**GSAR Journal of Economics and Finance**
ISSN: 3107-9520 (Online)
Frequency: Monthly
Published By GSAR Publishers
Journal Homepage Link- https://gsarpublishers.com/gsarjef-home/

# Realism and Economics: The Implications of Economic Theories.

## A Discussion of the Austrian School of Economics

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**Article History**

*Received: 11/06/2026*
*Accepted: 17/06/2026*
*Published: 19/06/2026*

**Vol – 2 Issue – 6**

*PP: -33-71*

***Abstract***

*This paper starts from the assumption that economics is a social science. As such, it must be grounded in reality, both in its underlying assumptions and conceptual frameworks and in its practical effects; it cannot be, to borrow Alfred Marshall's expression, "the celestial mechanics of a non-existent world". For this reason, the paper examines the Austrian School of Economics, a body of thought that has exerted a significant influence on political life. The analysis focuses on one of its leading contemporary representatives and challenges certain aspects of his approach on the basis of realism, as well as what are considered flawed legal assumptions. At times, the law—ex facto oritur ius—proves more realistic than economics.*

## Defining the Problem

Some ideas in economics are often presented as unquestionable postulates. Among these are the notions of competition and of price formation based on firms acting as price takers whose sole objective is profit maximization.

This view overlooks not only the fact that firms are frequently price makers and quantity takers, possessing significant market power and often managed by executives who are more concerned with the growth and size of the firm than with the maximization of profits. More importantly, it neglects the reality that the so-called mark-up—that is, the margin incorporated into prices which covers profits as well as costs beyond labor, such as the cost of raw materials—may vary according to the balance of power between firms and workers. It is therefore not determined exogenously by the more or less competitive structure of markets.

Another widely held idea concerns the relationship between savings and investment, which is regarded as fundamental to economic growth. In reality, causality runs from investment to savings rather than the other way round. In a capitalist economy, the decisions of firms play a far more crucial role than those of consumers and households. Investment decisions constitute an independent variable which, together with any budget deficit and exports, determines the rate of growth, profits, and income. Investment depends primarily on expectations of future profits, since no one invests without anticipating a return. Firms do not look solely at the rate of interest, which is itself variable and may depend on a wide range of factors, including international economic policy.

This is how things work in the real world.

Prices, like investment, also depend on expectations of future profits and on entrepreneurs' decisions.

In this respect, it may be argued that certain approaches associated with the Austrian School of Economics converge with ideas developed by schools of a very different orientation. This study focuses on the Austrian School of Economics, comparing it with alternative schools of thought and, above all, assessing its possible impact on reality and on certain modern legal approaches that it appears either to deny or to take insufficiently into account. The political consequences of a theory—or, more broadly, the consequences observable in practice—are important because, regardless of the intentions behind the theory itself, they may ultimately render its own economic prescriptions unworkable.

The Austrian School is particularly suitable for such an inquiry because it is often argued that its greatest success has been achieved in the realm of ideas, understood in a political sense, rather than within academia itself. It is therefore a body of thought that should display significant practical implications. The origins of the Austrian School are conventionally traced to the publication in 1871 of Carl Menger's *Principles of Economics*.

More recently, Yanek Wasserman has attempted to reconstruct the intellectual environment from which the first

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two generations of Viennese economists emerged and which shaped the distinctive and unmistakable style of the so-called Austrian School of Economics. Today, the Austrian School is commonly associated with neoliberalism, the intellectual current that, in the post-war period, vigorously defended free trade while seeking to counter the expansion of social democracy. The term "neoliberal" is used primarily by critics to describe economists who oppose market regulation, state intervention, and redistributive policies.

Menger's principal disciples—Eugen von Böhm-Bawerk and Friedrich von Wieser—not only consolidated the scientific reputation of the Viennese School but also expanded its influence by attaining prominent positions in both academia and the imperial administration. The golden age of the Austrian School followed a trajectory parallel to that of the Habsburg Empire. When Austrian economists emigrated to the United States, they brought with them not only their academic talents but also the combative spirit and political instincts developed during the turbulent years in Vienna. They had learned through experience that sound ideas do not prevail by their own force and that only persistent lobbying can transform them into public policy.

The American Right, for its part, was in immediate need of intellectual resources to deploy in its cultural struggle against Rooseveltian liberalism. Several members of the Austrian School entered this debate, but the struggle permanently altered the profile of the school itself. Whereas the writings produced during the European period generally reflected a politically moderate position between communist and fascist extremes, from the 1940s onwards there was a clear shift towards radical laissez-faire liberalism. Social welfare institutions—from public healthcare to unemployment benefits—which had formed an integral part of the proposals advanced by Viennese economists during the years of the Austrian Republic, came in the American period to be regarded as threats to individual freedom.

The mid-twentieth century also witnessed the emergence of a new professional figure: the "technical" economist. With the mathematization of neoclassical theory and the development of econometrics, economics acquired increasingly esoteric characteristics and became progressively detached from the political sphere. The discipline separated itself from psychology, sociology, and political theory. Although they had been among the co-founders of neoclassical economics, Austrian economists increasingly found themselves swimming against the tide and eventually became marginalized. Consistent with the positions they had adopted at the beginning of the century, they opposed the use of mathematical models and openly expressed skepticism towards empirical forecasting. At the same time, they embraced interdisciplinary research, exploring the broad territory between economics, sociology, and political philosophy, as well as the emerging field of cognitive science. Their opposition to mathematical modelling has remained one of the principal criticisms directed against them.

The principal representatives of the mainstream Austrian tradition include Carl Menger, Eugen von Böhm-Bawerk, Ludwig von Mises, Friedrich A. Hayek, Murray Rothbard, Ludwig Lachmann, and Israel Kirzner.

For this very reason, the Austrian School ought to be particularly attentive to the constraints imposed by reality.

It appears to me, however, that the views advanced by one of the School's leading representatives—and all the more significant because he is a contemporary scholar, directly confronted with present-day problems rather than being merely, albeit authoritatively, a figure of the past—namely Professor Jesús Huerta de Soto, suffer from a lack of realism and are moreover grounded in legal assumptions that are open to question. For this reason, given his authority and his international standing as one of the foremost representatives of the Austrian School of Economics, I shall focus primarily on his work.

The principal legacy of the Austrian School is to be found outside pure economic science, in the fields of economic policy and institutional design. Yet even here there are both strengths and weaknesses. Until the 1970s, the history of neoliberalism was largely a history of defeats—a rearguard struggle against Keynesian policies and the expansion of the welfare state. According to the conventional narrative, the neoliberal revival began with the governments of Ronald Reagan and Margaret Thatcher and subsequently continued, more subtly, through its influence on the economic agendas of center-left leaders such as Bill Clinton, Tony Blair, and Gerhard Schröder.

Is it therefore legitimate, as Yanek Wasserman argues, to claim that Austrian economists have "won the battle of ideas"? The seeds planted more than a century ago continue to bear fruit in unexpected places. Those who trade in Bitcoin, for example, are often unaware that many of the ideas underlying cryptocurrencies descend directly from those developed by Viennese economists. Projects aimed at separating money from state control and protecting private savings through a plurality of competing currencies have become part of the anti-European ideology that opposes the monetary monopoly of the central bank.

Huerta de Soto, in particular, advocates the restoration of a 100 per cent reserve requirement **on** demand deposits and their equivalents. He further proposes opening the banking system to competition through the abolition of central banks**,** which he regards as unnecessary once a system of full-reserve banking has been established. In addition, he advocates the privatization of money through the reintroduction of gold as money and a return to the gold standard, a consequence, in his view, of combining full-reserve banking with a regime of free banking, that is, a banking system operating without central banks.

I shall begin with a brief overview of the Austrian School of Economics. Subsequently, however, my attention will focus primarily on Huerta de Soto, both because he is arguably the most authoritative living representative of the School—and

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therefore the scholar whose economic prescriptions should be expected to engage most directly with contemporary reality, understood as the world of observable facts—and because he is the figure with whom critics of Austrian economics must most seriously contend. Any criticism directed at Austrian theory is likely to receive its most immediate and sophisticated response from Huerta de Soto himself. Moreover, he belongs to the more libertarian strand of the Austrian tradition, a strand that has found significant political resonance within certain sectors of the American Right.[i]

## I. A Brief Description of the Austrian School of Economics

The theorists of the Austrian School advocate minimizing government intervention in the economy, emphasize the strong protection of private property, and generally support methodological individualism. For this reason, they are frequently invoked by *laissez-faire*, libertarian, and objectivist movements. Austrian economists such as Ludwig von Mises, however, insisted that praxeology should remain value-free. In other words, it should not seek to answer the normative question, "Is it right to adopt a particular economic policy?", but rather the analytical question, "If this policy were implemented, would it produce the intended effects?"

