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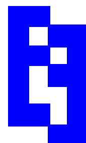

Luxembourg Institute for European
and International Studies

EXECUTIVE SUMMARY

Conference on

J.M. Keynes and Europe: Memories and Prospects

4 and 5 December 2009
Trier

Introduction

The Luxembourg Institute for European and International Studies (LIEIS), in association with the University of Trier, convened an international seminar on "John Maynard Keynes and Europe: Memories and Prospects" on 4-5 December 2009 in Trier. This seminar was held on the occasion of the 90th anniversary of Keynes' visit to Trier in the aftermath of the First World War when he was instrumental in negotiations over the lifting of the post-Armistice blockade of Germany and over her war reparations. In part, these events led him to write *The Economic Consequences of the Peace*.

The seminar consisted of two half-days of round-table discussions, a keynote lecture by Professor Robert Skidelsky and a valedictory address by Professor Gerhard Michael Ambrosi on his retirement from the Jean Monnet Chair of European Economic Policy at the University of Trier. Approximately 25 participants from around Europe debated Keynes' economic theory in its historical context and its relevance in the current crisis. Though there was broad agreement on the significance of Keynesian monetary and fiscal policy in recessions, the discussions highlighted fundamentally different analyses on the underlying causes of the global credit crunch, the proximity of Keynes' and Marx's ideas and policy prescriptions for Europe.

In his opening remarks, Armand Clesse, Director of the LIEIS who chaired the proceedings, urged the participants to eschew conventional ideas and narrow concepts in favour of more overarching theories and the moral foundations of Keynesian economics. The aim was a lively exchange of ideas and a free-wheeling discussion.

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I. Keynes and Europe: An Assessment

The first session consisted of a round-table discussion on the historical context of Keynes' important book *The Economic Consequences of the Peace* (1919) as well as the impact of Keynes on past and present economic theory and policy.

A. Some brief historical observations

In *The Economic Consequences of the Peace*, Keynes reveals that he became a European when he acted as a British negotiator at the Paris Peace conference in 1919. Already during re-negotiations over the terms of the armistice in January 1919 in Trier with his German counterpart Dr Carl Melchior, Keynes experienced a deep and earnest friendship across enemy borders – as evinced by his essay "Dr. Melchior – a defeated enemy" (in *Essays in Biography*, vol. X of *The Collected Writings of John Maynard Keynes*, London: Macmillan, 1972, chap. 38, pp. 389-429). In this essay Keynes describes – among many other things – how Melchior unsuccessfully negotiated for an allied credit for Germany – an idea which Keynes, in the last chapter of *The Economic Consequences of the Peace*, subsequently developed into the proposal of a US credit for allied and enemy countries alike. Keynes thus formulated in 1919 a proposal which foreshadowed the essential elements of the 1947 Marshall Plan. Henceforth, Keynes and Melchior worked repeatedly together on important international projects. As Robert Skidelsky remarked ("Keynes", in: Keith Thomas, editor, *Three Great Economists*, 1997, p. 251) "through his friendship with the Hamburg banker Carl Melchior, [Keynes] acted almost as unofficial adviser to the German government in 1922-3" (G.M. Ambrosi).

Keynes also began to develop ideas for a different worldwide economic and financial system at this time which would shape the creation of the Bretton Woods institutions at the end of the Second World War. Far from endorsing the freely roaming, unfettered global capital, he advocated limits on capital mobility and argued in favour of money serving community rather than financiers. Nor were these limits confined to the system of nation-states. On the contrary, Keynes, although a British patriot, did see important economic and administrative functions in other empires, too. But the First World War destroyed four empires (the Tsarist, the Ottoman, the Austro-Hungarian and the Hohenzollern) and the subsequent fragmentation made international and indeed trans-national arrangements even more necessary and desirable (G.M. Ambrosi).

B. Keynesian ideas today

After this brief historical perspective, the discussions turned to the significance of Keynes' ideas for current debates about economic theories and policies. It was suggested that for Keynes the *raison d'être* of economic theory is to get to policy. Economics is not – and should not be – a purely speculative venture (Geoff Harcourt). The discussions revolved around three issues. First of all, labour market flexibility; secondly, banking and finance; thirdly, the fate of the Eurozone and current international arrangements (Mark Hayes).

