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Keynesian renaissance?[*]

This article mostly deals with issues raised on the basis of the publications written by Paul Krugman *and* Gregory Mankiw. *The authors of works that are used as basic textbooks in Hungary, too, are making theoretical, while the economic politicians of Germany, France and England are making practical efforts to raise the duality of state intervention and demand expansion to the level of theoretical requirements. After the introductory part of this study, attempts are made to enumerate the facts, to compare them with former similar situations, and to describe the elements of the possible remedy. It is shown that globalisation and EU regulations, as well as the changed role of expectations do not justify the revival of Keynesian solutions.*

In the 1970s, when Keynesianism was a mandatory element of good manners in economics, in Western Europe and the United States the so called "anti-crisis" policy designed to protect jobs and production, as well as to counteract the structural changes of the world economy led to permanent *stagflation*, which had earlier been defined as something impossible by the textbooks. A similar phenomenon evolved in Japan, too, in the 1990s. Under the influence of these phenomena, solutions called "neoclassical synthesis" lost their appeal. Economic politicians turned to other directions. The sizable group of economists interested in reality, who were called the engineers of the economy by the new Keynesian Gregory Mankiw (who is known as a textbook writer and also as the senior economic advisor of President *Bush* /2006/), turned towards another school. While in theory there was a sharp divide between the fronts, e.g. between the neoclassical and the Austrian schools, or the new Keynesians and the followers of new institutionalism, a specific agreement was reached in the everyday life of the OECD countries. The essence of this agreement is the unique pragmatic approach resulting from the mixture of monetarism and new institutionalism, known as the period of "great moderation" in financial literature. This means that the government refrains not only from the classical general boom-regulation envisioned by Keynes, but also from large-scale programmes, great deficits, and the accumulation of state debts,

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preserving price stability as a value in conjunction with the central bank, and expects a growth spurt from the private economy, while it ensures compliance with the rules of the game, as well as environmental and social sustainability. This means that – contrary to the minority concept of developmental states (Csáki, ed., 2009) – the state is characterised more by what the government refrains from than by what it does. And while there are plenty of writings and proposals praising and urging nannyism by the state, it was beyond any doubt that compared to the self-regulation of the market these measures could be only supplementary or subordinate to the government's refraining behaviour outlined above.

IS THE GENERAL PROFESSIONAL AGREEMENT TO BREAK UP?

However, under the influence of the financial crisis, which started with the collapse of the British real estate developer Northern Rock in 2007, and which presumably became open after Lehman Brothers was let to go bankrupt in September 2008, things went wild. Concepts that had earlier been considered obsolete for a long time became accepted not only in governmental practice, but also in the economic jargon. Solutions that were generally ignored, like the nationalization of large banks that serve as the nervous system of the market economy, have initially emerged as coercive, and then as a forward-looking measures. And especially in respect to the latter the intellectual turnaround of the 1930s seems to be repeating itself, when state intervention and the direct forms thereof were considered as the determining, or even inevitable direction of the future not only by Marxists.[1]

There are at least four fields in relation to which 2008 is regarded as "the year of turnaround" by many.

■ On the one hand: there is no doubt that the *central power must do something against the dramatic drop in demand* – induced by external and internal causes, fundamental and psychological factors reinforcing one another. Whether this is a Keynesian turn is not evident, not even in the first step, since the monetarist concept has always started out from the fact that while money is neutral in the long run, in the short run fluctuations of the economy are induced and intensified by the discretionary activity of the government and the central bank. This is exactly what *Milton Friedman* and *Anna Schwarz* (1963) show empirically in their classic work in relation to the economic history of the United States, and this is from which they derive the requirement of a budgetary and monetary policy restricted by rules or institutionally indifferent towards the short-term processes. In other words, the idea is that the task of monetary policy is to smooth out fluctuations in the economic cycle, which can now be considered as an axiom.

■ The second field that requires to be reconsidered according to many people is that of *regulation*. Today it is commonplace to state that non-intervention characteristic of the Greenspan era, or – according to others – investment friendly, targeted intervention aiming to prevent each market bubble from popping no matter what, was the direct cause of the financial crisis of 2007–2009. Many people – including a few Nobel laureates – conclude from this the need for the reinforcement of governmental intervention, and this opinion was shared by the participants of the G20 Summit held in May 2009, among others. However, the devil is in the details here, too. On the one hand: in today's world regulation is less and less governmental, and increasingly trade and profession related, and horizontal (see, for example, blacklisting by the banks). On the other hand: the exact time of the emergence of a bubble on the money

market, and when it swings into "exorbitance", can be known only afterwards, but never in advance. And last but by far not least: among the major elements of the development of the US stock market bubble the culprit was less the non-existence of state regulation and more the concrete absence and deficiencies thereof, i.e. it was a case of *governmental failure* (for more details see Győrffy, 2009).

■ The third area where changes have occurred in practice and then in theory, too is related to the ownership relations. If the past three decades were about privatisation and deregulation under the aegis of conservative revolution and the change of the political regime, then now direct and targeted governmental intervention, and even the thought and solution of *nationalization* have been deployed. What is more, this has happened in England and Germany, where these measures were earlier most sharply criticized, and especially in the financial area, which is considered to be the most detrimental, last but not least due to the great variety of coordination problems characteristic of the field.[2]

■ Finally, the notion of *market protection,* which is known as protectionism by its maiden name, and has long been considered obsolete, seems to be gaining ground. There emerged a range of solutions reminiscent of the "impoverish your neighbour" type politics of the great depression, and subordinating the requirements of multilateral and balanced international trade to short-term election interests under the disguise of "patriotic economic policy". And while it is barely necessary to rewrite the books supporting the advantages of multilateral trade and freely convertible currencies, in practice – especially in France and Germany – old-fashioned market protecting and trade restricting measures have become prevalent. Initiatives aiming at the global regulation of offshore centres represent only the visible level of this intention, however, sending migrant workers home, transferring manufacturing capacities to the main business address, or lay-offs at the "peripheral" companies – without regard to the profitability and market perspectives of the latter – can be listed among the cases well-known from the daily press.

