

*The World Economy in Crisis – The Return of Keynesianism?
13th Conference of the Research Network
Macroeconomics and Macroeconomic Policies (RNM)*

Berlin, 30-31 October 2009

A Keynes moment in Euroland?

Andrea Terzi, Franklin College Switzerland

Abstract: The Great Recession has produced a come back of the name of Keynes on media, as well as the implementation of policies with a Keynesian ‘taste’: unlimited liquidity provision at low policy rates and fiscal packages of unusual size. Yet, policy makers are not signaling a change in paradigm. This holds true especially in Europe, where both ECB and Commission maintain that non-standard monetary policy actions as well as a coordinated fiscal stimulus are consistent with their fundamental policy apparatus that needs no change, nor ‘quick fix’. This approach builds upon a ‘sovereignty deficit’ that has so far been acknowledged as a means to force member nations to comply with rules that mimic those of the gold standard.

Indeed, both the ‘quick fix’ and the rules of ‘discipline’ approach are extraneous to Keynes. His legacy is the description of a market system that oscillates within bounds, constantly underperforming. Full employment and price stability are pursued with structural, not cyclical, policies that require full monetary sovereignty.

A true return of Keynesianism in Europe begins by reading Keynes as a ‘classic author’ who can still enlighten the present debate by challenging major claims of European policy-making, including: the alleged benefits of price and wage adjustments, of net exports, of private and public savings; the necessity of curbing booms; and the ineffectiveness of fiscal policy. Keynes’s lesson is incompatible with the current political-monetary sovereignty deficit that is destabilizing the European construction.

OUTLINE SUMMARY

(NOT TO BE QUOTED WITHOUT PERMISSION)

1. WHAT KEYNESIANISM?

The Great Recession and Keynesianism

The extent of the impact of what is now labeled the 'Great Recession' has abruptly ended the Great Moderation and brought a come back of the name of Keynes.

Many professional mainstream economists must be finding this 'return of Keynesianism' annoying, if not irritating. After all, it is all in neoclassical microeconomics (with 'Keynesian results')!

To the question posed by this Conference's organizers, one can easily answer that yes, there is a return of Keynesianism on the media, and this happens because of the extent and depth of the economic crisis. And yet, this does not necessarily affect the mainstream paradigm and policy consensus.

There is also another sense of a return of Keynesianism. The 'Keynesian arm' of the macroeconomic consensus provides a foundation on how to employ short-run policies in dealing with the urgent and politically pressing emergency of a crisis that has created huge output and job losses.

This is the return to Keynesianism that we all have seen last year in the U.S. and Europe, following an economic crisis that trailed (*and not inevitably*) a banking crisis, a banking crisis that trailed (*and not inevitably*) a financial crisis that, on its turn, had trailed (*and not inevitably*) a liquidity crisis. In many ways, however, this was not a very successful return of Keynesianism, with public policy unable to act timely and preemptively.

Central banks show a taste of Keynesianism when providing liquidity without limits to meet banks' needs at the policy rate, and broadening the required collateral. A taste of Keynesianism also belongs to the considerable fiscal packages approved in several countries, notably, the U.S. and China, as well as, unevenly, in Europe. In all cases, these were fiscal policy measures in a scale that had not been seen for a long time, and that one could not realistically imagine or expect, on the basis of conventional wisdom, only two years ago.

Yet, such emergency measures do not so far portend a change in paradigm.

The Keynesian arm built in the existing rules has made it possible to adapt policies without modifying rules, thus fully complying with the notion that policy actions need only temporary corrections, not fundamental revisions.

Has the Great Recession meant a return of Keynesianism? The return of Keynesianism that we are seeing is largely inspired by a political necessity, and yet builds on the existing consensus, mainstream view of macroeconomic theory and policy. While some observe the developments of rising fiscal deficits and 'quantitative easing' on the monetary front with increasing concern, a number of mainstream economists do not object to the unusual adoption of liquidity measures and fiscally expansionary budgets, on the basis of the argument that after a shock of such magnitude self-adjustment would take an intolerable long time.

European policy makers have agreed on undertaking extraordinary measures on condition that such measures are coherent within the existing sound long-run policy principles, and intend to remain 'vigilant' that a return to normality follows suit. If, as I suspect, this Conference organizers are seeking for a return of Keynesianism that challenges the existing mainstream paradigm, this we have not seen yet.

