

## **Belief in Austerity Policies**

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### **Abstract**

The purpose of this paper is to argue that awareness of epistemological issues is critical to understanding the crisis and the policy response, to challenging that understanding and to encouraging a radical policy shift. Because reason and evidence cannot be enough to establish a theory to be 'correct', economists must ultimately rely on belief in one theory or another. The crisis has demonstrated the shortcomings of mainstream economic theory. But a major source of continuing belief in its policy prescriptions arises from the fact that mainstream economists have been persuasive that their theories are scientific, *not* relying on belief. As a result their belief in the general reliability of markets to act in the social interest came to be widely shared. This belief continues to prevail in spite of the crisis, justifying austerity policies. There has been a strong argument against austerity on ideological and ethical grounds, but many have been persuaded by the mainstream position that this is separable from the economic arguments for austerity. Rhetoric in its narrow sense has played a crucial role in the cementing of beliefs which generate austerity policies and in the widespread support these have received. This paper focuses on the much more fundamental Smithian role of rhetoric (encompassing ideology) as integral to epistemology and accordingly to policy understanding and policy direction. The mainstream are convincing because their results are presented as scientific such that debate is diverted away to what are seen as the separable areas of ideology, power and ethics. The critique of austerity policies is therefore strengthened by a critique of this rhetorical (mis)representation of economic theorising.

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## **Introduction**

After the early fiscal stimulus as the crisis took hold, the dominant policy response since then, particularly in Europe, has been fiscal austerity. Belief in this policy stance became conventional, on a par with belief that inflation is a monetary phenomenon, being held for example by the major political parties in the UK. But there were dissenting views. On the one hand, a range of social protests against austerity policies focused on the moral issue that the cost of the crisis was being borne by the weakest members of society, while the bankers who were seen to have caused the crisis continued to sustain their wealth without substantive penalty. On the other hand a broad coalition of economists under the banner of Keynesianism produced good reasons, along with supportive historical evidence, why austerity policies would be self-defeating (worsening the fiscal position) and damaging to growth. Arguments continue to be developed and publicised by a range of groupings of economists, such as Economists Against Austerity in the UK.

The community arguing against austerity has gained in strength and has attracted wide attention. Indeed the policy landscape now in the wake of the crisis is quite different from the ‘great moderation’ period, most notably in the recognition of interdependence between fiscal and monetary policy. Indeed actual fiscal policy did not necessarily match the austerity rhetoric. But there is no question that contractionary fiscal policy has in general had a huge impact, particularly in Eurozone countries like Greece. Nevertheless now that growth is resuming and budgetary problems waning, on however fragile a basis, the argument against austerity policies is more difficult to get across since it requires a counterfactual of higher and earlier growth under a hypothetical alternative expansionary fiscal policy. The belief in austerity policies as based on sound expert economic reasoning does not seem to have been shaken.

Why have Keynesians so far been unable to shake this belief? Two forces have been of fundamental importance in driving support for austerity: an ideological commitment to reducing the size of the state on the one hand and vested interests among those with financial power on the other. But the conventional support for austerity extended well beyond those who shared that ideology and even more so beyond the minority with financial power. The purpose of this paper is to explore the mechanisms by which belief in austerity policies became conventional, in order to understand the reception of the Keynesian critique. The paper will approach the question by considering the nature of knowledge in terms of belief, and the role of ideology, power and ethics in the building up of knowledge alongside reason and evidence. A focus will be put on the rhetorical power of mainstream economic policy being presented as the outcome of a technical scientific process distinct from ideology, power and ethics. The paper arrives at a conclusion in terms of broadening the range of argument against austerity to include a critique of mainstream scientism. This critique has been well developed more generally with respect to mainstream economics; the argument here is to apply it particularly to arguments for austerity.

