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Great depression no. 2: finance and the real world

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Abstract The current crisis is triggering off a number of overdue reflections and interventions. The need for closer regulation of the financial system is widely perceived to be necessary. That is no doubt necessary, but probably insufficient. A careful overhaul of the functions of the banking and financial system is also needed. Our forefathers, at the time of the Great Depression, were perhaps less demurring to trim a bloated financial system.

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1 Introduction

It is not easy today to make sense of the current predicament of our wilting economies. Economic opinion, as of spring 2009, appears divided. Some economists and economic opinion leaders argue that the present crisis provides scope for a necessary adjustment after years of tumultuous growth. The trade cycle is not a thing of the past, as some had fancied especially during the roaring 1990s. It stays with us and, on the whole, it is probably not too bad. It is something we can learn to live with, as it performs a physiological function. Things are *bound* to adjust, though (admittedly) perhaps not as quickly and promptly as, say, the real cycle theory used to predict.

It is obvious that in *any* depression, this particular standpoint has constantly been there and that it embodies, indeed, the most immediate and sensible reaction to a

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depression. Of course, it is also a kind of reaction, which, as a rule, is likely to be relished by CEOs and politicians alike, both when trying to avert being indicted for the disarray and when aiming at milking the taxpayer's purse. Some would also argue that, even if doubtfully, it is a good thing to spread the idea of a fundamental stability of the economy, essentially to keep defeatism at bay, as the latter no doubt is a stimulant of the crisis. In particular, when pondering on the view of economists on policy, it is very instructive to recall where and when they got their PhDs, but it is sometimes perhaps even more instructive to keep in mind on which boards they are currently sitting.

Indeed, what I am describing here used to be the general optimistic mood behind the whole of economic theory for a long time, an ideal of theory firmly based, sometimes unwittingly, on a principle known as Say's Law. Things started to change as economists became more interested in the economics of the short period, approximately at the turn of the nineteenth into the twentieth century. It is perhaps useful to recall that that was precisely the standpoint, which Keynes meant to challenge.

The debate between Hayek and Keynes on the trade cycle, for example, despite the fact that it was largely based on Keynes's *Treatise on Money*, is still important today and has something to tell us on the economics of recessions: we see on the one side the optimism of self-adjustment, however painful, and on the other side the pessimism of those who see the economy stuck in a curious type of 'equilibrium' and inclined to call the state to the rescue.

Much as it happened at that time, the optimistic position seems to be the dominant one also today. Men of finance, in particular, when they are successful and when they go bust, are firmly optimistic as to the stability of the system and on the long-run advantages of financial expansion in creating wealth. After all, to mention a famous case, a major unwitting upholder of Say's Law was David Ricardo, an extremely and uniquely successful man, both as a theorist and as a loan contractor on the stock exchange market. Ricardo is quoted as saying in an upbeat comment that he had made his money by observing that people in general exaggerated the importance of events.

At the same time, there are voices in the wilderness. Some observers try to reconstruct the recent vagaries of economic theory, especially in the macro camp. The Keynesian paradigm trickled down slowly, but steadily at the time and exploded into full triumph only after the end of Keynes's own lifetime. Admittedly, it was not so much the triumph of pure Keynesianism; it was mainly the success of the so-called Neoclassical synthesis, also called 'bastard Keynesianism'.[1] The triumph, and the way it occurred, meant a leap into mechanic or hydraulic Keynesianism. All this produced violent swings in the general scientific mood. The very success of 'bastard Keynesianism' was (to a considerable extent) self-defeating and came to be instrumental in paving the way to the demise of the Neoclassical synthesis itself. There was a rapid decline of the Neoclassical synthesis, which was then pushed aside. A monetarist revival was already well under way at the end of the 1960s. The revival, however, ended up in a 'market mystique', as Paul Krugman has

[1] See Pasinetti (2007).

dubbed it, which appears at the root of the searing excesses and consequent havoc affecting our financial institutions.[2]

Of course, following this line of thought, the view of the crisis takes a very different shape. After the economic disasters produced by communism in the past century, it seemed difficult to do worse. But here, if we take the situation of some of the ex-socialist economies as an example, we may really be in the face of something even worse. Hayek's famous argument, on the dire consequences of the 'pretence of knowledge', can now be retorted against a whole host of gallant defenders of the free market, who have been all too easily assuming themselves to be immune from that kind of disease.

