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The End of Laissez-Faire — or was it?

Luciano Barros [a] and Louis-Philippe Rochon [b]

[a]Federal University of Rio de Janeiro, Brazil; [b]Laurentian University, Canada

ABSTRACT

A century after the publication of Keynes's 'The End of Laissez-Faire', this paper seeks to contextualize the essay, present its central arguments, and explore their relevance for both the development of economic theory and the contemporary macroeconomic paradigm. Drawing on Keynes's seminal insights, the paper traces the recent historical trajectory of liberalism — from its post-war decline to its resurgence over the past fifty years — and offers a critical assessment of its current manifestation within the New Consensus in Macroeconomics. In doing so, it advocates for the post-Keynesian agenda as a compelling alternative for building a more prosperous and equitable future.

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1. Introduction

After graduating in mathematics[1] and spending a few years working at the India Office,[2] John Maynard Keynes joined Cambridge, where he taught economics until the outbreak of the First World War. He then joined the British Treasury, where he participated in deliberations regarding the post-war reorganization of the European economy (Skidelsky 1999).

It was this experience that led to the publication of the first work that would bring him widespread recognition, *The Economic Consequences of the Peace* (1919), in which he acknowledged the fragility of the European economy following the conflict, and harshly criticized the excessive reparations imposed on Germany (Friedman 1989 [1997]; Schumpeter 1946). The book revealed his keen analytical skills, which would unfold in a series of dire predictions — soon proven accurate — regarding the economic, social, and political consequences of the Treaty of Versailles.

Keynes's analysis of the economic consequences of the war for Britain also demonstrated his intellectual brilliance. Confronted with a scenario of chronic unemployment, he criticized the country's monetary policy, which was obsessively focused on returning to the pre-war gold standard.[3] This policy led to an overvaluation of the pound and

CONTACT Luciano Barros luciano.barros.ufrj@gmail.com Federal University of Rio de Janeiro, Brazil

[1]*A Treatise on Probability*, essentially completed by 1911, would be published in 1921.

[2]This experience led him to write *Indian Currency and Finance* (1913), his first major publication.

[3]Keynes's views on these matters are present in *A Tract on Monetary Reform* (1923) and in the pamphlet *The Economic Consequences of Mr. Churchill* (1925). The issue will be addressed in the next section.

persistent current account deficits, contributing to the mediocre economic performance throughout the 1920s.

It was in this context that, between November 1924 and June 1926, Keynes delivered two lectures — one at the University of Oxford, and the other at the University of Berlin — in which he criticized economic liberalism and anticipated a new form of state intervention in the economy. This insight, too, would prove deeply prescient in the decades that followed. The content of these lectures turned into a pamphlet that was published by the Hogarth Press in July 1926 under the title *The End of Laissez-Faire*.

With the onset of the Great Depression, the Second World War, and the institutionalization of state intervention in the economy in the following decades, Keynes's intuition (expressed in this pamphlet) would prove remarkably prophetic. Moreover, his theoretical contributions — particularly following the publication of *The General Theory of Employment, Interest, and Money* in 1936[4] — would catalyze the consolidation of this new paradigm, ushering in what would become the most prosperous period in human history, that is, of higher per capita income growth[5] (Maddison 2001).

In the 1970s, however, post-war 'Keynesianism' was gradually eclipsed by the rise of Monetarism, led by Milton Friedman, which marked the resurgence of the dominance of liberal economic principles. The prevalence of the (current) economic policy framework grounded in these principles has contributed to the economic performance of the last decades: lower growth (compared to the post-war period) and a clear process of rising income and wealth inequality.

It is in this scenario — of a fraying social fabric combined with a devastating environmental crisis, after decades of neoliberalism — that Keynes's *The End of Laissez-Faire* turns one hundred years old. Unfortunately, economic liberalism remains as entrenched today as it was at the start of the 20th century, bringing with it serious political, economic, social, and environmental consequences. This is why a return to Keynes's classic essay is so essential today. This paper is devoted to that task.

Accordingly, this paper aims to contextualize the writing of the essay, present its main ideas, and use them to analyze both the evolution of economic theory and the current dominant macroeconomic framework. Despite partially drawing on Keynes's contributions, this framework also retains important features of the liberalism he so sharply criticized.

The paper is structured as follows. Section Two outlines, from the perspective of economic history, the turbulent 1920s in England. As will be argued, alongside the country's long-term (relative) economic decline, the period also witnessed the adverse effects of liberal policies aimed at restoring the gold standard to its pre-war parity. These developments provided Keynes with critical insights into the limitations of liberal policies, motivating him to write *The End of Laissez-Faire*, the principal contributions of which are presented in Section Three. Section Four analyzes the evolution of economic theory after Keynes's contribution. Finally, Section Five critiques the current dominant macroeconomic paradigm, pointing to the post-Keynesian approach as a more coherent alternative for achieving a more just and prosperous society.

[4]Some of the ideas later developed in the "General Theory" were already anticipated in "A Treatise on Money" (1930), written in the late 1920s. See Lerner (1974) and Seccareccia (2004).

[5]From a long-term perspective, average world growth between 1950 and 1973 was significantly higher than in other periods (1000–1500, 1500–1820, 1820–1870, 1870–1913, 1913–1950, and 1973–1998).

2. England in the Early 1920s: The Search for the 'Fool's Gold'

The First World War was, indisputably, a fundamental milestone in human history, to the extent that a renowned British historian dated the beginning of the 'Short 20th Century' to 1914, as the conflict *marked the breakdown of the (western) civilization of the* 19th *century* (Hobsbawm 1995, p. 6). The so-called 'Great War' initiated a period of profound ruptures, linked to a range of developments — such as the decline of European centrality in favor of American ascendancy, the collapse of the major colonial empires, the Russian Revolution, and the rise of Nazifascism — which would shape the political and economic dynamics of the following decades.