## **Knowledge and belief**

It is well-established now that mainstream economics evolved by emulating physics (Mirowski 1989). The aim was to develop theories which were both internally logically consistent and testable against empirical evidence. According to logical positivism, such an aim marks out science from

non-science. Indeed prior to the emergence of logical positivism, the marginalist methodological approach started the shift of economics away from the class-based framework of Classical political economy towards a focus on the supposedly universal optimising behaviour of individuals within competitive markets. Marginalism required and thus promoted the increasing use of formal mathematics to such an extent that the deductivist formal mathematical method has come to define the discipline as far as mainstream economists are concerned.

According to this 'scientific' (indeed scientific) approach to economics, theory appraisal and policy prescription are matters of logic and evidence; there is no place for belief as far as economists are concerned. Inconsistently, beliefs do feature in agents' expectations in mainstream models, reflecting the subjectivity of expectations and the learning required to adjust expectations in the light of evidence. Agents' beliefs are particularly important with respect to the behaviour of state agencies; central banks are enjoined to behave in a consistent way which enhances credibility and thus the correctness of beliefs. But beliefs are constrained eventually to settle on the final equilibrium values which are identified by technical analysis. Were economists' beliefs to be analysed, they would similarly be constrained to converge on the correct model.

Mainstream arguments in favour of austerity policies accord with this view of economics as a technical subject (see Ball and Mankiw 1996 for a typical statement). Much of the discourse responding to the challenge posed by the crisis was conducted, not in terms of rethinking the reliance on formal models, but in terms of finding a better technical model (Lawson 2009). The underlying theoretical argument for austerity is a technical result of the formal structure of mainstream models which has not fundamentally changed. Given long-run aggregate supply at full employment, public sector expenditure crowds out private sector expenditure. Since markets are assumed to be more efficient than the state, growth is enhanced if public sector deficits are reduced, by raising taxes or reducing expenditure. Since taxes and government expenditure are both seen to distort growth-enhancing market efficiency, the preferred solution is reduced expenditure, i.e. austerity.

The argument for austerity has increasingly been expressed in terms of the assumption that financial markets have accepted the technical result that deficits crowd out private sector expenditure and reduce growth, such that they will factor it into the pricing of assets, including government debt, constraining the government to accept an austerity stance. This thinking was embedded in the Maastricht rules, limiting the size of deficits and public sector debt relative to GDP in order for fiscal policy not to interfere with the priority of controlling inflation through independent monetary policy. The force of the pro-austerity reasoning has been strengthened by the research findings of Riehart and Rogoff (2011), whose historical evidence of budgetary positions and growth rates confirmed the technical results. Reason and evidence are assumed to be sufficient for generating and accepting the austerity conclusion. Beliefs only enter into the policy arena once politicians input their political preferences (Colander 2002).

Yet even physical scientists talk in terms of belief, as in belief in global warming. This is a clear indication that there is too much uncertainty surrounding climate change to be able to demonstrate

definitively that global warming is occurring. The physical world is an evolving, complex, open system. Reason and evidence support the belief in global warming; but others find support for alternative beliefs. While promoters of the global warming view regard their critics as wrong-headed, nevertheless the matter is treated as one of belief, requiring persuasion to change from one belief to another. Pure deductive reasoning, built on premises which all agree to be true, is not enough; any deductive chain is vulnerable to premises not being reliably true. Pure inductive reasoning, extrapolating from past observations, is not enough; there is no guarantee that past structures and relationships will continue as before. Even in the physical sciences, then, arguments require belief – that premises hold true, or that structures and/or relationships will continue to hold – even when this cannot be demonstrated definitively.

