concluding Remarks**

Despite of the existence of a substantial literature that has addressed an interface and/or conflict between Keynes’s and Hayek’s thoughts, a closer examination of their arguments from a critical discursive perspective is certainly worthwhile.

Hayek and Keynes had different understandings about procedural economic means, which originated from their different point views concerning economic reality, institutions and agents. As Skidelsky (2006 p. 86) asserts, they were both liberals and had different conceptions of economics, which derived from their previous philosophical trainings. Nonetheless, they believed in the power of ideas, although diverging on practical terms on how to achieve their goals.

As pointed out throughout the article, a critical discourse analysis based on Michel Foucault’s thoughts emphasizes the role of external, reverse and discontinuous influences towards a theory or statement. We cannot simply imply that a discourse evolves in a continuous and definitive manner; on the contrary, discourses represent a combination of several ontological, epistemological and historical aspects that read reality differently, especially on what concerns economic discourses and theory formation.

A closer look into Keynes’s and Hayek’s debate demonstrated two crucial aspects. First, a discontinuous influence of Hayek on Keynes’s late beliefs, because one cannot simply consider the traditional discourses and schools of thought as the only ones that were relevant for the construction of Keynes’s theory, such as Malthusian and Marshallian economics. Secondly, – and most importantly – a throughout analysis of their discourses shows a reverse influence inasmuch as Hayek represented the opposite of Keynesian thought. Keynes had to deal with Hayek’s criticism and thereby created a strong, consistent theory, therefore constituting a reverse influence. Indeed, historians of economic thought could benefit from the role of other possible indirect traditions in the constitution of a theory, thus enlightening further thoughts about the rise and strength of an economic discourse.

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1. Keynes’s *Essays on Persuasion* (CW IX, 2013b) [1931] published a different (and shorter) version of *The End of Laissez-Faire*, which excluded the three first sections of the original version of the pamphlet, published by Hogarth Press in July, 1926. [↑](#footnote-ref-1)
2. According to Bentham’s *agenda*, he defines it: “What the legislator and the minister of the interior have it in their power to do towards increase either of wealth or population, is as nothing in comparison with what is done of course, and without thinking of it, by the judge, and his assistant the minister of police. The cases in which, and the measures by which, the common end may be promoted by the hands of government, may be termed *agenda*. With the view of causing an increase to take place in the mass of national wealth, or with a view to increase of the means either of subsistence or enjoyment, without some special reason, the general rule is, that nothing ought to be done or attempted by government. The motto, or watchword of government, on these occasions, ought to be—Be quiet”. (Bentham, 1843, original highlights). [↑](#footnote-ref-2)
3. It is noteworthy to point out Hayek’s clear distinction of what he considers “true individualism” from other individualistic approaches. The first arose with the British tradition of Locke, Hume, Smith and Burke; whereas the latter emerged from Descartes and the French tradition (more on this, see Hayek, 1948, p. 11). [↑](#footnote-ref-3)
4. We can define the Rule of Law as the rules of the game, or the fixed rules that are announced beforehand that enable individuals to foresee the actions of the government. For Hayek, a liberal society demands the Rule of Law and justice to delimit the scope of individual freedom. Or, as Kukathas (2006, p. 185) affirms, “liberalism upholds the idea of a free society in which individual conduct is regulated by rules of justice so that each may pursue his own ends or purposes in peace”. [↑](#footnote-ref-4)
5. It it noteworthy that, despite their differences, Keynes and Hayek shared a mutual opponent: Walrasian General Equilibrium Theory (cf. Skaggs, 2014). [↑](#footnote-ref-5)
6. Original scan retrieved from: <http://austrianeconomists.typepad.com/files/cambridge_vs._lse_1932.pdf> (accessed 19 May, 2015). [↑](#footnote-ref-6)
7. This letter is available for consultation in the archives of LSE (Wapshott, 2011, p. 325, note 44). [↑](#footnote-ref-7)