Is Keynes the quick fix guy, or is Keynes a Classic?

The persistence of two competing Keynesian 'brands' of scholars is well-known within the economics profession. Two diverging and mutually incompatible readings of Keynes exist. One is a short-run theory of how demand can temporarily affect output and cause deviations from the long-run supply-driven growth path. The other is a theoretical framework that explains the structural characteristics of a monetary economy of production where growth is demand-driven.

One essential contrast, between Keynes and the mainstream Keynesian arm, matters in the context of the current policy actions aimed at ending the recession. For Keynes, our economies are subject to several conditions of stability that prevent them from either reaching quickly a state of maximum efficiency or a state of total collapse. Keynes's analysis leads to the necessity of structural policies to permanently achieve a full employment growth path, not to the necessity of temporary policy actions to soften painful cycles. Temporary, quick-fix measures are in fact the opposite of Keynes's recommended policies, aimed at full employment and price stability. The end of a recession, for Keynes, happens 'naturally', relying on the conditions of stability of the system. The real challenge begins with the character of the recovery.

If we then ask if the Great Recession is seeing a return of Keynesianism in this latter sense, i.e., in the form of an intellectual effort designed to change those 'natural' tendencies' for the sake of an improved public good, the answer cannot yet be affirmative.

In Keynes' economics, mechanisms to maintain aggregate demand that support full-employment should be the core of public policy in any nation that chooses to attain this goal.

These considerations suggest that a meaningful inquiry about the return of Keynesianism ought to be spelled in the following, different terms: Is Keynes an author worth reading to learn more about our own times? This question fundamentally asks if Keynes should be considered a 'classic'.

We should consider Keynes a classic author if we believe that despite having written well over half a century ago, when capitalism was significantly different today and the world economy was deeply shattered by military conflicts and a Great Depression under a gold standard system, he can still enlighten the present and may provide lessons. Thus, the question about a return of Keynesianism is really the question of whether reading Keynes can still be instructive today in order to understand business fluctuations and use the best means to prevent them by pushing the economic system to its potential.

Going back to the classics is common in hard times, and the global crisis will have served a purpose if it persuades us to reconsider some blindly accepted conventional wisdom pillars and use Keynes's insights, instead, to find better answers to our macroeconomic questions, and ultimately improving the economic world.

For Keynes, a theory is only as good as its practical applications. So, the discussion of Keynes as a classic must continue in a practical, historical context. In this sense, Europe seems today to be a good example of the 'natural' tendency of economic systems to oscillate well below their full potential. Is the global crisis helping Europeans to devise more effective ways to achieve stable

prosperity (assuming they have an interest in achieving this goal)? Does Keynes have anything to teach to European policymakers?

2. EUROLAND

A political project with a sovereignty deficit

A discussion of how European policymakers are dealing with the Great Recession and in general with the attainment of long-run economic objectives must begin with an assessment of macroeconomic governance in Europe.

In this regard, one should notice that the creation of a single currency area (Euroland) has meant a net reduction of political sovereignty of European countries. For all nations that have entered the single currency area, national sovereignty on setting, issuing and spending the nationally enforced means of payment was strictly limited at the country's level, and yet these powers were only partially transferred to a European body.

The most vital purpose of this approach was the creation of a 'state-of-the-art' monetary system (based on a sound, 'virtuous,' currency) that, if necessary, would act to 'discipline' countries so they comply with common rules. Such currency would be a functional piece of technology made possible by recent advances in economic theory and central banking techniques. It was meant to be a perfect form of money that needs no gold or state 'backing' it.

Thus, the creation of the euro was felt to be a win-win proposition: in the best-case scenario, it would be a means to promote 'sound money' and pave the way to the integration process; in the worst-case scenario, it would remain as a monetary accomplishment, even in the face of future political setbacks. This reflects the belief that the monetary and the political powers are more efficient when they act separately. A parallel political problem was that only a subset of countries in the EU have so far adopted the single currency, while others are either not ready or not willing to join. Because the single currency was intended to be a unifying process, it was not viable to separate these two groups politically. The lack of a distinct body assuming responsibility for economic governance for Euroland is partly the outcome of the problem of developing such entity separately from the rest of the Union.