Over time, economists associated with the Austrian School have come to be divided into two broad currents. While sharing a common intellectual heritage rooted in the work of Carl Menger, these currents differ in their methodological emphases and in their interpretation of some of the School's central doctrines.[2]

The first group follows the approach initiated by Friedrich Hayek and displays a degree of skepticism towards certain neoclassical concepts while nevertheless accepting the extensive use of neoclassical methods, including mathematical modelling.

The second group follows the approach of Ludwig von Mises and Murray Rothbard. It rejects neoclassical welfare economics and consumer theory, maintains that statistical and mathematical methods are inapplicable to economics, and argues that economic theory as a whole went astray during the twentieth century. Its proponents regard the Misesian approach as an alternative paradigm to mainstream neoclassical economics.

The principal contributions of the Austrian School to economic thought include its theory of price formation; its emphasis on the opportunity-cost nature of choice; its rejection of the dominant role accorded to mathematical methods in economics—a position that generated considerable controversy with neoclassical economists; Eugen von Böhm-Bawerk's critique of the Marxian labor theory of value; Böhm-Bawerk's theory of capital, upon which Huerta de Soto explicitly draws; the Austrian development of the subjective theory of value and marginal utility**;** the business cycle theory developed by Hayek and von Mises, commonly known as the Austrian Business Cycle Theory (ABCT)**,** which emphasizes the role of credit expansion induced by monetary policy; Hayek's concept of intertemporal equilibrium**;** the Hayekian and Misesian conception of prices as signals conveying information about relative scarcity; the theory of time preference; and the debate surrounding the Austrian claim concerning the impossibility of economic calculation under socialism**,** which gave rise to the well-known socialist calculation debate**.**

More broadly, the Austrian School is distinguished by its emphasis on methodological individualism, the entrepreneurial discovery process, the role of dispersed knowledge in society, and the coordinating function of the price system. These themes, particularly in the works of Hayek, have exerted a lasting influence far beyond the confines of Austrian economics itself.

Among the leading representatives of the Austrian School are Friedrich Hayek and Ludwig von Mises. The latter played an important role in shaping the intellectual development of the former. Hayek, in addition to being an economist and recipient of the Nobel Memorial Prize in Economic Sciences, became widely known as a political philosopher through a series of influential works published after the Second World War.

Hayek abandoned his earlier social-democratic sympathies largely as a result of his encounter with von Mises. He was also among the earliest proponents of monetary doctrines that have, in more recent times, been revived by Huerta de Soto. One of the most famous intellectual confrontations in twentieth-century economics was that between John Maynard Keynes and Hayek. This debate has been analyzed in detail by Nicholas Wapshott, who describes the conflict between two economists whose ideas came to underpin opposing schools of economic and political thought.

Although Hayek initially engaged directly with Keynes and his theories, he eventually abandoned any attempt to mount a sustained frontal attack on Keynesian economics. Instead, after the war he devoted increasing attention to political and institutional analysis, particularly through works ranging from *The Road to Serfdom* (1944) to *Law, Legislation and Liberty* (published between 1973 and 1979).

In *The Road to Serfdom*, Hayek emphasizes what he regarded as the affinity between fascism and communism, describing them as "twin totalitarian evils". In his view, this affinity was demonstrated by the relative ease with which young communists could be converted into Nazis, and vice versa, since both movements shared a profound hostility towards Western liberal society. For both groups, the true enemy was the old-fashioned liberal—the individual with whom they had nothing in common and whom they could scarcely hope to convert to their cause.

According to Hayek, by the time Hitler came to power, liberalism in Germany was already dead and buried, having been destroyed by socialism. What is striking in Hayek's analysis is the ease with which he associates the crisis of liberalism in Germany during the Weimar Republic and the conservative governments of the early 1930s, including that of

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Hindenburg, with Soviet-style socialism *tout court*. This tendency to subsume markedly different political and historical experiences under a common totalitarian category has remained one of the most debated aspects of Hayek's political thought.

In the latter work, Hayek reiterates his preference for the common law as a stronger safeguard of individual liberty. Without entering into legal controversies—even though my own background would incline me to explore the issue in greater depth—Hayek's reconstruction appears, in several respects, overly simplistic.

The requirement of legal certainty and predictability, for example, has been regarded since Max Weber as a crucial factor for economic activity and business development. In civil-law systems, this requirement is secured through mechanisms that differ from those of the common law tradition but are not necessarily as deficient as Hayek suggests.

According to Weber, one of the essential preconditions of modern capitalism is a rational legal order. Such a legal order renders the law calculable, that is, it increases the predictability of relations among economic actors and between private parties and public authorities. This predictability is particularly important for economic activities requiring substantial investments in fixed capital. Weber argued that this precondition emerged only in the West and was the product of a rational state characterised by two essential features: first, a legal order governing both access to political power and the exercise of that power; and second, a specialized bureaucracy whose recruitment and activities were themselves governed by law.

According to Weber's account in *General Economic History*, one of the factors that made the rational organization of the state possible was Roman law. Following the fall of the Roman Empire, Roman law was preserved by the notaries of the Italian cities and adapted to the needs arising from the increasing commercialization of economic life. At the same time, the universities developed a systematic body of legal doctrine that provided the intellectual foundations for a rational legal order.

The development of the common law followed a different path. Whatever the merits of theories according to which judges naturally adapt the law to the evolving needs of society and the economy, it is also true that by approximately 1230 the most prestigious activity within the legal profession was that of the *narratores*, advocates who presented the facts and argued cases before the courts on behalf of litigants. Around 1330, a group of *narratores* practicing before the Court of Common Pleas, known as the *serjeants-at-law*, organized themselves into a professional corporation.

Admission to this body involved an elaborate ceremony conducted with the participation of the judges of the court, during which the new member was invested with a white silk coif. From this practice emerged the name *Order of the Coif*. For a considerable period, this guild effectively monopolized judicial appointments. Later, the monopoly became more formal than substantive when it became customary to admit to the Order all those appointed to the royal courts.

The *serjeants-at-law* have now disappeared and have been replaced by barristers organized within the four Inns of Court: *Inner Temple*, *Middle Temple*, *Gray's Inn*, and *Lincoln's Inn*. The Inns served not merely as places of residence and legal study but also as communities within which learning occurred through observation and imitation, enabling younger lawyers to absorb the professional conduct and style of their senior colleagues.

During its six centuries of existence, the Order of the Coif admitted fewer than one thousand members in total, a circumstance that, according to Antonio Gambaro and Rodolfo Sacco, contributed significantly to the cohesion of the group.

The common law thus emerged through a process that is often portrayed as a natural adaptation of legal rules to the needs of society. Yet it was also the product of a highly cohesive—and, in contemporary terms, one might even say corporatist—professional elite whose members exercised substantial influence over both the interpretation and the creation of legal rules and who, to a significant extent, reproduced themselves through processes of internal selection and co-optation.

However, beyond the aspects of political theory—for which Hayek became almost as famous as he was as an economist, and to which he devoted a substantial part of his intellectual life, arguably even more than to economics itself—it is worth turning briefly to some economic themes that bring him closer to the contemporary Huerta de Soto.

Before leaving the realm of political theory, it should be noted that Hayek's reflections on economics—and, more broadly, on the history of economic thought—continue to offer valuable insights. First, his conception of the market runs counter to subsequent developments in economics, which, particularly after the Lucas critique, fully articulated in 1976, increasingly sought to incorporate expectations into economic models. The difficulty, however, is that the attempt to deal with heterogeneity ultimately led the Lucasian approach to reduce macroeconomic phenomena to an omniscient representative agent solving intertemporal optimization problems into the indefinite future. This is, to say the least, a questionable outcome.

In macroeconomics, it may be more fruitful to rely on models populated by agents with local interactions and limited information. Yet there is another important insight that can be drawn from Hayek's work. For the Austrian economist, the superiority of the free market over economic planning is not universally applicable. A revealing passage in *Freedom and the Economic System* makes this clear. In certain circumstances, Hayek argues, central planning may be necessary where a goal shared by the majority of the population can only be achieved through coercive collective action. One example is the containment of infectious diseases.

