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Introduction: there is more to Keynesianism than public spending alone

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In a recent article on our *Review*, prof. Anthony Thirlwall was quoted to have once said to his graduate class: "simple laws make for good economics" (Thirlwall, 2011). That may be true for economic models, but certainly not for policy prescriptions. As it was noted already by Kregel (2011a) among others, or more recently by Lopez (2012), after a rapid surge of Keynesianism in the USA and partly in Europe, in the wake of the financial and economic crisis, the cultural and political debate has now already returned to fiercely opposing it.

The point is that Keynesianism is often taken in its simplest and bastard form, to imply a prescription of large public spending, and indeed ever more spending – with no check, no limit or allowance for a country's actual financial and economic situation. Once again, the new issue of our journal aims at pointing out how far from reality such caricature is, with some of the articles by self-identified Keynesian writers taking on radically different and significantly more nuanced approaches, as well as how far is it from the economic policy that is needed right now (on which see for example Roncaglia, 2011, and the references therein).

As of the first quarter of 2012, the current situation seem worrying at best, for most developed countries. At the international level, the financial system and the international monetary system do not seem to be considered as a priority any longer by the policy-makers of the leading Western countries, despite they still show signs of fragility. At the national level, the USA seems to be benefiting from a small recovery, though job creation is problematically very slow. Even the BRICS slow down their pace, as the crisis hits Europe with a violence that appears as higher than it has even in the USA. Indeed, the extent to which the

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European Union and its self-inflicted austerity may negatively contribute to the growth of global aggregate demand is often undervalued (in Europe more than elsewhere).

The crisis erupted in Europe as a financial crisis, mostly connected to the 2007-2008 crisis in the USA and the financial market turmoil that followed it. Truly, some European countries such as Italy or Germany at first faced a real impact rather than a financial one, through the collapse of their exports in 2008-2009. But the countries that suffered the most at the beginning were involved in banking crises (Iceland, the United Kingdom, Ireland) or a sovereign financial crisis (Greece). Then, in the last two years the crisis has taken on a new, real dimension, not only due to the impact of the financial and banking crises on the real economy (especially in terms of credit crunch and balance-sheet recession) but especially due to the late, insufficient and inappropriate policy response to it (D'Ippoliti, 2012).

In the first article of the present issue, Hein (2012a) connects these two dimensions, the economic policy stance and the real crisis induced by a financial one, under the name of "finance-dominated capitalism". Due to the filiation of the European crisis from the American one, and the insufficient policy response on both sides of the Atlantic, he defines the current crisis as a crisis of a whole stage of capitalism, characterised by two main developments: the preponderant role acquired by the financial over the productive activities (the financialisation of the economy), and a set of social preferences, cultural values and economic policy prescriptions that we may loosely term neo-liberalism (though in some cases, especially in Europe, ordo-liberalism may be more appropriate), especially based on policies aimed at the deregulation of labour markets, the reduction of government intervention into the economy and of aggregate demand management, the re-distribution of income from the (lower) wages to profits and rents, and the deregulation and liberalisation of financial markets. Hein's contribution focuses on the identification of direct and feedback effects through which developments in the real economy (especially concerning economic growth and the distribution of income) may produce financial fragility and financial crises. The article points out in particular the fragility of consumption growth financed by

households' (i.e. workers') debt, which corresponds to the capitalists' lending to them. Thus, the model present a Post-Keynesian/Kaleckian alternative (possibly a complementary one) to the Post-Keynesian/Minskian explanation of the crisis, which in our journal was put forward by Bhaduri (2011).

Lopez (2012) provides an empirical application of how this Kaleckian argument may be applied to explain the roots of the 2007-2008 financial collapse in the USA. However, when extended to an open economy, the argument may be extended to account for the European crisis too (as done for example by Hein, 2012b). In Europe, we evidently face a financial crisis, with sudden oscillations of financial assets prices (especially but not only the sovereign bonds of the peripheral euro-zone countries), of such rapidity and magnitude that no underlying real economic dynamics may explain. A solution to this situation clearly requires a more compelling approach to financial regulation, as discussed below. And yet, it may be argued that in the euro-zone, finance was called upon to fill a wide and enlarging gap between the member countries' real economies – a colossal task that may have induced that proliferation of exotic and complex financial products (it constituted the demand for such growth of finance), of which financial markets liberalisation facilitated the supply.

Indeed, current account imbalances across the euro-zone countries require equal and opposite monetary and financial flows between these countries: thence a need for increased financial efforts on both sides, with the surplus countries accumulating assets in the deficit countries, and the latter accumulating debt towards the former (though possibly these increasing loans and debts are intermediated by financial operators, even third-country operators, a fact that may allow for an even longer periods of accumulation of such disequilibria). This is a crucial ingredient of the euro-crisis, together with the vast failures of its institutional architecture (starting from the hampered role of the European Central Bank, which had to rely on a legal loophole in its Statute in order to be able to partially and indirectly cope with some manifestations of the crisis through its three-years LTRO – Long-Term Refinancing Operation scheme). In other words, financial crises do not take place completely at random, and

serious flaws in the euro construction must be addressed as well as seeking a reform of the financial system.

