KEYNESIAN CONSIDERATIONS IN THE POST-NEOLIBERAL ERA

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ABSTRACT Based on the fact that the present financial and economic crisis is at the same time a crisis of contemporary economic thinking, this paper aims to interpret the collapse of mainstream economics from a Keynesian point of view. At the same time, this paper aims to show to which extent Keynesian inspired interventionism can and should be reconsidered. Furthermore, it proposes to establish adequate criteria in order to evaluate correctly a possible Keynesian reversal in economic thinking. In order to achieve these aims, this paper studies the controversies regarding the failure of academic economics and of neoliberalist orthodoxy and the possibility that a new or a newly adapted theory replaces the old one. This paper comes to the conclusion that, according to the evolution in current debates, a Keynesian reversal is possible, but at the present moment not sure.

KEYWORDS Keynesian economics, neoliberalism, mainstream economics

I. The crisis of markets, the crisis of economic thinking
This paper tries to demonstrate that, in the context of the current financial and economic global crisis, the economic science is in front of a disaster, comparable to the one it faced eighty years before, at the beginning of the world economic crisis of 1929. As the neoliberalist and monetarist orthodoxy is confronted with its own collapse, a Keynesian reversal in mainstream economics is possible. Proofs for such a revolution, resembling the comeback of the long forgotten and discredited Keynes, can be found in theoretical debates as well as in the applied economic policies of an important part of the G 20 led by the United States. The crisis has drawn up a series of problems and scientific weaknesses of modern economic theory. Almost no economist was able to anticipate the events of 2008. The models of contemporary macroeconomists in which, in many cases, the financial sector does not even exist, and consumers and entrepreneurs are equal to each other, were of no help in establishing the ways for getting out of the recession. Such economic crises, as the one which begun in 2007-2008, cannot be explained by such models because of their restrictive hypotheses. As German economist Thomas Lux (2009) put it, "the economics profession appears to have been unaware of the long build-up to the current worldwide financial crisis and to have significantly underestimated its dimensions once it started to unfold. The economics profession has failed in communicating the limits, weaknesses, and even dangers of its preferred models to the public."

It seems to be very clear that, by the time the crisis will be overcome, the economists will analyze their profession as well as the world and the society as a whole with other eyes. A whole series of methods, theories and models, especially those of extreme neoliberal inspiration, which were regarded until now as a quality peak of economic research, will have failed the test of political, social and economic realities. According to Buiter (2009), the majority of theoretical innovations created by mainstream macroeconomics starting with the 70s was in the best case a self-reference, a research motivated by an inner logic, never leaving roads already paved. On the other hand, the wish to truly understand the functioning mechanisms of the economy played only a subsidiary role. Buiter's sentence is relentless: macroeconomic research of the last decades was, individually as well as socially, nothing else than a waste of time and other resources.

The same opinion, maybe even tougher in its clarity, is to be found in the works of Robert Skidelsky, who contributed to the Keynesian reversal we are trying to demonstrate. After describing the visible causes of the current financial and economic crisis, Skidelsky (2009) points out to one of Keynes's conclusions and sums up: "For the present crisis is, to a large extent, the fruit of the intellectual failure of the economics profession."

II. The errors of dominant orthodoxy
One of the causes of the fact that important parts of macroeconomics studied unworthy, even useless aspects, has to be searched in the false self-image which this science developed in the past. In the economists' jargon, this science...
studies the rarity of resources. It is the definition which each student has to face. Mankiw's handbook (2008) starts with the following: "Political economy is the science of rare social resources." This definition is short-sighted and deceiving as it merely reduces economic science to an analysis of optimal questions to well formulated questions. Thus, one loses sight of the fact that in the real economic system there is dynamics, therefore change and insecurity. By defining economics like this we reduce it to microeconomics and numerous phenomena are lost, like for example the issue of failure of coordinating various economic actors.

In the context of the economic crisis the macroeconomics of the last decades simplified its task more than allowed, reducing itself to a theory of stability. However, the world we live in is a world of multiple instabilities, therefore the vast majority of conclusions which can be drawn from the common model of economic stability cannot be used in the analysis of the reality.