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A distinction must therefore be drawn between Hayek's conclusions regarding the market and his broader political-economic views. The former do not necessarily imply the latter. Hayek could recognize the theoretical limitations of markets while simultaneously maintaining, in his more explicitly political writings, that planning policies should be resisted because they pose a threat to individual liberty. Ironically, it is the theoretical Hayek who is sometimes invoked today by thinkers on the political Left. His ideas concerning markets have attracted the attention even of advocates of more ambitious forms of economic planning.

Among them is the economist Mariana Mazzucato, who sees the complex nature of markets as a reason for greater state intervention. Moving beyond theories of market failure that remain excessively focused on neoclassical equilibrium, Mazzucato's concept of the entrepreneurial state seeks to develop strategies capable of taking account of the dynamic nature of markets and the localized character of knowledge, thereby harnessing and directing these forces. Similar concerns can also be found in the work of more mainstream economists such as Dani Rodrik.

Although Hayek is often described as a traditional conservative, he entitled the postscript to *The Constitution of Liberty* "Why I Am Not a Conservative". There he defines the distinctive features of his liberalism by contrasting them with conservatism. Liberalism, in his view, is open to and confident about change, whereas conservatives "are inclined to use the powers of government to prevent change or to limit its rate to whatever appeals to the more timid mind". They are characterised by a strong "fondness for authority", a failure to understand economic forces, and a tendency to defer to established power. For liberals such as Hayek, the primary concern is "that power should be kept within limits", whereas conservatives are chiefly concerned that authority should not be weakened. Such an attitude, Hayek argues, is difficult to reconcile with the preservation of liberty.

Hayek favors individual freedom and a social order that emerges spontaneously through the actions of individuals freely pursuing their own interests and making use of the opportunities offered by the market to improve their condition. Within this framework, government should play only a limited role: protecting property rights, enforcing contracts, and removing obstacles that impede the operation of market processes. Government should, in other words, cultivate the conditions of development rather than determine or direct it.

The liberalism advocated by Hayek derives, in his own words, from the discovery of a "self-generating" or *spontaneous order* within social reality—an order that makes it possible to utilize the knowledge and abilities of each member of society to a far greater extent than would be possible under any order consciously created by a central authority. This insight, he argued, led naturally to the desire to make the fullest possible use of the powerful forces that generate spontaneous order. As Hayek stated in a paper delivered to the Tokyo meeting of the Mont Pèlerin Society in September 1966, "Liberalism is therefore inseparable from the institution of private property, which is the name we usually give to the material part of this protected individual domain."

In this perspective, the coercive functions of government should be limited to the enforcement of general rules of conduct that provide the framework within which individuals with different ends and values interact. These are predominantly negative rules, specifying what individuals may not do. Beyond enforcing such rules, government may intervene coercively only to require citizens to contribute, according to uniform principles, to the costs of enforcing them and to financing certain public-service functions.

These functions include services that, for various reasons, spontaneous market forces cannot provide, or cannot provide adequately. Hayek specifically mentions protection against natural risks such as hurricanes, floods, earthquakes, epidemics, and similar disasters, together with the measures necessary to prevent or remedy the damage they cause.

He also identifies a second category of risks, one for which the need for government action has been recognized only more recently. These concern individuals who, for various reasons, are unable to earn a living in a market economy: the sick, the elderly, persons with physical or mental disabilities, widows, and orphans. These are individuals suffering adverse circumstances that may affect anyone and against which many people are unable to insure themselves adequately. A society that has achieved a certain level of prosperity, Hayek argues, can afford to assist them.

To this form of insurance against natural and social risks, Hayek also adds support for a minimum income. In his autobiographical reflections, he explicitly stated: "I have always said that I favor a minimum income … an income floor on which everybody can rely." Likewise, in *The Constitution of Liberty*, he refers to "a system of public assistance under which nobody suffers from severe deprivation" and which guarantees that no member of society lacks food or shelter in cases of genuine need.

If one turns instead to Hayek's more strictly economic ideas, one encounters the question of whether economic calculation is possible under socialism, an issue that he inherited from Ludwig von Mises and which now appears somewhat dated. The central problem, however, is how to ensure that the information possessed by individual economic agents is utilized efficiently, given that it cannot be aggregated and concentrated in a single individual or central authority. Because of this impossibility, Hayek's solution is fundamentally decentralized: a free-market economy in which economic agents coordinate their actions, drawing upon their limited and local knowledge of the circumstances surrounding them, through a mechanism that allows information to be communicated and utilized. For Hayek, this mechanism is the price system.

Of greater relevance are two further issues, both later taken up by Huerta de Soto, the second of which brings him closer to the libertarian tradition.

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The first concerns business cycle theory. The business cycle and its causes occupied a central place throughout Hayek's work. Building upon Ludwig von Mises's *The Theory of Money and Credit* (*Theorie des Geldes und der Umlaufsmittel*, 1912), in which the Austrian economist applied the concept of marginal utility to money, drawing also upon the theories of Carl Menger (the theory of the origin of money), Eugen von Böhm-Bawerk (the average period of production), Knut Wicksell (the effects of interest rates on prices), and Tugan-Baranovsky and Spiethoff (the disproportionality theory), Hayek developed an interpretation of the business cycle that later became known as the Austrian Business Cycle Theory.

In *Prices and Production* (1931) and *The Pure Theory of Capital* (1941), Hayek argued that business cycles are the result of artificial credit expansion, that is, an expansion not supported by a corresponding increase in real savings. Such expansion, brought about by central banks through artificially low interest rates, gives rise to what Austrian economists term *malinvestment*, namely the misallocation of investment resources across the structure of production.

More recently, Huerta de Soto has argued that the Peel Act of 19 July 1844, formally the *Bank Charter Act 1844* and commonly known as Peel's Bank Act, established the foundations of a banking system whose essential characteristics subsequently spread from Great Britain to the rest of the world. According to De Soto, the Act contributed to the development of a system in which banks are able to extend loans in amounts exceeding the money actually deposited with them—at that time primarily gold and silver. This created a profitable but potentially dangerous system, comparable to the sudden discovery of new gold deposits.

The monetary expansion thereby generated, which in De Soto's view violates long-established legal principles governing deposit contracts, is never distributed uniformly throughout the economy. Under a system of full-reserve banking, depositors would be assured that the funds deposited remained fully available. By contrast, under fractional-reserve banking newly created money enters the economy sequentially and in successive stages. The first recipients of bank credit enjoy a purchasing power created ex nihilo that is substantially greater than that available to later recipients in the long chain of monetary circulation.

Those who subsequently receive the additional money created by banks through market processes are affected only gradually—and to differing degrees—by the resulting increase in the prices of both consumer goods and capital goods. According to this interpretation, the effect of monetary creation and its subsequent circulation is that the earliest recipients derive a systematic advantage. They benefit at the expense of later recipients, particularly those who receive the new money only at the end of the transmission process.

The result is a redistribution of income that disadvantages those who depend upon fixed incomes and who benefit most from a stable, or increasing, purchasing power of money. Furthermore, price increases are not proportional, as suggested by the monetarist equation $MV = PQ$. Prices change not only in absolute terms but, more importantly, in relative terms, thereby generating significant distortions and structural imbalances throughout the economy.

The objections raised by many Keynesian economists, and their concerns—most notably, though not exclusively, those of Hyman Minsky—regarding the role of money and the potential instability of the financial system, are well known. Bank money is created in response to the demand for credit by firms, which make their investment decisions on the basis of expectations that depend only marginally on current income and much more significantly on expected effective demand.

In this respect, the Keynesian position appears to me more realistic, provided that it is accompanied by robust and effective forms of regulation and supervision capable of offsetting the absence of a 100 per cent reserve requirement and of recognizing the entrepreneurial role played by banks themselves. Uncertainty, irrationality, and the conventional nature of expectations constitute permanent sources of instability within a market economy. Yet should the pursuit of absolute perfection come at the expense of economic development?

Certainly, the accumulation of speculative debt positions means that, during periods of optimism, risks can build up and create the conditions for a future crisis. When a large number of economic units are no longer able to generate a sufficient flow of income to remain solvent, even a modest increase in interest rates, a tightening of credit conditions, or a decline in prices may trigger a crisis that spreads throughout the economy through networks of credit and debt relationships.

The appropriate remedy, however, lies in a legal and regulatory framework of supervision, in the entrepreneurial judgement exercised by banks and financial institutions, and in the recognition that uncertainty cannot be eliminated. Would economic stagnation be preferable? The capacity of economic agents to service their debts ultimately depends on the flow of profits, while the current flow of profits depends upon investment, government deficit spending, and, in an open economy, exports. Expectations regarding future profitability and future investment levels influence current investment decisions and, consequently, the current flow of profits.

