

RAFFAELE MATTIOLI LECTURES

In honour of the memory of Raffaele Mattioli, who was for many years its manager and chairman, Banca Commerciale Italiana has established the Mattioli Fund as a testimony to the continuing survival and influence of his deep interest in economics, the humanities and sciences.

As its first enterprise the Fund has established a series of annual lectures on the history of economic thought, to be called the Raffaele Mattioli Lectures.

In view of the long association between the Bocconi University and Raffaele Mattioli, who was an active scholar, adviser and member of the governing body of the University, it was decided that the lectures in honour of his memory should be delivered at the University, which together with Banca Commerciale Italiana, has undertaken the task of organising them.

Distinguished academics of all nationalities, researchers and others concerned with economic problems will be invited to take part in this enterprise, in the hope of linking pure historical research with a debate on economic theory and practical policy.

In creating a memorial to the cultural legacy left by Raffaele Mattioli, it is hoped above all that these lectures and the debates to which they give rise will prove a fruitful inspiration and starting point for the development of a tradition of research and academic studies like that already long established in other countries, and that this tradition will flourish thanks to the new partnership between the Bocconi University and Banca Commerciale Italiana.

Cambridge University Press

978-0-521-18975-0 - The Making of Keynes' General Theory

Richard F. Kahn

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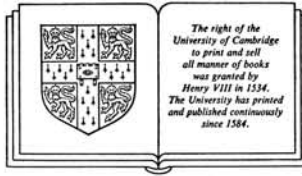
THE MAKING OF KEYNES'
GENERAL THEORY

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RAFFAELE MATTIOLI FOUNDATION

Richard F. Kahn

*THE MAKING OF KEYNES'
GENERAL THEORY*



CAMBRIDGE UNIVERSITY PRESS

CAMBRIDGE

LONDON NEW YORK NEW ROCHELLE

MELBOURNE SYDNEY

Cambridge University Press
978-0-521-18975-0 - The Making of Keynes' General Theory
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CAMBRIDGE UNIVERSITY PRESS
Cambridge, New York, Melbourne, Madrid, Cape Town,
Singapore, São Paulo, Delhi, Tokyo, Mexico City

Cambridge University Press
The Edinburgh Building, Cambridge CB2 8RU, UK

Published in the United States of America by Cambridge University Press, New York

www.cambridge.org
Information on this title: www.cambridge.org/9780521189750

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Banca Commerciale Italiana, Milano, Italy

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First published 1984
First paperback edition 2011

A catalogue record for this publication is available from the British Library

Library of Congress Catalogue Card Number: 82-19761

ISBN 978-0-521-25373-4 Hardback
ISBN 978-0-521-18975-0 Paperback

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FOREWORD

The problems that confronted the economic systems during the Seventies' and the difficulties encountered by so-called Keynesian policies have not dimmed interest in the figure of Keynes. On the contrary, they have helped to keep the work of the great economist firmly at the centre of the economic discussion.

The analytical frame of reference of Keynesian policies lay in the macroeconomic model that emerged from the traditional interpretation of Keynes' thought. But when the first symptoms of crisis appeared, Keynes' ideas were not ousted by those of other economists. What happened was a process of reinterpretation of his theories, which became the focus of renewed and closer meditation.

This process brought out once again the depth and range of Keynes' theoretical contribution, many aspects of which, overlooked in the overschematisation of the IS-LM model, were pursued with great interest.

One example is the theme of uncertainty, which played such an important part in the formation of the *General Theory* and on the consideration of which Keynes had explicitly based the line of demarcation between his theory and that of the classical economists.

Another is the theme of effective demand which, despite the fact that it was the pillar on which the Keynesian theory rested, had been relegated to a secondary role in the more fashionable macroeconomic models.

In the past few years the debate on the reinterpretation of Keynes' ideas, which reached its height in the Seventies, seems to have been less intensive.

But one has to admit that Keynes is still at the centre of the most important theoretical developments which in recent years have devoted increasing attention to the analysis of expectations, a point which is at the heart of Keynes' theoretical approach.

