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It Is All About Setting the Right Question

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Setting the appropriate question is a major prerequisite for giving the right answer. In the website of the Science Forum (http://www.thescienceforum.com) there is a poll on the so called Keynes vs Friedman debate. Responders have to choose among two simplified alternatives: Keynes - a regulated market economy and Friedman - a completely free market economy. Yet, sometimes simplifications make things complicated.

J.M. Keynes, a classical economist himself, motivated by the astonishing failure of the markets during the big crisis in 1929, published his magnum opus, "The General Theory of Employment, Interest and Money" in 1936. His intention was not to question the standard doctrine, but to draw attention to the inappropriately and sometimes dangerously long lasting adjustment towards the supposed self-regulated socioeconomic equilibrium. His following phrase is indicative: "But this long run is a misleading guide to current affairs. In the long run we are all dead". (A Tract on Monetary Reform, 1923, Ch: 3).

Keynes recognised two major reasons for the failure to return to balance: first, as time passes, the evolution of microeconomic relations and transactions along with the associated institutional advancements give rise to the so-called rigidities of the authentic price mechanism. In a way, we should picture it as the naturally arising corrosion of the main coil that has to be lubricated and fixed. Second, there are certain moments, certain socioeconomic circumstances that cancel the self-regulating procedure as a whole. Keynes' "liquidity" and "investment" trap is simply another way to formulate, in "acceptable" terms, the Marxian overproduction and over-accumulation of capital. The noteworthy difference is that, unlike to Marxists, Keynes understood this as an extraordinary situation that needs extraordinary handling: credit expansion by the state in order to absorb the surplus of capital and products.

The majority of the columnists see in Milton Friedman the main rival of the Keynesian derogation. In fact, exaggerating a bit, some recognize him as one of knights, defenders of modern bourgeois society. Is he? His 1962 book "Capitalism and Freedom" rather confirms the designation of Friedman as a contemporary systemic advocate. Yet, with respect to his relation to Keynes, things are more complex: as he admits on the 4th of February 1966, "… in one sense, we are all Keynesians now; in another, nobody is any longer a Keynesian..."

The truth is that the founder of the Chicago school used Keynesian language and apparatus. Friedman accepts fully markets' short-run impotence. He denies their total failure – for him liquidity trap is an extremely extraordinary situation – but emphasizes the dysfunction of price mechanism. Actually, in "fooling model" he provides additional arguments for that. In fact, he also suggests that there are situations where small expansion of the money supply is the only wise policy. So it would not be at all risky to claim that, in the current context, Friedman would argue for a controlled increase in the supply of € by the ECB. In that sense, I dare to say that Solow's anecdotic critique is, as it should be, exaggerated. Milton may be the "preacher" who tries to bring Keynesianism back to systemic temperance and bourgeois orthodoxy. He may also be the main opponent of a reckless expansion of governmental demand, but even for him, money supply stability is not any dogmatic sacrosanct, especially in periods of persisting, for what reason ever, shortage of aggregate demand.

So, who is right? Starting from the less convenient, both refer to a theory that overlooks the systemic character of the present crisis. The inflated financial capital, spoiled by excessively high, self-generated returns, avoiding its reinvestment in the actual production; the widening interregional disparity and social inequality; the antagonisms intensified by the dwindling resources and the tempered global demand; all these speak for a phase that goes beyond any ordinary business cycle. It is the regularly reappearing historical moment, where capitalism pays the bill…

Beyond that, alone the fact that we are experiencing a recession that lasts annoyingly long, gives the credits to Keynes; not for being the first or the only one who anticipated the apparent weaknesses of the suspiciously simplistic law of Say, but for being intelligent enough to overcome his classical status as an economist and brave enough to declare it through his writings.

Nevertheless, although the disarmingly simple proposition for an intervening government can be hardly denied in periods of persisting downturns, overdoing it is not only useless, but it can be also extremely harmful. Here, we have to agree with Friedman. Even if there are significantly different reasons for claiming it, state credit expansion is simply an aspirin. In no case can provide a way out of the underlying structural problems – instead, if we stick to it, this could add more complications in the future.

Beside to the above mentioned systemic inconsistencies, the fact that both, states and especially the banking systems, are heavily in debt is primarily the result of previous periods of overexpansion. Government debt slightly surpassed 90% of the €-zone's Gross Domestic Product (GDP) in 2012, for which surely we can not be happy. Yet, the major concern is by far the banking sector's size with total liabilities amounting to more than 250%!

Obviously, such a macroeconomic environment abridges contemporary policy choices. In fact, it gives additional reasons for investing politically on inflationphobia: even if an expansionary monetary policy is necessary for €-zone, it generates unpleasant conflicts of interests. Terms of trade and the exchange value of capital accumulated by northern exporting countries would be deteriorated. In addition, given the situation described, the depreciation of the common currency is even more risky as it would probably provoke an outflow of deposits from central and northern European banking systems.

Sometimes, complicated questions shall be answered by resetting them. This is not avoidance. It simply confirms the exhaustive and inexhaustible evolution of human knowledge: is not finding the end,

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but discovering the way. We saw where Keynes and Friedman proved to be correct, as well as the aspects of the present socioeconomic reality not being covered in neither of the two traditions. Nevertheless, as it is common in times of crisis, basic doubts arise. If we give up the fantasy of perfect competition, market liberalization is freeing whom and from what? Is it perhaps the time to change the paradigm in search for a new utopia?