This is a complex system that requires oversight by the monetary authorities through a framework of legal rules administered by responsible institutions. The solution lies in maintaining this balance and continually seeking to preserve it. Minsky himself argued that financial regulation can help limit excessive risk-taking by banks and firms.

Instead, what has often been advocated is unrestricted freedom and deregulation, with the effect of encouraging the pursuit of profit by financial institutions without adequate constraints. As Victoria Chick argues in “The Evolution of the Banking System and the Theory of Monetary Policy”, the historical evolution of banking has progressively increased banks' ability to manage credit through financial innovation,

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making them increasingly independent of reserve requirements, while securitization represents the most advanced stage of this evolutionary process.

The appropriate response, therefore, is reasonable and effective regulation—one might say a Keynesian response—of the kind embodied in the restrictions introduced after the crises of the 1930s, many of which were subsequently removed. The answer does not lie in a 100 per cent reserve requirement, nor in the criticism of the Bank Charter Act of 1844.

Business cycle theory was heavily criticized by a number of economists, particularly those associated with neoclassical and Keynesian economics. Other economists have argued that Hayek is remembered today more for his contributions to political theory than for his contributions to economic theory. In an interview with Alan Ebenstein, Milton Friedman, recipient of the 1976 Nobel Memorial Prize in Economic Sciences, stated: "I am an enormous admirer of Hayek, but not for his economics. I think *Prices and Production* is a very flawed book. I think his capital theory book is unreadable. On the other hand, *The Road to Serfdom* is one of the great books of our time."

On the political level, Hayek has frequently been criticized both by liberal authors and by writers influenced by the Marxist tradition.

Socialists have often accused him of holding an excessively conservative view of economics. Despite the sophistication of the arguments Hayek employed in support of his positions, critics have argued that he treated laissez-faire economics as a dogma and allowed his analysis to be shaped by ideological commitments. Others, however, have maintained that neoliberalism represents a distortion and vulgarization of Hayek's ideas rather than a genuine implementation of his economic theories. Referring to Hayek, Eric Hobsbawm wrote: "Men like Hayek were never pragmatists... In reality, figures such as Hayek were adherents of an economic religion" (*The Age of Extremes*). For these reasons, Hayek has often been described as one of the intellectual fathers of so-called "market fundamentalism".

Hayek has also been criticized by authors associated with the radical Right, who regarded him as a defender of the capitalist modernity that undermines traditional communities, historic nations, and ties of blood and ethnicity. For Alain de Benoist, perhaps the leading representative of the French *Nouvelle Droite*, Hayek's work displayed a "highly questionable Darwinian tendency". Finally, Hayek's thought has also been strongly criticized by anarcho-capitalist authors such as Hans-Hermann Hoppe, Walter Block, Anthony de Jasay, Murray Rothbard and others, who highlighted what they regarded as the ambiguities of a liberalism not always prepared to denounce the illegitimacy of the state and of actions that infringe individual liberty, threaten the autonomy of the free market, or undermine a legal order founded upon private property.

The second issue concerns the abolition of the state's monopoly over money and the freedom of currency issuance by both public and private institutions.

"National currencies are neither inevitable nor desirable." This is one of the most revealing themes in the work of Friedrich August von Hayek. Hayek arrived at the arguments developed in *Denationalization of Money* (1976) through a line of reflection extending from *Monetary Nationalism and International Stability* (1937) to *Choice in Currency* (1976). Taken together, these works represent more than forty years of research devoted to identifying the conditions necessary for what Hayek regarded as *monetary stability*, understood as a precondition for the proper functioning of the market, which he viewed as an extraordinary mechanism for the utilization of knowledge, the preservation of peace, and the advancement of civilization.

Hayek adopts what lies at the core of the Austrian Business Cycle Theory: "The belief that cheap money is always desirable and beneficial makes inevitable and irresistible the pressure exerted upon any monopolistic political authority thought capable of reducing the cost of money through the issue of additional quantities of it." Artificially cheap money, in his view, distorts the market for money itself and undermines the signaling function performed by the price system. The result is a large-scale monetary illusion, fueled by misinformation generated through governmental interference in markets for goods and services.

The theoretical approach adopted by Hayek is fundamentally microeconomic. He regarded it as better suited to constructing ideal types consistent with a dynamic market order because it takes account of our ignorance of many relevant facts. By contrast, macroeconomic analysis attempts to overcome this unavoidable difficulty by relying upon aggregate variables and statistical averages. Hayek considered this approach unsatisfactory and potentially misleading, since it merely describes empirically observed correlations without providing adequate explanations for why such relationships should hold generally.

From these premises emerges a radical economic and political proposal. Since money is the one good whose attractiveness depends upon the preservation of its purchasing power, Hayek argued that competition should be extended to the monetary sphere itself. Once individuals are offered alternatives to state-issued money, it becomes impossible to compel them to hold what he regarded as an inferior currency.

Hence his practical proposal: freedom of currency issuance by both public and private institutions, the end of the state's monopoly over money, and competition among issuing banks. Such competition, he believed, would force competing issuers to provide the best and most stable currency available, on pain of being driven from the market.

Although Hayek was broadly sympathetic to the process of European integration, he expressed serious doubts as to whether a European common currency could emerge in a manner consistent with the principles of a free society

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governed by the rule of law and in which governments were deprived of discretionary control over monetary policy. In his view, "ever since finance ministers were told that running budget deficits was a virtuous act and that, where unused resources existed, additional public expenditure imposed no costs on citizens, every effective obstacle to the rapid growth of public spending has been destroyed."

In this respect, the emancipation from monetary nationalism advocated by Hayek may find a partial, albeit imperfect, approximation in the euro. Nevertheless, as the contemporary Austrian economist Jesús Huerta de Soto has argued, advocates of free enterprise, free markets, and the rule of law ought to support the euro, since the only alternative would be a return to monetary nationalism.

## II. Convergences Across Different Schools of Economics

Even those who are strongly opposed to Keynes and Keynesian economics appear to acknowledge that prices, like investment, depend on expectations of future profits and on entrepreneurial decision-making. This is true, for example, of Jesús Huerta de Soto. More generally, beyond his criticisms of Keynes, Huerta de Soto is distinguished by positions inspired by the Austrian School of Economics, including the advocacy of a 100 per cent reserve requirement for bank deposits and a return to the *gold standard*. Whatever their theoretical merits, these proposals appear to me to be insufficiently realistic. They are arrangements that have existed largely as intellectual constructions, occasionally envisaged by earlier thinkers such as the Spanish Scholastic Luis de Molina, but which remain highly abstract when considered in relation to contemporary economic realities.

From a legal perspective, one may certainly question legal positivism or maintain that legislation is not the sole source of law. However, the invocation of principles closely resembling *natural law* appears difficult to reconcile with the realities of modern legal systems. I shall return briefly to these legal issues later.

Returning to the question of prices, Huerta de Soto rejects the view that the widespread commercial practice of determining selling prices by applying a *mark-up* to costs provides a valid general explanation of price formation. More specifically, he denies that costs determine prices. If that were the case, he argues, there would be no genuine entrepreneurial problem. Producers would simply apply a *mark-up* to their costs, sell their output, and systematically earn a profit.

According to Huerta de Soto, causality runs in the opposite direction: prices determine costs rather than costs determining prices. On the basis of their subjective valuations and expectations, entrepreneurs estimate the future market prices of the consumer goods they intend to produce. It is these anticipated future prices, and the profits expected to derive from them, that guide their present decisions regarding the purchase of factors of production. Entrepreneurs form expectations about tomorrow's prices and, on that basis, determine how much they are willing to pay today for labor, capital, and other productive inputs.

To use one of Huerta de Soto's own examples, "a *sombrero* is not sold for €100 because it costs €90 to produce and the producer adds a €10 *mark-up*. Rather, its price is €100 because the producer expects to be able to sell it for €100 tomorrow and is therefore willing to spend up to €90 today in order to produce it."

In this respect, despite the profound differences separating Austrian and Keynesian approaches, both assign a central role to expectations concerning the future. The disagreement concerns not the importance of expectations themselves, but rather the theoretical framework within which they are interpreted and the broader implications drawn from them.

Whether this argument is entirely persuasive is open to question. In some cases, entrepreneurs possess sufficient market power and forecasting ability to determine, through the process that Huerta de Soto describes as valuation, the price at which a good is likely to be sold. On the basis of that anticipated selling price, they adjust costs accordingly, purchasing labor and other factors of production at prices consistent with their expected profitability.