From various points of view, the macromodels which economists work with are based on an unrealistic hypothesis. For example, many of such models start from the idea that there is equality between people, between companies. This simplifies the models since the analysis of only one agent, considered to be representative, is sufficient. Nevertheless, such an approach proves to be problematic from various points of view. Obviously, the agents are per definitionem different, including with respect to the relevant economic problem, with respect to fortune, access to credits, human capital they dispose of etc. It is exactly these differences that are actually the spur necessary for major economic processes. Trying to deduce recommendations for real economic policy despite all of the above means exposing oneself to the danger of worsening economic problems.

Drawing a conclusion in respect to the economic system as a whole starting from a representative agents constitutes yet another time a mistake since this approach does not take into consideration the fact that the system is more than the sum of the parts it is made up of. Such fallacies of composition are by far rare, however mainstream economic science does not seem to take their existence into account.

We should also emphasize the paradox situation in which the present economic science is to be found in respect to its historic evolution. According to Lux eight decades ago it was in a much more evolved point than it is now. The main point of Keynes’ research was exactly the fact that economy as a whole does not function after the models of efficient markets and that it has to be analysed in a different manner. As monetarism and neoliberalism were winning ground a new trend emerged, that of claiming the microeconomic foundation of macroeconomic models. Statements regarding national economy had to be deduced from the behavioural pattern of individual actors, this being the new credo of economic science. But, due to the fact that the economists drew conclusions based on the analysis of the behavioural pattern of some representative agents, the old errors in judgement re-emerged. As a result, however complex from a mathematical point of view some of the models built over the last three decades may be, economic science is back to where it was in the 20s.

Another hypothesis which was not validated by the financial crises seems to be the one of perfect markets – as important as it may be for the economic theory as far from the reality it proves to be. The hypothesis of efficient (perfect) markets was proved wrong long before the start of the crisis in 2007-2008. Presenting some of the theories and hypotheses popular among mainstream economists which have been questioned, if not also invalidated by the present crisis, the conclusion can be drawn that the economic thinking itself is in a crisis. In order to overcome this crisis the present has to be reconsidered and the past brought back to actuality. On the one hand, economic policy needs better models, while on the other hand it needs a better understanding of some factors considered to be soft, like emotions, feelings, as many times the economic behaviour of individuals depends more on such elements than on the rational cost-benefit analysis. One can thus conclude that neglecting such non-economic elements is a major mistake of orthodox economic science.

Also from this point of view economic theory seems to have been once in a better situation than it is right now, thanks to John Maynard Keynes. He talks about animal instincts, but the debate about irrational expectations and optimism and pessimism which are the cause of the activities of the topics from economy was one of the first elements that were dropped by the exegetes of Keynes.

The second largest world economic crisis of the modern era had to start in order for the hypothesis of animal instincts to be reduced to the foreground. George Akerlof and Robert Shiller asked for a complete change in paradigm in the modern macroeconomics, in the sense that macroeconomic models and non-economic motivations, irrational behaviours, and the human inclination towards fairness and excessive optimism, should be taken into consideration. Otherwise economists would oversee important forces of the financial and economic crisis, i.e. psychological and emotional factors. The conclusion of the two is a simple one: any financial and economic crisis has its roots in factors of psychological nature.

Therefore we rightfully ask a question regarding the economic policy effects resulting from the importance invested by economists in psychology. The conclusions drawn by Akerlof and Shiller are amazingly similar to the teachings of Keynes: the state has to intervene in the economy; it has to play an active role in the economy and to wear off the fluctuations triggered by animal instincts. The market should not be left to take care of itself. Without doubting the reason of capitalism to exist the ones who succeeded in pointing out the errors in contemporary economic theory think that market economy cannot lead to the beneficial effects that generations after

5 Mankiw, Gregory, Grundzüge der Volkswirtschaftslehre, Schaeffer-Poeschel Verlag, Stuttgart, 2008
generations were used to and cannot conserve its stability in the face of a lack of public regulations. If humanity learned this lesson painfully in 1929 – 1933, in the meantime it has forgotten it. On the other hand, Kirman states that, although "change (in economic science) is essential if progress is desired, the lethargy in the economists’ profession is strong and although economy has proved that it can quickly move on to a new phase it is very likely that economists organise themselves in order to prevent such an evolution of their own profession in the near future."