If we do not wish to share the doctrinarian standpoint of the intellectual level of the introductory textbooks – which decision-makers could not allow themselves in any country, not in any concrete situation or any period of economic history – then we must not stop at blaming the "ugly bad world". It must be acknowledged at theoretical level, too that there are situations and occasions when the enforcement of "principality" does more harm than good. Obviously, the question in each case is *duration and extent.* We agree with the related opinion of *Tibor Erdős* (2009, pages 248–251), in which analysing Hungarian anti-crisis measures and recommendations he cautions against hasty generalisations, the application of theses that are true in an abstract sense without consideration of the circumstances, and against taking widely spread recommendations offering "surefire type of solutions". At the same time we think it is worth pondering whether the theoretically unprepared measures taken under pressure in each country would indeed form a new spiritual and economic policy trend – a paradigm – as it could be witnessed by the 1930s. Since if this was the case, not only the textbooks, but also the determining policies of the European Union – such as the Maastricht and the Nice Treaties, as well as the Stability and Growth Pact and the underlying basic treaties of the EU – would have to be urgently re-written. Since public recommendations and calls of this kind are plentiful, it makes sense to briefly summarise the events before trying to answer this complex question with scientific rigour at the end of this study.

FACTS BEFORE ANY GENERALISATION

Research institutes and international institutions regularly publish analyses covering the EU-27, which I do not intend to repeat. All the more, since a theoretical summary shall not attempt to continuously comment on current data. Therefore, I would only like to draw attention to a few facts that are ignored – as far as I see – in the crisis related debates conducted on the level of historical philosophy. The most important of these facts is perhaps the "so many countries, so many customs" phenomenon. This means that for very different reasons one can observe processes involving various elements and consequences, the common feature of which is that at the level of the national economy – i.e. not in the different companies or sectors – economic downturn seldom lasts for more than one calendar year. Since the ECB had all right to decide that for the recession – which justifies intervention by the central bank – it would use as a yardstick *four quarters* (instead of the two proposed by the US press), which contain fewer statistical uncertainties, we will also go by this unit. In this respect, the first and foremost remark is that in 2007, and even throughout 2008, production/GDP still grew: in the euro zone by 2.7 percent in 2007, any by 0.7 percent in 2008. The same figures equalled 2.9 percent and 0.9 percent, respectively, for the entire EU. In 2007 and 2008 the consumer price level/HICP grew by 2.1 percent and 3.3 percent, respectively in the eurozone, i.e. to a greater extent than the 2 percent target figure set by the ECB. The same figures for the entire EU equalled 2.3 percent and 3.7 percent.[3] This means that at the time of closure of this study all that could be known is that neither recession, nor deflation, let alone depression occurred. Of course, the future is unknown to all, but in July 2009 all forecasting organisations, even the OECD, which is considered as the most pessimistic of all, expected growth in 2010.[4] There have been serious sectoral crises, unemployment jumped to an average level of 8.3 percent calculated for the OECD area according to the latest publication of the organisation[5]. Obviously, this is nearly twice the natural rate, however it can hardly be compared to the slump of the 1970s. If the decline of the global economy is 3–4 percent as expected by most of the institutions, it will remain true that this is the worst result in the past 60 years, and also that the bad result of a single year – as summarised above – does not justify the doomsday spirit characteristic of public life. It is true though that certain EU member states closed already year 2008 with a setback. According to the statistical figures released by the ECB, such countries included Ireland –2.3 percent, Italy –1.0 percent, Denmark –1.1 percent, Estonia –3.3 percent, Latvia –4.6 percent, but these slumps did not make the total performance of the EU negative. This means that preserving the adequate extent is important here, too.

Let us briefly see what problems may arise in the individual states!

- The most common problem is the popping of the real estate bubble. This cannot be regarded unprecedented in history, either in terms of size, or in terms of mechanism. This situation is typical for Spain, Ireland, the Baltic states, Romania and Bulgaria. The regular booms and busts of the real estate market can be listed among the thoroughly investigated elements of the over two hundred year old literature studying the fluctuations of the market economy, one conclusion of which is that fluctuations can be nowhere and never prevented, not even by strict state regulations. Fluctuations are linked neither to financial innovations, nor to deregulation.
- In the second place sectoral crises, presented in detail in the press, can be mentioned. Some of these crises emerge in the financial sector itself, and some are the reflection of

these crises in other sectors. Investment banking is less wide-spread in Europe than in the US, wherefore the sector's self-liquidation and the collapse of the mortgage market implied less loss of jobs and capital. An interesting feature of this crisis element that especially the rather overregulated German and Italian semistate banks – that were occasionally presented as examples – suffered great losses, because they strongly invested into the overseas business. However, it was not their "core activities" that suffered a blow, even if the loss of capital – irrespective of the underlying cause – is always embarrassing. The exposure of pension funds and of the construction industry is obvious. However, this is the side-effect of the global village, and does not show unique and system specific features. The financial institutions of the Netherlands and Belgium paid a very high price, while the prudent Scandinavians suffered a minor loss. *It seems that the tension does not appear at the level of the EU.*

▫ The collapse of oil and gas prices – the fall of quotes from over 155 dollars in the summer of 2008 to below 50 dollars, and the stabilisation thereof at around 60 dollars after a year – had a double effect. On the one hand, this must have been the most effective "anti-crisis policy" if it is a rather strong and comprehensive tool for boosting demand, it has automatic effects and does not raise inflation, and requires neither tax increase, nor governmental decision. At the same time, however, "what's food for one is poison for another". The economy of Russia slumped back into recession after one decade, which pointed out the rather ad hoc nature of Putin's economic policy and the dominance of boom elements (OECD, 2009). Baltic states that are strongly involved in the re-exportation of Russian natural resources, as well as other CIS countries specialised in other primary products were also hit hard by the fall of prices. And of course, the proportionate amount of the well-accustomed, significant excise tax is missing from the public finances of each country.