In many other cases, however, this is not possible. In his analysis of price formation, Huerta de Soto appears to suffer from a form of excessive methodological individualism. Prices do not depend solely on individual entrepreneurs and their subjective representations of a product. It is certainly true that entrepreneurs advance expenditures and subsequently recover them by selling their output for money. Consequently, they benefit when prices rise and incur losses when prices fall. Yet movements in prices cannot be explained solely by reference to individual entrepreneurs or individual products.

Price formation is instead the result of a complex system of interdependent relationships, akin to a set of communicating vessels, in which countless decisions and events interact. Many of these events are only remotely connected to one another, yet they may contribute to inflationary or deflationary processes for reasons entirely unrelated to the intentions or actions of particular individuals. Price increases may be temporary, just as price declines may be temporary, often without any significant role being played by individual actors. At most, cumulative expectations may contribute to such developments.

Macroeconomic phenomena, exchange-rate movements, developments in foreign-exchange markets, and fluctuations in commodity prices may all generate inflationary pressures. Inflation, in turn, may discourage saving and set in motion further chain reactions throughout the economy. Deflation may likewise trigger a contraction of production and rising unemployment, generating its own cumulative effects. These phenomena cannot be adequately explained solely by reference to individual entrepreneurial decisions.

Keynes regarded both inflation and deflation as harmful. As he observed, "inflation is unjust and deflation is inexpedient"; however, the latter may be the greater evil because, in an

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impoverished world, “it is worse to provoke unemployment than to disappoint the rentier”. Whatever one may think of this judgement, both inflation and deflation are phenomena that transcend the decisions of individual entrepreneurs and are more properly understood as manifestations of broader macroeconomic conditions rather than purely microeconomic processes.

Even in the absence of the classic neoclassical model of numerous small firms for which price is simply a given, and even where entrepreneurs possess a certain degree of market power within their particular markets, it does not necessarily follow that prices determine costs and that costs merely adjust accordingly.

One should consider not only the sale of the final good—the *sombrero* in Huerta de Soto's example—but the entire production chain. Every good forms part of a broader supply chain composed of numerous entrepreneurs operating at different stages of production, together with a variety of intermediaries who often provide services rather than producing a good or a component thereof. Each contributes a component, a raw material, or a particular stage in the production process. The final good emerges from this complex network of relationships, and its price is inevitably influenced by it.

The seller of the final product is constrained by the prices of intermediate goods and intermediate services. Services, indeed, would require a separate analysis and perhaps an entire book of their own, especially when one considers that companies such as Apple increasingly expect future profits to derive more from services than from the iPhone itself, arguably one of the most innovative products of the modern era.

How, for example, is the process of valuation, in Huerta de Soto's terminology, applied to services? How is the expected future price of a service determined? Which service should be considered—the service associated with the chain of intermediate production or the final service delivered to the consumer? Services are often difficult to standardize and are highly personal in nature, both because they frequently relate directly to individuals and because their provision often depends upon the specific characteristics, skills, and judgement of the provider. In many cases, services are supplied by professionals who are required to comply with demanding ethical obligations and therefore cannot simply provide their services according to the willingness and ability of clients to pay.

It is perhaps the peculiar nature of services that lends support to the New Keynesian view that prices are frequently determined through the application of a *mark-up* over costs. Producers and sellers are constrained by the prices of raw materials, by energy costs, and by a wide range of external factors over which they exercise little or no control. The prices of energy and many raw materials are often determined in international markets and may be affected by exchange-rate fluctuations that neither intermediate producers nor final producers can influence.

For these reasons, the New Keynesian *mark-up pricing* approach does not appear to me to be a theory that should be dismissed simply in order to assert that prices determine costs. Nevertheless, Huerta de Soto's argument retains considerable value because, much like Keynes, it highlights the central role of the entrepreneur. Investment decisions, and indeed the decision whether to invest at all, ultimately depend upon entrepreneurs and upon the expectations and prospects that they form at every level of economic activity.

Like Keynes, Huerta de Soto emphasizes the importance of entrepreneurial decisions based upon expectations regarding the future. These decisions are influenced only partially by interest rates and are based primarily upon anticipated demand and upon present assessments concerning the future value and likely market price of a good. These observations come from a determined critic of Keynesian economics, yet they are closely related to arguments advanced by Keynes himself in *The General Theory of Employment, Interest and Money*.

In Chapter Three of that work[3], Keynes reverses a conventional perspective and asks, from a realistic standpoint, which economic actor actually determines the level of output. Is it the worker, offering labor at a given real wage, who induces the entrepreneur to produce more? Or is it the entrepreneur who decides how much output can reasonably be expected to be sold profitably in the market? If the latter is true, then entrepreneurs choose the level of employment required—given the existing capital stock—to produce the quantity of goods they expect to sell profitably. In practice, effective demand and expectations of profit play a greater role than either interest rates or production costs alone.

Vision, innovation, and entrepreneurial creativity also play a decisive role. New products are developed because entrepreneurs believe that they will be capable of creating or expanding markets in the future. The iPhone provides an obvious example. Such developments are driven by expectations regarding future demand and profitability rather than by purely mechanical calculations based upon existing costs.

My approach throughout this study is guided by the importance of reality as an analytical criterion. This requirement should apply across a wide range of issues, including the legal principles upon which authors such as Huerta de Soto rely. Many of these principles have, for centuries, been regarded as no longer fully applicable in their original form. Once law became, at least in part, legislative law, it came to be shaped through representative institutions that, in theory, are expected to respond to the concrete needs and conditions of society rather than to principles or theorems regarded as eternal and immutable.

At times—this observation is offered with due humility—it seems that economics is more prone than legal history to overlook this dimension. By paying insufficient attention to historical development and institutional evolution, economic theory occasionally risks placing excessive confidence in abstract principles at the expense of the realities that those principles are intended to explain.

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Reality is better understood by examining the way investment generates savings and by analyzing how economic actors—above all financial institutions—create money, rather than by assuming the existence of an abstract consumer endowed with perfect sovereignty and rationality. Such a figure did not exist even during episodes such as the Dutch Tulip Mania of the seventeenth century. It is not always useful to begin analysis at the level of the individual consumer and the individual firm, as though human nature and behavior existed independently of cultural elaboration. Human behavior cannot be regarded as antecedent to culture and society; it is neither predetermined nor independent of the institutional and social environment in which it develops.

In reality, employment is determined not primarily in the labor market but in the goods market. Downward wage flexibility, another widely held economic belief, contributes little to the achievement of full employment. Unemployment depends largely upon insufficient aggregate demand and upon broader macroeconomic factors. Exchange-rate developments alone may be sufficient to influence levels of employment and unemployment.

More generally, economic growth, employment, and macroeconomic equilibrium are often influenced far more by structural factors than by labor-market adjustments. One example is the cost of electricity. In Italy, even before taxes and other charges are taken into account, electricity prices have in recent years been approximately three times higher than Scandinavian averages, twice those prevailing in Spain and France, and roughly one-third higher than in Germany. According to estimates published by ISTAT, between November 2022 and August 2024 Italian manufacturing turnover declined by approximately 8 per cent, partly for this reason. The contraction was particularly severe in energy-intensive sectors, including textiles (-24 per cent), metallurgy (-15 per cent), rubber and plastics (-14 per cent), and motor vehicles (-23 per cent).

When one further considers that electricity prices in Europe are significantly higher than those prevailing in Asia and North America, Italy finds itself burdened with some of the highest energy costs in the world. At the same time, approximately 734,000 additional jobs were created in Italy after 2022, a result claimed as an achievement by the government. Yet the Bank of Italy, in Governor Fabio Panetta's inaugural Annual Report of May 2024, suggested a more complex explanation. High interest rates and elevated energy costs encouraged firms to substitute labor for capital, preferring to hire workers—often at relatively low cost—rather than invest in machinery and equipment.

These developments are relevant to the long-standing debate concerning whether employment and unemployment reach equilibrium through labor-market mechanisms alone, through the interaction of labor supply and labor demand, or whether they are primarily determined in the goods market by broader macroeconomic forces. The evidence appears to suggest that employment outcomes depend heavily upon macroeconomic conditions, international developments, institutional arrangements, and legislative responses—or the absence thereof. Competition alone is rarely the decisive factor.

Too often, insufficient attention is devoted to the role of aggregate demand.

For many economists, demand should never constitute a genuine problem. Whatever its level, demand is assumed to be capable of absorbing a country's output and thereby ensuring the full employment of labor and capital. Even in the presence of unsold goods, unemployed labor, and idle productive capacity, the flexibility of prices and wages is presumed to be sufficient to restore equilibrium between aggregate demand and the full-employment level of output.