1. Labour market flexibility

For some years now, a wide variety of countries have dismantled their welfare state and labour protection, based on a misguided economic theory that focuses on supply-side factors and the costs of the real wage. Keynes, by contrast, emphasized demand-side factors and the importance of wages for aggregate demand. Of course, there are issues of flexibility and productivity, but the idea that we can reduce demand-deficient unemployment by cutting wages and benefits is misguided (M. Hayes). Keynes did not question the different type of unemployment embodied in the concept of the natural rate of unemployment. The key challenge was – and still is – how to increase the share of labour in national income without harming the interests of capital. At the time of Keynes, the velocity of change was much slower than nowadays (not least due to rapid technological change) and perhaps we have to accept lower wages in times of crisis. Moreover, we need more flexibility in labour market in order to cope with phenomena such as seasonal work (Alfred Steinherr).

2. Banking and finance

From a Keynesian perspective, governments and regulators should break up big banks, separate investment from retail banking and reduce the greed of the financial sector. Now that the Anglo-Saxon model has run aground, money should be re-directed from finance itself and speculation in real estate to businesses. Casino banking should be expensive (not too-big-to-fail) and inaccessible (by introducing a clear legal separation between different types of banking). In all likelihood, such a change will only be proposed and enacted by European leaders (M. Hayes). But it was argued that the global crisis cannot be explained in terms of the US real estate bubble alone, otherwise we risk explaining one endogenous variable with another endogenous variable. What about exogenous factors, in particular soaring global imbalances as a result of 50% increase in liquidity in excess of nominal incomes (A. Steinherr)?

3. The Eurozone and international arrangements

A monetary union among different countries reduces concerns about balance of payments disequilibria. But currently there are tensions amongst the members of the Eurozone concerning current debt and deficit levels as well as future inflationary pressure. Can the Eurozone afford to do the same as Britain and see its currency devalued in order to maintain its market share? The second phase of the Bretton Woods era (after approximately 1973) has turned out to be fragile and unstable, with increasing levels of volatility and uncertainty. In the face of growing Chinese influence on the global economy, a new Bretton Woods system is needed, including the possibility of a Commodity-Reserve Currency (M. Hayes). It was however contended that there is no realistic chance for a Bretton Woods 3, but of course more coordination and cooperation are always desirable and after the recent crisis feasible. A 'world currency' based on special drawing rights (SDRs) is not at all the same as Keynes' ambitions in the post-war period. Keynes' proposals were characterised by symmetry, which would put pressure on both deficit and surplus countries. Of course the US and Europe need to cut back their consumer and public debt as well as current account deficits, but the current surplus run by China is totally unsustainable (A. Steinherr).

These rival accounts triggered a lively debate which focused on the following issues. First of all, the origins and the nature of the ongoing economic turmoil. Secondly, the relation between finance and the rest of the economy. Thirdly, the limits of the European economic model. Fourthly, the possibility of combining the insights of both Marx and Keynes. Fifth, the implications of the current crisis for economic theory and policy.

[i] The current crisis

The fundamental disagreement among the participants was on the role of debtor and surplus countries in triggering the ongoing turmoil. Some participants argued that both central bankers and the financial sector in mostly Western countries failed to recognise the unsustainable character of the real estate bubble which was credit-fuelled and debt-leveraged (Ingemar Schumacher; Jens Hölscher). Others pinned the blame more firmly on the vast currency reserves of surplus countries, in particular China, parts of East Asia and the Gulf states but also Germany and other EU members. National savings can be used either to invest in current account surplus or to finance deficits and service debt. It seems that a lack of confidence in their own economy would explain why the Germans (and also the Chinese) do not invest more at home (A. Steinherr). In this context, it was said that the post-war economic success in the West was built in part on the fact that export surplus countries like Germany permitted occasional re-valuations of their currencies, something which the Chinese are (rather conveniently) forgetting when they resist a re-valuation of the Yuan.

Yet other participants drew a different implication: since money is a public good (as the economist Paul De Grauwe argues in the introductory pages of his *International Money*), currencies should be international – not national – because they facilitate transactions and exchange. But the temptation is always great for single banks and single countries to cash in on these services of money by excessive issuance of the money they can create. This strengthens the case for a well managed world currency. One reason for the present Chinese foreign currency accumulation was to keep the Yuan pegged to the US dollar; and to avoid the fate of countries like Thailand, Korea and Malaysia during the Asian Financial Crisis of 1997. If imbalances are now a problem, then there is an even greater need for international monetary reform than was already the case before the present crisis. At the same time, Keynes was aware that there must be leeway for an active monetary policy. Apparently he called the gold standard a 'barbarian relic' (G. M. Ambrosi; M. Hayes).