The euro was meant to be the golden apple of Europeans, and to be such it had to be 'technically' sound. It was a compromise between Hayek's denationalized, private, competitive money and the traditional state monopoly assigned to the chartered central bank. It was denationalized, yet not private; public, yet chartered by a supranational Treaty. It was created to be a means to reduce policy mistakes, such as those made when central banks 'lean towards inflation' with rising unemployment, or when 'undisciplined fiscal policy' actions are undertaken by an expansion-oriented political process leading to national default or inflation. These should have become mistakes of the past, not to be repeated.

Euroland economics spelled its own conditions for soundness along two principles. First, the new single currency must provide an anchor of price stability for which the ECB is responsible. Second, national fiscal policies must accept to stay within the limits in their actions dictated by rules that prevent them from interfering with monetary management and are aimed at preventing default (not of inflation, because 'monetization' of debt is precluded in a system where governments have lost monetary sovereignty).

'Sound currency' so defined would be a necessary, though not sufficient, condition for long-run economic prosperity. In this construction, two additional policy tools must complement the monetary action. First, fiscal budgets must build adequate room for automatic stabilizers to play

their part during the business cycle. Second, a largely national effort (although coordinated and encouraged at the EU level) would modify some institutional characteristics of European economies in an effort to enhance the degree of competition and wage and price flexibility, and ultimately increasing the capacity of the economy to flexibly achieve its long-run potential output growth path.

The theoretical background of the above policy propositions includes the following beliefs:

- a) monetary policy can do nothing to directly promote growth except providing a medium / long-run anchor to prices;
- b) fiscal policy can do nothing to directly promote growth except refraining from interfering with monetary management and providing a medium / long-run fiscal sustainability framework that allows for temporary deviations aimed to counter business cycles;
- c) because temporary demand shocks cannot be avoided, there must be a sufficient power for self-adjustment, and this is partly provided by automatic stabilizers (to those disciplined government that can afford them), and partly by market mechanism whose functioning can be enhanced by structural reforms;
- d) structural reforms will primarily serve the purpose of sustaining long-run growth by increasing the efficiency by which existing resources are used.

When one considers this configuration, it does not seem very different from what was in vogue at the time Keynes was writing *The General Theory*: price stability would be strengthened by the gold standard, automatic stabilizers would contain fluctuations, and the best way to enhance growth is by raising its supply possibilities.

This design of removing political sovereignty from the European single currency conflicts with the reality of how the monetary system in Europe has been shaped by political decisions and how monetary developments have responded to political announcements. Indeed, management of a monetary system cannot do without the sovereignty dimension.

Policy actions to resolve the crisis

The liquidity crisis, the financial and banking crisis, and the Great Recession that followed suit have offered Euroland important tests of its capacity to respond. With respect to the liquidity crisis, the ECB has proved to manage it quite effectively. When the crisis sparked in August 2007, the ECB was prompt to reconsider the way it has been traditionally providing liquidity to the Eurosystem and adopted unlimited tenders at the policy rate. This meant abandoning any ambition to control the quantity of bank liquidity and accepting instead that it would only set the ask and the bid price of money for forward delivery. By providing an unlimited short-term provision of liquidity at the policy rates, the ECB succeeded in restoring liquidity conditions.

After all, there is not much more the central bank could do in terms of restoring credit, output, and growth in the euro area. The central bank can only effectively set the terms for banks to substitute financial assets (titles to receive money forward) for immediate liquidity, effectively reversing the action of sovereign bond issues when government substitute liquidity for titles to receive money forward. Functioning as a market maker that sets upper and lower limits to the ask and the bid price of money, the central bank does not directly affect the net worth of banks (except for the interest rate payment charged that influences banks' profits, and rentier income).

The ECB has provided a more diplomatic explanation of its efforts by claiming that “If the money market doesn’t work, the mechanism for transmitting monetary policy doesn’t work.” In this respect, the ECB has been careful in communicating the purpose of these actions as being consistent, and indeed required, by its primary policy objective of price stability. The ECB has repeatedly stressed how the non-standard measures adopted during the crisis were no exception to the long-run rules of operations of the ECB.

The ECB opinion, constantly voiced to Europeans, is that economic, as opposed to monetary, policy, must contemplate the typical ‘duet’: creating “flexible and efficient structures in product and labour markets,” and ensuring “the sustainability of public finances, effectively limiting government deficits and indebtedness, thereby also ensuring that automatic fiscal stabilizers work effectively as an adjustment mechanism in the currency union”.

