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Keynes and Friedman on Laissez-Faire and Planning

Where to draw the line?

Sylvie Rivot



Keynes and Friedman on Laissez-Faire and Planning

The 2008 crisis has revived debates on the relevance of laissez-faire, and thus on the role of the State in a modern economy. This volume offers a new exploration of the writings of Keynes and Friedman on this topic, highlighting not only the clear points of opposition between them, but also the places in which their concerns were shared.

This volume argues that the parallel currently made with the 1929 financial crisis and the way the latter turned into the Great Depression sheds new light on the proper economic policy to be conducted in both the short and the long run in a monetary economy. In light of the recent revival in appreciation for Keynes' ideas, Rivot investigates what both Keynes and Friedman had to say on key issues, including their respective interpretations of both the 1929 crisis and the Great Depression, their advocacy of the proper employment policy and the theoretical underpinnings of the latter. The book asks which lessons should be learnt from the 1930s? And what is the relevance of Keynes' and Friedman's respective pleas for today? Through this exploration, we are able to see that, at the theoretical level, in some ways Keynes and Friedman shared a common approach to the functioning of a monetary economy. At the policy level too they seemed to have complementary lessons to offer us in regard to stabilisation policies, despite ideological backgrounds that seem at first sight to present an insurmountable barrier to any comparison between the two authors.

Sylvie Rivot is Assistant Professor at *BETA-Theme*, University of Strasbourg, France.

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L'avenir dure longtemps
[The future lasts forever]
Louis Althusser

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1 Introduction

Without denying what constitutes the specificities of their original findings about the functioning of economic macro-systems that led them at roughly 30 years of distance to launch the first two revolutions in macroeconomics of the twentieth century, our view is that significant similarities but also strong ties are at work in the logics that govern Keynes' and Friedman's respective approach to political economics. In particular, there is a problematic that is common to their two theoretical constructs, which is the issue of stability in a monetary economy. Truly, this shared concern for stabilisation is not founded upon identical theoretical principles and is not necessarily formulated in the same fashion (especially regarding the relevant time horizon to deal carefully with this fundamental issue). Strikingly, for both authors the main feature of the modern economies we live in is that they use monetary assets to facilitate exchanges. On this basis, through the lens of the stability issue a careful reading of their advocacies about the economic policy brings to light the convergent matters of concern at work in their political advices. In particular, for both of them the key task of policy guidelines they call for turns to anchor private agents' expectations. Hence, over and above the received ideas that might remain about their pioneering works, and even despite the professions of faith (hardly reconcilable) that these two authors themselves might have wanted to give, there are similar preoccupations that should deserve our attention.

It is with this perspective that another look could be taken at the way we currently grasp the issue of crises. To take but a few examples, Keynes should have for his part a lot to teach us about the necessity to implement new policy devices to stabilise both the real and the financial sides of the economy, which basically means the management of long-term expectations. On his side, Friedman should have a lot to warn us about the adverse consequences of erratic policies for the dynamics of private agents' expectations in the short run.

Let us first present the aims and scope of this book. We will then provide the reader with an outline of the following chapters.

1.1 Aims and scope

To which extent is State intervention able to stabilise a decentralised market economy and to improve its day-to-day functioning? Depending on the precise

2 Introduction

way one looks at the problem, on how one frames the terms of the debate at stake, the issue of the proper economic policy to be implemented is addressed in very different manners. But in any case, Keynes and Friedman are caricatured in the most stereotypical images as poles apart on almost everything.

The very first way one can address the issue is the way Hayek did, in particular in *The Road to Serfdom* (1944). Here, the alternative is set in terms of freedom versus planning. Worded this way, the issues that arise are the following. To what extent are freedom and efficiency deeply intertwined values to be pursued hand in hand? Once one allows the State to interfere with the daily functioning of markets, what should be the moral principles underlying its interventions? If the battlefield is formulated this way, the answer given by these caricatured figures would be for Keynes to give up to planning all that is necessary for the sake of efficiency and in the opposite a pure *laissez-faire* regime and not the smallest concession to freedom for Friedman.

The second basic way to address this basic problem is to gauge the self-adjusting capacity of a decentralised market economy, in the long run as well as in the short run. In case of a large and protracted shock, when the economy suffers a severe downturn, are discretionary actions of public authorities necessarily detrimental, so that the State should refrain from intervening and let the purge go on? On the contrary, if one considers that Say's law proves utterly irrelevant in our modern monetary economies, how are State authorities supposed to intervene so as to forestall the potential problems inhering in decentralised market economies? Once State intervention is acknowledged in the public's interest, how should these policy devices be designed and implemented? Besides, it can also be considered that a *laissez-faire* system is self-adjusting but only in a long-run perspective, so that it undergoes short-run departures from the growth path of the economy, which are costly in terms of collective welfare. If so, are State authorities supposed to intervene with the view to ensure the maintenance of full employment? And what is the best way to avoid those departures? Here again, Keynes and Friedman are said to be poles apart. Keynes would have made a radical case for big government, impotence of the monetary weapon, anti-cyclical discretionary policies, no care for public deficits and inflation and above all an insistence on short-term devices. As for Friedman, a dismissal of public spending and of short-term fine-tuning, anti-discretionary monetary policy and above all a strictly kingly State, which means *laissez-faire* in every single area of State intervention.

As this book aims to show, the reality is a far cry from this oversimplified image. First and foremost, this book is an exercise of text reading. Through a careful analysis of what these two authors wrote concerning the functioning of a monetary economy, its ability to stabilise by itself at around full employment and also what they viewed as State duties regarding this fundamental goal, our aim is not merely to bring to light similarities and dissimilarities in their theoretical constructs. By the same token, we do not aim only to establish some parallels in their policy advice.

At the theoretical level, our ambition in this book is to investigate the logics that underlie these proximities in the way Keynes and Friedman respectively