[ii] The relation between finance and the rest of the economy

It was also argued that global finance is increasingly disconnected from the 'real' economy. The difference between traditional economies and finance capitalism can be described in terms of a series of layers built on top of the everyday market economy composed of agriculture, manufacturing and industry. These layers – local, regional, national and global – are characterised by ever-greater abstraction. At the top sits disembodied global finance, seeking returns anywhere, uncommitted to any particular place or industry, and subjecting anything and everything to market valuation and commodification. Whilst financial speculation is no longer confined to shares but extends to real estate and commodities (including food and oil), the rest of the economy depends for loans and credit on global finance. Unlike monetarists who look to the growth of money supply, Keynesians consider the output gap and in times of recession seek to stimulate aggregate demand (Adrian Pabst).

Beyond the divide between Keynesianism and monetarism, there are plenty of concrete alternatives that neither rely on centralised bureaucratic state-planning nor unbridled free-market capitalism, including housing associations, community banking and public-interest investment and infrastructure banks. Rather than merely increasing the money supply (as monetarists would advise), it is economically preferable to change the relationship between capital and labour by widening the distribution of assets (including via the welfare system) and by increasing ownership (cooperatives, employee-owned companies, public interest utilities, etc). This provides a viable alternative to speculative finance and cartel capitalism (A. Pabst).

Others disagreed with this account, saying that employee ownership puts excessive risk on the business and concentrates workers' savings in a company that could go bankrupt. In any case, Keynes had very little to say about labour participation in capital (A. Steinherr).

[iii] Europe

It was also said that neither the EU nor the Eurozone correspond to the best of Keynesian ideas and policies: the single market is like a rich man's club; the Maastricht convergence criteria lack any economic logic; the Eurozone's monetary policy is little more than a German approach which is shaped by a historically contingent experience of hyperinflation and therefore has an inbuilt contractionary dimension; calls from both left and right for greater flexibility in the labour market means in practice the creation of a compliant and quiescent labour force open to further exploitation by the owners of capital (G. Harcourt).

[iv] Implications for economic theory and policy

Some participants suggested that it is important to distinguish two 'economic' worldviews. Either it is thought that local and global markets are equilibrators which clear in the medium and in the long run. This is based on the triple assumption of perfect competition, symmetric information and rational expectations. Or else the argument is that there are cumulative causation processes whereby markets get ahead or fall behind and subsequently they stay ahead or behind. This rival account is founded on the triple premise of imperfect information, asymmetric information and bounded rationality. Moreover, the economist Kalecki theorised the distinction between a political economy that restores balances and a system that maintains balances. Crucially, Keynes understood inter-related processes, systems and different temporalities better than the founding fathers of classical economics. This matters today because bankers suffer from euphoria in the upturn and from panic in the downturn. Interestingly, this is also Minsky's interpretation of Keynes (G. Harcourt). Other participants referred to Frank Hahn, according to whom all equilibrium models are local, so global imbalances are of a different kind and require other solutions (A. Steinherr).

Yet other participants shifted the debate about economic theory and policy to the question of demand. Keynes was interested in effective demand. He did not recommend raising nominal wages in order to fuel demand because with given marginal productivity of wages this would just feed into higher prices, thus leaving effective demand in wage units the same as before. In this context, technological change is tremendously important because it affects frictional and voluntary unemployment. But it is also clear that 'disguised unemployment' (Joan Robinson) is key: people are forced into unwanted jobs. Neither cutting wages nor enhancing the

flexibility of labour markets would be a solution to this problem or the phenomenon of seasonal work. Moreover, there is a paradigmatic opposition between the neo-classical position on the one hand, stressing the scarcity of resources and the necessity to move along the given production possibility curve. On the other hand, the Keynesian position concerning effective demand stresses that in a business slump the really scarce thing is not resources but turnover. Advertisement is such a big business in our economies not because resources are scarce but because it brings turnover which firms desperately vie for. This is why firms like Google can supply their services free of charge for the users. When effective demand is deficient, there is a definite role for governments and the state. (M. Hayes, G.M. Ambrosi).