The optimal policy approach remains that of reducing moral hazard, attaining a higher potential output by addressing market segmentation and enhancing competition, and allowing wage flexibility downwards: “wage policies should be compatible with trend developments in productivity in order to foster employment and should take into account the overriding importance of wage flexibility as an equilibrating adjustment mechanism in EMU.”

In the tool bag of Euroland, the management of aggregate demand is absent. An aggregate demand response beyond automatic stabilizers could only come from a political body either at the EU level, or at the level of nation states contemplating breaches of the Stability and Growth Pact. In November 2008, a modest fiscal stimulus was approved. The aim of the European Economic Recovery Plan was to ‘stop the downward spiral of demand, investment and employment.’

The EERP has been budgeted for roughly 1.5% of the EU’s GDP. Along with a revised Stability and Growth Pact that allows longer deadlines to adjust public finances if growth turns negative (and not necessarily -2%), it aimed at creating more ‘fiscal room’ for countries (though manifestly insufficient to deal with the crisis).

If this is the Keynes moment in Euroland, it is not supposed to last very long, nor being much effective.

The ‘sound, or ‘virtuous,’ currency syndrome is clear: the ECB intends to manage the euro as if it was backed by gold. This means that debts owned and debts owed entail not just monetary but rather real resources, or at least they should be treated as such. The sovereignty deficit thus looks intentional, as nations are forced to comply with rules that mimic those of the gold standard.

3. KEYNES’S LESSONS

Reading Keynes as a Classic

An author is a ‘classic’ when the act of reading it carries suggestions and guidance of contemporary relevance. In this sense, if he is a classic in this sense, we should find in Keynes’s writings a perspective that can help us improve our current attitudes towards macroeconomic problems. A diluted and artificially flavored form of Keynesianism today is reduced to the belief that cyclical use of fiscal policy may be warranted when a recession is too serious to be quickly fixed by usual adjustment mechanisms (on condition that national debt remains ‘sustainable’) and to the belief that the multiplier effect extends the benefit of public spending by limiting the impact on debt. Opponents believe that the fiscal multiplier is small and the long-run effects of a rising debt on sustainability far exceed the benefits.

If there is a Keynes moment in Europe, it is limited to this.

Keynes's theoretical construction was not a foundation for devising ways to soften cycles. Keynes's economics is not about approving a smaller or a larger fiscal stimulus. It is about aiming at full employment, and ultimately about proving an analytical point that provide support to a political decision of seeking ways to enhance economic prosperity by generating the conditions for full employment of existing resources. This was seen as a way to care for the future generations, and strengthen the liberal foundations of society. It was never a short-run, myopic plan, driven by a cynical attitude that in the long run we are all dead anyway.

Keynes developed several analytical points to strengthen his long-run argument. Yet, at a moment when Keynesianism seems to come back, these are not given a sufficient consideration for us to view the current situation in a different light.

Price and wage adjustment mechanisms. A traditional remedy to a slump is to let wages adjust so that a higher rate of employment and growth can be restored. European policy makers believe this is an important flexibility feature of a healthy market system. For Keynes, price and wage declines have an ambiguous and fundamentally negative impact. This is due to the reduction of prospective yield of investment caused by an expectation of declining wages and by the increasing burden on debt as a result of falling prices (as monetary debts do not deflate). Keynes admits only a once for all wage cut 'by decree' could have positive effects by creating an expectation of rising wages. On the contrary, downward flexible, sagging wages contribute to worsen the business climate. The only traditional channel through which lower wages could stimulate growth is if they cause a lower interest rate, but here of course it would be just enough if the central bank lowered rates directly (given we no longer have a gold standard). Keynes concluded that there is 'no ground for the belief that a flexible wage policy is capable of maintaining a state of continuous full employment; — any more than for the belief than an open-market monetary policy is capable, unaided, of achieving this result. The economic system cannot be made self-adjusting along these lines.' (GT, Ch. 19)

Keynes's analysis was clearly raising important questions for policy makers who consider wage flexibility being a condition for economic soundness, and such questions remain unresolved within the macroeconomic consensus paradigm.

