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CAN WE RETURN TO KEYNESIAN ECONOMICS?

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ABSTRACT

This paper reflects on the introduction to the new Japanese translation of Luigi Pasinetti's *Keynes and the Cambridge Keynesians*. In that introduction, Pasinetti asks his readers to focus especially on his call in the third (and final) section of the book to undertake the creative theoretical work of further developing Keynesian economics. The paper asks who the economists are who are likely to take up this call with special attention to whether libertarian free-market economists can be attracted to this project.

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JEL codes: B2, B31, E12.

In his introduction to the new Japanese edition of his classic *Keynes and the Cambridge Keynesians*, Luigi Pasinetti asks his readers to focus on the third and final section of his book, which is a call to do the creative theoretical work necessary to further the Keynesian Revolution. His call flows from his experience with the original edition of the book which garnered much critical attention for its first two more historical sections on Keynes and the Cambridge Keynesians, but little or none for the third section and its call to arms.

But who might join that revolution? Where are the foot soldiers in this new Keynesian army to be recruited? In the early years of the Keynesian Revolution, in the "Years of High Theory", the foot soldiers were reliably drawn from both the right and left; they were people who saw the most basic "economic liberty" as being defined by having access to employment. These were also likely to be people who believed in the necessity of the

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welfare state because they understood that industrial capitalism generates not just entrepreneurial winners, but also many forms of inequality, disability, and dislocation. It was, perhaps, not difficult to find people on both the right and the left who fit this description in 1936 since the evidence was clear to them, made manifest by the Great Depression. Of course, not every economist in the mid-twentieth century was a Keynesian, but the group was so large that it defined the mainstream of the profession.

Today, however, the situation is quite different. The global financial crisis has come and gone and Keynesian ideas have only gained a limited foothold the mainstream of the economics profession, despite their central role in helping to prevent the collapse of twenty first century capitalism. Barry Eichengreen has nicely defined one aspect of the problem in his *Hall of Mirrors: The Great Depression, The Great Recession, and the Uses – and Misuses – of History* (2015). Eichengreen's central argument is that policy makers stopped short prematurely in their use of demand management tools once it was clear that the total collapse of the banking system had been avoided. He excoriates policy makers like Ben Bernanke and Jean Claude Trichet for their failure to provide the leadership necessary to see that the recovery was fully extended to those who lost their jobs. In this understanding of how economic policy played out, we were denied a full picture of the power of Keynesian demand management because its use was throttled too soon.

Dieter Plehwe (2017) has explained another related reason that Keynesian ideas have only received a limited success after they helped prevent a world-wide depression in 2009-2010: an active well-organized campaign by libertarian, free market economists to limit the role of the state. Immediately following the first wave of stimulus that was created by the government programs around the world to bail out failing banks, members of the Mont Pelerin Society began to push hard for austerity, and their influence helped put a stop to expansionary fiscal policy and led to a deep cuts to the welfare state in many countries. These were the arguments of the libertarian economists that policy makers were unwilling or unable to stand up to.

Thus, whereas we might have expected that the global financial crisis would generate a more clear eyed picture of the damage that can happen to people living in a capitalist economy gone awry; and, whereas we might have expected that the role in the initial recovery of the huge fiscal expansion caused by the bank bailouts would have caused a widespread embrace of the power of Keynesian policies; we instead have suffered through many years of austerity and, hence, much less stimulus than was needed. Even the recent radical fiscal stimulus caused by American president Donald Trump's tax cuts in 2017 (which were, ironically, warmly embraced by libertarian economists) have not caused people to favorably re-evaluate the power of Keynesian stimulus.

But if the calculus of political and professional support for Keynesian ideas has not been what Keynesians might have expected, nor have they been what the libertarian economists expected. Almost everywhere in the OECD where the libertarian right's political allies have gained power, their gains have been linked electorally to nationalist, xenophobic, racist, and anti-liberal ideas.