The concept of ‘animal spirits’ was also mentioned, with some saying that ‘animal spirits’ express Keynes’ conviction that even when capital would be not scarce any more, there will be entrepreneurial activity and investment going on although the statistic probability of returns might be zero (G.M. Ambrosi). Others discussed this concept in relation with Akerlof and Shiller’s book *Animal Spirits* and they questioned the explanatory value of this idea which they considered as really disappointing (Serge Allegrezza). But it would also seem that man is neither good nor bad but instead feeble. Moreover, bankers have responded to incentives which are conditioned by institutional arrangements (Guy Kirsch).

[v] Similarities and differences of Marxian and Keynesian ideas

According to some participants, the growing concentration of wealth and ownership is a direct consequence of the current crisis. Here Marx’s critique of the concentration of finance capital is perhaps unparalleled and no less relevant now than in the past. Indeed, "the state has become an executive committee to defend the interest of capital", as Marx himself wrote (G. Kirsch). Even if the banking sector looks very different today compared with Keynes’ times, there can be little doubt that banking (and, to a lesser extent, finance) is characterised by a lack of competition. With high barriers to entry, there’s little choice other than to break up the big banks (Herbert Christie).

However, other participants contended that a clear separation between retail banking and investment banks is problematic. One reason why you will not have perfect competition is because IPOs require vast amounts of capital and also professionalism (relationships, not just brains). All this is mired by asymmetric information. There are such high earnings because the spirit of investment banks is partnership, as top bankers take their clients with them. It is therefore useless to dream about perfect competition. Rather, we should think about the modalities of public protection of retail banking and even non-banks like LTCM or AIG. And since we are talking about systemic risk, we cannot go for conventional measures (A. Steinherr).

II. Keynote Address: Keynes and the Crisis in Europe

The second part of the conference consisted in a keynote address by Professor Robert Skidelsky on "Keynes and the Crisis in Europe" and a discussion. Yves Mersch, the Governor of the Central Bank of Luxembourg, introduced the keynote speaker, highlighting the importance of Skidelsky’s recently published book *Keynes: The Return of the Master* and putting the renewed interest in Keynesian ideas in a European and international context.

A. Keynote address

The keynote address was divided into five parts. First, risk *versus* uncertainty. Second, why economies and investment break down. Third, the case for stimulus policies. Fourth, the shape of a new system to guard against future crises. Fifth, reforming economics. R. Skidelsky began his lecture by quoting the Chicago economist Lucas who after the onset of the economic crisis declared that "we are all Keynesians in a foxhole". In reality, the argument in favour of Keynesian concepts and policies is much stronger than the contingencies of the crisis would suggest.

1. Risk versus uncertainty

Prior to the global credit crunch, it was widely assumed that the efficient market hypothesis based on rational expectations holds true. According to this theory, markets clear as a result of the rational use of all available information and all risks are correctly priced (with merely random errors). Even though central bankers such as Alan Greenspan recognised the under-pricing of risk, the dominant theory of risk and risk management is still in place today.

The problem with this approach is not just the availability and use of information in the face of possibly perverse incentives, but crucially the pricing of risk. For Keynes, the distinction between risk and uncertainty is key. Risk is the measure of frequency of the probability of certain events, whereas uncertainty means that no such measure is possible. There are different types of probability. Ordinal probability describes events which are more or less probable, without, however, a clear measure of the probability involved. The problem is of course unknown probability. In a 1937 essay, Keynes speaks about 'uncertain knowledge'. This is particular relevant to the investment process which is driven by long-term considerations.

Crucially, human motives and intentions break the link between physics and economics. That is why economic theory is a moral rather than a natural science. As a result, economics itself needs to reintroduce restrictions on the use of econometrics in economic policy-making. Since relations are heterogeneous and not homogeneous, regressions and the constancy of relations they imply are of limited usefulness. Moreover, much of quantitative analysis is in reality ad hoc and requires prior justification. The bottom line is that we know very little about the future and that the Chicago model pretends otherwise.

Ramsey's attack on Keynes centred on the claim that prior probability is based on subjective beliefs (the rationality of bets) whereas posterior probability is a function of the number of objective observations. However, Keynes would deny that subjectivity can ever correspond perfectly to objectivity, as this would presuppose the veracity of inductive hypotheses when the number of known variables is in fact limited. The difference between this model and reality is the unknowability of future, singular events. For this reason, the idea that we can construct a mathematical model which measures future probability is deluded. Indeed, the financial collapse of 2008 does not provide a better probability forecast for the next crisis than before.