This was Hume's (1739-40) thesis, having grappled with Cartesian deductivism and having specified the problem of induction, that knowledge rests on belief. This belief applies at a variety of levels, starting with a conventional belief in existence, but also incorporating belief that some theoretical propositions are reliable, on which to build other propositions. Hume, like Smith, adopted a Newtonian approach, whereby knowledge is built up through a process of abduction. Any resulting theory must be regarded as provisional since its premises may not apply to other times and places than those from which evidence is drawn. Even as explanation rather than prediction, a theory is provisional given the reliance on belief at various stages of reasoning. Knowledge is more reliable the more it draws on experience and on reason – the philosopher (scientist) is someone drawn to applying more reason than others, and thus to challenging conventional beliefs. But knowledge is always subject to some degree of uncertainty.

Keynes (1921) pursued Hume's agenda by exploring how we establish grounds for belief. He understood this as being an objective process, drawing on evidence and reason; anyone in the same circumstances, environment and psychological state would arrive at the same belief. But circumstances, environment and psychological state differ, such that, not only does the evidence brought to bear differ, but so do the conventional beliefs and intuition employed and also animal spirits. Beliefs therefore differ. Beliefs can be justified up to a point by reason and evidence. Thus the more different types of evidence support any belief, the greater the evidential weight. But what is admissible as evidence depends on judgement as to its relevance which depends on the underlying theoretical perspective and ultimately on belief (Dow 1995).

Critics of austerity policies have marshalled a compelling range of arguments challenging both the deductive and empirical elements of the case for austerity. For example Chick and Pettifor (2010) provide empirical evidence from a range of historical episodes in the UK which contradicts the mainstream arguments for austerity. They show in general that fiscal expansion has been associated with falling public sector debt, higher growth and lower interest rates. A key argument is that austerity cannot achieve its object of reducing public sector debt because of automatic stabilisers: austerity causes revenues to fall and expenditure to increase. Increasing expenditures on the other hand have a multiplier effect on incomes and thus on revenues, while reducing unemployment benefit and spending on social services. Similarly Herndon, Ash and Pollin (2014) provide a detailed critique of the evidence on the relationship between deficits and growth behind

the Reinhart and Rogoff thesis. These are just two examples of what would appear to be powerful direct challenges to the arguments for austerity on the same ground of reason and evidence. So why does the argument for austerity still persist?

While apparently misguided (even delusional) beliefs can persist, it is also possible for them to change in the light of evidence, particularly when it has a direct effect on experience. Thus for example it was the initial experience of defaults which punctured the belief that financial markets had reliably priced risk and protected itself against default, setting off the crisis. Mainstream theorists too have responded to the experience of the crisis by adapting theory to incorporate a range of constraints on the free operation of markets and on rational optimising behaviour. But, although it would seem that pointing out false logic and contrary evidence should change attitudes to austerity policies, this has only been true to a limited extent. Belief in austerity policies is necessarily based on more than reason and evidence.

At the level of belief in the nature of the economy, the arguments for austerity are all predicated on economic structure being unchanged. But the crisis and its real consequences provide ample evidence of the scope for the structure of social systems and behaviour within them to change in a non-deterministic way, i.e. for the subject matter to be an open system. Thus an important aspect of the Chick and Pettifor (2009) argument is the reference to changes in the policy-making architecture (particularly with respect to monetary policy) in the periods under study. Rather than separable deductive reasoning tested against evidence, their argument involves abduction, whereby observed structural changes alter the interpretation of the data and the reasoned argument. And yet the mainstream persists in adopting a closed-system approach which implies a closed-system subject matter (Lawson 1997). It is this approach which allows conclusions to be treated as reliable which rest on deductive argument applied to an unchanging structure or which rest on extrapolation from empirical evidence. Mainstream arguments in favour of austerity are only ‘technical’, independent of belief, within such a system. Yet the system itself rests on the belief that the social system can be treated as if it were closed. As Hume had argued, all knowledge is founded on ontological belief.

Because reason therefore has limited scope, efforts to change others’ beliefs is a matter of persuasion rather than pure reason. As Keynes ([1934] 1973: 470) put it:

‘In economics you cannot *convict* your opponent of error, you can only *convince* him of it. And, even if you are right, you cannot convince him, if there is a defect in your powers of persuasion and exposition or if his head is already so filled with contrary notions that he cannot catch the clues to your thought that you are trying to throw at him’ (emphasis in original).