Specifically concerning England, the First World War brought both direct and indirect consequences that accelerated a process of relative decline already observable since the 19th century. Notably in terms of industrial production, the country had been losing ground to its competitors at the forefront of the Second Industrial Revolution, particularly Germany and the United States.

> The difficulties of Great Britain began in the 1870s. From the beginning of the century until then, industrial production had been increasing at an annual rate of not much less than 4 per cent; thereafter until the war the rate was less than 2 per cent (…). At the same time, other countries were forging ahead. The cumulative annual increase of manufacturing production from 1873 to 1913 was 4.8 per cent for the United States, 3.9 per cent for Germany, 3.7 per cent for the world as a whole, and only 1.8 per cent for the United Kingdom. (Lewis 1949, p. 74)

Although physical destruction on British territory was limited (when compared to continental Europe), the war resulted in the death of nearly one million Britons (Mazzucchelli 2006). Even so, by redirecting (and overburdening) its productive structure towards the war effort, the country achieved a real GDP growth of just over 13 per cent between 1914 and 1918, despite inflation more than doubling both consumer and wholesale price indices (Mitchell 1992).

Meanwhile, the country experienced a rapid deterioration of its trade balance due to the disruption of global trade, the loss of markets, and the urgent need to expand imports. However, the greatest burden came from war financing. Having abandoned the gold standard to do so, Britain accumulated significant domestic public deficits, liquidated various foreign assets, and incurred substantial external debt, especially with the United States (Mazzucchelli, 2006). By 1918, Britain held only 7.7 per cent of total gold reserves in the hands of central banks and governments, compared to 39 per cent held by the U.S. and 9.7 per cent by France (Eichengreen 2000).

In the immediate post-war period, expectations of economic growth were widespread, supported by the anticipated reestablishment of international trade and capital flows, pent-up investment (both in fixed capital and inventories), and the removal of wartime economic controls. Furthermore, the country benefited from forced savings and suppressed demand generated during the conflict.

However, this demand pressure, facing a still-inadequate productive capacity (in both level and composition, due to the war effort), along with shortages of inputs and labor, exerted significant upward pressure on prices. As noted by Mazzucchelli (2006, p. 86), this inflationary pressure was further exacerbated by speculative activity and the depreciation of the pound sterling. Consequently, accumulated inflation in 1919–20 was

approximately 22.5 per cent for consumer prices (CPI variation) and 37 per cent for wholesale prices.

A long-term trend of relative decline, combined with different internal and external imbalances, influenced British post-war economic policymaking. The authorities' immediate response of implementing fiscal and monetary contraction aimed not only to contain inflation but also to pave the way for a return to the gold standard.

Reinstating the pre-war monetary standard not only required the adoption of austerity policies deemed appropriate at the time but also, by the very mechanics of the gold standard, was expected to correct various economic imbalances. It also symbolized Britain's effort to restore its (monetary and) geopolitical power. Nevertheless, belief in the essentiality of the gold standard was widely held in the early 20th century.

> Indeed, the essentiality of the gold standard to the functioning of the international economic system of the time was the one and only tenet common to men of all nations and all classes, religious denominations, and social philosophies. It was the invisible reality to which the will to live could cling, when mankind braced itself to the task of restoring its crumbling existence. (Polanyi 2001, p. 26–27)

British authorities not only sought to reestablish the pre-war monetary regime but insisted on restoring the pre-war parity of 4.86 US$/£. Since U.S. inflation during the war had been significantly lower than in Britain, returning to this parity would imply a real appreciation of the pound against the dollar. Once this path was chosen, deflationary contraction became the only available strategy.

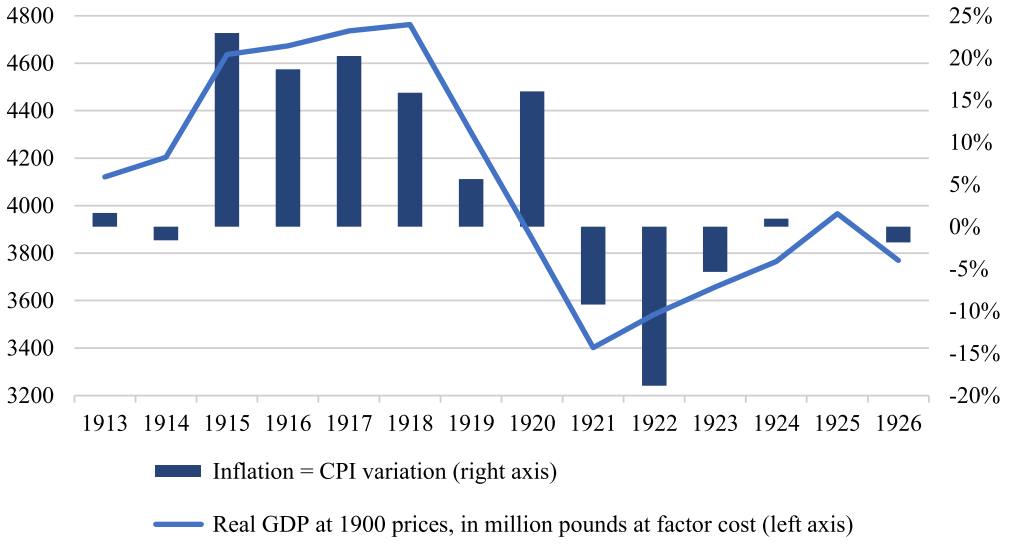
This process began in 1919, but inflation remained high in 1920 (16 per cent consumer inflation), still reflecting wartime imbalances. Contractionary policies continued into 1921, coinciding with a global decline in trade, reinforcing recessionary trends. Between 1918 and 1921, Britain's real GDP shrank by 18.5 per cent, and deflation was finally achieved (see Graph 1). From 1921 on, GDP exhibited modest growth, but prices continued to decline — largely due to efforts to suppress trade unions — until, finally, in 1925, the gold standard was reinstated. Without going deeply into the macroeconomic[6] dynamics of 1920s Britain, two observations are worth noting.