2. Why economies and investment break down

This point led Robert Skidelsky to address the question of why economies and investment tend to break down. The fundamental problem is that economists, bankers and financiers make unreasonable assumptions about human nature and the economic system. They use present knowledge to calculate future risk and thereby confuse the partially knowable probability of risk with the unknowable probability of uncertainty. Here the issue is not merely changes in information but rather the underlying assumption of stable preferences and rational expectations, both of which are philosophically flawed. New frameworks based on the idea of informational 'white noise' are no more accurate because they subscribe to the same foundational premises.

An economic collapse like the crisis of 2007-09 translates into a propensity to hold and to hoard money instead of consuming or investing it. Interestingly, Keynes did not limit this phenomenon to moments of collective market panic but extended it to 'ordinary times' which are as much characterised by bursts of optimism and spending as they are by bursts of pessimism and hoarding. When the latter drives up the real costs of lending, we are dealing with nothing less than usury because banks make money on the back of peoples' lack of confidence and fear of the future.

But is it therefore also the case that the Occident is in a state of permanent deflation as a result of the oriental hoarding of money? No, because the current state of global imbalances is in fact a recurrent pattern. The East has for a long time suffered from the absence of social security and more recently the effects of insuring against capital flight (in the wake of the 1997 East Asian crisis). Both these structural features underscore a persistent fear of the future.

The Chicago model of economics is untenable for other reasons too. It misconstrues mass unemployment as a rational choice in favour of (unpaid) leisure and fails to recognise that both wages and interest rates tend to be sticky. It was Keynes who first observed that hoarding keeps interest rates higher than they should be and that it is fear about future yields which fuels hoarding and higher interests – even in the long run when all markets are assumed to clear.

3. The case for stimulus policies

In part, the failure of free-market fundamentalism confirms the need for stimulus policies during protracted recessions. Conservative critics of these policies denounce the limited impact and the associated costs – either dramatically raising taxes or drastically cutting expenditure or reducing public debt through inflation or a combination of all three. However, these criticisms are as shrill as they are misguided. Only sustained growth will manage to reduce both budget deficits and public debt.

The point which is most often missed in the debates about the merit of fiscal and monetary stimuli is the output gap (rather than money supply alone) and Keynes' attack on Say's Law. Moreover, printing money is necessary but insufficient because without an increase in aggregate demand, a rise in the money supply will merely reduce interest rates for private lending, but in the current situation interests rates are at historically low levels. For all these

(and other) reasons, governments led by the UK were right to agree on fiscal expansion as well as quantitative easing.

4. What future system can guard against similar financial crises?

Beyond the stimulus policies, world leaders must urgently consider wide-ranging reforms of the international economic system. Simply enhancing transparency would represent little more than a placebo for increasingly complex financial instruments. Nor are better incentives sufficient to prevent speculation. Instead, what is required is to build effective firewalls that protect national and global financial systems from the danger of contagion – the spreading of systemic risk.

The first step should therefore be to separate utility from casino banking. It is absolutely crucial to reinstate the distinction and division of deposit banks, retails banks and proprietary trading houses (i.e. former merchant banks). This would be the safest way of reducing the scope for securitisation.

Secondly, economies need a larger share of state investment in order to balance the fluctuations in private investment. Both state and market failure are real, but if the latter can be corrected, so we must also think about how to rehabilitate the state as a potentially rational actor.

Thirdly, it is necessary to redistribute more income in order to stimulate consumption. Such a policy could take the form of helicopter money, e.g. spending vouchers for lower-income groups to purchase national goods. Ultimately, this is because mass production of goods and services requires mass consumption. However, what we are seeing at the moment is ‘a giant sucking pump’ which produces capital accumulation and concentrates purchasing power in the hands of the few, not the many. Only by borrowing can those on low incomes stay in the game, but cheap lending for these groups has dried up – only money from loan sharks and other similarly usurious practices are available to them.

Fourthly, the world needs to reduce global currency reserves and imbalances, which have soared from US$2.6 to 6.8 trillion in recent years. This flight away from consumption or investment into liquidity creates a huge reservoir of deflationary pressure. Keynes’ reflections on imbalances provides interesting insights into ways to reduce the costs of insuring against vast fluctuations. The Eurozone, which does not correspond to a traditional Optimum Currency Area, needs to address imbalances between North and South without, however, being able to resort to interest rate or exchange rate adjustments.

