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Exit Keynes the Friedmanite, Enter Minsky's Keynes

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Brad DeLong recently reposted his 1996 review of John Maynard Keynes's *A Tract on Monetary Reform* (1924). DeLong makes the case, quite compellingly, that Keynes, in this book, provides us with the best monetarist monograph ever written. DeLong leads, however, with a sentence that, in 2013, he might want to alter: "This may well be Keynes's best book."

It was the complete failure of the monetarist framework that led Keynes to deliver his *General Theory* in 1936. Quite sadly, in 1996 the Washington Consensus had effectively embraced the minimalist view of monetary policy responsibilities articulated by Keynes in 1924. And in so doing they set the world up for a 1929-style financial crisis in 2008–9.

As DeLong puts it,

> The belief that monetary instability—inflation and deflation—is the principal, or at least a principal, cause of other economic evils; the hope that sound monetary principles can be identified and, when identified, would greatly diminish uncertainty and risk; the focus on the job of the public sector being to provide the private economy with a stable measuring-rod and a stable environment—all these are core ideas of whatever we choose to call monetarism. Keynes believed these ideas very, very strongly in the mid-1920s.

DeLong then states the obvious reason for the big switch by Keynes: the events of the Great Depression. DeLong argues that from a modern (as of 1996) perspective, Keynes's switch was a mistake, driven by thinking that the forces causing the Great Depression played a more *general* role in macro dynamics:

> The magnitude of the Great Depression of the 1930s would destroy Keynes's faith in the proposition that stable internal prices implied a well-functioning macroeconomy and small business cycles. But from our perspective today—in which the Great Depression is seen as a unique disaster brought on by an unprecedented collapse in financial intermediation and in world trade, rather than as the largest species of the genus of business cycles—it is far from clear that Keynes of 1936 is to be preferred to Keynes of 1924.

In the aftermath of 2008, enthusiasm for Keynes's later work has, of course, mushroomed. Nonetheless, DeLong's 1996 essay is fantastically useful. For it forces us to ask the following: *Can we really ignore finance as a source of "regular" economic fluctuations?*

DeLong raises what, for me, is a version of the same question posed in an April 2011 post: "Why Aren't Economics Departments Using their Macroeconomic Slots to Hire People Who Know Walter Bagehot?" More recently, a post by Paul Krugman makes the same point: "What really impresses you if you study macro, in particular, is the continuity, so that Bagehot and Wicksell and Irving Fisher and, of course, Keynes remain quite relevant today."

Bagehot, Fisher, Keynes—and, I would add, Minsky—wrote richly of an economic world strongly at odds with the neoclassical fiction of finance as a veil. These thinkers would arguably have seen the Great Moderation very differently from DeLong à la 1996, with financial market dynamics, not wage and price swings, driving increasing fluctuations in the macroeconomy, ultimately ending in the brutal global Great Recession of 2008–9.

Perhaps the most indictable offense that mainstream economists committed, from 1988 through 2008, was to retrace, step by step, Keynes's path of discovery from 1924 through 1936. Wholesale deregulation of finance and categorical confidence in a reductionist role for central banks came into being as the conventional wisdom embraced the 1924 view that free markets and stable prices alone give us the best chance for economic stability. To add insult to injury, the conventional wisdom before the crisis was embedded in models called "New Keynesian," which were gutted of the insights of Keynes. This conventional wisdom gave license to a succession of asset market boom-and-bust cycles that defied the inflation/deflation model but were, nonetheless, ignored by central bankers and regulators alike.

Quite predictably, in the aftermath of the grand asset market boom-and-bust cycle of 2008–9, we are jettisoning Keynes circa 1924 for the Keynes of 1936. In effect, we study business cycles but seem incapable of extricating the economics profession from reciting its assigned lines as the play unfolds. In Act I, we are students of market mayhem, in the aftermath of a big crash. In Act II, we become more comfortable with the power of stabilizing policies as the crash recedes from view. Act III involves the creation of a storyline that defines the asset market bust in *unique disaster* terms.

And in the final act? We are champions of minimalist intervention strategies, aimed at moderating real economy pulses and stripped of concerns about the veil of finance. Thus, we seem perpetually doomed to avoid the sins of our fathers, and perpetuate the follies of our grandfathers. Hardly a description of progress.

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