Reason and evidence are sufficient for argument according to mainstream economics, at least as far as the official discourse goes. (McCloskey, 1986, demonstrates that the unofficial rhetoric of the coffee room is – necessarily according to our argument - more pluralistic.) But reason and evidence are not even in principle sufficient from a Keynesian perspective. Thus for example,

while Joan Robinson demonstrated a logical inconsistency in mainstream theory in the *Capital Controversies* (an exercise in pure reason) the principle of factor substitution was not rejected; pure reason was insufficiently persuasive. On the other hand, the Monetarist/Keynesian debates about the relative slopes of the IS and LM curves remained unresolved in spite of extensive empirical work; empirical testing was insufficiently persuasive.

Argument rather needs to address the complex structure of knowledge, encompassing also the nature and role of beliefs within that structure. In Kuhnian terms, beliefs underpin the worldview of any paradigm; in critical realist terms, beliefs about the nature of reality (ontology) determine epistemology. But since theory develops by abduction, involving a going-back-and-forward between experience and theory, beliefs continue to penetrate all subsequent reasoning, including the interpretation of evidence. We have focused so far on belief in the epistemological sense. Indeed much of the critiques of austerity draw on the large literature which spells out the foundation of orthodoxy, like heterodoxy, in beliefs as to what constitutes reliable knowledge. There is no basis in modern philosophy of science for mainstream economists to claim that their research is more scientific than that of heterodox economists because of their reliance on formal deductive mathematical reasoning and appeal to what are presented as independent facts. The grounding in undemonstrable beliefs is there, unacknowledged or not.

It is challenging enough to get this argument across to fellow economists. But for persuading public opinion more generally to challenge the mainstream results, these epistemological arguments may have limited traction. What may have more traction is the argument that, among these beliefs, all economic reasoning involves moral judgements, as Hume had argued (Kayatekin 2014). Thus for example arguments for austerity prioritise efficiency over distributional concerns. But the moral judgements are even more deep-rooted. Where it is assumed that workers are paid the value of their marginal product, this is taken as a technical result without moral content. Yet the suggestion that government should support the market in paying CEOs of banks and low-paid workers their market value entails a moral judgement in favour of forces for maldistribution of income. The moral content is more evident in alternative approaches which understand pay levels to be politically and socially determined. This is taken by mainstream economics to be an indication of poor science – reasoning invaded by ideology. What is widely ignored is that this is in the nature of a social science and that mainstream economics too incorporates ideology.

The belief that the market produces a morally-acceptable distribution of income has of course been widely challenged as a result of austerity policies. Yet the presentation of mainstream arguments for austerity as a technical result has been persuasive that moral arguments about income distribution are separable from the content of mainstream economic theory. The conventional view that mainstream economics is the only scientific approach therefore diverts attention from any discussion among economists of belief on the grounds that any such discussion would not be ‘scientific’. It also diverts the moral argument in public discourse away from mainstream economics.

The fact is that some beliefs hold more sway over the policy process than others. In the next section we consider the process of persuasion which ensures that some beliefs become conventional in spite of the fact that critics of austerity policies regard the basis of these beliefs in reason and evidence as very weak.

### **Rhetoric, power and belief**

If conventional beliefs spread through persuasion, then we need to consider further why the rhetoric of austerity has been so successful. We consider three elements in this process of persuasion: the content of the rhetoric, the means by which it is communicated and the relative power of those attempting to persuade.