At the same time, the present economic turn produces self-critical concerns on the kind of economic teaching that has become dominant and uniform all over the globe. Such an attitude is sometimes favourably taken, almost as a proof of sound scientific reliability: but it is also increasingly tempting to cast doubt on that widespread belief. Whether sincere or mixed with crocodile's tears, taken at face value recantations abound.

2 Money, finance and the real world

Political economy has been historically somewhat wobbly in choosing whether to put the main emphasis on financial or real phenomena in the economy. It is probably fair to say, however, that, at least from a certain time onwards, real aspects have got the upper hand. Any historical reconstruction of economic analysis invariably shows that the real aspects are at the centre of the stage almost at all times. It would be interesting to have a financial history of the world, for example, along the lines of the recent book by Niall Ferguson, which seems to provide a fair start on the subject. On the whole, at the level of historical analysis, we mostly have partial works on the working of the monetary and financial system, rather than analyses at the planetary level.[3] Otherwise, we have a flourishing literature on finance and growth; how far it can be useful to read into the present downturn has now become a moot question, as hinted above.

It can be interesting to try and compare, side by side, two centuries: to wit the seventeenth contrasted with the eighteenth century. A parallel history of economic thought and analysis during those two centuries can give an idea of what it means to switch from a money and finance perspective to a real one in describing and analysing the economy. The seventeenth century is a revolutionary age from the standpoint of the financial history of the world: that is, the time in which central banks were established and states found it expedient to raise resources without taxing their people, simply via borrowing the resources from them with the issue of public debts. It was the result of a long process, which led to the creation of the

[2] Krugman (2009).

[3] Among the authors of interest are Charles Goodhart, Barry Eichengreen, Ben Bernanke, Joe Stiglitz and others. For a general treatment concerning Europe, Kindleberger (1984) and Ferguson (2008) are still among the best references.

fundamental institutions of our monetary and financial system: central banks, public debts and the rise of the financial market. The establishment of the stock exchange, in particular, comes into the stage mainly as an instrument designed to control and regulate in some way the wanton expansion of the financial activity.

Modern political economy can be taken to be focussed on the question of aggregate *wealth* (i.e. defining the *nature* of wealth and suggesting ways to *improve* and increase wealth overall). That is why Adam Smith ended up writing an Inquiry on the *Nature* and *Causes* of the *Wealth* of Nations, rather than a book of *Principles* of Political Economy. Modern political economy is a long series of endeavours to solve the 'mystery' of economic growth.[4]

In ancient times, wealth was originally conceived to be instrumental for happiness. Through the modern age, however, wealth turned into an end in itself or, rather, *the* end of *economic policy*. It is economic policy, in modern times, which provides the main source for economic analysis or political economy proper. This transformation took place particularly during the sixteenth and seventeenth centuries and extended well into the eighteenth century. It entailed a transition from an idea of possessive *acquisitiveness*, based on commerce (mercantilism), to one of *productivity*, based on primary production and on circulation (physiocracy), to approach, as a further step, a line of thinking based on *creativity*, founded on learning and on human and social capital. The novelty of the last approach is also the unusually larger space given to the analysis of the motivations to action and to institutions. This last strand of thinking finds its typical personification in Adam Smith, even if it can be shown that Smith's contribution, as the founder of the 'classical school' in economics, could hardly be understood independently of the 'Italian school'.

At the centre of the stage, the question that deserves special attention is the nature of the relationship of the *monetary* (and financial) aspects of the economy as compared with the *real* aspects and their respective significance. Indeed, in talking about mercantilism, it is customary to focus attention on commerce. However, everybody knows that historically commerce, both in theory and practice, presupposes banking and banking directly leads into finance. To make this fact explicit, financial institutions showed an extraordinary development during the seventeenth century, particularly, as just mentioned, with the creation of central banks, the launch of public debts and the rise of the stock exchange markets.