The first concerns Keynes's critical stance on the return to the gold standard — in his words, *a barbarous relic* (Keynes 1923 [1929], p. 172) —, since he advocated for greater exchange rate flexibility and, consequently, for a more autonomous economic policy.[7] He also criticized the chosen parity, which, in his view, implied a real appreciation of the pound against the dollar, thereby reducing British competitiveness. Moreover, Keynes (1925 [2010]) opposed the contractionary policies adopted at the time, which he

[6]Another important aspect of the performance of the British economy during the period — also beyond the scope of the present paper — concerns the structure of British industry, or more specifically, its lag in the Second Industrial Revolution. According to Aldcroft (2001, pp. 37–38),

> [t]he intermittent policy of deflation in connection with the return to the gold standard in April 1925 helped to depress activity below potential though the main problem was a structural one. A large proportion of resources was tied up in the old basic industries of textiles, shipbuilding and coal, the demand for whose products, both at home and abroad, was declining rapidly.

[7]Keynes didn't even believe that a return to the pre-war gold standard would bring about the desired stability. *Therefore, since I regard the stability of prices, credit, and employment as of paramount importance, and since I feel no confidence that an old-fashioned gold standard will even give us the modicum of stability that it used to give, I reject the policy of restoring the gold standard on pre-war lines* (Keynes 1923 [1929], p. 176).



Graph 1. Consumer inflation and real GDP in England (1913–1926). Source: Own elaboration based on Mitchell (1992).

Table 1. Unemployment rates in Great Britain (1918–1929).

1918	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929
0.8%	3.4%	2.0%	11.3%	9.8%	8.7%	7.2%	7.9%	8.8%	6.8%	7.5%	7.3%

Source: Mitchell (1992).

interpreted as aiming to restore competitiveness by suppressing wages, and thus altering the wage-exchange rate relationship.

Secondly, one must emphasize the substantial costs — in terms of output and employment — associated with the adoption of this exchange rate regime, both in its aftermath and, more importantly, in the period leading up to it, marked by the sacrifices made to restore the gold standard.

As Table 1 indicates, after the full employment achieved during the war, unemployment surged, peaking at over 11 per cent in 1921, and averaging 8.4 per cent between 1921 and 1929. It was in this context, in the mid-1920s, that Keynes conceived the essay 'The End of Laissez-Faire', which, according to Minsky (1985, p. 1), *reflected the troubles* of his time — *the failure of Britain to attain prosperity in the 1920s.*

3. The prophecy of 'The End of Laissez-Faire'

Although the lectures delivered by Keynes in the mid-1920s — later transformed into a paper in 1926 — were deeply rooted in the historical context and reflected his dissatisfaction with the economic performance of Europe in general, and of Britain in particular, they also expressed a growing discomfort with the economic liberalism of the preceding century. This is understandable because, as Polanyi (2001, p. 24) summarizes, *at the end of the Great War* 19th-*century ideals were paramount, and their influence dominated the*

following decade. Minsky (1985) adopts a similar point of view, acknowledging the central role of economic liberalism, epitomized by the maxim 'laissez-faire',[8] as well as its deep historical roots.

> Laissez-faire is a doctrine that was central to capitalist ideology in much of Europe - especially Britain - and the United States in the century and a half prior to the Great Depression of the 1930s. (Minsky 1985, p. 3)

Keynes begins his essay precisely by examining the historical and philosophical origins of economic liberalism[9] since the 17th century. In the context of the transition from feudalism to capitalism, there emerged, in parallel, a set of ideas grounded in reason, individual liberty, and contractual relations, which challenged former religious and absolutist beliefs (Keynes 1926, pp. 272–273).

According to Keynes, while thinkers such as Locke and Hume laid the foundations for the valorization of the individual, others like Paley and Bentham provided the philosophical underpinnings (via theological and rationalist routes, respectively) for utilitarianism, according to which the pursuit of happiness, both individual and collective, should guide human action. The success of liberalism, at the level of ideas, would stem from its ability to reconcile individual interest with collective well-being, under a framework that claimed scientific legitimacy.

In the sphere of concrete reality, however, the corruption and incompetence of 18th-century governments fostered a widespread aversion to state intervention in private affairs (Keynes 1926, p. 275). Simultaneously, the impressive development of productive forces observed in that period appeared to result almost exclusively from individual enterprise. Theoretical conclusions and practical observations, therefore, converged in support of liberalism.

> The individualism of the political philosophers pointed to *laissez-faire*. The divine or scientific harmony (as the ease might be) between private interest and public advantage pointed to *laissez-faire*. But above all, the ineptitude of public administrators strongly prejudiced the practical man in favour of *laissez-faire* – a sentiment which has by no means disappeared. (…) On the other hand, material progress between 1750 and 1850 came from individual initiative, and owed almost nothing to the directive influence of organized society as a whole. Thus practical experience reinforced a priori reasonings. (Keynes 1926, p. 275)

In the 18th century, even though the principles of liberalism aligned with certain elements of French physiocracy — such as the notion of *essential harmony of social and individual interests* — Keynes observed that laissez-faire doctrine *finds little support in the writings of this school* (Keynes 1926, p. 278).

During the late 1700s and early 1800s, the expression 'laissez-faire' was absent from the writings of Smith, Ricardo, and Malthus. According to Keynes, although these authors clearly supported liberal principles, their advocacy was not dogmatic. This is particularly evident in the reactions of Adam Smith — considered one of the fathers of economic liberalism — to the Navigation Acts and usury laws (Keynes 1926, p. 279).

[8]In the same paper, Keynes attributes the origin of the expression "laissez-nous faire" to the merchant Legendre, in a conversation with Colbert at the end of the 17th century. According to Keynes, the first to employ the phrase explicitly in association with economic liberalism — particularly in defense of free trade — was the Marquis d'Argenson, around the middle of the following century (Keynes 1926, 278).

[9]Henceforth, the term liberalism, as used in this discussion, will refer specifically to economic liberalism.