▫ Relatively many articles discussed the fact that in 2008 and 2009 the activities of the banking system were formed by the counteracting effects of psychological and real factors. On the one hand, according to the balance sheets and the preliminary reports that were already available at the closure of this study, in the banking sector, taken as a whole, neither capital loss, nor loss-making financial management was typical. While certain entities miscalculated themselves thanks to their speculations – including such politically prominent companies like the Dutch Fortys, or the German BLB and Hypo RealEstate – the sector as a whole accumulated significant income. At the same time, the crisis, and especially the hysterical processing thereof induced a classical panic reaction. In certain cases, large financial institutions failed to provide loans to their booming subsidiaries, started major down-sizing, and with the exaggerated, almost abnormal prudence they aggravated – sometimes induced – the contraction of the real economy. *And in a crisis of trust, the stimulation of demand by the state, and the pumping of money into the economy are hardly helpful.* In the short run – as long as the panic wears off – money is not spent[6], however, later it may appear as unsecured demand raising inflation (which can happen even before the recovery of the economy).

▫ Talks of the great depression have become so frequent that a significant portion of analysts – and unfortunately of economic players – seemed to forget about the presence of automatic stabilisers. In most countries – especially in continental European states with extensive welfare systems – fluctuating booms and busts are not accompanied by the regular and automatic shrinkage of wages in most sectors, primarily in the public sector. The automatic and significant curtailment of pensions and other transfers that significantly influence consump-

tion in the aging societies comes into play even less. There is no decline in state investments projects. "Nonconventional" employment, i.e. part-time work, e-work, work from home, subcontracting and outsourcing have become wide-spread. And while these phenomena are surely below the American level, where they account for a larger share of employment, they are not as negligible as they were seven decades ago. And then it may happen that orders decrease, but not to zero, and people do not get laid off.[7] Since neither depression, nor inflationary explosion is in sight, neither an increase, nor a decrease in savings can be observed. It is common knowledge that the service sector, which currently gives 71.6 percent of the GDP of the EU member states on average (ECB, page 7), can tolerate crises more than agriculture, which traditionally produces the largest fluctuations, and the share of which in the EU's GDP shrunk to barely 1.8 percent by 2008. The much coordinated measures of the governments – in part through Ecofin, and in part the G-8 – fortunately differ from the unique attempts experienced in the period of the great depression, which also makes the economy withstand the crisis, and eliminates short-term advantages from the circumvention of the rules.[8]

As we could see, in 2008 production was still growing in most EU Member States, and hence in the European Union as a whole. We could also see that global and European growth was forecasted to resume in 2010. According to the preliminary data, the world economy still has growth hubs such as China and India, and more and more financial leaders can see the signs of recovery. Since shares that have become cheap for our income generating ability make good companies the targets of investments, and the disintegration of bad ones would trigger productivity surpluses, the whole process indicates the acceleration of structural adjustment. This means that growth has reserves both in the real and the financial sectors.

It must be noted that forecasts – including our own one – are highly uncertain. Today even meteorologists know that a forecast for one time unit requires good quality data from three time units in the past. And yet the outlook is burdened with significant risks. In contrast with this, forecasts that made world historic projections emerged one after the other under the influence of the panic. What is more, it is not uncommon – especially among financial investors – that speaking in public is motivated by one's own market positions, and the need for random futures transactions. On this basis we have never shared the once highly publicised opinions forecasting the collapse of the global processes of the world economy and the European Union (for more details see Csaba, 2009). Recovery, although it is a fragile process, does not reflect a self-exciting, disintegrating, plummeting economy, even if it is received by the general public with doubts throughout Europe due to "jobless growth", and the discomforts of the 1.5–2 year delay in labour market expansion.

HAVE WE SEEN ANYTHING SIMILAR?

The current crisis, especially the psychological and communication definiteness thereof, should make the authors of curricula think about how proper and effective was the "modernisation of curricula", which took place in the United States in the 1970s, in England a decade later, and in Europe two decades later. Then, under the aegis of practicality, almost all opinion-shaping, historical and theoretical subjects were eradicated, and the narrow practical need for a first job was confused with laying the foundations for lifelong learning. To cut it short: most decision-makers studied hardly any economic history and theoretical history,

wherefore they were surprised to see the extremely high demand for the experts of these two disciplines in the months of recession and panic.

In the following we are going to summarise, without making claim for completeness, and ignoring the documentation commonly used during the presentation of new subjects, the conclusions that the experts of international and domestic economics have drawn from studying the multi-year economic recessions of former periods, which implied significant social costs. It is obvious that the detailed presentation of this topic would require a separate volume. At the same time, however, I think that the dramatic power of the events studied in the short run cannot justify the avoidance of the question formulated in the subheading, since the basis of each effective remedy is case history.

■ The first and maybe the most important conclusion is that recessions that emerge at different times are different in nature and mechanism, i.e. cannot be managed well with the cycle theory popular in theoretical modelling, too, since the nature of the recurring phenomena is different. The well-remembered features of the years 1929–1933 include uncoordinated and hasty state intervention, isolation, and the crisis generating nature of the spread of anti-market solutions (see Berend, 2008), as well as the acceptance of the transient and temporary nature of the success of budget policy intervention. According to the analysts of the era (Navratil, 1934/2008), the economic crisis will clear up by itself, by the regeneration of the market processes, there is no other way. The government may assume a helping or aggravating role, but it does not hold the trump card.

■ During the process induced by the oil price explosion in 1973 and 1979 – and which was also called the dawn of a new era – it turned out that the *Keynesian tools used for smoothing out short-term fluctuations are useless against structural changes. What is more, the artificial inflation of demand and the protection of jobs lead to stagflation.* In theory this was interpreted differently by many, and by the 1980s it became a common axiom of various economic policies, since the defeat of the French and Italian economic policies of the time by the German and later the Thatcherian solutions was striking.

■ The stock exchange crash of 1987, which originated in the United States, made the decision-makers realise that it was neither possible, nor reasonable to calibrate the macroeconomic variables in a closed economic model and by ignoring the flow of capital. It also turned out that while in the short run the money markets were efficient, in the longer term they got separated – already then – from the real processes, and were not always able to approach the general balance, not even by their own standards. The adjustment costs of balance swing-overs are destructive and often exorbitant, and do not necessarily lead to market cleaning in the traditional sense of the word. Therefore, the role of public power is to mitigate money market swings and to prevent bubbles from popping. Although this practice is linked to the name of *Greenspan*, the concept was widely spread and accepted in Europe, too.