The export industry as a demand engine. Countries that remedy a lack of domestic demand with an export-oriented policy pursue a socially harmful strategy that makes them dependent on foreign fluctuations of demand. By net exporting to the rest of the world, countries accumulate financial assets abroad at the expense of their current standard of living. In other words, they match the desire for savings of the private sector with a lower level of domestic consumption than if savings were matched by domestic demand. It means falling into the Mercantilist error of pursuing an accumulation of gold as a national objective. Keynes thought the Mercantilist true aim was to increase the stock of gold to allow a lower rate of interest. Outside the gold standard, when central banks are in power of interest rates, even this justification loses its appeal.

In a micro dimension, exports do reward business excellence. In a macro perspective, they should be used to provide room to imports so that a country can transform the real goods released abroad to real goods acquired from abroad. By contrast, net accumulation of financial assets will match a parallel reduction of real output consumed domestically.

The fact that such strategy requires that other countries pursue an opposite strategy (they must be willing to net import) entails that it can hardly be claimed to be a principle of soundness. An

export-led growth model, as practiced by the economically more powerful euro member, is self-defeating as it makes Euroland dependent on foreign business cycles, as well as it reinforces divergence and internal deflationary tendencies.

On curbing booms. A popular explanation (that the ECB has subscribed to) is that the Great Recession is partly the consequence of the excessive boom that preceded it. If this is true, the best action to prevent a slump is to curb 'over-investment' by timely raising the rate of interest. For Keynes, the most appropriate notion of over-investment is not applicable to a boom, but rather to 'a state of affairs where every kind of capital-goods is so abundant that there is no new investment which is expected, even in conditions of full employment, to earn in the course of its life more than its replacement cost.' By contrast, during booms, we observe a different kind of 'over-investment', i.e., 'investments which are destined to disappoint the expectations which prompted them for which there is no use in conditions of severe unemployment.' Booms turn into slumps not because the interest rate is too low but because some investments is misdirected (driven by speculative excitement in directions that are in special danger of being over-exploited, something that happens often, not necessarily during a boom), or expectations are too buoyant ('over-optimism triumphs over a rate of interest which, in a cooler light, would be seen to be excessive'), in which case, and until full employment is reached, interest rates (notably, long-term rates) should be lowered, before disillusion turn expectations into excessively pessimistic. This is the situation that Keynes considered the main point that economics should explain: 'a condition where there is a shortage of houses, but where nevertheless no one can afford to live in the houses that there are'. In other words, a recession is caused not by a decline of production possibilities, but by a monetary obstacle that prevents us from fully using the existing resources of the nation.

Raising interest rates is a way to overcome the speculative excitement and, at the same time, check every kind of reasonable new investment, an action that 'belongs to the species of remedy which cures the disease by killing the patient.' Keynes again: 'The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom.'

The desire for private and public savings. There is no macroeconomic reason for encouraging the private sector to further increase its savings beyond the existing desired level through a reduction of spending. A stimulus to savings is healthy when it happens with an increase in spending! Savings are the accounting equivalent of investment spending, so their total size is not under the control of the savers. Savings (notably, net financial savings) do matter because when the private sector feels it does not have enough savings, a reduction of spending and a decline of output and employment will ensue. When the private sector feels it ought to restore its savings, it reveals a need to repair balance sheets. Considering macroeconomic flows, there are only three possible means to accommodate and compensate this desire for savings by the private sector:

- a) a sufficient flow of business investment – that could only spark from a spontaneous change in confidence;
- b) a sufficient net flow of exports – that depends on foreign economic dynamics and means to surrender sovereignty to the economic and political power of foreign nations;
- c) a sufficient flow of net government deficits – i.e., a reduction of public savings that entails an increase in private savings by matter of accounting.

In Europe, this last option can hardly be generated within the existing constraints. Conversely, intended deficit reductions to meet fiscal discipline criteria and increase public savings will lower the available savings of the private sector and thus hurt the economy well beyond any interest rate effects of 'deficit-biased budgets.'

The relative effectiveness of monetary and fiscal policy. Business investment is restored when a confident business climate is restored. A variation of the rate of interest cannot by itself restore a confident climate, but only influence the yield at which investors discount their future expected proceeds. For Keynes, "it is not so easy to revive the marginal efficiency of capital, determined, as it is, by the uncontrollable and disobedient psychology of the business world. It is the return of confidence, to speak in ordinary language, which is so unsusceptible to control in an economy of individualistic capitalism. This is the aspect of the slump which bankers and business men have been right in emphasising, and which the economists who have put their faith in a "purely monetary" remedy have underestimated." Keynes considered how monetary policy—modifying the forward price of money—fundamentally differs from fiscal policy—modifying incomes and net worth of the private sector: 'a large capital programme would increase the profits of business men [and] would increase the wealth of the country' (XX 361). He rather expected 'to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organising investment' (P. 164, my emphasis).