This line of reasoning denies any significant relationship between the growth of demand and the growth of productivity, treating them as distinct phenomena. Economic growth and employment growth would therefore depend primarily upon a country's productive efficiency, provided that prices in general—and wages in particular—remain sufficiently flexible.

This view, which remains highly controversial within economics, has been challenged by authors such as the Nobel laureate Paul Krugman. Consider a post office employing ten workers to sort 1,000 letters. If, as a result of an economic downturn, the number of letters falls to 500 because of a deficiency of demand, has the productivity of the post office necessarily declined? Would the appropriate response simply be to reduce labor costs, cut wages, and scale back welfare expenditure, while treating the problem of demand as secondary? Should the priority not instead be to ask how the volume of mail might return to 1,000 letters?

Even Adam Smith recognized the existence of a relationship between the extent of the market and productivity. This insight, subsequently developed by the Italian economist Paolo Sylos Labini under the label of the *Smith effect*, has been revisited repeatedly in economic literature and is now often associated with *Verdoorn's Law*.

In reality, it is the size of the market and the strength of demand that enable firms to adopt more sophisticated production methods, realize economies of scale, and introduce innovations that arise in response to the needs and preferences of consumers. Products such as the iPhone may be invented elsewhere, but there is no reason why the benefits associated with such innovations should remain the exclusive preserve of other economies.

In the Italian case, moreover, a deficiency of demand appears evident in several respects. Supply-side factors and demand-side factors do not operate independently of one another; rather, they interact continuously. Economic performance depends upon the relationship between productive capacity and the level of effective demand capable of sustaining its utilization.

## III. The Austrian School of Economics, Monetarism , and

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## Keynesianism: Points of Divergence.

In the present discussion, I rely primarily, though not exclusively, on Huerta de Soto's well-known treatise[4], and on the criticisms he advances against both Monetarism and Keynesianism.

According to the Austrian School, neoclassical economics treats production and consumption as if they were simultaneous processes, without recognizing the existence of distinct stages within the production process or the necessity of time elapsing before the results of production can be realized.

1. John Bates Clark, in particular, conceived capital as a permanent fund that automatically generates returns in the form of interest. According to this view, the larger the stock of capital, the lower the rate of interest, irrespective of any influence exerted by *time preference*. In essence, this approach represents little more than a transposition of Walrasian general equilibrium theory—an atemporal and objectivist conception of economic equilibrium described through a system of simultaneous equations that purports to explain the formation of market prices for goods and services without giving significant consideration to subjective valuations, expectations, or individual decision-making.

From the Austrian perspective, such an approach fails to recognize that the variables and magnitudes involved in economic activity unfold sequentially through time as the production process advances. Production is driven by the actions of economic agents operating within a temporal framework, and the relevant decisions occur in succession rather than simultaneously. Consequently, the economy cannot adequately be represented as a system of simultaneous relationships detached from the temporal structure of production and the subjective choices of the individuals participating in it.

Walras's system, by contrast, is static. It fails to account for the passage of time and does not recognize that the various economic variables and parameters never emerge simultaneously in real life.

According to the Austrian School, Clark suffers from many of the same shortcomings as Walras. His approach lacks a genuine temporal dimension, a characteristic which, in the Austrian view, is shared by many classical economists, from Adam Smith and David Ricardo to Alfred Marshall. Austrian economists criticize this objectivist conception of the production process and, in particular, Clark's view of production as the consequence of participation in a mysterious and self-sustaining fund of capital operating within a production process that effectively takes place outside time. Such an approach, they argue, pays insufficient attention to the relationship between microeconomic and macroeconomic phenomena and leaves little room for the entrepreneurial decisions made by human beings throughout the production process. Similar criticisms were directed by the Austrian School at the work of Frank H. Knight.

For similar reasons, the Austrian School also criticizes Monetarism. In the Austrian view, Monetarist theory likewise neglects the role of time and the stages of the economy's *structure of production*, while adopting a mechanistic interpretation of the *quantity theory of money*. Monetarists base their analysis upon an equation that purports to establish a direct causal relationship between the total quantity of money in circulation, the general price level, and total output.

The equation,
$MV = PT$

where $M$ represents the money supply, $V$ the *velocity of circulation of money*, that is, the number of times a unit of currency changes hands, $P$ the general price level, and $T$ the aggregate quantity of goods and services exchanged during a given year, is intended to demonstrate that, assuming a stable velocity of circulation and an economy operating close to full employment, money is neutral in the long run. Under these assumptions, an increase in the money supply ($M$) will tend to produce a proportional increase in the general price level.

According to the Austrian critique, Monetarists assume that monetary inflation affects all sectors of the economy in a uniform and proportional manner. Consequently, they fail to recognize the possibility that monetary expansion may disrupt or distort the *structure of production*. As can be seen, the Monetarist perspective is primarily macroeconomic and largely ignores the microeconomic effects of monetary expansion on the composition and organization of production.

From the Austrian standpoint, this approach suffers from the absence of an adequate theory of capital and effectively removes the temporal dimension from economic analysis. More importantly, it fails to explain how credit expansion affects the production structure itself.

For example, the Monetarist economist Ralph Hawtrey argued that the first symptom of an economic downturn is a decline in sales of final consumer goods. Austrian economists respond that, before such a decline becomes visible, there is typically a much larger fall in the prices of capital goods. Fluctuations in the prices of consumer goods are relatively modest when compared with those affecting capital goods produced at stages of production more remote from final consumption.

Hawtrey maintained that credit expansion generates an excess demand distributed relatively uniformly across the various goods and services in the economy. According to Huerta de Soto and the Austrian School, however, the opposite is true. Credit expansion affects different sectors unevenly and reshapes the economy's *structure of production* in an asymmetrical manner, thereby generating the distortions that ultimately give rise to the business cycle.

Hayek criticized Monetarism because of its almost exclusive focus on the general price level and its inability to identify the effects that an expansion of the means of payment has on the

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relative price structure. In his view, it fails to take account of the principal problems generated by an inflationary process, namely the *misallocation of resources* and the increase in unemployment.

More specifically, Hayek's criticism of Monetarism was that, as an essentially macroeconomic theory, it overlooks important underlying microeconomic realities. It neglects the effects that credit expansion exerts on the *structure of production* and fails to recognize that changes in the general price level are, in reality, reflected in changes in the structure of relative prices. Variations in credit do not merely produce increases or decreases in the general price level; rather, they alter relative prices throughout the economy. A depression, therefore, is not primarily the result of monetary contraction but of the distortions generated by prior credit expansion, inflation, and their effects upon the productive structure.

When confronted with an economic depression, Keynesian economists typically invoke arguments based upon the positive effects of *effective demand* on real income. According to this view, an increase in effective demand may generate higher income and, consequently, higher savings. Through this mechanism, an "artificial" expansion based on credit creation may be sustained without the process of resource misallocation necessarily culminating in a recession.

Hayek replied that productive processes financed through credit expansion can be sustained without causing a recession only if the entirety of the additional monetary income created by the banking system and used to finance such processes is voluntarily saved by economic agents. In other words, the resources employed must ultimately originate in genuine savings. Savings must come first, followed by bank credit, and only then by investment.

Representatives of the Austrian School also criticize the quantity equation,
MV = PT

because, in their view, it merely expresses in a tautological form the relationship between the growth of the money supply and the decline in its purchasing power. The equation simply states that the total amount of money spent in transactions during a given period must equal the total amount of money entering those transactions during the same period. Yet changes in the money supply ultimately affect the purchasing power of money in ways that the equation itself cannot explain.

According to Austrian economists, reliance upon this formula discourages analysis of the underlying microeconomic realities by imposing a mechanistic interpretation of the relationship between the money supply and the general price level. In doing so, it obscures the true microeconomic effects of monetary expansion.

Ludwig von Mises maintained that every increase in the quantity of money in circulation necessarily produces a change in the structure of relative prices of goods and services, except in the purely hypothetical case in which newly created money is distributed proportionately and simultaneously among all economic agents. In practice, however, money always enters the economic system sequentially and at specific points, whether through public expenditure, credit expansion, or the discovery of new gold deposits.

As a consequence, only certain individuals receive the newly created money first and therefore enjoy the opportunity to purchase goods and services before those goods and services have been affected by the monetary expansion. This sets in motion a process of income redistribution in which the earliest recipients benefit at the expense of other economic agents, who experience rising prices for the goods they purchase before any of the newly created money reaches them.