■ Following the establishment of the European Monetary Union and the debates about it, the economic cycles, and the money and budgetary policies of the Member States significantly converged, and former swings diminished (Andrikopoulos et al., 2007). The cited analysis does not state that this was achieved by the EU regulations. Instead it claims that the debate about the development of the European Monetary Union resulted in a community of thoughts and actions. As a result, the period of unique solutions – popular in the 1930s – ended once and for all. Decision-makers do not only speak the same language, but in the best case scenario they think on the same wavelength, too.

■ An extensive and exquisite *system of basically private market tools* has been developed for the global distribution of financial risks. On the one hand, this has allowed for much more development than before in all countries, but especially in poor ones, and on the other hand, it restricted the efficiency of regulatory tools deployable by the governments. This was made evident by the collapse of the Barings Bank in the early 1990s, or the dominance of derivate transactions.

■ The crisis of 1997–1999 opened a new chapter (Lamfalussy, 2000/2008). This series of events is often associated with the term *contagion*, since unrelated players who seemed completely innocent to the external observer also became victims. And although the two main explanations of the crisis – the one built on unrealistic exchange rates and expectations, and the one condemning crony capitalism – are still up against each other in literature, it is generally accepted that a new model of financial crisis came into being at that time. Namely, the type where the "fundaments", i.e. the fundamental growth and balance indicators of the national economy no longer play crucial roles. Since no matter which theory is accepted, the one based on a specific institutional system, or the one based on expectations, these processes can only rather indirectly be linked to changes in indicators concretely and regularly observed during the research of booms. And it is even less possible to interpret the intertwining of the crises of countries that maintain hardly any trading and investment ties, and have different business cycles.

■ The world has created a uniform, mostly electronic money market which operates on a 24/7 basis, which requires no "circulating medium", which is not linked to a specific place, and is dominated by derivative transactions and risk funds. In this relation globalisation is neither a swearword, nor a metaphor, but reality. This global financial network functions as a type of reinsurance system. In peace time – i.e. during the dominating part of the development stage, in ten years out of 11–12 years – it ensures that the weakening of certain players would not automatically and necessarily bring down other players. Especially not like in the days of *Marx*, or during the years of the great depression. As a result, development became faster, more extensive and less fluctuating (Mishkin, 2009). Last but not least, it is especially due to this process that there has been no *deflation* (the general and permanent reduction of price levels), no *devaluation* competition (one-sided currency devaluation competition with a view to increase exports) in the past 50 years, and therefore there has been no *depression*. In economics the latter is defined as a multi-year process characterised by an annual decline of 5 to 10 percent. For this reason, this expression could only be applied in relation to the specific – transformational – recession following the change of the political regime, and only for the Commonwealth of Independent States and the Baltic states, and hardly in relation to the entire global economy.

■ Finally, we must recall what is highlighted by the above cited work by Lamfalussy, i.e. the role of the generational factors. The dominance of young decision-makers and players who are not familiar with the experiences of the former era, not even from textbooks, has become typical both in the financial world and in economic communication. This goes together with the electronic revolution, the acceleration of events, burning out from working 14 hours a day, and many other factors that can explain this factor either in part or in full.

From this the author draws the conclusion that the market, and often the market players have no memory. Therefore, they are prone to repeat mistakes made earlier.

It stands out from these issues that from time to time corporate management develops a cult for *incremental interest* despite the fact that

the only thing that can be known about the market is that its growth is not infinite. Similarly, in good times the regulatory authorities are willing to interpret the framework more leniently, and do not necessarily enforce the valid requirements in order "not to keep breaking the flow of the game", as said in football jargon. All what is stated in the quoted book in connection with the crisis of 1997–1999 could be witnessed a decade later, too. For example, the Sarbanes–Oxley Law, which was developed in response to the Enron scandal of 2001, mandated very strict requirements and a system of responsibilities in the financial sector and for auditors, too, highlighting the element of personal responsibility. As we know, until the autumn of 2008 no attempt was made for the application of these regulations, although there is no doubt that with adequate circumspection the most abject failures could have been avoided. This includes the spread of investment solutions reminiscent of pyramid games, unsecured mortgages or the spread of investment schemes built on the assumption of incessant growth.

It is worth recalling that articles that were published well before the crisis (Frydman – Goldberg, 2007) drew attention to the fact that the novelties of the money market would make this area crisis sensitive even more than before. In part because the economy has certain rules of thumb, with which one can sense the overvaluedness of a product or service, or its distance from its income generating ability. And in practice this is followed by engineers, traders and other practical people on the basis of experience, who instinctively take adjusting and restraining measures. In contrast with this, on the monetary market of the past decade self-serving and unrealistic modelling was at its peak. The less a scheme was understood the more elegant it was thought to be. The less it had to do with reality, i.e. the less transparent and controllable it was for the customer, the "cooler" it was.

And this contributed to the *disappearance of the market players' sound sense of danger.* The role of the Greenspan practice preceding these fluctuations as well as that of modelling that presented the elimination of risks as a real possibility – which money owners accepted with pleasure – are issues of dispute in literature. In relation to the latter presumably we have more right to ponder about the spread of incompatibility – which was prohibited by law earlier too – than complaining about character deficiencies that are as old as mankind (such as the lust for profit) in a manner dishonouring to the clergy. Yet, the vocabulary of financial analysts was surprisingly enriched with this type of empty moralising.

In conclusion of this subsection we can confirm that while the current crisis naturally differs from the previous ones, not all elements, extent and mechanisms of the series of events are totally unprecedented. And in this case it is not evident that we must get rid of the foundations of European economic policy thinking, too, and that we should produce a new theory for each new event as it is done by the representatives of the media. At the same time there is no doubt that the old practice – the propagation of the general non-intervention strategy, which in fact is followed by very much targeted interventions in politically sensitive areas – cannot be maintained any longer.

THE REMEDIAL FRAMEWORK – OR WHAT CAN WE NOT KNOW?