As noticed above, political economy wavered for quite a long time historically on whether monetary and financial aspects should take the lead over the real aspects in economic analysis. The famous 'system' of John Law is entirely a product of the seventeenth century in this sense, as a theory that places finance and growth first, using public credit to increase prosperity. Law declared (1705, p. 42) 'An Estate in Money does not grow by words, but an Estate in Credit increases by it wonderfully'. Such and similar teachings became established *doctrines* producing new styles of behaviour and leading to a series of performances with a tragic finale. The shock of the Great Crash, i.e. the demise of the law 'system' that took place in Paris in 1720 (which incidentally set the stage for the creation of the Paris Stock Exchange)

[4] See Helpman (2004).

became a crucial passage for the history of economic thought. It certainly marked the passage from mercantilism to physiocracy, although this was only partly true given the fact that other actors were also on the stage.

It suddenly started to appear evident to everybody at the time that it could only have been out of sheer madness that people were led to take monetary and financial assets as the basic form of wealth. On the contrary, wealth must be *real things* in the first place, with money and finance in the ancillary role of *means* to the end of getting real things. The meaning of *physiocracy*, where *nature* rules, is precisely to be found in a complete disavowal, and indeed a *reversal* of the disastrous logic based on money and finance in the *first* place.[5]

In parallel with the physiocratic school, there are a number of authors who indeed take up mercantilist themes, including monetary and financial aspects, in the context of a different agenda in which real growth, based on a concept of real income, is conceived to take the lead together with an emphasis on creativity in a context of trust and sociality. These authors largely belong to the Italian school: Pietro Verri, in particular, is among them together with Antonio Genovesi, Ferdinando Galiani, Cesare Beccaria and a number of other figures. That Italy experienced an extraordinary development of studies on money is well known. *Money* and *trust*, and thereby sociality, are bound to go together. The time was coming when talking of money came to mean talking of *reform*, both in theory and practice: the metallic reforms that would historically lead to supremacy of the gold standard.

Since those times, political economy has focused attention on *real* magnitudes. Joseph Alois Schumpeter, who, along with John Maynard Keynes, albeit with quite different arguments, contributed to re-shape economic analysis by shifting the focus back on money, banking and finance, noticed this kind of transitions through the history of economic analysis. For example, back in the seventeenth century, Schumpeter spotted the signs of the transition from a monetary to a real analysis on capital and interest (thus giving rise to the 'theory of capital' as still conceived today) in Nicholas Barbon's *Discourse on Trade* of 1690.[6] It was the prelude to an overall change in economic analysis.

The great *coup de theatre*, however, took place during the eighteenth century, when the physiocratic school set in, as an outspoken censure and an indictment against the monetary and financial reasoning of the previous century. Growth, i.e. the creation of wealth, is emphatically *not* money. Money is, purely and simply, a *numéraire* or a means of exchange. Wealth is, indeed, the result of income, i.e. of the flow of the accrual of *real* things through time. If we look for a single personality who bears the stigmata of the drama, it is certainly Richard Cantillon,

[5] See Sonenscher (2008, p. 192). The idea was that the world had reached the stage, in Mirabeau's words, of 'indispensable revolutions, of the collapse and fatal end of the effects of modern politics and their entirely mercantile and fiscal principles'. Physiocracy, the rule of nature, was to provide, Sonenscher continues, the 'only barrier against this terrifying prospect': it merely put in analytic and sophisticated form the 'widely shared view that the modern world's overcommitment to industry, trade, empire, war and debt could not last' (ib., pp. 254–255).

[6] Schumpeter (1954, pt. II, Chap. 6, p. 329) wrote 'There is no bridge between Locke and the monetary theories of today. Instead, there was a new departure [……….] when Barbon (*Discourse of Trade*) wrote the momentous statement: "Interest is commonly reckoned for Money … but this is a mistake; for the Interest is paid for Stock"'.

the great Irish banker who understood the dreadful excesses into which the law 'system' had fallen and put in practice the same kind of action, which, up to the present day, those who are committed to averting a widespread crash fear most: short selling. As a consequence, he had to leave Paris in a hurry as the climate had turned unhealthy for him.[7]

In the middle between mercantilism and physiocracy, we find a considerable group of authors who take up mercantilist themes connected with money or private and public finance in a very different light. Their focus is on real growth and, at the same time, they place great emphasis on what we call 'social capital' or (Walter Eucken's *Soziale Marktwirtschaft*) 'social market economy' today, which encompasses trust, interpersonal relations and the like. Many of the authors in those times are part of the Italian enlightenment through the latter half of the eighteenth century.

