



EUROPE AND ECONOMIC THEORY

Based on theoretical reasoning this article suggests that a radically new conception of Europe is required to get out of the present economic and political crisis situation. Neo-liberal Europe must give way to a social-liberal Europe.

“FACTS ARE SILENT, ONLY A THEORY MAKES THEM SPEAK”

This proposition is due to the German economist Erich Schneider – Einstein would have subscribed, and Keynes, too. Theory is indeed fundamental to understand economic phenomena, most importantly value and price, distribution, and employment. Theory is also required to come to grips with the developments in Europe since the breakdown of Socialism around 1990.

However, *no unique* system of economic theory exists. Two great theoretical strands have emerged in the course of history: liberal neoclassical economics and social-liberal classical-Keynesian political economy. *Economics* is derived from Adam Smith’s vision of a self-regulating economy, with the market at the centre and the state relegated to the institutional framework surrounding it. In principle, competitive markets solve all the great economic problems. Specifically, there is a tendency towards full employment. Money and finance are, in principle, unimportant and international trade, based on the principle of comparative costs, greatly contributes to securing peace.

Political economy puts the social process of production, taking place within interrelated industries, at the centre of the economy, which, in turn, represents the material basis of society, carrying a political, legal, social and cultural superstructure. Money and finance play a crucial role, distribution is, positively, a problem of social power, normatively of distributive justice, and the level of employment is governed by effective demand, implying that system-caused *involuntary* unemployment is possible. Effective demand increases as income distribution becomes more equal.

Which theory is more plausible? Theoretical discussions and the occurrence of great crises strongly speak in favour of classical-Keynesian political economy.

HOPES AND DISAPPOINTMENTS IN EUROPE SINCE 1990

After the downfall of Socialism around 1990 euphoria has overwhelmed Europe. Neo-liberalism and its historic realisation, industrial-cum-finance capitalism, seemed definitely the only possibility to institutionally organise the modern world. Neoclassical-Walrasian equilibrium economics and its Marshallian supply and demand developments became *pensée unique* in economic theory. This has shaped socio-economic institutions. Globalisation was given free way and a great free-trade area and a single currency were created in Europe. Hopes were high: more intensive competition was expected to lead on to increasing technical progress, higher rates of growth and levels of welfare. In a neoclassical vein, the European policy approach was entirely supply-oriented.

These hopes have not materialised. Unemployment has increased considerably and income distribution has become markedly more unequal in Europe since the introduction of the Euro. Austerity policies have greatly worsened the situation. The social consequences are very serious. Poverty increases and a new social class comes into being, the *Pre-cariat* (Guy Standing). The situation is particularly dramatic in Greece. An eminent and most respected Greek economist, Maria Negreponi-Delivanis, speaks of socio-economic genocide. Globalisation and Europe seem to be a blind alley. The eminent classical-Keynesian political economist Nicholas

Kaldor has always argued that trade-liberalisation and a single currency for large free-trade areas with unequal development levels of individual countries would lead on to cumulative processes producing more inequality and higher involuntary unemployment, the social consequences being a weakening of the middle-classes, growing poverty and the formation of very rich oligarchies. In his view, increasing returns to scale – average costs decline as output increases – is the main reason for these destabilising cumulative processes, compounded by Schumpeterian technological dynamism, that is, the ability to introduce new products and improved technologies in view of conquering new markets. On account of the external development mechanism based on exports the stronger get stronger and the weak are crushed. In this Darwinian context, it is frequently argued that the countries of Southern Europe as well as France and Great Britain must carry out reforms to improve their competitive position. In fact, these countries should become like Germany, Switzerland and Scandinavia. If this happened, Europe and the world would, in a Kaldorian perspective, literally get mad! Due to limited world effective demand competition would become ferocious and the struggle over market shares would dramatically increase. The external development mechanism fails because the world economy is a closed system.