The question raised in the above subtitle is important, since if the knowledge of the former era did not completely lapse, in a prudent approach it is advised to start out of the fact that there are many things about which we know that we CANNOT know, and therefore CANNOT turn them into actions. Since one of the most frequent dangers of economic poli-

cies accompanying democratic policy is that we would transfer to the decision-makers tasks – often under the pressure of the media, and often due to carelessness – for the implementation of which the government is not equipped, or even if it received these mandates, it would be detrimental to the free society and economic development. The few positive proceeds of the 20th century include especially the fact that the failure of governments following diverse ideologies and encompassing the entire society and economy, i.e. the total governmental failure could be experienced in so many forms and cultural environments. And under democratic conditions those realisations that are considered as milestones and therefore recognised with the Nobel Prize, such as the neutrality of money (Friedman, 1968/1986) or the Lucas criticism (1976) based on the forward-looking and adaptive nature of expectations, or the Kydland-Prescott model (1977) which emphasised the extremely harmful nature of case by case political consideration – the "concrete analysis of a concrete situation" – and which made the observance of rules the norm, all caution us from listening to sirens demanding "as many inspectors and policemen as possible to the commanding posts of the economy".

■ It can be known for sure that it is neither necessary, nor possible to develop an international financial "architecture" that could be called the "new Bretton Woods", i.e. that would follow the paths specified by the governments, as it was urged by the G-20 and mostly by the EU at several of its summits during 2008–2009. As we could see earlier – in part directly, in part from the cited literature – the governments lost control over the new operational order of the money market at the latest by the creation of the euro currency markets in the 1970s, and after electronic transactions became generally accepted. Since then both technical developments and the changes in the transaction types have spread the practice of "bodiless" money and trading not linked to certain places. There are no tools or procedures with which one or more governments could eliminate the competition for sites, and – using the wording of old textbooks – could adjust the amount of money put into circulation to the "need of turnover". Since the latter has been for a long time created and regulated by private actors instead of the central banks. The national economy – as a close unit – exists only in the descriptions of introductory textbooks. Therefore, demand, which plays a central role in Keynesian thinking, cannot be "calibrated" either, since it evolves from the decisions made by hundreds of millions of players all over the world. Not to mention the fact that due to the discrediting of governments, the expectations are neither naive, nor retrospective. The demand – mostly derivative demand – established by the money markets is neither theoretically, nor partially related to the "needs of turnover", and does not seem to follow the signs of the government's interest rate policy. For example, at times of zero interest rates it flees to commodity exchange and real estate transactions, it creates artificial bubbles for the multiplication and rechanneling of incomes. The genie cannot be returned to the bottle.

■ Due to the above written we are extremely sceptical about the proposal that has been urged by the German Finance Ministry for many years, according to which "order could eventually be restored" by the liquidation of tax heavens and the development of a certain global tax police, no matter what this expression means. We hereby note that such efforts failed even in the eurozone, which follows a coordinated economic policy, and not only Switzerland, but Luxembourg, Austria, Great Britain and Ireland also objected to the noble thought of the tax straight-jacket. Consequently, due to the differences in interests and the competition for sites, the possibility for the introduction of such a measure is even less elsewhere.[9]

There is no doubt that in several cases it was especially the transformation of the financial arena into a global village that made seemingly sound, financially strong, market leading financial institutions – external in respect of the home country – the victims of the collapse of the American mortgage market. At the same time, this mishap does not annul the fact that in the previous decade especially these companies accumulated income and wealth not through their hard work often praised in the press, e.g. through loans to family-owned companies, the management of the employees' bank accounts and their health insurance. The significant part of this income has been invested in gold, corporate stakes, government bonds, i.e. it can in no way be regarded as "perished" according to the wording widely used in the media. On the contrary, financial assets come to life again in the emerging boom, wherefore they themselves induce recovery and make a great portion of the companies creditworthy.

■ President *Sárközy* called – most vividly perhaps at the Extraordinary Council Meeting in Brussels in March 2009 – for concerted EU-level actions for the recovery of the economy, which call has been received favourably by many. However, it is not a secret that in most cases, 99 percent of what is called "EU programme" include investment projects initiated and implemented at regional level funded from national resources, within national governmental or chamber frameworks. And this cannot be otherwise, since the reform intentions of the EU developed since 1999 have regularly lacked plans that assume larger-scale federalism or greater community. Most recently, especially the creation and acceptance of the Lisbon Treaty required abstention from federalism, which the Irish Government stipulated in a separate protocol in 2008 as a precondition for the repeated referendum. However, there is no jubilation without money: in its current form the EU is not a superstate that could run to the rescue of its members, and this in great part due to France.[10]

■ The demand for an anti-crisis policy has multiplied the calls for trusting the development of each major element of permanent economic growth to the government all over Europe. A good part of these questions has been answered negatively by economics in the past decades. This includes the socially most important factor, i.e. *job creation*. In this issue complicity is of course unacceptable, saying that "there is no market economy without unemployment", the rate of which was 8.4 percent at the closure of this article according to the above cited OECD study, 8.6 percent at EU level, and 9.2 percent in the eurozone, which has presumably not hit a record high yet – the cited rates can be regarded twice the natural rates. At the same time it is not questionable either that using the tools of the 1930s – e.g. public works and transfers, and pay rises in certain groups[11] – the government can achieve only short-term results. Employment – especially longer-term presence on the labour market – cannot be directly influenced, since this is the result of various, only partially overlapping factors. The latter includes the level, quality and distribution of education – according to age groups, regions and ethnic background, the match of education to job offers, the readiness to learn and cooperate, the achievement of growth via labour saving or labour intensive technologies, the level of regulation of public dues and of the labour market. It can be seen from the above written, too that public power has tasks and possibilities in the improvement of the level of employment, however by itself is not able to create permanent and productive jobs other than those for the so called "cotton people" employed only for statistical purposes. Most governmental measures exert their impacts only in the medium and long run, and through many transmissions. For example, it is to no avail if the level of education of young

people is good, if micro and small enterprises are not willing to hire new employees due to the contraction of the market and for the lack of trust in the future.