It is possible that governments' loss of credibility with respect to their capacity to effectively manage expenses and taxes is the effect of a lack of leadership in those long views of the general social advantage. Reducing sovereignty, however, is not an effective answer, and it recalls the remedy of curing the disease 'by killing the patient'. When sovereignty is limited, it is likely to strike back in the form of populism or other non-democratic forms of power.

Full employment and financial stability. The most effective way to end a financial crisis and restore the ability of paying debts is to increase employment. The defaults that bring systemic damage are not those coming from frauds. Rather, it is the defaults that are caused by a decline in incomes, cash flows, and available jobs. So there is a connecting link between demand, employment and the financial health of the private sector. Following this logic, restoring demand and jobs has a more direct effect in restoring the health of the banking system than capital injections. Not only unemployment is 'an absurdity, a confession of failure, and a hopeless and inexcusable breakdown of the economic machine' (XX 321), but full employment and the ensuing increase in incomes would also increase the number of credit-worthy customers seeking funds.

This relation between employment and financial health, however, is completely absent from ECB commentaries. It is true that employment is not the primary objective of the ECB. Yet, if employment builds financial stability, and financial stability is a condition for the functioning of monetary policy, then employment should be given comparable priority.

Money illusion in Euroland

In neoclassical economics, money illusion indicates a serious fault in decision making, or a questionable assumption in economic models. It shows when economic agents mistaken changes in nominal values for changes in real values. This was also the critique of IS-LM-based Keynesian models where the system's lack of automatic adjustment depends on agents aiming at maximizing nominal, rather than real, values. The same critique would also apply to expansionary policies that aim at increasing nominal GDP.

The criticism of money illusion, however, is not applicable to Keynes's writings. Keynes never confused nominal with real values (and in The General Theory macroeconomic magnitudes are expressed in terms of wage units). Rather, he considered a false division the one between the theory of relative prices and the theory of money. In contrast, he argued that a more productive distinction would be that between the theory of industry, or firm, and the theory of output and employment in the economy as a whole, where the latter requires the theory of a monetary economy, where expectations of cash flows influence the present actions.

He stressed the view of money as an instrument that may lead to persistent stagnation or economic prosperity, depending on how we handle fiscal and monetary management. While monetary management should be aimed at preventing speculative excesses and investment misdirection by holding rates not too high, fiscal management should be aimed at generating sufficient private incomes to maintain full employment.

Keynes had manifested his dissatisfaction with 'the 'sound currency' dogmas of the mid-nineteenth century early in his life. His constant battle to design a monetary system that do without gold was intended to free the economic system from unnecessary constraints. He thought that monetary and economic soundness can be achieved at full employment, not when the economic system underperforms and fluctuates below full employment (just like in today's Europe).

A form of money illusion may indeed belong to the current policy framework in Europe. The ECB's approach separates monetary from economic soundness: the former can be technically achieved, even when governments do not do enough to achieve economic soundness. But this primacy of monetary soundness is illusory unless it is accompanied by effective macroeconomic governance, and thus economic soundness. Without the latter, the ECB cannot effectively be accountable for its medium-term policy strategy.

In this sense, European rules and policy paradigms can be seen as manifestation of a new form of money illusion: that money soundness can be separated from economic soundness, and that money soundness is achieved by limiting the growth of nominal income to less than 2% higher than real output, and consider such goal as an essential pre-condition for growth.

When analyzing the economy as a whole, Keynes was thinking not in terms of relative prices but in terms of cash flows, sales proceeds and balance sheets, that act as constraints on what ultimately matters to nations' standard of living, i.e., output and employment. Policies should thus be aimed to free the system from such monetary constraints.

Euroland (and European) policy-makers follow a very different direction. Even when they seem to acknowledge that hard times require a somewhat different approach, they are not sending a signal that after the recovery Europe will be on a track different from the one of price stability and stagnation of the first ten years of euro.

There is always an alternative option: that we discard Keynes as a visionary, for he believed that men and women can find a way to govern the economy by breaking the monetary constraints and escape from allegedly natural tendencies.