In addition to the obvious interest of the capitalist class and entrepreneurs in promoting the doctrine of laissez-faire, some of its main opponents, such as protectionists and Marxist socialists, ultimately contributed, due to their scientific shortcomings, to the consolidation of that doctrine. Thus, *the obvious scientific deficiencies of these two schools greatly contributed to the prestige and authority of* 19th-*century laissez-faire* (Keynes 1926, p. 286).

By the end of the 19th century, however, critiques of liberalism began to emerge from within orthodoxy itself, notably from Cairnes in his introductory lecture on 'Political Economy and Laissez-Faire'. Even Marshall, one of the most influential economists of the neoclassical school (and Keynes's teacher at Cambridge), devoted considerable attention to cases where individual and collective interests failed to align.[10]

After arguing that economists do not choose their assumptions based on realism but rather on their simplicity, and listing some liberal assumptions that underpinned their conclusions, Keynes launches a direct attack on the doctrine.

> Let us clear from the ground the metaphysical or general principles upon which, from time to time, laissez-faire has been founded. It is not true that individuals possess a prescriptive 'natural liberty' in their economic activities. There is no 'compact' conferring perpetual rights on those who Have or on those who Acquire. The world is not so governed from above that private and social interest always coincide. It is not so managed here below that in practice they coincide. It is not a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally is enlightened; more often individuals acting separately to promote their own ends are too ignorant or too weak to attain even these. Experience does not show that individuals, when they make up a social unit, are always less clear-sighted than when they act separately. (Keynes 1926, pp. 287–288)

It is important to note that this critique of laissez-faire (understood as a form of extreme liberalism) does not imply a wholesale rejection of liberal principles. On the contrary, Keynes, while recognizing both merits and flaws of all parties across the British political spectrum, collaborated for years with the Liberal Party and acknowledged his position in the class struggle, even stating: *I can be influenced by what seems to me to be justice and good sense; but the class war will find me on the side of the educated bourgeoisie* (Keynes 2013, p. 297).

Keynes consistently advocated for capitalism, which, he believed, *wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable* (Keynes 1926, p. 294). His objective was always to preserve the system and extract from it the greatest benefit for society, making use of liberal principles where appropriate, and proposing *improvements in the technique of modern capitalism by the agency of collective action* (Keynes 1926, pp. 292–293).

In this sense, after his critique of laissez-faire, Keynes moves to a constructive agenda, suggesting a middle ground between extreme individualism and complete collectivization of decisions, asserting that *the ideal size for the unit of control and organization lies somewhere between the individual and the modern State* (Keynes 1926, p. 288). Thus, he proposes *separate autonomies* and provides concrete examples, such as

[10]One can note that in "Principles of Economics" (1890) Marshall recognizes that the free market does not always lead to collective well-being, due to factors such as externalities and monopoly power.

universities, the Bank of England, the Port of London Authority, even perhaps the railway companies (Keynes 1926, p. 289).

He then distinguishes the agenda of government from the non-agenda, *those services which are technically social from those which are technically individual*, making clear that it is the role of the State to take responsibility for *decisions which are made by no one if the State does not make them*. Having highlighted that many of the major economic issues of his time, such as *unemployment of labor, or the disappointment of reasonable business expectations, and of the impairment of efficiency and production*, were *fruits of risk, uncertainty, and ignorance* (Keynes 1926, p. 291), Keynes proceeds with concrete suggestions for State intervention.

> I believe that the cure for these things is partly to be sought in the deliberate control of the currency and of credit by a central institution, and partly in the collection and dissemination on a great scale of data relating to the business situation, including the full publicity, by law if necessary, of all business facts which it is useful to know. (…)
>
> My second example relates to savings and investment. I believe that some coordinated act of intelligent judgment is required as to the scale on which it is desirable that the community as a whole should save, the scale on which these savings should go abroad in the form of foreign investments, and whether the present organization of the investment market distributes savings along the most nationally productive channels. I do not think that these matters should be left entirely to the chances of private judgment and private profits, as they are at present. (Keynes 1926, p. 292)

It is worth returning here to the historical context in which the essay was written — mid-1920s Britain, a period marked by austerity policies aimed at returning to the pre-war gold parity, which had the adverse economic consequences outlined in the previous section. Keynes emphasized that not even the experience of centralized economic control during the First World War was enough to shift the mindset of liberal academics and policymakers.

> Nor has the most notable divergence into centralized social action on a great scale - the conduct of the late war - encouraged reformers or dispelled old-fashioned prejudices. (…) War experience in the organization of socialized production has left some near observers optimistically anxious to repeat it in peace conditions. War socialism unquestionably achieved a production of wealth on a scale far greater than we ever knew in peace (…). (Keynes 1926, p. 286)

The post–Second World War scenario, however, would be entirely different. The social gains resulting from State intervention in the economy — which Keynes had already intuited in the 1920s — would be implemented and institutionalized in the following decades, fueled by the Great Depression and substantiated by his later theoretical contributions. Unfortunately, contrary to what Robinson (1964) had hoped, even after this *long time a-dying*, this did not mark 'The Final End of Laissez-Faire'. Keynes's prophecy of 'The End of Laissez-Faire' proved accurate, though that end would not be definitive.

4. The Eclipse of Economic Liberalism In the Post-War Period

With the advent of the 1929 crash and the Great Depression, the capitalist world as a whole witnessed a sharp decline in production levels. In the United States, real GDP fell by more than 26 per cent between 1929 and 1933, the year in which the

unemployment rate surpassed 25 per cent. In the United Kingdom, unemployment, which had peaked at 11.3 per cent in 1921 and averaged more than 8 per cent throughout that decade, would exceed 15 per cent in 1931 and 1932, maintaining an average of 11.2 per cent between 1930 and 1939 (Mitchell 1992).