III. Rediscovering Keynes. Conclusions

Harry G. Johnson set five main conditions under which a trend in economic thinking can replace another one and to bring about in mainstream economic science a change of paradigm. Johnson showed in what ways the fulfilment of these conditions led to the disavowal of liberalism by Keynes' "General Theory..." as well as the way in which monetarism replaced Keynesianism. The conditions are the following:

- (i) the new theory attacks the main message, the essential core of the doctrine in a way that is acceptable from a scientific point of view, but which transforms this message into its complete opposite. At the same time, a present economic problem is being discussed, in the case of Keynes the crisis of 1929 – 1933, especially the unemployment problem, while in the case of Milton Friedman's monetarism it was the problem of inflation;
- (ii) the attacking theory has to be a new one, but it has to contain just as many elements as the previous theory, without admitting it. As Johnson wrote: "In this process, it helps greatly to give old concepts new and confusing names, and to emphasize as crucial analytical steps that have been previously taken as platitudinous";
- (iii) the new theory needs to have an acceptable, adequate difficulty level. Johnson draws here the attention on a nuance, in the sense that the new theory has to be so complicated that the elder economists cannot fully understand it, dealing in their analysis with unsignificant details which cancels their criticism against it. On the other hand it has to be so complicated as to attract young scientists, as the Canadian economist writes: "At the same time, the new theory had to appear both difficult enough to challenge the intellectual interest of younger colleagues and students, but actually easy enough for them to master adequately with a sufficient investment of intellectual endeavour";
- (iv) the new theory should offer intelligent and less opportunist economists a new methodology, a new approach to economic problems;
- (v) the new theory has to contain enough study material for the rising number of the specialists in the field of econometrics.

If we apply to the current situation the five conditions stated by Johnson, whereby the re-evaluation of interventionism in economic policy is undisputable, we will notice that interventionism meets the first, the second and the fifth condition, whereas the degree to which it meets the third and the fourth condition is less obvious. At the same time we should make a distinction between the reversal of Keynesian ideas in the media, a fact which is undisputable, and the rediscovery of Keynes in the academic environment, where the situation is more complex. In respect to the first condition mentioned by Johnson it is more difficult to doubt things. In the context of the financial and economic crisis of 2007-2008, the consensus regarding the superiority of a free market economy started being criticised including by the shapers of academic opinions from within mainstream. All these comments led to a re-evaluation and in some situations even to a radical transformation of leading opinions. We can also find these processes of re-evaluation in numerous academic papers, in the media, in public debates, in governmental policies. On the one hand, a viable explanation of the crisis cannot be established without the help of Keynesian theories. On the other hand without recording to the interventionist guidelines the danger of the crisis becoming worse is only sharpened.

Two other aspects should be emphasised. Keynes pointed out the idea according to which large public debts are not desired, however victorious neoliberalists after the 70s thought that the governments do not have to worry if such debts exists. Starting with the year 2008 one can notice that a significant number of economists consider that the existence of such instability should be a major concern for the governments. At the same time, if Keynes was in favour of a restrictive control on the international cash flow, the western economists argued in the last 30-40 years almost exclusively against any hurdles in the path of the free flow of capital. In 2009 and 2010 the control of capital flows seems to have been re-included among the instruments of accepted macroeconomic policy, even if the International Monetary Fund warned about the abuse of control. It remains to be seen if the international society will accept to reintroduce rules (some of them less strict but nonetheless rules!) or if it will limit itself to restating some recommendations of good practices.

With regard to the second condition mentioned by Johnson things are more complicated and deserve a more detailed analysis. The new theory is not new; we have to mention that we deal with a rediscovery, with a return to a theory which has fallen into abeyance. Not even the extent to which this theory is being reinterpreted, reintegrated in the

7 Kirman, A., The Economic Crisis is a Crisis for Economic Theory, CESifo Economic Studies 4/2010
present economic context is highly new. But, indeed, Keynes’ rediscovery does not disconsider what tends to become now the old theory, neoliberalism. A denial of market economy did not and does not take place. It is rather a matter of nuance, of fine tuning. The debate revolves around interventionism and the degree to which the state can and must intervene in the economic mechanism. From this point of view, the second condition stated by Johnson is validated.

However, the third condition is not validated. One could hardly state that understanding Keynes is a major hurdle. Under the circumstances of such a rich exegesis the difficulty may lie in the conceptual reduction of Keynes’s theory, reduction meant to oversimplify the message of the Keynesian work. Nevertheless, this disadvantage may be surpassed, and nowadays, even though it implies intellectual effort, one can correctly interpret Keynes and his ideas based on "sufficient investment of intellectual endeavour", to put it in Johnson’s words.