This redistribution process alters the structure and relative weight of the value scales of different economic agents and necessarily results in a change in the entire structure of relative prices throughout society. From the Austrian perspective, these changes in relative prices—and not merely changes in the general price level—constitute the most important consequence of monetary expansion.

The remedies frequently advocated to counter economic crises—including those often supported by Monetarists—namely increasing the quantity of money in circulation and reflating the economy in order to offset the monetary contraction that typically follows a crisis, merely make it more difficult, according to the Austrian School, to liquidate the unsustainable projects undertaken during the expansionary phase and therefore tend to prolong the recession.

Even proponents of the *rational expectations* hypothesis, according to which economic agents possess or are able to make use of all relevant information, do not reach correct conclusions when they argue that fiscal and monetary policies are incapable of producing real effects. Entrepreneurs, even if they possessed perfect knowledge—assuming such a condition were possible—could not escape the consequences of credit expansion, because their desire to earn profits would lead them to take advantage of the newly created money entering the economy.

Although they might fully understand the dangers associated with credit expansion unsupported by genuine savings, they could still earn profits by accepting newly created credit and investing in new projects, provided that they were able to withdraw from the process in time. In other words, they could profit by selling newly produced capital goods at elevated prices before the decline in asset values that typically accompanies the onset of a crisis.

Thus, entrepreneurs may continue to earn profits even when they are fully aware that credit expansion will ultimately lead to a downturn, provided that they succeed in exiting the market before losses materialize.

The point, according to Huerta de Soto, is that entrepreneurs are entrepreneurs, not professors. They cannot cease behaving as entrepreneurs by voluntarily renouncing opportunities for short-term profit when an expansionary process is underway. They cannot simply engage in theoretical reflection

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concerning what may occur in the future. On the contrary, even if they knew with certainty what would happen, they would seek to benefit from the process before the adverse consequences emerged.

If newly created money enters the economy, entrepreneurs will naturally seek to take advantage of it. As Huerta de Soto remarks, “one does not look a gift horse in the mouth”; the objective becomes not to avoid participation in the process but rather to leave it before losses arise. Entrepreneurs, therefore, cannot realistically be expected to forgo the immediate profit opportunities generated by monetary creation, even when that monetary expansion is not supported by prior saving.

For this reason, the Austrian School argues that credit expansion will always generate distortions within the *structure of production*, even under the highly unrealistic assumption of perfect expectations or perfect information.

With regard to these issues, I have already emphasized the need for a framework of rules, including legislative rules, together with preventive forms of supervision and monetary oversight. The appropriate response lies in regulation and institutional safeguards rather than in the kind of deregulation that has often characterised financial markets in recent decades.

**2.** Let us now turn to the Austrian School's criticisms of Keynesian economics, having already examined its criticisms of Monetarism and of rational expectations theory, both of which belong broadly to the neoclassical tradition.

Today, Keynesian economics probably occupies a less prominent position than either Monetarism or rational expectations theory. Nevertheless, the Austrian School levels against Keynesianism much the same criticism that it directs at Monetarism, namely that it lacks a genuine theory of capital capable of explaining the division of economic processes into successive stages of production and the role played by time within those processes. Keynesian theory relies upon concepts such as the general price level, the aggregate quantity of money in circulation and, to some extent, the velocity of circulation of money, much like Monetarist theory, although it also possesses distinctive features of its own.

Keynes criticized Say's Law and challenged the classical economists' belief that supply automatically creates its own demand.

The Austrian School attempts to explain why, under certain recurring circumstances and as a consequence of credit expansion, Say's Law ceases to apply. Through its subjective theory of money, capital, and the business cycle, it seeks to identify the conditions under which Say's Law loses its validity.

With regard to Say's Law, some similarities between the two schools may be observed.

Keynes sought to eliminate any role for bank credit as a disruptive factor capable of affecting the relationship between saving and investment. He was familiar with Hayek's position; whose principal argument was that credit expansion eventually generates an unsustainable divergence between entrepreneurial investment and society's voluntary saving.

Keynes attempted to challenge Hayek's argument by maintaining that bank credit does not possess independent expansionary effects on aggregate investment. He based this conclusion on the accounting argument that the corresponding assets and liabilities generated by bank lending cancel each other out.

The Austrian School rejects this argument and regards it as insufficient to conceal the powerful distortive influence that credit expansion exerts upon investment. The recipient of a loan becomes indebted to the bank for the amount borrowed while simultaneously becoming the holder of a deposit of an equivalent amount. The debt owed to the bank is not money, whereas the deposit constitutes money, or a perfect money substitute. When the borrower uses those funds to purchase capital goods and productive services, newly created money is employed to increase investment without any corresponding increase in voluntary saving, while leaving the borrower's indebtedness unchanged.

Keynes advanced a second argument in addition to the accounting argument just described. He maintained that the creation and extension of new bank credit do not finance investment in excess of voluntary saving because the newly created money may be used to purchase consumer goods. To the extent that it is not spent on consumption, the newly created money generates a form of implicit saving. Consequently, when such money is invested, the amount invested coincides with a prior and genuine act of saving. Keynes therefore relied upon the *ex post* identity between saving and investment in order to deny that credit expansion necessarily produces harmful effects on investment and on the productive structure.

The Austrian response is that even if every investment financed by newly created credit were simultaneously matched by an equivalent amount of saving, the fundamental problem would remain. Once the newly created money reaches its final recipients—workers, owners of capital goods, and owners of the original factors of production—those recipients may decide to spend it on consumer goods and services to a greater or lesser extent. At that point it may become evident that the economy's *structure of production* is excessively capital-intensive and that a recession is therefore unavoidable.

Artificial credit expansion cannot compel economic agents to behave in a particular manner or force them to save more than they would freely choose to save. Austrian economists further argue that Keynes falls into a paradox when he insists that voluntary saving does not necessarily generate additional investment while simultaneously maintaining that every investment presupposes prior saving. If one accepts that savers and investors are not necessarily the same individuals and that a lack of coordination may arise between their decisions, then, it is argued, such discoordination may arise not only from the side of saving—more voluntary saving

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without additional investment—but also from the side of investment—more investment without prior saving.

Finally, Keynes sought to rebut the Austrian thesis concerning the harmful effects of credit expansion by arguing that credit expansion finances additional investment, which in turn increases income and therefore ultimately increases saving. According to Keynes, it is therefore impossible for entrepreneurs to invest borrowed resources at a faster rate than the public increases its savings.

The Austrian reply is that Keynes considers saving and investment to be equal by definition and therefore fails to perceive the distortive effects that investment financed through newly created credit exerts upon the *structure of production*.

Could the increase in real income generated by higher investment ultimately produce sufficient additional saving to render sustainable the investments initially financed by credit expansion? Hayek denied that investment financed through new credit expansion could generate the voluntary saving necessary to sustain those investments permanently and thereby sought to refute Keynes's argument. Yet even if the Austrian criticism were entirely correct, a further difficulty remains. If, as Austrian theory maintains, credit expansion can avoid distortion only when it is fully backed by prior saving, then such a system ultimately requires a 100 per cent reserve requirement.

At this point the Austrian School's difficulty lies less in its diagnosis than in its proposed remedies. Must a legal requirement imposing full-reserve banking be introduced in order to prevent credit expansion unsupported by prior saving? Is such a proposal realistically achievable?

Huerta de Soto, in particular, argues that credit expansion gives rise to a widespread *malinvestment* of resources, which compounds and overlays the errors that had already accumulated within the economic Keynes is also well known for having revived and popularized the theory of the *investment multiplier*. Austrian economists argue that this theory fails to explain how saving is transformed into investment through a series of underlying microeconomic processes, which it allegedly ignores altogether. In their view, Keynes developed a purely mechanistic conception of the investment multiplier. According to Keynes, the greater the *marginal propensity to consume*, the greater the increase in national income generated by a given level of investment.

The Austrian response is that the investment multiplier rests upon a mathematical argument that is inconsistent with the economic logic of capital theory. Any increase in credit expansion, according to Keynesian reasoning, gives rise to an increase in real national income in a proportion determined by the inverse of the *marginal propensity to save*. Under this logic, the less people save, the greater the multiplier effect on real income.

Austrian economists argue that the mathematical mechanism underlying the multiplier bears little relationship to the actual processes taking place within the *structure of production*. Credit expansion generates investment, which initially increases the prices of the factors of production and subsequently leads to a more-than-proportionate increase in the prices of consumer goods and services. Although gross money income may rise as a consequence of the injection of newly created bank money, the multiplier, because of its mechanical and macroeconomic nature, is said to be incapable of capturing the distortions that credit expansion invariably produces within the productive structure. As a result, it allegedly conceals the widespread *malinvestment* of resources that, in the long run, impoverishes rather than enriches society.