What is most ironic is that, after the weak performance of the British economy in the previous decade had largely stemmed from the pursuit of a return to the gold standard, this very monetary system would spread and intensify the depression. With the collapse of international capital and trade flows, countries adhering to the gold standard were forced to implement contractionary monetary policies to maintain parity, thereby exacerbating depressive tendencies. As Temin ironically remarked (2018, pp. 5455–5456), *the primary transmission channel of the Great Depression was the gold standard. (…) The gold standard was a Midas touch that paralyzed the world economy*.

Even in the face of deteriorating economic indicators, various governments were reluctant to abandon liberal principles and implement countercyclical measures during the early years of the Depression. As Joan Robinson noted, this reluctance was not exclusive to policymakers but extended to academia as well.

> Even in the depth of the slump in 1932, Professor (now Lord) Robbins produced an Essay on the Nature and Significance of Economic Science, widely acclaimed, defining economics as "The science which studies human behaviour as a relation between ends and scarce means which have alternative uses". As the depression dragged on, the failure of the system to employ a large part of its means for any end at all became more and more painfully obvious. (Robinson 1964, p. 3)

Despite the initial hesitation, the impact of the Great Depression was so profound that it provoked a revolution in economics, both in practice and theory. Keynes had already announced this shift in the previous decade, and at this juncture, the catastrophic state of capitalist economies stood in stark contrast to the strong performance of the Soviet Union.

On the political front, the crisis created space for what Kalecki and Kowalik termed a 'crucial reform', a movement toward greater state intervention in the economy to fill the demand gaps that characterized and worsened the depression.

> The turning point was the crisis of 1929–33, which shook the foundations of the capitalist system. Its failures contrasted with the progress of the economy of USSR, which at that time was developing rapidly. The period of "crucial" reform of capitalism began, especially in the two leading capitalist countries which had been most strongly affected by the crisis, Germany and the USA. With initially fairly strong opposition from the grand bourgeoisie, capitalist governments set about protecting the foundations of their system from the threat of mass unemployment. What is quite typical, though, is that this programme of improving the capitalist economy consisted, not in its planned control, but in government intervention to fill the gap of insufficient demand and to organize additional employment. (Kalecki and Kowalik 1991, pp. 471–472)

This movement toward greater state intervention — also identified by Polanyi as a 'great transformation' — began in socialist Russia, advanced in fascist countries and liberal democracies during the 1930s, and would later consolidate across various nations through post-war Keynesianism.

> In the early thirties, change set in with abruptness. Its landmarks were the abandonment of the gold standard by Great Britain; the Five-Year Plans in Russia; the launching of the New Deal; the National Socialist Revolution in Germany; the collapse of the League in favor of autarchist empires. While at the end of the Great War 19th-century ideals were paramount, and their influence dominated the following decade, by 1940 every vestige of the international system had disappeared and, apart from few enclaves, the nations were living in an entirely new international setting. (Polanyi 2001, p. 24)

To deal with the consequences of the Great Depression, various countries were already adopting countercyclical policies, albeit without solid theoretical grounding. Nonetheless, it should be noted that Keynesian ideas were already present in the public debate, and Keynes himself visited the United States twice, in 1931 and 1934. *On the second, Keynes met Roosevelt, and most of the architects, as well as some of the critics, of the 'New Deal'. The influence of his presence and writing on the first phase of the 'New Deal' has been underestimated* (Skidelsky 2010, p. 33)

As Keynes had already indicated in the previous decade, the movement within economic science was also heading toward moving away from liberal principles. Finally, in 1936, with the publication of 'The General Theory of Employment, Interest and Money', economic theory acquired a robust foundation for this new mode of state intervention in the economy.[11]

This movement toward increased state intervention would consolidate with the advent of the Second World War, due to the necessity of organizing the economy for the war effort. As noted by Kalecki and Kowalik (1991, p. 472), *The Second World War accelerated the 'crucial' reform process. Government intervention in the expansion of markets became an institution.* Thus, the Keynesian theory that had gained traction in the interwar period would be elevated to orthodoxy following the Second War.

> The new doctrine was stoutly resisted; controversy was still turbulent in 1939. War-time experience of full employment provided a crude illustration of Keynes' thesis, and when post-war reconstruction was being discussed his theory was enthroned as the new orthodoxy. (Robinson 1964, p. 4)

At this point, it is important to emphasize certain distinctions between Keynes's contribution and the so-called 'Keynesians', who came to dominate public discourse and economic policymaking in the postwar period. For these economists, the economy would tend toward a full-employment equilibrium in the long run, so that short-term involuntary unemployment would be caused by rigidities, thereby justifying the adoption of corrective economic policies to accelerate the return to equilibrium. Keynes, on the other hand, argued that there is no inherent tendency toward full employment (regardless of whether or not wage and price rigidities exist),[12] which justifies the need for an active and permanent economic policy aimed at the better utilization of society's available

[11] *Keynes moved from problems to analysis and from analysis to proposals for action without allowing his judgement to be inhibited by some preconceived view of the principles that should govern state intervention. Yet there is a consistent view of the state and its duties that emerges from his work and is given fullest and most coherent expression in 'The End of Laissez-Faire'*. (Cairncross 1978, pp. 38–39).

[12] In Chapter 3 of the General Theory, Keynes (2018, p. 24) explicitly states that the assumption *that the money-wage and other factor costs are constant per unit of labor employed* was merely a simplification "*introduced solely to facilitate the exposition.*"

resources. This divergence led Joan Robinson to coin the term 'bastard Keynesians' to refer to those economists (Robinson 1962).[13]

Despite the adoption of economic policies based on (what we regard as) a distorted interpretation of Keynes, as well as eventual technical limitations and ethical shortcomings of governments, it is precisely during the (specific) postwar period — when state intervention in the economy was more widely disseminated — that the global economy experienced its best performance.[14] Through different forms of intervention that varied across countries and subperiods, the role of the state was central to this process.

In addition to this more active role played by States at the national levels, the geopolitical landscape of the Cold War prompted the United States to foster an international environment of growth and to tolerate — and even promote — the development of other nations.[15] In this context, Western capitalism experienced its most prosperous phase, the so-called 'Golden Age'.