And so the celebration this year of the centenary of his birth

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has not just been a passing rediscovery of Keynes but rather the occasion for a deeply felt tribute to an economist whose ideas are as fresh and original as ever.

In inviting Lord Kahn to give the second course of lectures in memory of Raffaele Mattioli the Scientific Committee of the Mattioli Lectures wanted his testimony to take us through an extremely interesting chapter in the history of economic thought and to reconsider the roots of Keynes' theory, too often forgotten in the cut-and-thrust of the debate that has raged during these years on macroeconomic theory and policy.

Lord Richard Kahn needs no introduction and it would be out of place as well as presumptuous to outline his claims to our attention. We were all more or less brought up on his celebrated article of 1931, 'The Relation of Home Investment to Unemployment'¹ and his important contributions to various fields of economic theory are well known.

However, it gives me great pleasure to endorse a sentiment and a memory of Lord Kahn's common to all the sponsors of the Raffaele Mattioli Lectures: the long-standing and deeply-felt links with Piero Sraffa and, through him, with the Bocconi University, Cambridge and Milan.

I do wish to express my warmest thanks to Lord Kahn for accepting the invitation to give these Lectures and for devoting so much time and energy to preparing them both in the spoken version and in the final form in which they appear in this volume.

The original title of the course of lectures was 'The Development of Theories of Employment and Prices'.¹ In rewriting them for this volume Lord Kahn has chosen to concentrate on the evolution of Keynes' thought up to the publication of the *General Theory* and not to go into its subsequent developments, on which

1. *Economic Journal*, June 1931, pp. 173-98; reprinted in RICHARD KAHN, *Selected Essays on Employment and Growth*. Cambridge: Cambridge University Press, 1972, pp. 1-27 (Italian version edited by Gabriele Pastrello with the advice of Michele Salvati: RICHARD KAHN, *L'occupazione e la crescita*. Torino: Giulio Einaudi Editore, 1976, pp. 3-28).

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he had made many most interesting comments in the course of his oral exposition.

A happy choice, in my view, not only because it enabled him to throw more light on the roots of Keynes' thinking and its links with the Cambridge tradition but also, and more importantly, because it takes the reader back to the climate of the Thirties in which Keynes' ideas took shape. We all, and I think especially the younger among us, need to be reminded of that Thirties' atmosphere, of the sense of anguish and despair at a situation with which economic policy was utterly unable to cope as solutions could be found only in a courageous quest for new theoretical approaches.

In that crucial moment what was written in Cambridge was without doubt a seminal page and Lord Kahn has performed a valuable service in conjuring up the Cambridge atmosphere of those days by calling to mind not only its great men but also that indefinable tissue of circumstances that goes to make a great centre of culture.

Since the quarter century 1948-1973, when the world experienced economic growth at hitherto unheard-of rates, many past problems have resurfaced: the extinction or blunting of the forces of economic growth, the triggering of inflationary spirals, the grievous problems of unemployment, the reappearance on the international scene of severe signs of financial instability, especially in exchange rates and debt structures.

The context is undoubtedly different from what it was then. One need only consider the fact that present international debt problems are largely attributable to extensive borrowing by developing countries on international markets in a general context of international trade flows that have a momentum unthinkable in the Thirties. However, despite the differences in general pattern, there is no lack of likenesses: the recent resurgence of protectionist tendencies should be enough to warn us that the shades of the past are still with us.

The dip into the climate of the Thirties and the re-evocation of the courageous response that theory brought to bear on the

1. See also Lord Kahn's Preface in this volume, p. xvii.

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problems of those tormented years are fraught with meaning for us today.

Theory, as the great masters have taught us, must continually be refashioned by historical research. Lord Kahn's Lectures are a wonderful example of how the history of ideas can be made to yield the roots of theory by tracing the connections between the course of events and the appearance of ideas and simultaneously by applying theories to events in order to explain them.

The content and pervading spirit of this volume are certainly worthy of the man in whose memory these Lectures have been instituted. Raffaele Mattioli, as a banker – and he was a banker in the true sense of the term at a time when banking was not fettered by all the constraints that hamper it in our country today – was always alert to the problems of his time but he combined the gifts of a great entrepreneur with an awareness of culture and above all of history.