Regarding the fourth condition, we convene that it is difficult to validate in the current situation. Nevertheless, if by the new approach resulting from the resurrection of Keynesism we understand the exceedence of the limits of economics, by rationally integrating concepts pertaining to other sciences (biology, psychology, philosophy) into economics, then reviving Keynesian hypotheses may indeed signify a new approach to a complex issue.

Finally, the fifth condition stated Johnson is validated, even if superficially analysed. One must draw the attention on a fact, which is the fact that excessive mathematisation of economics has been and is one of the essential points of the discourse of those who claim that the actual crisis is a crisis of economic thinking. The request re-emerges to expand the conceptual frame of economics by resorting to the concepts and instruments of other sciences, thus connecting Johnson’s last condition to the one before last.

Analysing all the opinions in favour of returning to Keynesian economics we can conclude that Keynes’ comeback in the forefront of economic debate in the media is something certain. In respect to the academic debate the situation is slightly different. With the exception of Skidelsky’s paper – a succession of strong points of view to support Keynes – there has been no significant reversal materialised in the form of work to contradict the neoliberalist fundamental theories and to reinstate the Keynesian hypotheses. However, serious doubts have arisen in regard to the relevance of the neoliberal postulates, thus criticising the hypermathematised mainstream oriented towards models which prove inefficient in reality. In 2008-2009 James Galbraith9, arguing in favour of the collapse of monetarism and the irrelevance of the monetarist consensus, demonstrated that there are no significant changes of view among the economic researchers nor is there a re-evaluation in depth of the dominant discourse.

When attempting to identify the extent of the Keynesian reversal in economic thinking, we cannot disregard its inherent limit. In the context in which both Europe and the United States of America are facing a major crisis in public debt, crisis fuelled, at least partially, by the measures of economic stimulation adopted and implemented 2009, the nearly global consensus regarding the need of incentive of Keynesian economics has collapsed. There is only one relevant example, the one of Keynes’s homeland, which starting with May 2010 has switched to a programme of severe austerity, similar measures being adopted in other European countries too. In June 2010 the G20 welcomed the trend towards fiscal consolidation in the detriment of incentive packages generating major public deficit10.

The International Monetary Fund has supported the same approach and in 2008 it intensely backed the implementation of incentivising policies by supporting the actual demand. In July 2010 the president of the European Central Bank, Jean-Claude Trichet, endorsed the same opinion by stating that the highly industrialised nations must switch to austerity measures in the detriment of stimulation plans. This caused the columnist of the influential newspaper Financial Times11 to conclude that the markets have managed to reaffirm themselves as the main influential factor on economic policies in the Western countries.

We believe that, despite some arguments in favour of the reversal of Keynesianism and its restauration to economic mainstream thinking, by returning to origins deemed antiquated, we cannot yet determine if we are dealing with a paradigm change in favour of public interventionism and the return of the state as main actor in economic life. We consider this evolution possible, its degree of probability depending first and foremost on the evolution of global economy, on the moment when the actual crisis will be overcome and on the global restructuring of the political and economic stage.

This paper attempted to establish to what extent one can talk about an actual resurrection of the interventionist theories of Keynesian origin in the present economic discourse, both in the media as well as in the academic context. With regard to Keynesianism, there may be talk about a new approach to the ideas but under no circumstances about a new theory.

This new approach can be based on the much needed reform of economic science. It is also possible to find the adequate solutions for the social and economic deadlock which, at least at the date of this paper, continues to impede the main global political and economic actors. All the requirements are met for this connection between the academic and media debate on the one side and the real, political and economic world on the other to happen.

10 http://www.g20.org/Documents/201006_Communique_Busan.pdf
11 Stephens, Philip - Three Years on, the Markets are Masters Again, in Financial Times, July 30th 2010
Nevertheless, the danger of detaching the theory from the criterion of validation through immediate implementation still persists.

This paper expresses an reserved optimistic opinion regarding the reversal of Keynesianism as a major trend in economic thinking, reversal supported by the necessity of solving a series of practical economic problems. This is supported by the statement of German scientist Max Planck who wrote in 1949: "A new scientific truth does not triumph by convincing its opponents and making them see the light, but rather because its opponents eventually die, and a new generation grows up that is familiar with it". 

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