Between 1950 and 1973, even with the highest population growth rates ever recorded, global per capita GDP grew at an average rate of 2.9 per cent per year in real terms. The outcome was even more remarkable for the major losers of the Second World War — Japan and (Western) Germany — whose per capita GDP grew, on average and in real terms, by 8 per cent and 5 per cent per year, respectively (Maddison 2001).

> By a mixture of good luck and not too bad management, unemployment was kept very low (by pre-war standards) in North-West Europe for fifteen years after the war. Each recession in the United States raised alarms which passed again. The economic miracles in Germany, France, Italy and Japan disconcerted the critics and astonished even the supporters of private enterprise. A new ideology has vaguely emerged, with very little positive intellectual content, beyond: Capitalism works, doesn't it? (Robinson 1964, pp. 4–5)

However, the very prosperity of the post-war era engendered economic and political changes that would lead to its decline. On the international front, socialism began to show relative weakness from the 1970s onward, while the resurgence of international capital flows (which had dried up in the 1930s) curtailed the degrees of freedom available for national monetary policies. The reconstruction of European and Japanese productive capacities, alongside the industrialization of new countries, intensified global

[13] As Keynes indicates in the title of the General Theory — *placing emphasis on the term general* (Keynes 2018, p. 3) — and highlights in the very first chapter, his analysis addresses the general case of monetary capitalist economies, in which the underutilization of productive resources is the norm. The so-called "bastard Keynesianism", which corresponds to the Neoclassical Synthesis, originates in Hicks's 1937 systematization of the General Theory in his paper "Mr. Keynes and the Classics: A Suggested Interpretation", and is further developed through various contributions, such as Modigliani's 1944 "Liquidity Preference and the Theory of Interest and Money", and Samuelson's textbook "Economics: An Introductory Analysis" (1948) — the most influential reference of the synthesis. This approach distorts and narrows Keynes's original contribution by confining his analysis to exceptional cases such as deep recessions or rigidities in prices and wages.

[14] We do not intend to make generalizations about the competence or ethics of governments. It was Keynes (1926, p. 275) who spoke of government corruption and incompetence in the 18th century, while reflecting on the factors that help explain the rise of liberalism, and Robinson (1964, pp. 4–5) who described postwar economic policies as a case of "not too bad management". The central aim here, given the analysis of the evolution of the role of the state in the economy, is to recognize its central importance.

[15] In addition to a general environment of low interests, fixed exchange rates and tolerance for protectionist policies and capital controls, the United States extended to some countries (such as those in Western Europe and Japan) what has been called a "development by invitation"— i.e., military and financial support, privileged access to the American market, favorable exchange rates, and technical assistance missions. On this, see Wallerstein (1979) and Medeiros and Serrano (1999).

competition and raised new challenges for the United States' external accounts, which began to deteriorate in the 1960s, eventually leading to the end of dollar convertibility to gold under the Bretton Woods framework (Arrighi 1996; Frieden 2008).

Domestically in the main capitalist economies, the period of high growth and low unemployment increased the bargaining power of the working class, which began to demand wage increases surpassing productivity gains (which were slowing). This raised the labor share in national income and increased unit labor costs. The outcome was both a compression of profits and an acceleration of prices from the late 1960s (Barros and Bastos 2025).

This inflationary trend, though preceding the oil shocks, was catalyzed by them. In parallel, governments across capitalist countries adopted stop-and-go policies to curb inflation and adjust external balances. The result was a scenario of economic stagnation coupled with rising prices — the so-called 'stagflation'.

Beyond these economic changes induced by prosperity itself, sustained low unemployment rates triggered political shifts by structurally enhancing workers' bargaining power (Stirati 2001). In this regard, the case of the United States is emblematic: in addition to the strengthening of unions and various political organizations, there was considerable unrest within civil society, marked by protests of student movements and advocating for civil rights, women's liberation, countercultural expressions such as the hippie movement, and widespread opposition to the Vietnam War.

The movement in favor of economic liberalism had been developing since the 1930s (when it opposed the New Deal), and now, amid political and economic instability, it saw an opportunity to regain influence in public debate and economic policy-making (Phillips-Fein 2009). The ascension of conservative governments — such as those of Reagan and Thatcher — and of monetarism, led by Milton Friedman, must be understood within this context.[16]

Friedman offered a clear and direct diagnosis for stagflation: the government was to blame. Excessive government spending, financed by rapid monetary expansion, generated inflation. The dynamic responses of economic agents and the monetary authority's need to fight inflation would inevitably lead to stagnation, producing the observed scenario.

> At first, monetary growth stimulated production but had little effect on prices. (…) As rapid monetary growth continued, the pressure of demand raised prices as well as production. (…) The only way to make an expansion of this kind last is to continue to accelerate monetary growth. However, that would produce still more rapid inflation. To avoid this consequence, the Federal Reserve has already sharply reduced monetary growth (…).
>
> The tapering off of monetary growth, like the initial monetary expansion, will at first affect production more than prices. Prices and wages, now set in the light of anticipations of inflation, will continue to rise. Inflation has a momentum of its own; it cannot be turned off like a water tap. With lower monetary growth, total spending will not be sufficient to support these higher prices at full employment. **This will check the rise in prices somewhat**

[16] According to Harcourt (1987, p. 758), the prominence of "bastard Keynesianism" would be fundamental in this process, since *just because the neoclassical synthesis version dominated the profession when the monetarist counterrevolution came to prominence in the late 1960s and early 1970s, Keynesians were weakened in their fight back because they had already, unnecessarily and illegitimately, conceded the framework of the approach within which the battle was to be fought.*

> **and produce some unemployment**. Prices will rise less than anticipated, thus discouraging production and employment. (Friedman 1966, pp. 1–2, our emphasis)

If the government is to blame for inflation, then the solution lies in reducing the role of the state in the economy — that is, a return to laissez-faire.[17] In this sense, the monetarist framework recommends fiscal austerity and a stable, rule-based monetary policy.