Similarly, the majority of the people expect the government *to restore public trust.* There is no doubt that the state has tasks to solve in this respect, even if they are indirect and become visible in the long run only (Sajó, 2008). However – as can be seen from the quoted research reports – direct order-making, the pseudo-actions characteristic thereof, the loud vows and the infringement of the rules of the game several times during the year, i.e. the government's busy-bodiness experienced again in the past years trigger and may trigger a counterproductive impact. Although the survey pertains to the Hungarian empirical material, it is valid in a broader context. The development of the rule of law requires the convergence and cooperation of the state and the market players through common learning, which cannot be created unilaterally.

It is often said, especially in relation to the EU, that the state should ensure the acceleration of innovation. And while it is not doubted at all that there is nothing to build on without basic research and state financed universities, in the international literature dynamism is indicated by the fact when the ratio of technical development funded by the companies (BERD) exceeds that of financed by the government (GERD).[12] And the reason behind this is that innovation relevant for economic development, i.e. technical development manifesting itself in technological progress is possible through the involvement of and control by the market players. This can be witnessed even in state controlled models such as South Korea and Sweden.

There are some people who alluding to the developmental states of East Asia, and stricken by the collapse of the money markets, would trust the state with the distribution of resources at the level of the national economy, too. This idea is based on a multiple misunderstanding. On the one hand, the efficiency of the distribution of resources has surely not improved with the expansion of the money market, and this has had a beneficial effect on less developed countries, too (for more details see Mishkin). On the other hand, it is also evident that the developmental states of East Asia emerged from the crisis of a decade ago having undergone a major transformation. An important feature of these countries – which is documented in the above cited volume (editor: Csáki, 2009) in detail for several countries – is that contrary to the former direct distribution of resources, the financial mediating system has more independence, and the allocation of scarce resources has been increasingly carried out on the basis of market conditions.

Finally, from these things it can be well seen that the pace of economic growth can be made dependent on the government neither in theory, nor in the medium run – as it was first pointed out by the classical paper written by *Robert Solow* (1956) almost sixty years ago – since it mostly depends on the above written, as well as on the efficiency of the financial system. In other words, it is not reasonable to expect recovery from the actions or inactions of the government, while in the formation thereof the role of central governmental coordination is not negligible. It can be easily seen that countries with major spending, such as Ireland and Germany, emerge from this decline, too, with a larger, not smaller, growth sacrifice.

▪ Many expect the solution in all fields of life, ranging from finances to corporate development, from the reinforcement of government level regulation. We have cited the relevant initiatives of the G-20 and the EU, which grow in number day after day. In literature it can be taken as a general agreement that the efficient operation of the markets require the

reinforcement of regulation, and the improvement of the quality of regulation.

However, it is worth recalling the fact that (Vörös, 2004) during the past decades in the regulation of economic processes the role of solutions initiated and enforced by nongovernmental, horizontal, professional grass-root organizations has regularly and significantly grown, while the effectiveness of intergovernmental measures represented by the UN seems smaller than even before. The failure of the peace processes in Rwanda and Darfur is a good illustration for this. At the same time, the attempts of the Republican government, which tried to "restore order" with unilateral interventions, with slogans against preventive and humanitarian intervention and against the war on terror, has also yielded little permanent result. In relation to the subject of this article this means that public figures who are trying to find a way out through the busibodiness of the order-makers delegated by the public power instead of the horizontal self-regulation of the different professions. Since most questions are so complex both technically and by themselves – no matter if they are about risk assessment or the side-effects of the remedies – that they surpass the information processing ability of lay decision-makers. And then we must accept that although "the war is too important to be left to the soldiers", the all-encompassing regulatory momentum of democratic public power cannot be the yardstick of success.

■ Finally, we must express our concerns about the fact that the intentions summarized so far – the common feature of which is the augmentation of short-term interventions under the guise of "anti-crisis politics" without consideration to the consequences – have on the whole led to the freezing of reforms urged in relation to the Lisbon programme of the EU. While the Lisbon programme aims at the significant, albeit gradual restructuring of the social model of the European Union by coupling growth with the improvement of jobs in number and quality, at the closure of this study it was still unknown whether a new ten-year programme would be approved. And it is even more questionable whether national and EU level reforms aimed at the introduction of measures ensuring the flexibility of the labour market, the increased involvement of employees, and the sustainability of the pension systems will be continued or not.

Earlier we have argued in several forums that such restructuring is needed by both the old and new Member States of the European Union. What is more, this could lay the foundation for the successful operation of the European Union. Therefore, in conclusion of this subsection it must be noted: it is important that the plans for the future be based on the *acceptance of the limitations of governmental interventions and institutional knowledge.* Although we do not believe that the crisis has not raised new and exciting economic theory issues, so far we have proved that instead of getting rid of all former knowledge and tools it is more reasonable to outline the path of the future on the basis of such knowledge and tools.

THE NEW POLITICAL ECONOMICS OF THE NEW ECONOMIC POLICY

The economic approach, in which efforts are taken to integrate the institutional, political, legislative and communication tasks that foster or hinder the practical implementation of solutions considered to be right in theory in a single package. The novelty of this intention is implied in the fact that it regards the economy neither a black box (like mainstream, neoclassical economists), nor the servant of public power (like the German Historical School, Marxism, or the various nationalistic and environmental-friendly approaches). Therefore, the new political economics does not strive to

search for and support solutions contradictory to the solutions developed by general economics. The emphasis is rather on how economic rationality could be adjusted according to the criteria of social *acceptability*, and therefore *sustainability* in the broader sense of the word.