3 Economic analysis and finance beyond the eighteenth century

Particularly with the dominant role of British authors and their influence, especially throughout the nineteenth century, the mainstream of economic analysis considers finance as a subordinate subject with respect to the economics of the real world. It is a situation that applies much more to private finance rather than to public finance. This, of course, does not rule out that there are a number of side developments and half-hidden streams of literature, which pursue the analysis of the financial world in the first place. But the dominant features of economic thinking are almost entirely taken up by problems of the real economy.

Perhaps the best known of the underground currents is the school of Saint-Simon. It appears from the extant materials that Piero Sraffa, who was extremely competent in finance, had in mind to produce a comprehensive collection of the works of the French Count Saint-Simon, Claude-Henry de Rouvroy. Saint-Simon is an extraordinarily creative personality, who however has no prominent place in the pantheon of the economic science. This is mainly a result of the fact that scientific economics tends to conform to an abstract ideal of 'pure' science and leave all connections with the financial world to the realm of applications.

At the same time, in parallel with Sainsimonism, some other developments should be considered among which a prominent one is the British debate between the currency school and the banking school, which went on during the whole of the first half of the nineteenth century. This was an important debate, which also had practical consequences, for example: the decisions made, by the mid-1840s, on the arrangements and the rules governing the behaviour of the central bank in Britain as provided in the Bank Charter Act of 1844, as the classic work of Walter Bagehot explains. The currency school is the product of Ricardo's economics: it is the origin of all those conceptions of a quantitativistic nature leading to the concept of a 'monetary veil', which would later be put into question by Wicksell first, then by

[7] He unfortunately did not escape the dreadful fate of a violent death, years later though, and for other and different reasons.

Schumpeter and later (with much larger *éclat*) by Keynes.[8] Keynes, by emphasizing the term 'general' in the title of his major book, meant precisely to dissolve the monetary veil.[9]

It would probably be of the utmost interest to try and dig out bits and pieces of an immensely vast treasure of forgotten writings, especially throughout the nineteenth century, on the issue of *bimetallism*.[10]

Of course all the above is far from denying that there are monetary issues and prominent arguments on money and finance of the utmost significance in the economic writings of the 19th century. One only has to think of the well-known pages of John Stuart Mill, Alfred Marshall and Irving Fisher for some major examples. However, this does not change the fact that, as a general matter, money and finance were the ground of those applied and policy-oriented people, who, no doubt, ruled the roost during the mercantilist period, but who were later overtaken by 'pure' economists. Even the more academic figures among them, such as Georg Friedrich Knapp or others and better known theorists belonging to the Austro-Marxist strand for example (take Simmel, Sombart, Hilferding and others), including Max Weber himself, have ended up taking their place in the *Inferno* of the economic science, or (at best) in its *Purgatorio*. They did not rise to full light.

It is customary, during the Neoclassical period, to talk about the triumph of 'pure' economics and it must be taken into account that pure economics is mainly and basically economics of the real world, which puts money and finance in an ancillary role. The development of Walras's own thinking goes in the same direction.[11]

4 Crises in the twentieth century: conflicts of interest of banks and firms

The first great economist who first successfully brought to the general attention the question of the integration between monetary and real economics was, no doubt, Joseph Schumpeter. Schumpeter's diagnosis is straightforward: modern economics has ended up putting the *sordino* on money and finance, simply because it has completely lost sight of the problem of (in Schumpeter's star title) the *wirtschaftliche Entwicklung*, i.e. economic growth. With money and finance swept into the background, it becomes much easier to concentrate on a theory of choice under scarcity, with an emphasis on the *allocation* problem and on the use of a *static* frame of analysis.

[8] The phrases 'veil of money' or 'monetary veil', along with 'neutrality of money', are, of course, a more recent innovation and were first used in the early works of Schumpeter, as argued by Klausinger (1990, pp. 617–621).

[9] Keynes confessed (1936, p. VI and p. 3) 'When I began to write my *Treatise on Money* I was still moving along the traditional lines of regarding the influence of money as something so to speak separate from the general theory of supply and demand. … I have called this book the *General Theory of Employment, Interest and Money*, placing the emphasis on the prefix general'.

[10] See Friedman (1990).

[11] We omit Marx, whose contribution is much too diverse and complex to be treated within the limits of this paper. We also assume that probably few will lament the omission.