Although monetarism acknowledges that nominal variables may affect real variables, this effect occurs only in the short run, due to agents' monetary illusion. In the long run, unemployment converges to the natural rate. The latter, determined solely by supply-side factors within the Walrasian general equilibrium framework, would be the only one compatible with price stability (Friedman 1968). Any temporary attempt to reduce unemployment below this rate would generate inflation; persistent attempts would lead to accelerating inflation, as seen in the 1970s.

Thus, according to monetarism, in addition to maintaining stable economic policies, governments should make labor markets more flexible and curb union power, as this would reduce the natural rate of unemployment and thereby open the possibility of lowering actual unemployment without generating inflationary pressures.

> (…) we should adopt stable monetary and fiscal policies and seek to make the labor market as free as possible. Government measures are the primary cause of unnecessary unemployment — particularly minimum-wage laws and measures granting special immunities to trade unions. (Friedman 1972, p. 75)

Although monetarism has faced criticism in subsequent decades, some of its core tenets — such as the concept of a natural rate of unemployment and the revival of the classical dichotomy in the long run — still underpin the theoretical framework of today's economic mainstream, the so-called New Consensus Macroeconomics.[18]

While the post-war period witnessed a notable retreat from laissez-faire principles — ushering in an era of considerable prosperity — these principles would re-emerge with renewed strength from the 1970s onward, albeit rebranded and incorporating elements of the so-called 'Keynesian revolution'. In this sense, what occurred was not the end of liberalism, as the titles of Keynes's (1926) and Robinson's (1964) papers had suggested, but rather a temporary eclipse.

5. There is No Consensus between Keynes and the Laissez-Faire

At the end of the 20th century, a new school of economic thought rose to prominence in the mainstream, aiming to achieve a synthesis of contributions from various theoretical traditions. Therefore, this school called itself the 'New Consensus in Macroeconomics'[19] (Goodfriend 2007; Romer and Romer 2002; Taylor 2000; Woodford 2009).

[17] *The Federal government is the engine of inflation—the only one there is*, and thus, *There is one and only one cure for inflation: for the Federal government to spend less and create less money* (Friedman 1978, p.80).

[18] *The end of the 1970s and the beginning of the 1980s saw the emergence of an important new consensus among policymakers about the functioning of the economy and the effects of policy. The natural-rate hypothesis, with its rejection of a long-run tradeoff between unemployment and inflation, provided the guiding framework of the consensus*. (Romer and Romer 2002, p.33)

[19] The label is certainly ambitious; however, as Taylor (2000, p. 90, our emphasis), acknowledges: ***It would be an exaggeration to say that a consensus now exists*** *in advanced research about how macroeconomics should evolve in the future. (…) Nevertheless, at the practical level, a common view of macroeconomics is now pervasive in policy research projects at universities and central banks around the world.*

From the so-called 'Neoclassical Synthesis,' the New Consensus (NC) retained the notion that current output is determined by aggregate demand due to price rigidities. This idea — in our opinion, based on a misinterpretation of Keynes — was theoretically grounded by the New Keynesian school through micro foundations.

A central element of the NC, also derived from the New Keynesian contribution, is the concept of the Non-Accelerating Inflation Rate of Unemployment (NAIRU). While this concept has its origins in Friedman's natural rate of unemployment, it diverges in that it applies to non-competitive markets and is therefore compatible with the existence of involuntary unemployment. Similarly, the NC adopts from Neoclassical Theory the concept of potential output (determined solely by the supply side, based on factor endowments and productivity dynamics), yet it diverges by adjusting the efficient use of productive factors to the levels of utilization that do not accelerate inflation.

Furthermore, the NC incorporates the DSGE (Dynamic Stochastic General Equilibrium) modeling framework from the Real Business Cycle school, alongside the microeconomic foundations and rational expectations hypothesis from the New Classicals. It is important to note that, whereas Friedman's adoption of adaptive expectations allowed for monetary illusion and a short-run breakdown of the classical dichotomy, the use of rational expectations in the NC significantly restricts this possibility. Consequently, price rigidity becomes essential in explaining why current output is determined by aggregate demand.

Aggregate demand, in this theoretical structure, is negatively related to the real interest rate. This relationship, derivable from the first-order condition of intertemporal utility maximization, implies that lower real interest rates stimulate higher demand for goods and services (Taylor 2000).

According to this view, monetary authorities are tasked with managing the nominal interest rate — considering inflation — to influence the real interest rate and, through it, manipulate aggregate demand to contain inflationary pressures. This entails aligning the market interest rate with the natural interest rate, thereby equating current output with potential output.[20]

From this rationale, the widely adopted Taylor Rule for monetary policy emerges. This rule states that whenever inflation is above target (or, similarly, when current output exceeds potential output, or unemployment falls below the NAIRU), monetary authorities should raise the real interest rate (by increasing the nominal rate, given the inflation) to stabilize markets and curb inflation. The very adoption of such rules is said to enhance central bank credibility, influence agents' expectations, reduce the employment costs of inflation control, and lower macroeconomic volatility (Goodfriend 2007).

It should be emphasized that this policy rule presupposes an accelerationist Phillips Curve, according to which inflation (or deflation) accelerates whenever unemployment is below (or above) the NAIRU. This relationship is directly derived from Friedman's work, albeit using the NAIRU in place of the natural rate of unemployment and rational expectations instead of adaptive ones.

[20]This proposition can also be traced back to – Wicksell and – Friedman.

> Thanks to Wicksell, we are all acquainted with the concept of a "natural" rate of interest and the possibility of a discrepancy between the "natural" and the "market" rate. (…) The monetary authority can make the market rate less than the natural rate only by inflation. It can make the market rate higher than the natural rate only by deflation. (Friedman 1968, p. 7)

Another core element of the NC, aligned with Friedman's contribution, is the understanding that fiscal policy is slow, inefficient, and vulnerable to political manipulation. Therefore, it should be subordinated to a logic of austerity.[21] Moreover, akin to Friedman's view, the NC advocates for labor market flexibilization to reduce the NAIRU (or the natural rate of unemployment), thereby enabling a reduction in current unemployment without accelerating inflation.