5. Reforming economics

Finally, economics need to be reformed profoundly. The efficient market and rational expectations hypotheses must be abandoned because innovation itself disturbs regular patterns. Behavioural economics is now in the ascendancy, drawing on cognitive psychology to produce a different account of human nature and social interaction. However, this approach is philosophically flawed because it tends to reduce the workings of the mind to the functions of the brain. By contrast, Keynes views human behaviour as reasonable in some circumstances rather than rational across the board. And given the highly contingent character

of forecasts, it is imperative to reduce the size of markets which are based on unknowable probability.

In conclusion, R. Skidelsky argued that the distinction between risk and uncertainty is key; without it, Keynesian economics collapses into classical economics. Uncertainty is the guarantee of human freedom, creativity and common rules and norms of behaviour. As such, a Keynesian perspective charts a middle way beyond the extremes of an unbridled free market and a centralised planning system.

B. Discussion

Following the keynote address, Samuel Brittan made a few comments. He began by saying that the neo-liberal outlook which has fallen into disrepute was in large part invented by Germany's *Ordnungspolitik*. As such, it is not quite accurate simply to blame Chicago economics and the Anglo-American model.

It is clear that Chinese reserves are the single biggest factor in causing this unprecedented level of global imbalances. Keynes' idea of 'currency confiscation' was in fact aimed at the USA, and it is far from evident whether it can be applied to China today. As a result, the Chinese surplus is best viewed as an exogenous factor which – at least for the time being – can only be treated as a given.

In the late 1960s and 1970s, high unemployment and stagflation were the result of trade unions and the rigidities of the social market model. The current crisis is the product of defective demand. But why secure more effective demand through state spending rather than private consumption? Nor is there ample empirical evidence today that public investment is more stable than private investment. Uncertainty means that we do not know whether a slump is short- or long-term. Stimulating private consumption, by whatever means, seems sensible, concluded S. Brittan

G. Harcourt contended that public investment is indispensable to addressing problems such as global climate change, social housing and education. Whereas helicopter money can be hoarded by the private sector which needs to de-leverage and reduce debt burden, public spending feeds directly into the economy. The question is therefore the composition of aggregate demand.

Moreover, tax cuts only work in a recession if they benefit income groups with a high propensity to consume. Chinese reserves are indeed a significant problem, but it seems difficult to stimulate private demand given China's prevailing structures of power, as R. Skidelsky remarked.

III. Keynes and the Crisis

In the third and final part of the conference, the discussions focused on the insights and limits of Keynesian economic theory and policy against the backdrop of the current crisis and the proposed reforms.

This session was held at the Study Centre "Karl Marx House", maintained by the "Friedrich Ebert Stiftung" in vicinity of the Karl Marx museum, the birth place of Karl Marx in 1818. In an introductory address the hostess, Mrs. Elisabeth Neu, a member of staff at the study centre, drew attention to the historical background of the venue and to the relations between Keynes and Karl Marx. H.E. Jansen in an article on "Marx and Keynes" (*Atlantic Economic Journal*, Dec. 1989, pp. 29-38) came to the conclusion that in spite of many differences, Marx and Keynes "both …had a ´vision` for a potentially realizable good society".

The ensuing debate revolved around three topics. First, speculation and the financial crisis. Second, different exchange rate regimes and central bank policies. Third, reforming institutional arrangements at the national and the international level.

1. Speculation and the financial crisis

At the beginning of the session, it was argued that speculation is seen as systemically beneficial by orthodox economics and harmful by (post-)Keynesian economists. Given the role of speculative capital in fuelling and ultimately bursting the recent bubble, how to reduce speculation in housing, capital and currency markets? (G. Harcourt)

This set the stage for a heated debate about the reality of speculative bubbles and effective remedies. Some participants questioned whether speculation has reached unsustainable levels and whether speculative capital justifies heavy-handed state intervention in markets. According to this view, speculative bursts existed well before the era of deregulation and liberalisation which began in the 1970s and some speculation is necessary to assess risks and explore investment opportunities which might otherwise not exist or remain unrealised. Moreover, there is a crucial difference between investment and placement and between investment and saving. Finally, the phenomenon of irrational exuberance means that stock market prices and possible bubbles are difficult to analyse, whereas real estate prices give you greater insight. None of this solves the problem of China's exponentially growing reserves and the ensuing global imbalances (S. Brittan).