It must be acknowledged that the problem is a bit more complicated than that. Both the physiocratic school, which had largely drawn inspiration from Cantillon, and the British classical school had precisely provided attempts at unveiling the 'mystery' of economic growth. All that was done, however, on the basis of arguments quite different from those involving directly the sphere of money and finance. The transition taking place, as political economy drives away from the mercantilist perspective, is an intriguing passage in the history of economic thought and analysis. It can be properly understood, for example, through a comparison of Pietro Verri and Adam Smith, a comparison which certainly is not out of place at this point. Verri, who precedes Smith, *already* has, much as Smith himself would have, a view on economic growth, which conceives of it as a real and civil transformation. It goes beyond the mercantilist horizon and even beyond physiocracy. At the same time, Verri's view *still* is essentially grounded (differently from Smith) on monetary and financial mechanisms.

Going back to the beginning of the twentieth century, economic facts and economic history acquire a vital role. The Santsimonian movement gave rise to the *Crédit mobilier* and, in the German-speaking world, there is the great experience of the rise of universal banking, the so-called 'German model' of banking. What Schumpeter appears to do is to produce an analysis of the system, which takes these and such practical facts and institutions into due account. In the Anglo-Saxon world, things are run differently and firms face the stock market. The universal bank has a minor role; the model of banking is the merchant bank.

At the same time, from the outset of the twentieth century there was a widespread interest for the short-term dynamics of the system. It is at that stage that the rise of the business cycle theory set in, with a close analysis of the swings of economic activity of booms and depressions. It is here that monetary factors would be retrieved and put in the limelight. The assumption of *liquidity preference* is essential to Keynes's approach to depressions. The idea of liquidity preference has a role in Keynes's *General Theory* and it is used with a view to accounting for hoarding and for the waste of resources thus involved. It is certainly not by mere chance that Keynes goes back to mercantilism in the *General Theory* itself (1936, Chap. 23); he goes back to those remote authors not so much, or not just, thinking of their pleas for limiting free trade (perhaps the aspect of mercantilism, which more easily comes to our mind when we think of that school). Rather, he goes back to mercantilism precisely for its monetary theory of interest and, more generally, for the integration of money and the real economy.

5 Economics as finance and the myth of a boundless growth of wealth

The stock market makes its appearance in history and establishes itself initially as a solid core reality of modern capitalism, mainly as an institution devoted to trading government funds. However, had *that* remained the main function of the Stock market, we could not fully explain its role and relevance in the development of finance capital (Hilferding's *Finanz Kapital*) in the contemporary world finance. At this point, we choose to focus on one aspect of the phenomenon, which seems particularly important.

A general tendency of latter-day capitalism was to foster tight relations between banking and industry. What this implies, especially under the influence of the deepening and flourishing of universal banking, is that the focus of the banker's concern is shifted from the care for the interest of the saver and the liability of the bank toward the saver–depositor to the planning of the use of funds in all forms of lending, contracting and operating on the stock exchange market. This is true both in the world of universal banking and in the realm of merchant banking.

This general trend is subject, in fact, to wide fluctuations. The great depression in particular marks a return to a more cautious course of action. There comes to be a widespread increase of forms of regulation and control on banking activity and on the functioning of the stock exchange, especially concerning credit to firms and to industry in general. In Italy, for example, in 1933 the IRI (Istituto per la Ricostruzione Industriale) was established after a series of diverse attempts at tackling the problems posed by the interrelations of banking to industry. Under the IRI, the state became the entrepreneur, an experience that would hardly be conceivable, but for the difficulties of that time besetting the universal bank as a model of banking. In fact, the launch of the IRI almost coincides with a new banking law which in the Italian experience lasted well into the post-war period.

Let us summarize the situation using the words of Paul Krugman (2009): 'America emerged from the Great Depression with a tightly regulated banking system, which made finance a staid, even boring business. … And the financial system wasn't just boring. It was also, by today's standards, small. It all sounds primitive by today's standards. Yet that boring, primitive financial system serviced an economy that doubled living standards over the course of a generation'.