This volume will be followed shortly by two others that are in press: one by Professor Franco Modigliani on 'The Evolution of Monetary Theory and the Debates on Stabilisation Policies' and the other by Professor Charles P. Kindleberger, who deals with 'Economic Laws and Economic History'. The series is intended to include the following volumes currently in preparation: the lectures of Professor Peter Mathias on 'The Industrial Revolution in England' and those of Professor Erik F. Lundberg on 'The Development of Swedish and Keynesian Macroeconomic Theory and its Impact on Economic Policy'.

The range of interests spanned by the Lectures listed above reminds me of Raffaele Mattioli's library. A stupendous library whose riches included books on the history of economic thought – many of which are first editions, a real joy for a bibliophile –, works on the latest economic theories, works of literature, and where the leaven of history was ever present. In a sense, while saying little about him, because of the discretion and reserve with which we surround our inmost feelings, with these Lectures we enter the library of the man whose memory we cherish. And this is the finest way of getting to know him.

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I would end by expressing the profound gratitude of the Bocconi University to Banca Commerciale Italiana, the sponsor of these Lectures, and to all members of the Scientific Committee for their valued contributions to the organization of this venture.

It is a venture in which numerous leading men of learning have taken part, witness the wide-ranging discussion reported in this volume. We are committed to continuing on the course on which we have embarked and shall gradually add further note-worthy volumes to this series.

INNOCENZO GASPARINI
Rettore
Università Luigi Bocconi

EDITORIAL FOREWORD

In this volume we have supplied footnotes as and when needed, to help the reader follow through the various topics dealt with in these Lectures.

The organisation of some parts of the book call, however, for a few general explanations, which we give hereunder:

CHRONOLOGY. This is the briefest factual record of some salient events, circumstances, authors and studies connected with the formation of Keynes' ideas that recur in the course of the Lectures.

LECTURES. As Lord Kahn recalls in his Preface, the final text of the Lectures that appears here differs in several respects from the spoken version. Most importantly, allusions to the developments of Keynes' ideas after the publication of the *General Theory* and to current problems of economic policy, which had stimulated many contributions to the discussion after the Lectures, have been dropped.

BIBLIOGRAPHIC REFERENCES. The volume contains numerous references, which for works of authors other than Keynes often mention several editions of the same book. It has therefore been decided to include in the footnotes as well as in the general bibliography (pp. 277-94) the full bibliographic information on the works quoted, using abbreviations only in the body of each Lecture. In the references, unless otherwise stated, we have quoted the first edition.

DISCUSSION. The text of the discussion that appears in this volume does not include the contributions referring solely to topics subsequently dropped from the final version of the Lectures. In the published contributions there remain a few references, which we saw no reason to cut, to the parts that have been dropped or to comments Lord Kahn made in the course of his Lectures that do not appear in this final version.

COLLECTED WRITINGS OF JOHN MAYNARD KEYNES. For the works of Keynes, references are given in abbreviated form with the indi-

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cation KEYNES, followed by the number of the volume of the *Collected Writings of John Maynard Keynes*, published for the Royal Economic Society. The complete list, updated to the publication date of this book, is given on pp. 269-75.

BIBLIOGRAPHY. Includes all the works quoted in the volume. In addition, it gives the specific studies of John Maynard Keynes referred to and indicates the edition and the corresponding volume of the *Collected Writings*.

ANGELO PORTA

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PREFACE

The six *Raffaele Mattioli Lectures* which I delivered in June 1978 at the Luigi Bocconi University are presented in this book in a completely rewritten form. I am most grateful for being allowed to make this transformation. Even the title has been changed from *The Development of Theories of Employment and Prices* to *The Making of Keynes' General Theory*.

In accordance with the wishes of the Trustees of the Raffaele Mattioli Foundation, the book is an exercise in the development of thought, culminating in the completion of Keynes' *General Theory*.

By stopping at that point I have been able, within reasonable compass, to deal more intensively than I did in my Lectures with the process of development.