It is apparent from the above rough overview that one of the biggest problems of the current period is that the gap is *growing between* the general opinion, and the issues raised and solutions proposed by decision-makers following the general opinion, as well as the approach of economics that was developed in the past 50 years and that processes and summarises the experiences of the former period. Even those decision-makers – such as *Ben Bernanke*, Chairman of the Federal Reserve, who is regarded to be the best student of Friedman and Schwartz – who have something to draw on, have often chosen the slippery road of improvisation. And it seems that improvised decisions are not able to and cannot formulate an anti-market paradigm like the one witnessed in the 1930s. The products of scientific publishers, and the articles of the leading journals show no sign of this – contrary to the daily and electronic press that operates on the basis of the principle of "anything goes in competition". It is edifying that with the exception of the *Journal of Economic Perspectives* intended for policy-makers there have been hardly any attempts to interpret the crisis at the level of theory, and detailed analyses that are mostly available in *working paper format all follow the proven path.* This holds for the employees of the international organisations – ECB, BIS, OECD, IMF – as well as the economists of research institutes and universities. While the articles emphasise the significance of tax reduction, targeted and restrained government spending, as well as of competent regulation, none of the articles cited at the beginning of this study represent a radical break from the former theoretical and economic policy standpoints of their respective authors. On the other hand, politicians themselves regard the unusual measures – such as nationalisation or the drastic growth of government debts[13] – as *temporary derailment, and not as the beginning of a new era.*

Therefore, we accordingly formulate and summarise the normative conclusions which can serve as a basis for the development of the new European economic policy practice. Non-European countries are not the subject of this article, but it can be stated that the economic policies and macroeconomic statistics of the United States, Australia, Canada, China or Korea do not show such a considerable change as some of the EU member states. Therefore, if we study the not yet closed question of the change of paradigm, it can only result from the phenomena witnessed on the European continent.

■ It can be regarded as a general conclusion that basically all analysts agree on the *need for the reinforcement of regulation and the improvement of its quality.* However, there is by far no agreement – as we could see – on the identity of the regulators, as well as on methods and objectives of regulation. As a starting point we should accept the idea of the German ordoliberalists and of the constitutional political economists of the US, according to whom regulation must never aim at the improvement of the relative position of the individual players. Instead, it should always focus on a certain public interest or general objective, such as transparency, prudent banking behaviour, balance between the interests of lenders/depositors and borrowers/deposit holders, public dues and the like, including personal responsibility.

Governmental intervention, especially in the three large EU member states, has so far exclusively served the temporary settlement of the situation of certain depositors and other interest groups, wherefore it obviously failed to comply with the above theoretical requirement, and failed to create the preconditions required for the prevention of reoccurrence.

The real total amount of the rescue packages is little known, however the explosion-like growth in the government debts of several countries, such as Great Britain and the Baltic states already makes it perceivable. This raises much less concern for the common budgetary rules of the European Union, since they themselves stipulate that in times of recession expansive behaviour must be exhibited. The foreseeable consequence would much rather be the fragility and weak sustainability of the emerging boom, coupled with the risk of reigniting inflation.

It can be easily seen from the above written that within Europe in the forthcoming years *regulation of the state would presumably be more necessary than regulation by the state.* It can be easily seen that under the pretext of the assumed and real social requirements of crisis management most EU member states have adopted a practice based on case-by-case considerations and random decisions that lack any principle – such as financiability, transparency, predictability, public benefits and sustainability, as well as the general public finance principles. And while in Europe the rescue packages do not generally exceed 2–2.5 percent of the GPP – according to the often cited June forecast of the OECD, which can be regarded acceptable given the recession being 3–4 percent, soaring actual costs are no longer confined to the exceptional cases in the US, Ireland and the Baltic states. The avalanche of corporate rescues, transfers, indemnifications and the undertaking of guarantees pursuant to ad hoc political bargains cannot be stopped for the time being, although the adverse nature of these solutions became common knowledge already in the 1970s, and became unsustainable in the 1980s. It is high time to stop overspending and prepare plans to confine costs, and to prepare plans for the prevention of the inflationary effect of unspent income in the economy.

It would be extremely important *to sharply distinguish between growth and systemic, structural measures* in accordance with the traditions of German and English economics. It would be especially important to mitigate the – not illusionary – threat (as we could see) that one-off measures can become system forming measures having been raised to the level of principle. It is quite evident – and net saving countries ranging from China to Saudi Arabia have even indicated it – that the market will not finance any debts at any yield levels. This again predicts the fragility of the boom in Europe, unless the markets are reassured by serious plans that indicate the reestablishment of financial discipline. Multiannual budgetary adjustment plans could provide a macroeconomic framework for the various concepts for restructuring and modernisation.[14]

Because of the above written it can be stated that little by little *it would be necessary to stop managing the crisis and develop sustainable policies both at national and EU levels.* For example price stability should be kept in mind, and instead of the imaginary disease of deflation attention should be paid to the confinement of the inflationary pressure, which is not at all unusual in the periods of boom. The former policy of the ECB – which focused on the stability of the eurozone as a whole, and not on the short-term stability of individual regions/sectors – must be preserved and shall not be transformed (as indicated by much of the English language literature). It is advised to develop long-term policies for the protection of the natural environment and the creation of the security of energy supply. An important part of the latter is the creation of the single European energy market. It is advisable to extend the Lisbon Strategy for another decade, and to include the resulting new major expenditure items in the financial figures beginning with 2014. A programme must be developed for the reduction of excess government debts,

evidently within the frameworks given by growth and balanced public finances, i.e. in an organic, slow pace.

■ It should be made clear that in a market economy based on private ownership *the risk of bankruptcy is systematically a private matter,* since it results basically from the private nature of economic decisions. For example, it cannot be declared as public interest if significant amounts are invested on the basis of obviously deceitful promises (Baumag), or if certain financial institutions collapse due to sub-prime lending. In the given case interventions referred to as "governmental aid" concretely mean the compensation of private errors by the taxpayer community. Therefore, such interventions must be avoided as much as possible. And in the case of exceptions it must always be made sure whether the rescuers can formulate the usual reasons for community intervention, i.e. public benefits, public good, avoidance of larger bad costs, temporariness, getting over the crisis relying on own resources, as well as the concrete enforcement of the basic principles of adequate own resources. In the meantime it is reasonable to make sure that despite the demand of the electronic media, and against the urging of some representatives of economics, *the criteria of micro and macrolevel consideration should not mix.* This is the most common mistake as a result of which most errors were made both in the 1930s and today, on the basis of the "my story is history" notion. For example, the continuation of mining "pursued for generations", the protection of the heritage of "national cake making" against foreigners, or the prevention of dismissals by external owners – regarded adverse by the current management of the company (but only by them!) – are not human rights.

■ It results from the above written, too that transparency, and the related personal *accountability – and holding concrete persons accountable* – are elements of market cleansing, and also dynamic and renewing growth factors in the European market economy. Here this tool is being used less frequently than by the United States, Australia, or even Korea and Malaysia.