Keynesian solutions have been proposed to address the specific problem of the within-eurozone international real imbalances, that move well beyond the simplistic bastard Keynesian recipe of increasing public expenditure per se. At least two such proposals are worth mentioning, both aiming at overcoming the deflationary bias inherent in fixed exchange rate systems (such as the euro), when the burden of rebalancing balance-of-payments disequilibria is completely and exclusively weighted on the deficit countries (Thirlwall, 2011). A first possible way to have surplus countries contributing to the rebalance, an alternative that would prove to their and the deficit countries' advantage, was proposed among others by the same Eckhard Hein (2012b). It consists in the coordination of expansionary fiscal policies in the European countries exhibiting a balance-of-payments surplus, with a more restrictive policy stance in the balance-of-payments deficit countries. A second solution has been laid down by Brancaccio (2012), who proposes the establishment of a "European wage standard", i.e. collective wage bargaining rules or other institutional set-ups that imply that no country can seek real competitive devaluations by having average wages grow less than average productivity.

These options would indeed be more viable alternatives than the current beggar-thy-neighbour strategy of competitive devaluations by almost all the eurozone member states at the same time, i.e. the attempt to recover the European economies at the expense of their main trade partners, namely the other EU member states themselves. According to this strategy, countries in balance-of-payments deficit (though usual reference, in mainstream media, is to public sector deficit) should seek wage and price deflation, with the aim to reduce imports and boost exports. While the relevance of price competitiveness in shaping trade patterns has been challenged by several authors (including Thirlwall, at least since his famous article on this journal: Thirlwall, 1979), the strategy misses its main goal for a number of further reasons. First, if all EU countries decide to devaluate at the same time, there are only two alternatives: either relative prices do not change and the policy is

ineffective at all, or a race to the bottom must start, whereby the countries that impose more suffering upon their population may finally hope to ripe some benefits, while for the others the suffering will have proven mostly useless. Second, such a process will pinpoint even more competition between EU countries for the same external markets, in a period in which the current global business cycle is not positive enough. Third, by reducing aggregate demand in Europe, given the size of the EU's economy, it will spiral into a vicious cycle of lower global demand, to which the other countries will necessarily respond by engaging in the same devaluation race and/or with retaliatory protectionist moves. The experience of the post-1929 world should be a reminder of the risks of such competitive mercantilist policies.

On the contrary, the two mentioned Keynesian alternatives, by relying on expansions of aggregate demand in the surplus European countries, aim at reducing the balance-of-payments deficit in the European periphery countries on the basis that the latter are the formers' main trading partners. Yet, they are not the only trading partners, as even the EU as a whole cannot be considered as a closed economy. Thus, it should be recalled that periphery European countries indeed exhibit a low international competitiveness that an expansion of aggregate demand by their European neighbours may only temporarily relieve. For these countries, the institutional flaws and lack of coordination within the euro-zone are only part (though a significant one) of a larger problem, and in a longer run the reduction of the central European countries' competitiveness may end up substituting the peripheral countries' imports from the former with imports from non-EU countries, while only marginally improving the periphery countries' exports. For the case of Italy, the point of the crisis "coming from before" was raised on Moneta e Credito, the sister journal to the present one, by Ciocca (2010), D'Ippoliti and Roncaglia (2011) and Ferrari (2012).

As mentioned, however, while these underlying long-run real dynamics may be identified as some of the factors that created the conditions for the crisis, the crisis itself remains a financial one, though with major consequences on the real economy. Regulation of finance remains thus a crucial component of any exit strategy. In the present

issue, two articles concern topics on the economics and finance, with relevant prescriptions in terms of financial regulation.

Niccoli and Marchionne (2012) analyse the situation as it appeared at the outburst of the financial crisis in the USA, providing some empirical evidence that challenges the conventional view that the US sub-prime residential mortgages market is the only or even the main cause of the crisis. The authors compare default rates on such mortgages with the interest rates that were charged on them, and estimate the impact of these variables on banks' capital and profitability, through simulation techniques. The main finding is that in many cases sub-prime mortgages were probably profitable still after the beginning of the crisis, and that in general they may have contributed to the initial generation of turmoil in the financial markets, but certainly cannot be singled out as the origin of the crisis. Although the authors do not explicitly put forward alternative hypotheses, their analysis is broadly compatible with several other works published by our journal and its Italian sister series, pointing at structural and institutional failures e.g. in the derivatives market, complex securitisation processes, banking industry regulation, etc. (see for example the financial regulation implications of the recent works by Montanaro and Tonveronachi, 2011; Tonveronachi, 2010; Kregel, 2011b; or Masera, 2010).

The final article of the issue, by Girardi (2012), focuses on the commodities markets. It provides compelling evidence on the role that purely financial (speculative) operators play in the determination of wheat prices and the associated violent oscillations. The issue of speculation on commodity prices has become particularly pressing since the crisis began, with such enormous variance in prices to make it evident by itself that no underlying real factor could possibly be in place. The argument was already put forward with respect to energy prices (for example by Roncaglia, 2003, for the case of oil, in which however the issue of oligopolistic market forms overlaps with that of financial speculation). However, a crucial peculiarity of several non-energy commodities, such as wheat, is their use as food, which makes even more direct and rapid the negative social impacts of sudden upswings in their prices.

While attention of the media is narrowly focussed on the social impact of the crisis in the developed world, several developing and least developed countries are paying a very high price (in terms of food security and energy and commodities prices, but also due to the extreme swings to which their currencies are subject) amid general neglect of the issue.

While a more compelling regulation remains the first solution, along the lines proposed by Ghosh (2011), it remains an open issue the extent to which non-conventional measures of expansion of the monetary base in the developed countries (especially the quantitative easing rounds in the USA and the LTRO in Europe) contributed to fuelling even more financial resources in commodity speculation. This is but a further example of how the lack of supranational political institutions armed with sufficient power, or at least of efficient international coordination mechanisms, produces harm by itself and through the lack of adequate consideration for the big picture in the design and implementation of policies at the national level.

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