In my Lectures I devoted a considerable amount of time to controversies provoked by the publication of the *General Theory* – right up to 1978 – and to the behaviour of an economy under conditions which Keynes, in the *General Theory*, had not envisaged, although when the occasion arose, he readily applied his fundamental concepts to the problems of an economy operating under the stress of the War. I also in my Lectures devoted some attention to the tragic mismanagement of the world's economies at the present time, partly attributable to disastrous misinterpretations of Keynes' teaching. All of this calls – if presented – for a quite separate book. And indeed many books, and many articles – usually highly controversial – have been written.

In the first two Lectures of this book I begin – in so far as relevant to my theme – with a few words about Locke, Hume, and Adam Smith, and somewhat more extensively about Malthus, Ricardo, and John Stuart Mill. Even Marshall takes up little space – and my treatment of him is based partly on Keynes' Obituary.

A young Keynes already makes his appearance in Sections 3 and 4 of the first Lecture as the adviser in 1912 and 1913 of

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Dennis Robertson in the writing of his pre-War (published 1915) book and of his first post-War book (1922).

After the first and second Lectures I deal exclusively with Keynes, and am thus able to treat in detail some aspects of the development of his thought. Between 1912 and 1935 it was completely transformed. A study of the transformation is truly an exercise in the development of thought.

In accordance with the wishes of the Trustees my Lectures delivered in Milan included a number of passages about personal relations, in which I myself figured prominently but by no means exclusively. I have in this book collected them all in the final Lecture.

Professor Joan Robinson and I were close collaborators in the discussion with Keynes. She helped me tremendously both in the preparation of the Lectures and in their transformation into this book.

To Donald Moggridge (Professor of Economics at the University of Toronto) I am indebted in a number of ways. Under the guidance of Professor Sir Austin Robinson, he has produced *inter alia* those magnificent Volumes XIII, XIV and XXIX in the Royal Economic Society edition of the *Collected Writings of John Maynard Keynes* (the series is set out on pages 269-75). The publication of these Volumes has led, and will continue to lead, to a vast output of books and articles on Keynes' thinking.

An article by Donald Moggridge in *History of Political Economy*¹ I have found especially helpful.

Moggridge's work on the Royal Economic Society edition means he has been devoting most of his spare time to Cambridge, England. I have benefited from the advice and encouragement of one who, for many years, has been immersing himself in Keynes' unpublished papers and correspondence.

He is now starting to work on a second official *Life of Keynes*.

1. DONALD E. MOGGRIDGE, 'From the *Treatise* to *The General Theory*: An Exercise in Chronology', *History of Political Economy*, Spring 1973, pp. 72-88.

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This book, like Keynes' books, is insular, and centred on Cambridge. The two most significant independent developments of thought parallel with Keynes took place in Stockholm, where they still continue, and on the part of Michal Kalecki, the great Polish economist.

In Section 1 of the third Lecture I quote from an article published by Professor Ohlin, the Swedish economist, and refer to the articles published by Ohlin in 1937. Recently Ohlin has stated that

it seems quite clear that apart from the very considerable influence of Wicksell on Keynes, any other influence of the Swedish work on Keynes's development from 1930 to 1936 is very uncertain.¹

Wicksell, the great Swedish economist of the turn of the century, plays a considerable part in Keynes' *Treatise* with his 'natural rate of interest', only to be discarded in the *General Theory*.²

Had I mentioned Kalecki at all I should have felt obliged to devote to him a considerable amount of space. Here again, as with the Swedes, but far closer to Keynes' thinking, was an independent development – by one isolated and remarkable individual. Remarkable in many respects, Joan Robinson describes how

he had taken a year's leave from the institute where he was working in Warsaw to write the *General Theory*. In Stockholm someone gave him Keynes' book. He began to read it – it was the book that he intended to write. He thought that perhaps further on there would be something different. No, all the way it was his book. He said: 'I confess, I was ill. Three days I lay in bed. Then I thought – Keynes is more known than I am. These ideas will get across much quicker with him and then we can get on to the interesting question, which is their application. Then I got up.' [. . .]

