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Contribute to debate "Keynes and the ecocnomic policies of the 80's"

It is certainly not easy to discuss and debate such an important theme after the comprehensive and articulated speech by Professor Eltis. I will try, therefore, to speak about only some of the many considerations which this theme can suggest.

The following is why, then, one day Keynes seems to be definitely outdated and then on the next day he is discovered again and "resurrected".

It is my feeling that on at least some occasions when the question in posed about Keynes's relevance in the eighties, an answer is given which is almost taken for granted.

Sometimes, in fact, people try to state that Keynes had said certain things in order to demonstrate that those things are wrong or that in any case, the economic reality of these years and the growth in international integration tend to demonstrate that his ideas today have very little relevance.

It is my opinion, instead, that there are two messages, two lessons we can learn from Keynes's contribution which should not, in any way, be lost.

The first message, in my opinion, is the demonstration that an economic system, a market economy, does not necessarily determine full employment conditions. It is, therefore, society's responsibility to be concerned with the "management of the economy" and to debate the effectiveness of policy instruments and the limits of economic policy. Those who are more critical of Keynes, those who perhaps, to a certain extent, are celebrating his demise, tend, therefore, to demonstrate that the mistakes which can be made in utilizing instruments of economic policy can bring about results that are worse than those obtainable without the utilization of those instruments.

The second message, in my opinion, is that, "after Keynes" it has no longer been possible to refer to a macroeconomic analysis viewed as a sum of specific "partial equilibria". The economic system is a set of interactive sectors and even economic policy and its effects upon the various sectors of the economic system must be assessed with this view in mind, by managing to assess the effects and the links among flow and stock variables as well.

Now, if this is true, my conclusion is that, perhaps, more than celebrating Keynes's demise or resurrection, it is important to assess more precisely what has happened in these years in terms of economic events and in terms of policy instruments and economic policy utilization.

It seems to me that Professor Eltis was right in bringing into focus one of the major criticism of so-called Keynesian economic policy. This criticism tends to support the idea that even if economic policy, and fiscal policy in particular, could somehow, through demand management, achieve its objective resulting in better growth of production and employment, the costs, in terms of inflation, which are generated in reaching these targets are high and are continuing to rise. As such, they would, therefore, offset the possible positive effects in terms of demand and growth.

On this subject I would like to propose my initial reactions as a contribution to the debate. In reality, this kind of criticism became relevant at about the end of the seventies and further developed in the eighties, on the assumption that the great inflationary wave of those years was something strongly "build in" or perversely introduced into the economic systems by the Keynesian policy of deficit spending. It is my feeling that this is probably true, at least in part. Perhaps, however, the other source of inflationary thrusts has not been taken under just consideration: that is, thrusts which predominantly come from rising costs, from changes in the relative price system and from adjustments in supply and production structures. Therefore, one should really ask how these two thrusts toward inflation (from demand and from costs) react with each other and which part one or the other can play at different periods. It is also necessary to carefully assess the redistributive effects of inflation in order to be able to see who is paying, who is gaining and who is losing. I remember, for instance, that, apparently, in the case of Italy, the great inflation of the seventies did not seem to have translated into costs for any particular social group. In reality, the macroeconomic equilibrium was achieved, in a remarkable way, through a policy of negative real interest rates. Thus, we can perhaps conclude that, given the Italian experience of the seventies, the inflation impact was predominantly paid for by savers. It would be surprising then if one didn't accept the idea that, in some ways, monetary illusion can exist. This, however, would immediately mean that such a mechanism, more or less acceptable, could not determine long-term equilibria, simply because growth in the stock of public debt would reveal "monetary illusion" which, when discovered, would, soon or later, compel savers to ask for positive real rates. One can imagine then, what it would mean, from the point of view of the system's overall equilibrium, if the adjustment could occur through negative real rates or would have to be determined through positive real rates. Certainly, the experience of the eighties leads us to assess the effect of the adjustment process through the implementation of positive real rates and,therefore, leads us to support Professor Eltis's arguments on the phenomenon of displacement.

I would like to propose a second consideration on the subject of demand inflation and cost inflation. In reality we can say that if we keep demand under control, it need not be inflationary as long as production capacity utilization is allowed to increase. We, however, know that, as the upper limit of production capacity utilization is being approached, there could be, from one side, a push on prices, but, from the other side, there could also develop a mechanism which would push up growth in production capacity itself. It is then necessary to assess the two effects and determine which of the two phenomena starts first, and which is stronger. A more strictly Keynesian point of view would be to imagine that the inflationary impact would not be so intense and so lasting and that the increase in production capacity would occur in time enough to automatically determine a weakening in the inflationary thrust itself. On the other hand, however, from the point of view of cost inflation, one must remember that, even in this case the productive structure undergoes some adjustments. These adjustments probably require a much longer time to occur. I believe that our experience in the eighties demonstrates this phenomenon, at least in part. A change in factor cost promotes technological innovations and promotes an optimal utilization of technical know-how, but the time needed for restructuring the production process, and therefore for production capacity to re-adjust to the new demand conditions, is certainly longer.

It does not appear to be easy, therefore, to choose which one of the two roads would be more effective. In the first case, by not assessing the effects which a rising demand could have upon the capital formation process and upon the expansion of production capacity, one could conclude that Keynes is obsolete, at least according to one way of interpreting his readings and that the foundation for supply-side economics can be laid.

Finally, a third observation. It is my impression that, if in a certain sense one tends to declare Keynes "dead" as the champion of budget policy, it is, in reality, the dangerousness and ineffectiveness of certain specific public budget policies, taken by some countries during specific periods, which should, instead be pointed out. These policies do not necessarily reflect Keynes's message either from the point of view of its theoretical structure or from the point of view of the domestic and international economic environments in which they are applied. International integration today is so strong that it alone would modify the reference picture.

Furthermore, it must also be stated that monetary policies themselves, which should be substitutes for fiscal policies, cannot be effective in controlling the economy for any longer than brief periods and unless they are applied rigorously over brief periods. In fact, if monetary policies are rigorously applied over long periods, they would cause the market to become inured to them. For this reason, in order to be effective, monetary restrictions must be increased in time.

In conclusion, first, it is my belief that it is not correct to characterize Keynes as schizophrenic as a result of someone's enthusiastic interpretation of deficit spending, so that one can later judge his contribution negatively. In the second place, I do not believe that instruments of monetary and credit policies can replace the basic Keynesian message. In the third place, in light of the domestic and international environments of all countries where technological innovation and economic integration increasingly focus more attention on analysing the trend in supply and the structure of production, a policy aimed at controlling demand might very well be less effective than it would have been during other periods, and yet one cannot conclude from this that a policy aimed at controlling demand is useless or damaging.

Certainly regarding the American experience of the eighties, there have been economic policy lines of the "supply-side" type, but it is equally certain that the realization of their objectives was accomplished by strongly relying on demand policies which, either by their previous choice or by their acceptance afterwards, were Keynesian, at least in their basic message.

Therefore, I believe that if "Reaganomics" has some merit, it is precisely that it has demonstrated that perhaps theoretical and also empirical extremism in running economic policy, and excessive, "schizophrenic" enthusiasm for specific instruments, are indeed useful in correctly controlling the economy!

From this point of view, Keynes's message can neither be forgotten nor can it be celebrated in a great and sudden resurrection. His contribution maintains its validity because he recognized the problem of controlling the economic system and the need for public intervention in the economy, intervention which must be capable of penetrating and organizing both the control of demand and the effects on the structure of production, effects which the same policies aimed at controlling demand might generate. Public interventions would, thus, provide a market economy with more space and improved opportunities for development.