Of course, a comprehensive account of this school of thought lies beyond the scope of this paper. Nevertheless, this brief overview allows one to identify the monetarist origins of the NC's main policy prescriptions. In summary, the NC recommends fiscal austerity, rule-based monetary policy focused on inflation control, and labor market deregulation.

Alternatively, the post-Keynesian (PK) approach, situated within the heterodox field, *extends and generalizes the seminal ideas that were developed by the radical followers of John Maynard Keynes* (Lavoie 2014, p. 4). As there is NO consensus between Keynes and the Laissez-Faire, *While Post-Keynesian economists and their heterodox colleagues will recognize the dynamism imparted by entrepreneurship in a capitalist system (…), they question the wisdom of blindly relying on markets* (Lavoie 2014, p. 24).

Drawing on the contributions of Keynes (and Kalecki), the PK approach adopts the principle of effective demand. Accordingly, output is determined — both in the short and long run — by effective demand, regardless of any form of price rigidity. Since supply adjusts to demand, it becomes meaningless to attribute inflationary pressures to excess demand. From this perspective, the core of inflation is fundamentally shaped by the dynamics of production costs (Lavoie 2014).

Hence, different levels of output and employment can be consistent with price stability, and the notion of a natural rate of unemployment (or NAIRU) is rejected. From this perspective, although labor market flexibilization may help control inflation, it does so by suppressing wage growth through the weakening of workers' bargaining power, reducing their well-being, and leading to income concentration (Setterfield 2006). Moreover, income concentration itself reduces the marginal propensity to consume of the economy, negatively affecting demand and output levels.

Since effective demand determines output levels, this approach advocates active fiscal policy — given its large impact on demand through significant fiscal multipliers — as a means to counteract recessions, achieve full employment, and accelerate growth (Serrano and Braga 2022).

Conversely, due to the low sensitivity of consumption and investment to short-term interest rates (Cynamon, Fazzari, and Setterfield 2013), as well as their distributive effects (Lofaro, Matamoros, and Rochon 2024), some PK authors argue that monetary policy should not be used for fine-tuning the economy. This perspective has given rise to the so-called 'parking-it' approach to monetary policy, developed by Rochon and Setterfield (2007, 2008).

A comparative analysis reveals stark differences in theoretical assumptions, economic analysis, and policy recommendations between the post-Keynesian and New Consensus approaches. Focusing solely on policies, one notes that the NC advocates fiscal austerity,

[21]Friedman is unequivocal: *we cannot and should not use fiscal policy for fine-tuning the economy* (Friedman 1978, p. 81).

rule-based and inflation-targeting monetary policy (hence also 'austere'), and labor market deregulation — all of which are clearly aligned with the laissez-faire principles criticized by Keynes.

In contrast, the PK framework advocates active fiscal policy aimed at achieving full employment, alongside a monetary policy that pursues broader objectives beyond inflation control, such as external balance, employment levels, and distributive outcomes. It also opposes excessive labor market deregulation, given its adverse effects on workers' well-being, on income distribution, and output levels.

In retrospect, the post-Keynesian approach demonstrates a closer alignment with the policy practices of the post-war period, albeit not a complete one, whereas the New Consensus agenda is more closely associated with the economic policies of 1920s England. The latter has undeniably dominated economic discourse and practices in the last decades, a period widely characterized by many authors as neoliberal. Unsurprisingly, this era has witnessed lower growth rates compared to the post-war period and a clear trend of income concentration. The principles of laissez-faire have re-emerged, along with their associated negative consequences.

6. Conclusion

This paper initially sought to contextualize the writing of 'The End of Laissez-Faire' in 1920s Europe, marked by poor economic performance. The adoption of liberal policies and their consequences — particularly in the United Kingdom — not only motivated Keynes's pamphlet but also became the target of his academic and political critique at that time.

Thus, a century ago, Keynes set out to identify the historical and philosophical origins of liberalism, examine its rise, and ultimately criticize it while proposing a constructive agenda to improve the well-being of societies. In this regard, his stance was unambiguous: neither self-regulating capitalism nor its complete (or near-complete) abolition, but a middle path — a well-managed capitalism that acknowledges the merits of liberalism while recognizing its limitations.

Keynes thus advocated for an active role of the state in the economy. In particular, in that pamphlet, he proposed greater control over money and credit and coordination between aggregate saving and investment to improve the employment of resources. He also championed — contributing significantly to the development of national accounting systems and the very advent of macroeconomics — the systematic collection and publication of economic data.

'The End of Laissez-Faire' was prophetic. In the decades following Keynes's contributions, states around the world began to intervene more actively in their economies, especially addressing demand shortfalls and developing welfare systems. Unsurprisingly, the post-war period saw the highest growth rates in the history of capitalism and a significant reduction in income inequality.

However, this was not 'The Final End of Laissez-Faire'. Beginning in the 1970s, a new wave of liberalism emerged, initially represented by Friedman's monetarism and continuing today in the form of the New Consensus in Macroeconomics. The consequences of this resurgence have included slower economic growth, increased income concentration, and a deepening environmental crisis.

This is why Keynes's 'The End of Laissez-Faire' remains strikingly relevant today. In light of the world's pressing challenges — from structural inequality to climate change — the need for a more active role for the state in the economy becomes essential. In this sense, the post-Keynesian agenda presents itself as a solid and viable alternative to mainstream economic theory, providing a coherent framework for addressing these complex issues. We thus suggest reclaiming and updating Keynes's vision through the PK lens to reimagine macroeconomics in the 21st century in pursuit of a more sustainable, prosperous, and equitable society.

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ORCID

Luciano Barros http://orcid.org/0000-0002-4685-1607
Louis-Philippe Rochon http://orcid.org/0000-0002-8542-7497

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