It was noted at the start that the primary forces behind austerity policies were ideological (the aim of reducing the role of the state) and self-serving (the aim to protect capitalist economic interests). These forces are associated with socio-economic power and thus the capacity to influence what is regarded as reliable knowledge. There is a range of mechanisms for exercising that power. For academic economists it is the editorial policies of leading mainstream journals, research funding and the hiring process in universities. These mechanisms operate by 'peer review', where the peers predominantly promote mainstream economics as the most 'scientific' approach to economics. That governments actively promote this kind of peer review reflects their tacit acceptance of the mainstream closed-system view of knowledge. Since governments have the power to challenge such a view implies that it is perceived not to be in their interests to do so. Even where political interests would not appear to be best served by mainstream economics, the power of financial markets over governments can be seen as an effective constraint.

For the general public, the mechanisms are different, relying heavily on power exercised over various communications media. A growing body of work in discourse analysis is building up a picture of communications strategies in persuasion with respect to government policies. Pigeon (2008) provides a rich account of how the Canadian government used a variety of communications strategies to great effect to produce conventional belief in the wisdom of inflation targeting and fiscal austerity. Mercille (2014) concentrates on the role of the mass media in Ireland in promoting a conventional neo-liberal view in support of fiscal consolidation policies. Herndon, Ash and Pollin (2014) discuss how the Reinhart and Rogoff (2010) evidence had been used in the policy discourse. The language used itself can be very effective in persuading the general public to accept 'expert' opinion. Gabor (2011) emphasises the importance in Romania of the presentation of macroeconomic policy in technical, apparently non-political, terms, allowing the government to pursue a neo-liberal agenda. Her work is path-breaking in demonstrating the power of presenting political economy arguments as neutral technical results, an argument on which this paper has attempted to build.

Smith (1795) had emphasised the role of rhetoric in persuasion, given the impossibility in general of fully demonstrating a proposition by reason or evidence. Metaphor performs a powerful role in the communication of theories (McCloskey 1986), but also in their origination and development (Lawson 2003). Indeed Smith (1795) had likened theories themselves to imaginary machines. In

economics metaphors such as ‘the market’ have been very powerful in guiding thought. With respect to fiscal policy, the most powerful metaphor has involved likening a national budget to a household budget; fiscal austerity is presented as normal prudence. Households are then susceptible to the argument that, once debt reaches a particular level at a particular interest rate, debt servicing will make it increasingly difficult to control the budget. A budgetary surplus is therefore required to reduce the debt, and thus debt service, burden, and that surplus requires austerity policies.

While this may seem like a purely technical argument, it rests on the belief that a government is like a household. But, even setting aside the confusion in the public discourse between current and capital deficits, and the different capacities of governments and households to finance a deficit, a current deficit at the national level is not like a current deficit at the household level. When a household is earning from employment less than it is spending on current consumption, there is no mechanism to avoid ever-increasing debt other than to cut back on spending. A government’s earnings are primarily from taxation, which depends on the employment and spending of the population. Cutting back on government spending therefore reduces tax revenue and requires increased spending on social services, making the situation worse. It is not just government capital spending which can improve long run fiscal prospects, as can investment in human capital by households. The point is that government current spending can have multiplier effects on incomes and thus on the fiscal position; there is no such equivalent for households. The fallacy is to use a microeconomic metaphor, tapping into the public’s personal experience, for a macroeconomic problem.

A further rhetorical device is to make the recipients of austerity feel responsible for their plight. It is a clear implication of mainstream economics that (barring market imperfections) workers are paid low wages because of the low value of what they produce, or are capable of producing. Similarly unemployment is portrayed as an unwillingness to search adequately, move location, acquire appropriate skills, or accept the lower wage appropriate to that worker’s VMP. Vulnerable household borrowers, further, are portrayed as having been greedy and profligate, when in fact banks had had a duty of care (not to mention prudence with respect to their own portfolios) not to make loans without a reasonable expectation that they could be serviced. Of course this can be explained to some extent by banks buying into the expectation of continued asset price rises purveyed by ‘technical’ economics and finance experts, such that they had not appreciated the risks for them or their clients.