At present, we experience a new phase of explosive finance. Krugman in a few words gives a fair idea of the global experience we are going through now, and he does so much better than the flood of glib statements by some of the ruling gurus in Italy at the moment. Krugman writes 'In the deregulation-minded Reagan era, old-fashioned banking was increasingly replaced by wheeling and dealing on a grand scale. The new system was much bigger than the old regime … And finance became anything but boring. It attracted many of our sharpest minds and made a select few immensely rich'. In his contribution to this issue, Aldo Montesano makes it perfectly clear what the basic tenets are of the unsound 'philosophy' of our explosive finance largely rooted in the securitization business.[12] Krugman says 'The wizards were frauds whether they knew it or not'. The conclusion is natural that 'sooner or later, things were bound to go wrong, and eventually they did'.

In the Italian context, most reactions to the current crisis were, at least from the late 2008 to the first few months of 2009, in the sense of pointing out that the

[12] A glimpse of Montesano's carefully argued analysis on that unsound philosophy is captured by the picture Krugman (2009) takes of it: with the process of securitization, 'loans no longer stayed with the lender. Instead they were sold on to others, who sliced, diced, and puréed individual debts to synthesize new assets. Subprime mortgages, credit card debts, car loans all went into the financial system juicer. Out the other end, supposedly, came sweet-tasting AAA investments. And financial wizards were lavishly rewarded for overseeing the process'.

explosion of finance (innovation and deregulation alike) through the recent years was a vital factor in fostering growth worldwide. The gains of globalization seems to have, on the whole, outstripped the costs. It is also to be noticed that economists thus oriented (endowed with their self-styled ‘commonsense’ view of the slump: substantially a Pre-Keynesian view, where crises belong to the physiology of capitalism) are sometimes the same people who, in the course of the roaring 1990s, had made important contributions to lifting up our hearts by persuading us that the economic cycle was a thing of the past and that in the ICT economy it had become imperative to think seriously (at last!) of the Prometheus unbound: boundless growth for the global economy. They are also the same people who now incline to concede that errors or deceit from wizardry had, if any, a minor role during the recent financial explosion. From overpaid CEOs, to rating agencies, financial ‘engineers’ and the like, such agents perhaps do not deserve thanks and praise, but they should not simply be blamed either.

Of course, it is undoubtedly not a bad thing that people try to be coherent as much as possible and sometimes even a bit more. The financial euphoria, to which we have been accustomed to, is a complex phenomenon. It is therefore vital, at the present stage, to get the fundamentals right and decide, for example, whether the new financial era we have entered has produced a better sharing of risks or if, contrarily, the creation of new risks has been the upshot.

It is perhaps more appropriate to consider the question from a different angle. The forms of the explosion of the financial world through the recent years were based on the conception that banks are enterprises, which aim at maximum profits and the creation of shareholders’ value. This kind of view paves the way to reject any possible hint at social responsibilities of banks and financial institutions and reject at the same time their role in bearing the responsibility of protecting the interest of savers. The Italian case is particularly interesting (given the economic history of the country, especially for a long time after the Great Depression): there is a widespread feeling that any concession towards relaxing the faith in the virtues of globalization could lead back into old and well-known forms of intrusion of the state and of politics. The return of *statism*, the idolatry of state intervention, is the great danger.[13] ‘Market culture’, so to speak, is said to have superficial roots in Italy and it is due to the constraints created by the European Union if a landslide of sound market principles has not ensued.

The case of Italy is important to convey a more general message, which touches on one side the nature and role of the banks and financial institutions in relation to savers and to the state on the other side. ‘Negationist’ sentiments on the current crisis find to a large extent their basis in the general persuasion that the basic *conflict of interest* affecting the monetary and financial system is the conflict between monetary and financial institutions on one side and the state on the other. It is delusive, in that view, to expect the state to perform the role of a neutral economic supervisor or a safe neutral haven: the state has invariably to be unveiled as an instrument of oppression, wielded by the politicians in order to squeeze the citizens.

[13] Mario Monti, along with Francesco Giavazzi and Guido Tabellini, are leaders in warning against the risks of a new wave of statism. Followers are swarming.

This is the logic of Gaetano Mosca's political theory as well as of James Buchanan's *democracy in deficit*, which is now retrieved, very often in a technically more sophisticated, but conceptually more naïve form, by the upholders of the latter-day 'political economics'. The dire consequences of the state having turned into *the* banker of the system were exposed years ago in the Italian system, and it is not surprising to find that what some fear most is the return today of that old disquieting logic.[14] All of this has great significance indeed.