Other participants contended that the post-1973 era marked an inversion of the ratio of investment to speculation. Whereas between 1945 and 1973, this ratio was 9 to 1, after the onset of neo-liberalism the ratio was 1 to 9. Of course the total volume of capital rose exponentially as a result of lower barriers to monetary mobility, but it is nevertheless the case that short-term speculation became quantitatively and qualitatively more prominent in the world economy. New complex instruments like derivative-trading inflated the volume of capital in search of lucrative opportunities. With declining profit margins in industry and manufacturing, money switched to finance, insurance and real estate or FIRE. Thus the new economy was born. Reinforced by easy credit, the US and Britain went on a collective speculation drive and consumption binge – financed by a mountain of debt. All of which led to artificially inflated and grossly overvalued asset prices: in the USA alone, the dot.com bubble built up $7 trillion in fictitious value and the housing bubble a staggering $12 trillion. The corporate imperative of quick profits put a premium on high-risk short-term speculative bets, injecting volatility into money markets and infecting the overall economic system. With private equity companies and hedge funds increasingly speculating in commodities, the

price of oil, metals and foodstuffs is soaring – to the detriment of producers and consumers. The global food crisis of 2008 was of a piece with the financial crash (A. Pabst).

This debate raised the question of how we can tell whether certain price movements are bubbles and whether they can be forecast (S. Brittan, G. Kirsch). In response, it was said that past data, certain price to earnings ratios and debt levels as early as 2003 were strong indicators of real estate and credit bubbles and that economists such as Nouriel Roubini and Anne Pettifor predicted the 2007-09 crisis as early 2003-5 (G. Harcourt, I. Schumacher, A. Pabst).

However, we could say that the word 'bubble' is overused, which is why – based on the work of Charles Kindleberger – we should restrict it to certain types of mania. Since there is no natural price (which is just a convention), bubbles emerge when the natural price is assumed always to go up. What this means is that the convention is equated with price rise and the constant growth in the value of the underlying assets. For this reason, various market actors made a profit on the markets going up and going down (in 2007-08).

In this context, other participants mentioned the growing convergence of gambling and finance (R. Skidelsky). At the time of Keynes, gambling in the UK took the form of horse-racing, whereas in the US most gambling was on the stock-market. According to J.M. Keynes, this was due to the relative lack of grass in the US! Yet others stressed the importance of John Hicks' distinction between being a snatcher or being a sticker, i.e. snatching quick bucks or sticking with an investment project (G. Harcourt). Moreover, there is a class of 'market makers' who speculate in bonds in order to keep interest rates constant, as opposed to 'market takers' who react to the given price levels. In turn, this raises the question of the multiplier effect of different forms of (financial) investment, the conditions that make speculation harmful and the empirical reality of the paradox of thrift (Peter Spahn).

In terms of possible remedies, it was said that the current reforms envisaged by the G20 aim at tightening capital requirements and forcing banks to have counter-cyclical capital ratios. But this approach presupposes that there are cycles, that we know the stage of cycles and that banks do not re-define capital as either off and/or on their balance sheets. The controversial Tobin tax was also discussed. In its most basic form, such a tax risks punishing equally the good and the bad and might be set at too low a level in order to prevent the sort of speculation which has been so disruptive. At the same time, some form of grit might be necessary to reduce 'hot money' (R. Skidelsky). However, to raise transaction costs lowers profit margins and could increase erratic capital movements precisely because of such lower margins. This is because speculation reflects expectations but big players can move markets by changing expectations. This raises the question of arbitrage and the appropriate price (or right price) at which demand and supply coincide (I. Schumacher).

Here it was remarked that the conceptual link between the various issues discussed in the three sessions of the conference is the neo-classical concept of natural rates. But there is no natural rate of interest, no natural rate of unemployment, there are no fundamental natural values in markets (stock markets or others) and there is no natural exchange rate (M. Hayes). The idea of natural price goes back to Smith. Alfred Marshall qualified this by arguing that prices should be distinguished in terms of the short, the medium and the long term. Finally,

Nicholas Kaldor's *Economics without Equilibrium* dismisses the whole idea that natural prices exist, even in the long run (G. Harcourt).