While gdp has risen slowly and steadily since 2010, income inequality has continued to fester. The recovery from the deep recession of 2008-2010 has failed to bring increased welfare to many people. And worst of all for the free marketeers who demanded a quick return to austerity, their favored policy of austerity has drained support for the liberal economic regime they desire. It is difficult to believe that the libertarians can be happy with the growing demands for tariffs and the disruption of international trade, or the condemnation against immigrants and immigration, or the growing disregard for the rule of law.

One can only hope that the unintended consequences of their push for austerity have given some libertarian economists grave doubts about the wisdom of the austerity policies that they advocated. Would they have made such spirited arguments for the evisceration of the welfare state if they had understood that it would help unleash such a virulent reaction of anti-liberal responses? Of course, some libertarians will attempt to deny that the reductions in the social safety net or the premature removal of fiscal stimulus had anything to do with the rise of the reactionary right; but this response beggars belief. Unless one is able to dismiss the evidence of widespread voter alienation, it is clear that people are angry that bankers got bailed out of the messes they created while most people were forced to struggle with austerity and many were left unemployed despite the growth in gdp.

Is it possible then that some libertarian, free market economists might now embrace Keynesian economic policies? Might they be drawn into Pasinetti's project to create a new, more systemically robust Keynesianism? Can Keynesianism once again fully enter the mainstream?

Anyone who has worked in the economists' profession over the last three or four decades may not expect much change in the position of the libertarian economists. If one looks at the history of the Nobel Prize over the last three decades, for instance, as detailed by Offer and Söderberg (2016), one might give up all hope that economic theory is ever done on an objective, empirical basis and conclude instead that ideology is what actually drives economic analysis. In the world described by Offer and Söderberg, one is more likely to expect ideological entrenchment than a genuine concern for human welfare.

But perhaps the political reality of anti-liberal politicians and the emerging restrictions on free trade can bring some libertarian economists to see the necessity of Keynesian policies? If this is the case, it would not be without historical precedent. After all, Keynes insisted that he was a Liberal; and in the 1940's, at the time he was founding the Mont Pelerin Society, Friedrich Hayek was an advocate of a minimalist welfare state (Backhouse, et al. 2017). If it surprises anyone that Hayek supported the welfare state early in his career, albeit in a limited form, it should not. With public support for capitalism deeply attenuated following the Great Depression, it only made sense that he would consider the minimal effort necessary to rebuild and sustain that support. In Hayek's mind, there could be no liberal society without capitalism, so exploring the practical requirements of preserving capitalism was only logical.

There is even more reason for hope in the writing of Richard Posner (2009a, 2009b), the well-known Chicago economist, during the global financial crisis. In a series of pieces, Posner admitted that before the crisis he had been ignorant to the possibility that a capitalist economy could implode under the pressure of a loss of investor confidence. Never before had he considered it a possibility that aggregate demand could collapse, so he had never seen that demand management might be a necessary tool.

Scientific revolutions and cultural change are impossible to predict, of course, so it is perhaps an exercise in futility to ask where the foot soldiers will be found for a new Keynesian Revolution. The next scientific revolution in economics will not happen according to anyone's plan. After all, one consequence of the mainstream's absorption of Keynes's idea in the 1940's was that not all of Pasinetti's "Cambridge Keynesians" approved of the result. Joan Robinson was famous for labeling the neoclassical Keynesian synthesis as "bastard Keynesianism".

But even if the analytical future of Keynesian economics is unpredictable and uncontrollable, we can nonetheless hope with Pasinetti that his dream is realized. The best outcome now would be for a return to cutting edge theoretical work in a Keynesian mode. Regardless of whether that work is oriented toward a microeconomic or a macroeconomic perspective; regardless of whether it is focused on demand management or the welfare state; regardless of whether it is concerned with policies that address confidence or monopsony; we need good, new analytical work that is focused on the problems of "real, existing capitalism" and that offers people the hope of better lives. That would be a true return to Keynesian economics.

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