That does not mean, however, that we may feel free to forget (which is perhaps the greatest danger today) about another, different, though likewise *real*, conflict of interest: the conflict between monetary and financial institutions on one side and savers on the other side. The present crisis serves to remind the fundamental trust relation between banks and savers, which has been increasingly disregarded and pushed into the background by the current practices. All the motives leading to magnify banking and finance have entailed the side effect of making those institutions think about imaginative ways in designing loans and at the same time of de-emphasizing the need to heed the interest of savers and preserve and protect the value of their savings in the first place. The sanctity of savings is a constitutional principle in Italy.

If we revisit two great economists of the twentieth century who have insisted on the link between money and finance and the real economy, we have to observe the following:

1. The defence of the saver is not *the* point in the Schumpeterian system, where the safe working of the system is guaranteed by the ability of bankers in discovering and choosing the 'right' entrepreneurs.
2. The question of protecting and preserving savings is not *the* point of the Keynesian logic either: in the Keynesian system the true problem is hoarding as a result of uncertainty; this emerges also from several developments of the Keynesian school, as it is the case with Hyman Minsky's *Can 'It' Happen Again?* (1982), where the field has been opened to a flow of studies on financial 'fragility', well beyond the mere mechanism of hoarding.

Many factors have been at work in rendering the principle of caring for savings somewhat obsolete. Banks and financial institutions have fully adopted a different perspective, which includes them within the realm of 'irresponsible' enterprises, i.e. enterprises without any kind of social responsibility constraints.

Facing the current crisis, some commentators have expressed the opinion that the very system of the joint stock company has to be revised and called into question, as a system which has lost most of its potential in awakening animal spirits. Of course, there is no readymade automatic rule to give a new lease of life to the animal spirits of entrepreneurs. However, it may not be necessary to go as far as calling into question the logic of the modern corporation. What is probably necessary is to revise the scope and the ground for action to be reserved for banking and finance.

[14] During the 1970s, Mario Monti developed a famous compelling criticism of the state as banker in *Tendenze monetarie*, an influential periodical published by the economic research unit of the Banca Commerciale Italiana.

Reviving trust via fiscal stimuli or introducing new and better rules or extending their range of application is surely important, but perhaps still insufficient. What we need is to reflect, for example, on the comparatively recent return worldwide to the forms of universal banking: a process that was pushed forward with excessive speed, especially from the 1980s, while it would probably have been necessary to proceed with greater caution and by degrees. A reinterpretation of the 'dull' role of safer finance is called for and the problem is that no one seems to have the strength, the charisma and the imagination required. The result in the economies of the West is the widespread tinkering, while we keep telling each other every day that, indeed, things are getting better and there are positive signals.

The widespread fear of discretionary power in politics and economics leads, as a generalized tendency, to think of *technical solutions* beyond any reasonable limit. This is also a result of the 'imperialism' of the economic science, so typical of much of the current thinking on economic policy. This is a mind-narrowing self-defeating course of thinking and action. Much of current economics has ended up being trapped into playing quite a bad game.

The present state of the European construction also reflects this kind of ideology. As a typical example, the introduction of the Euro as a common currency is described not so much as a partial achievement in a more complex and multi-level construction, but as *the* achievement that has made it possible to harness the power of the state. What makes the Euro a *unique* currency is, according to this view, the fact that it is the sole currency in the world to which there does not correspond a political body. Behind such a conception, there is the view that monetary policy can be reduced to a technical process. Fortunately, after years of passive acquiescence to similar views, enlightened opinion is starting to wake up to new and more serious perspectives and tries to avoid the worst limits of a purely technical horizon. Demands are spreading that Europe should have its own fiscal policies and public debt. This means starting a new political process. That Europe has largely ended up in the hands of 'political economists', in the latter-day sense of the phrase, must be rated as one of the worst misfortunes of our age.

The present crisis demands a return to political economy in a more 'classical' meaning of the phrase. A number of analysts, journalists, economists and politicians are scared by the prospect of a return to some kind of statist ideology: which is sensible and realistic, if it refrains from the radical temptations of a purely technical perspective. It is indeed even more necessary at present to realize that it is precisely the mood leading to a purely technical view of the problems involved, deprived of any sense of the historical reality we are living in; a mood that is likely to make our near future much bleaker and hopeless than it would be otherwise.

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