2. Exchange rate regimes and central bank policies

At the start of the discussion on different exchange rate regimes and central bank policies, it was remarked that nominal GDP and the stock of outstanding credit to the capital held by banks exhibited a strong correlation for about 50 years (1940-1990). Since then, this relation has diverged radically and now stands about 140% (compared with less than 100% before). How are we to explain this? Is this the product of the end of Communism and the global spread of capitalism? Or is this trend the result of a change of central bank practices: in the past, central banks used not just interest rates but also quantitative rationing of credit to the commercial banking system as a tool of adjustment and intervention. Until the crisis and the widespread implementation of quantitative easing, interest rates seemed to be the preferred, exclusive policy instrument (P. Spahn).

It would appear that a rather impoverished variant of monetarism drove the Bundesbank and other European central banks to abandon quantitative rationing in the 1980s, in particular the unsophisticated idea that hitting the target interest rate will also secure the target inflation rate, based on the theoretical work of Taylor and others (P. Spahn). It was also remarked that since Paul Volcker's disastrous attempts to impose quantitative restrictions in order to curb inflation, both the Fed and the Bank of England also dropped this policy (G.M. Ambrosi).

In turn, this led to a discussion about the merits of different exchange rate regimes. Floating exchange rates did of course not originate in the 1970s but started as early as the 1930s when the gold standard was abandoned. Many Keynesians supported floating exchange rates, managed or otherwise (S. Brittan). But since floating exchange rates only work if all are committed to it and if people know the correct price (R. Skidelsky), it seems that Keynes' idea of 'commodity stabilisation', which was further developed by Kaldor and Tinbergen to include proposals for a world currency or a basket of currencies, is once again timely. This would almost certainly be more attractive for the Chinese than the US Dollar. Further monetary integration also has the advantage of reducing disruptive currency speculation: as soon as the convergence exchange rates for the Euro were announced, intra-European speculation disappeared (M. Hayes).

However, it was pointed out that currently margins are widening between German and Mediterranean securities, especially Greek bonds. Moreover, it is unclear to what extent the Chinese would be prepared to convert their reserves held in US $ into a basket of currencies or a world currency. Talk about such options seemed to be aimed at fighting off growing Western demands for revaluation. In any case, neither option reduces the level of current global imbalances (S. Brittan).

In this context, it was also argued that Keynes proposed the confiscation of persistent surpluses. Commodity stabilisation is – so to speak – 'behind the curve' because it does not distinguish between fluctuations around the curve or shifts in the curve itself. Since commodities speculation is real but not so significant, there are four other Keynesian proposals to consider. First of all, Keynes did know about banking crises and would have recommend the separation of investment from retail banking, though chapter 12 of *The*

General Theory would need updating. Second, this would have to lead to a wider change in the structure of banking. Keynes would not so much advocate massive state regulation but rather the restoration of 'boring banking' and establish firewalls against casino capitalism. Third, Keynes warned about excessive reserve accumulation. Finally, Keynes would urge us to rethink the investment function for the state, even after the failures of the 1960s and the 1970s (R. Skidelsky).

3. Reforming institutional arrangements

Most participants expressed doubt about the institutional reforms agreed or discussed by the G20. Even though the IMF has undergone a revival thought to be impossible, politicians are afraid to take on finance capital. Besides capital requirements, little else is being seriously envisaged. A bolder move would be to make sure that asset ratios rise in line with rising prices in order to starve off potential bubbles (G. Harcourt). Other international measures which are urgently required include protecting labour, separating retail banking from casino capitalism and addressing imbalances. However, it should be born in mind that the Chinese and other emerging markets accumulate reserves because their economies could be trashed by a free floating exchange rate (M. Hayes).

Other participants mentioned ambitious asset schemes, more genuine self-regulation beyond state centralism and free-market fundamentalism and Marx's utopia that the state will ultimately wither away as a radical alternative to bank nationalisation and state control of the commanding heights (S. Brittan, A. Pabst).

Concluding remarks

G. M. Ambrosi closed the proceedings by wondering whether Marx and Keynes converge on the question of the limits of capitalism in generating positive return on capital itself. Keynes' vision was that with stabilising economic cycles to a "permanent quasi boom", eventually capital accumulation would go so far that the rewards for capital services might dwindle to zero. In that case, capitalism could not but become casino capitalism. The Keynesian utopia is of course different from the Marxian, but ironically in this respect the two had a lot in common with the thought of David Ricardo.

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J.M. Keynes and Europe

Memories and Prospects

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Commemorating the 90th anniversary of
Keynes's negotiations in Trier, Germany, and of the publication of his book
"The Economic Consequences of the Peace"

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