THE WAY AHEAD: EUROPE AS A FAMILY OF NATION-STATES

Europe needs a new type of economic theory, classical-Keynesian political economy to wit, to shape institutions and socio-economic policies; moreover, the state must be given pre-eminence again through the rebuilding of states along – Keynesian – social liberal lines. Social liberalism is the political philosophy underlying classical-Keynesian political economy. The crucial feature of this doctrine is to conceive man as an *essentially* social being. This necessarily implies seeing man and society as complex entities. However, social liberalism does in no way imply totalitarianism, where the individual is, essentially, an exchangeable part of the social machine. On the contrary: society and the state are indispensable, but ancillary to the social individuals who can

realize their potentials only *based on* and *through* society. *Based on* society means that there must be preconditions or social foundations that have to be there if all social individuals are to be given the

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possibility to unfold their dispositions and to acquire capacities: full employment, fair distribution of incomes, a public education system, an appropriate legal system, a diversified and large set of cultural institutions. *Through* society signifies that the degree of perfection of the social individuals is enhanced through social activities: common aims are reached through cooperation and coordination as is the case in an enterprise, a football team or an orchestra. However, the social is everywhere, for instance, reading a book may produce new ideas through the interaction between author and reader. And last but not least, society and the state form a *social entity*, made up of *complementary* institutions, and ideally directed towards the well-organised society, within which the social individuals may prosper.

This social liberal view of society and the state has a very important implication regarding the conception of Europe. Liberalism and Socialism are universalistic; the size of the political entity is undefined and unimportant, the EU being an excellent example. Social Liberalism, however, implies a clearly bounded territory for each state. As a social entity, the nation or nationalities state is a complex system of institutions directed towards cultural and ethical aims, and the historical realisation of well-organised societies implies that the striving for fundamental values – social justice, truth in the

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sciences, various cultural values – will go on in a country specific way. Moreover, the size and the structure of government expenditures, the taxation system and the distribution of incomes must be such that the institutional-technical system is, broadly, brought into line with a *system-equilibrium* of prices and quantities, such that effective demand is sufficient to buy full-employment output. This renders governing extremely complex. Hence the state should not be too large to be governable. The historically grown small and medium-sized European ►

states admirably fulfil this prerequisite.

In a classical-Keynesian vein, distribution and employment policies would become crucially important again. This is required because in a monetary production economy there is no tendency towards full employment at all. To be able to achieve high employment levels and an equitable distribution of incomes each country needs its own currency; in larger states, regional moneys may be required to pursue regional

policies; for example, in the United Kingdom, Scottish banks may issue pound notes at parity with the English pound but valid in Scotland only. Hence the internal employment mechanism would become fundamental again. Effective demand would, basically, be determined by the government expenditures and by household demand, depending on the spending power of the population, determined, in turn, by income distribution.

The internal employment mechanism would set no restrictions on international trade. Exports and imports may be in equilibrium at any level. An appropriately implemented supranational world cur-

rency – Keynes’s *Bancor* – would force deficit and surplus countries to undertake efforts to bring about a tendency towards a current account equilibrium for each country. This system would easily allow for a Europe of solidarity: the richer countries would transfer real resources, financed by *Bancor* loans, to economically less developed countries.

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Europe organised along Keynesian social liberal lines would correspond to a *Europe des patries*, Adenauer and de Gaulle had in mind. Each country could preserve its way of life, which would go along with cultural diversity. And the mobility of individuals would be no problem with near full employment prevailing in each European country.

The social liberal vision of Europe set out here would be in line with a proposition by Jean Monnet: *Si c’était à refaire, je bâtirais l’Europe sur la culture*. In a culture-based Europe, Greece, presently crushed and humiliated, would take a place of honour again, because without ancient Greece there would be no Europe and no modern world. ■

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Anti-austerity protests in front of the Greek parliament (29 June 2011).

Source: Ggia on Wikimedia Commons.