At the end of his life, Michal told me he felt he had done right

1. BERTIL OHLIN, 'Some Comments on Keynesianism and The Swedish Theory of Expansion before 1935', in DON PATINKIN and J. CLARK LEITH (eds.), *Keynes, Cambridge and 'The General Theory'*, Appendix III, Proceedings of a conference held at the University of Western Ontario. London: Macmillan, 1977, p. 163.

2. KEYNES, vol. VII, p. 242.

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not to make any claim to rivalry with Keynes. It would only have led to a tiresome kind of argument. Perhaps scepticism about my [Joan Robinson's] claim for him was due to the difficulty of believing that anyone was capable of taking this high line in our degenerate age.¹

I have enjoyed much help and encouragement from the Rector of the Bocconi University, Professor Innocenzo Gasparini. I owe an immense debt of gratitude to the Editor, Professor Angelo Porta. I have given him immense trouble. In addition to correcting numerous misprints in my text, he has made a large number of valuable suggestions for amendment. I owe to his scholarship and pertinacity great improvement in the bibliographical footnotes, and the bibliography itself.

The Bank's printer, Signor Martino Mardersteig (of the Verona firm Stamperia Valdonega), has played a most important part in simplifying the footnotes and providing such a beautiful text.

Dr Bernardo Crippa of the Bank, who was in charge of organising and publishing the 'Raffaele Mattioli Lectures', in addition to giving me encouragement, has also played a valuable part in the editing of the book. After the text of the book reached the Cambridge University Press there still remained a great deal of editing to be done – involving close co-operation with Dr Crippa, Professor Angelo Porta and Signor Mardersteig. My Cambridge editor, Mr Francis Brooke, has carried out a task of considerable difficulty with masterly skill; his patience has been inexhaustible. His scholarly suggestions for amendment have been most acceptable. Miss Lynn Chatterton, Production Controller of the Cambridge University Press, has also played an important part. I would also like to thank Mrs Alison Rowlatt, the indexer. In the background have stood the Raffaele Mattioli Foundation and the Banca Commerciale Italiana, represented by the Chairman, Dr Innocenzo Monti, and by Dr Bernardo Crippa.

1. Contribution by JOAN ROBINSON ('Michal Kalecki on the Economics of Capitalism') to ÉPRIME ESHAG (ed.), 'Michal Kalecki Memorial Lectures', *Oxford Bulletin of Economics and Statistics*. Special Issue, February 1977, pp. 7-18 (the quotation on pp. 8-9). Reprinted in JOAN ROBINSON, *Collected Economic Papers*, vol. v, Oxford: Basil Blackwell, 1979, pp. 184-96. The quotation will be found on p. 186.

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If we had been obliged to rely on the Anglo-Italian Postal Service, in its present sad state, operations would have been quite impossible. The Bank undertook the conveyance of letters, telex messages and typescript. In the London Branch I am indebted to the Management, and for the readily provided services of members of his staff.

I owe much to my Secretary, Mrs Verna Cole, and to Mrs Marlene Gillson, who have, patiently and uncomplainingly, coped with my dreadful handwriting. Finally I am indebted to the Bursars of my College for the use of our xerox machine and to those in our College Office who have so skilfully handled it.

I am proudly grateful to the Raffaele Mattioli Foundation, the Banca Commerciale Italiana, the Luigi Bocconi University, the Stamperia Valdonega and the Cambridge University Press for the publication of this book.