Psychology clearly plays an important role in rhetoric. Smith (1762-3) had pointed to the importance of bearing in mind the beliefs and prior knowledge of the audience. Thus, for example, where heterodox economists see a crisis as disrupting structures and relations in an irreversible way, mainstream economists see constraints on equilibrating market forces. Smith also stressed the importance for successful rhetoric of appealing to what the audience would find psychologically satisfying (given that knowledge is sought to calm any sense of discomfort at unexplained events) (see further Smith 1795). He was fully aware of the aesthetic attractions of abstract argument:



‘It gives us a pleasure to see the phaenomena which we reckoned the most unaccountable as deduced from some principle (commonly a wellknown one) and all united in one chain... We need not be surprised then that the Cartesian Philosophy ... tho it does not perhaps contain a word of truth, ... should nevertheless have been so universally received by all the Learned in Europe at that time. The Great Superiority of the method over that of Aristotle ... made them greedily receive a work which we justly esteem one of the most entertaining Romances that has ever been wrote.’ (Smith 1762-3: 146)

Further, Smith distinguished between the natural and social sciences in terms of how far, on the strength of their own specialist expertise, they could sustain their theories in the face of contrary arguments. He argued that the natural sciences were protected from much public scrutiny because their theories are far removed from normal experience:

‘Natural philosophers, in their independency upon the public opinion, approach nearly to mathematicians, and, in their judgments concerning the merit of their own discoveries and observations, enjoy some degree of the same security and tranquillity’ (Smith 1759: III.2.20).

But as far as moral philosophy, and thus the social sciences, were concerned, he predicted that they would be held in check by the fact that the public understood the subject matter:

‘A system of natural philosophy may appear very plausible, and be for a long time very generally received in the world, and yet have no foundation in nature, nor any sort of resemblance to the truth ... But it is otherwise with systems of moral philosophy and an author who pretends to account for the origin of our moral sentiments, cannot deceive us so grossly, nor depart so very far from all resemblance to the truth’ (Smith 1759: VII.ii.4.14).

The device of mimicking the natural sciences and mathematics has allowed mainstream economics a degree of immunity from critique which Smith had not thought possible for economics.

## **Conclusion**

While the importance of putting forward arguments against austerity has been used by some Post Keynesians as an argument against a focus on methodology (see for example Lavoie 2012), the conclusion drawn here is that methodological, and indeed epistemological, differences from the mainstream are at the core of the *reception* of Post Keynesian ideas. The mainstream are convincing because their results are presented as scientific, such that debate is diverted to what are seen as the separable areas of ideology, power and ethics. The critique of austerity policies would therefore be strengthened by a critique of this rhetorical (mis)representation of economic theorising. Such a critique could refer to the epistemological belief that the social world is such as to generate technical, law-like conclusions. But it could also refer to belief in moral judgements about the nature and consequences of market forces.

The point is a general one, applicable to any policy advice. Hayek (1974) in his Nobel lecture address criticised the notion of the economic expert with a ‘pretence of knowledge’. The Post Keynesian arguments against austerity include a critique of belief in the beneficial role of markets relative to the state, something which Hayek did not share. His policy stance was based on the opposite belief. But, although the direction his ideas took differed markedly from Keynes and the Post Keynesians, he like Keynes had been profoundly influenced by Hume’s epistemology. For him too the limits to knowledge meant the limited applicability of formal mathematical argument and the need for other methods, and the inability to demonstrate proposition to be true.

The point is that mainstream economics bases its policy advice on a structure of beliefs, so that austerity policies need to be understood and critiqued with that in mind. This point can be made from the standpoint of any set of beliefs. But, as things stand, there is an asymmetry between arguments against austerity which combine beliefs and technical analysis on the one hand, and arguments for austerity put forward as if they arose from a purely technical analysis on the other. It is important to bring the debate onto a level playing field where all accept the nature and role of belief in their theories and arguments and are prepared to be explicit about this. Epistemology and methodology matter.

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