In fact, here we state nothing more than what has become evident in connection with the formulation of the Sarbanes-Oxley laws. The current corporate management and financing solutions tend to be based on the theory and practice of divided responsibility. This made it possible that no concrete person was ever responsible for wrong decisions – especially in large companies like Deutsche Bank or Fiat. This does not necessarily involve public property, although temptation is even bigger in the public sector. In the American example personal responsibility does not only mean legal consequences. The loss of the pension fund and savings deposited in the investment fund of the bankrupt company obviously hit the management harder.

■ One of the several benefits of the current crisis is that it has boosted the interest of professionals in studying the *long-term manoeuvring room of growth, the growth potential and the output gap.* Unfortunately, though, this mostly methodological and statistical trend has not yet aroused the interest of public figures despite the fact that the question "when shall we catch up with the West?" can be interesting not only in the new Member States, but, in relation to the Lisbon programme – and due to the growing gap between the US and the EU – at the level of the EU as a whole, too.

It is known from economic literature (Antal, 2004) that due to their nature such calculations imply a high degree of uncertainty, assumptions and methods significantly influence the results. What is more, there can be effects that overwrite the factors taken into account when developing the model. Yet, it is not fully coincidental that each of the calculations made and partially published – wherefore not much citeable – in the past one or one and a half years

consider the growth potential of the Visegrád and Baltic states to be much lower than before both in the short and the long run.

Different authors highlight different factors, such as the slow pace of technical development, the lopsided involvement in the international, intercorporate division of labour, the fragility of the financial mediating system, the melting away of the former advantages of the educational system, which is further deteriorated by the weakening of the social connective tissue and of the system of values. Some people complain about the low level of investments, or about the dynamism of small and medium-sized companies, while others find the government's performance unsatisfactory.

As far as we are concerned, we do not wish to take a stand about the details of these complex and technically demanding issues. In accordance with the genre of this study we can only confine ourselves to the summary remark that if *all* forecasts available to us project the *permanent weakening* of the growth potential, the growth of around four percent traditionally expected on the basis of the convergence models must be taken with precaution. According to our current knowledge this can be even twice as much as the growth we can expect assuming unchanged circumstances. This means that growth in the new Member States is not an endowment, but a task. *What is more, it is a central task.* Since in this decade the growth rate of the old EU member states dropped below two percent, it is probably to no avail to wait for the European impulse that would induce Hungary's economic upswing.

A FEW CONCLUSIONS

In this summary of thoughts we studied whether a change of paradigm is in the shaping in the economic policies of the EU Member States. The task was provided by the literature as well as statements made by authoritative public figures, such as heads of governments and finance ministers. In relation to the four fields outlined in the introduction – demand, regulation, ownership and market protection – we found nothing that would have urged us to sweep out all former knowledge. Based on the facts, the decline in 2009 can be said neither unprecedented, nor interminable. A significant part of the events witnessed now emerged also during the shocks of 1973, 1979, 1987 and 1997–1999. Therefore – as it was explained in a separate section – the current setback can be interpreted on the basis of information then obtained, as well as unhasty generalisation that has stood the test of time. What is more, we can tell the difference between the effective and wrong steps of the economic policy on the basis of this set of information.

Our answer is therefore, as it could be seen from the fourth part, is negative. Each discipline develops a new paradigm when it encounters significant events that cannot be explained within the framework of the old paradigm. This was not the case, therefore a *change in paradigm* is required neither in terms of science, nor at the level of economic policy analysis.

However, it is required that *several elements of practice be significantly modified.* Our normative statements in connection with this issue come from the proven, almost generally accepted concepts of economics. The two most important conclusions are the following. On the one hand, the method and costs of crisis management count both in themselves and for future growth. On the other hand: excessive debts and growing state intervention coupled with the inactions of the former decade have adversely affected the future growth potential, too. Therefore, the time has not come for our societies to “settle for less”, since the gap between Hungary and the EU average, as well as the most developed countries of the world has lately widened even more. Therefore we act

responsibly and with professional rigour towards the society if we take long-term measures serving the public interest and as the foundation for sustainable development more seriously than before, and make decision-makers accountable for such measures even if they are hardly popular at the political level – in any European democracy.

NOTES

[1] See Berend's (2008) all-encompassing summary.

[2] As it is now widely known from the works of Hayek (1945/1995), the assumption derived from the Arrow – Debreu model, according to which the same result can be achieved by centralised or competitive methods, cannot be maintained any longer. The reason behind this is that in reality prices carry a lot of information, and therefore convey the uncoordinated, or even contradicting intentions of millions of market players for different lengths of time, wherefore they cannot be substituted by anything, not even by central intervention.

[3] ECB: Statistics Pocket Book, June, 2009, Frankfurt/M., pages 39 and 38

[4] OECD Economic Outlook, 24 June, 2009, at: www.oecd.org , downloaded on 20 July 2009

[5] The Communication as of 13 July 2009, in: www.oecd.org., downloaded on 20 July 2009

[6] In relation to this the English say that you can lead a horse to water, but you cannot make it drink.

[7] According to top-notch journalists, home workers were ab ovo "in the streets", however this is not completely true.

[8] For example, full state guarantee on bank deposits is economic nonsense, but when this was introduced by Ireland in October 2008, the other Member States were forced to follow. True, after that the room for maneouvre across Member States with different exposures ceased to exist.

[9] The competion for sites is an evergreen issue of German economics from the 1970s, and cannot really be linked to a single author. For an excellent summary see Siebert, 2006. This is why we were surprised by the fact that German clerks do not know or do not use the theoretical (but practically significant) work of the German economists themselves.

[10] For more details see In: Csaba (2008) Magyar Szemle

[11] László Gazdag (2009): Magyarország útévesztése, Pécs, Dialóg Campus

[12] For more details on this issue see the monography by Török (2006).

[13] The government debt of Ireland, the former "honour student" more than triples, i.e. grows to 80 percent in the period of 2007–2010. Source: OECD Economic Outlook, June 2009, available at: www.oecd.org, downloaded on 23 July 2009.

[14] This does not necessarily have to be coordinated at EU level, as it is prompted by Rácz (2009, pages 314–316).

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