RICHARD F. KAHN
King's College, Cambridge

CHRONOLOGY

- 1842 Alfred Marshall's birth at Clapham, London, on 26 July.
- 1877 Alfred Marshall's marriage with Mary Paley in July.
 Arthur C. Pigou's birth at Ryde, Isle of Wight, England on 18 November.
 Publication, for private circulation, of *The Pure Theory of Foreign Trade, The Pure Theory of Domestic Values* by Alfred Marshall.
- 1879 First edition of *The Economics of Industry* by Alfred Marshall and his wife Mary (London: Macmillan).
- 1883 John Maynard Keynes' birth at Harvey Road, Cambridge on 5 June.
- 1884 Second edition of *The Economics of Industry* by Alfred Marshall and his wife Mary (London: Macmillan).
- 1890 First edition of *Principles of Economics* by Alfred Marshall (London: Macmillan).
 Dennis H. Robertson's birth at Lowestoft, East Anglia, on 23 May.
- 1907 Fifth edition of *Principles of Economics* by Alfred Marshall (London: Macmillan).
- 1909 Keynes' election to a Fellowship at King's College, Cambridge (his dissertation was published, in a revised form, as *A Treatise on Probability* in 1921).
- 1912 Publication of *Wealth and Welfare* by Arthur C. Pigou (London: Macmillan).
 Dennis H. Robertson started his *A Study of Industrial Fluctuation* (published 1915, London: P. S. King & Son).
- 1913 Publication of Keynes' first book: *Indian Currency and Finance* (London: Macmillan).
- 1920 Eighth (last) edition (few changes) of *Principles of Economics* by Alfred Marshall (London: Macmillan).
 First edition of *The Economics of Welfare* by Arthur C. Pigou (London: Macmillan).

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- 1921 Publication of *A Treatise on Probability* by John Maynard Keynes (London: Macmillan).
- 1922 Publication of *Money* by Dennis H. Robertson, with an Introduction by John Maynard Keynes (London: Nisbet & Co).
- 1923 Publication of *A Tract on Monetary Reform* by John Maynard Keynes (London: Macmillan).
 Publication of *Money, Credit and Commerce* by Alfred Marshall (London: Macmillan).
- 1924 Death of Alfred Marshall at Cambridge on 13 July.
 Second edition of *The Economics of Welfare* by Arthur C. Pigou (London: Macmillan).
 John Maynard Keynes started his *Treatise on Money* (finished in September 1930 and published at the end of the same year).
- 1925 Dennis H. Robertson finished his *Banking Policy and the Price Level*.
 John Maynard Keynes' marriage with Lydia Lopokova on 4 August.
- 1926 Publication of *Banking Policy and the Price Level* by Dennis H. Robertson at the beginning of the year (London: P. S. King & Son).
- 1928 Reprint of *Money* by Dennis H. Robertson (London: P. S. King & Son).
- 1929 Publication of *We Can Conquer Unemployment*, Liberal Party Manifesto, in March (London: Cassell), soon named the 'Orange Book'.
 Publication of *Can Lloyd George Do It?*, by John Maynard Keynes and Hubert D. Henderson, in May.
 Publication of the 'Government White Paper' on *Certain Proposals Relating to Unemployment (Memoranda)* in May (Cmd. 3331. London: His Majesty's Stationery Office).
 General Election on 30 May.
 Macmillan Committee on Finance and Industry appointed on 5 November.

CHRONOLOGY

- 1930 John Maynard Keynes finished his *Treatise on Money* on 14 September.
 Publication of *Treatise on Money* by John Maynard Keynes at the end of the year (London: Macmillan).
 Economic Advisory Council set up on 15 February (first meeting on 17 February).
 Committee of Economists of Economic Advisory Council appointed 24 July and reported on 24 October.
- 1931 Macmillan Committee reported in June.
 Cambridge 'Circus' from January to May.
 United Kingdom pushed off Gold Standard on 21 September.
- 1932 John Maynard Keynes started his *General Theory*.
- 1933 Publication of *The Theory of Unemployment* by Arthur C. Pigou (London: Macmillan).
- 1935 John Maynard Keynes finished his *General Theory*.
- 1936 Publication of *The General Theory* by John Maynard Keynes at the beginning of the year (London: Macmillan).
- 1946 Death of John Maynard Keynes at Firle, Sussex, on 21 April.
- 1948 Reprint of *A Study of Industrial Fluctuation* by Dennis H. Robertson (London School of Economics and Political Science).
 Reprint of *Money* by Dennis H. Robertson (revised with additional chapters, London: Nisbet & Co).
- 1949 Second edition of *Banking Policy and the Price Level* by Dennis H. Robertson (New York: Augustus Kelly; London: Staples Press).
- 1959 Death of Arthur C. Pigou at Cambridge, on 7 March.
- 1963 Death of Dennis H. Robertson at Cambridge, on 21 April.