Quite apart from the debate concerning the so-called long run as opposed to the short run, one may observe that, in the long run, not only are we all dead, but virtually everything may change in ways that are difficult or impossible to foresee. Moreover, a system in which credit expansion could occur only when backed by prior saving—an outcome that, in Austrian theory, would require a 100 per cent reserve requirement—would effectively prevent banks from performing their entrepreneurial function, namely making decisions under uncertainty, albeit within a framework of rules, supervision, and constraints.

Are we certain that credit expansion unsupported by prior saving always generates distortions? Is there really an automatic equivalence between credit expansion and *malinvestment*, as though every increase in investment were necessarily unproductive or accompanied by a substantial volume of misguided investment?

According to Hayek, Keynes failed to incorporate the theory of capital and interest developed by Böhm-Bawerk and neglected the existence of the various stages within the *structure of production*. In Hayek's view, the fundamental entrepreneurial decision is not whether to invest in consumer goods or capital goods, but rather whether to invest in productive processes that will yield consumer goods sooner or later in the future. To conceive of the productive structure as consisting merely of two sectors—one producing consumer goods and the other producing capital goods—without considering the temporal dimension of the latter and the successive stages into which it is divided, is, according to Austrian economists, what leads Keynes into the so-called *paradox of thrift*.

Keynesians explain economic crises primarily as the result of collapses in aggregate demand caused by irrational behavior on the part of entrepreneurs or by a loss of confidence and optimism among economic agents. According to the Austrian School, however, this analysis overlooks the fact that crises are the endogenous consequence of the credit expansion that previously fueled the boom.

It may well be true that entrepreneurs often focus on short-term opportunities and that banks are capable of fostering excessive optimism through the provision of abundant and inexpensive credit. Nevertheless, to regard crises solely as the consequence of credit expansion, to deny that such expansion can sometimes finance productive and successful investment,

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and to neglect the role of demand, appears to me to be an exaggeration equal and opposite to the thesis being criticized.

Entrepreneurs and banks are frequently portrayed in Austrian accounts as rational actors who knowingly participate in a process that will ultimately end badly, seeking merely to withdraw before losses materialize. Yet this depiction does not sufficiently account for the fact that the factors influencing demand, and therefore the success or failure of any investment project—or indeed any life project—are often inherently unpredictable. A sudden increase in raw-material prices, let alone a war or a major political event, may transform what appeared to be a sound investment into an unsuccessful one. More commonly, a complex and interconnected combination of factors, some of them contingent or accidental, may ultimately bring about what is described as a collapse in demand.

Monetarists generally regard the effects of monetary expansion as limited in comparison with those of fiscal policy and therefore often support policies aimed at increasing demand through public expenditure.

The Austrian School rejects this approach as well. According to Austrian economists, such policies make the necessary adjustment of the *structure of production* more difficult, exacerbate the distortions affecting the stages of production furthest removed from final consumption, and ultimately worsen the underlying problems. In their view, unemployment can be reabsorbed through Keynesian remedies only if workers and trade unions succumb to *money illusion*, maintaining their nominal wages in an inflationary environment in which the prices of goods and services rise more rapidly.

Consequently, Austrian economists argue that the policies of credit expansion and demand stimulation advocated by Keynesians have lost any genuine capacity to generate sustainable employment and, if implemented, produce serious distortions within the productive structure.

**3.** If the concept of the *multiplier* has attracted criticism from the Austrian School, the *accelerator principle* has fared no better.

According to Austrian economists, credit expansion affects the *structure of production* and can occur in a healthy and sustainable manner only when accompanied by a corresponding increase in voluntary saving.

For this reason, they also criticize the Keynesian *accelerator principle*, according to which every increase in consumption generates a more-than-proportionate increase in investment.

Under the accelerator theory, an increase in the demand for consumer goods and services produces a greatly amplified increase in the demand for capital goods. It is assumed that there exists a relatively fixed relationship between the production of consumer goods and the quantity of machinery required to produce them. Consequently, every increase in the demand for consumer goods gives rise to a proportional increase in the machinery required for their production, with the result that the increase in demand for capital goods becomes much greater than the original increase in demand for consumer goods and services.

Samuelson and Nordhaus illustrate the mechanism as follows:

Suppose there is a representative textile firm whose stock of capital equipment is always equal to twice its annual sales of cloth. Thus, when sales have remained for some time at $30 million per year, its balance sheet will show $60 million of capital equipment, consisting perhaps of twenty machines of varying ages, one of which wears out and is replaced each year. Since replacement exactly equals depreciation, the firm undertakes neither net investment nor net saving. Gross investment amounts to $3 million annually, representing the replacement of one machine each year.

Now suppose that, at the beginning of the fourth year, sales increase by 50 per cent, rising from $30 million to $45 million. In order to maintain the capital-output ratio of two, the number of machines must also increase by 50 per cent, from twenty to thirty. During the fourth year, the firm must therefore purchase eleven machines instead of one: ten additional machines plus the replacement of the obsolete one. Sales have increased by 50 per cent. By how much has investment in machinery increased? From one machine to eleven, that is, by 1,000 per cent![5]

The Austrian critique is that the accelerator, much like the multiplier, relies upon highly aggregated macroeconomic relationships and assumes a degree of proportionality that may not exist in reality. The theory abstracts from the temporal structure of production, entrepreneurial expectations, and the heterogeneity of capital goods. It therefore risks portraying investment as an almost automatic response to changes in consumption, while neglecting the complex entrepreneurial decisions and intertemporal coordination problems that characterize actual market processes.

According to the *accelerator principle*, an increase in the demand for consumer goods and services not only generates a substantially amplified increase in the demand for capital goods, but also implies that, if demand for capital goods is to be sustained, demand for consumer goods and services must continue to grow at an increasingly rapid rate. This follows from the assumption that a stable level of demand for consumer goods—that is, demand that ceases to grow—will lead to a sharp contraction in the demand for capital equipment, which will return to the level required merely for replacement investment.

In contemporary Italy, for example, private consumption accounts for the largest component of GDP. In 2022, approximately 59.8 per cent of Italian GDP was generated by household consumption expenditure. Were household consumption to collapse, the economy itself would inevitably suffer a severe contraction.

The accelerator principle therefore appears to find at least some support in empirical reality and is broadly consistent with Keynesian arguments emphasizing the expansion of consumption and *aggregate demand*. Critics describe this as

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an advocacy of "unlimited" consumption growth, although Keynes himself attached considerable importance to investment, productive investment in particular, as well as to what would today be termed "good debt". The criticism directed at Keynes is therefore straightforward: the greater the level of consumption, the greater the level of investment, while saving becomes largely irrelevant. But is this criticism justified?

According to Keynes's critics, the accelerator principle functions as a substitute for a genuine theory of capital, which they regard as insufficiently developed in Keynesian economics, and reinforces the belief that voluntary saving is both unnecessary and potentially counterproductive for economic development.

Leaving aside, for the moment, the question of whether this characterization of Keynesian theory is entirely accurate, it is worth considering some of the principal criticisms directed against the accelerator principle.

First, it is argued that the accelerator ignores the actual functioning of the entrepreneurial process and assumes that entrepreneurial activity is little more than an automatic and mechanical response to short-term fluctuations in demand for consumer goods and services. Entrepreneurs do not act mechanically, and there is no automatic mechanism through which an increase in consumer demand immediately and proportionally generates an increase in demand for capital goods. Entrepreneurs form expectations regarding future demand, while firms generally possess a certain amount of excess capacity and idle capital equipment that enables them to respond to sudden increases in demand without immediately undertaking new investment. Businesses typically maintain a reserve of productive capacity that can be utilized before additional capital goods become necessary.

To some extent, however, the accelerator principle may be defended using the very arguments advanced against it. It is certainly true that no automatic or instantaneous mechanism guarantees that an increase in consumer demand will be followed by a corresponding increase in demand for capital goods. Yet the accelerator may be interpreted not as a rigid law but as a broad tendency. Under this interpretation, without implying automaticity or immediacy, it suggests that increases in demand for consumer goods and services tend, over time, to generate increases in the demand for and production of capital goods.

A second criticism is that the accelerator principle assumes fixed and immutable relationships between capital goods, labor, and the production of consumer goods and services. As a consequence, it ignores the fact that identical levels of output can be achieved through very different combinations of fixed capital, working capital, and labor inputs. The specific combination selected by entrepreneurs depends upon the structure of relative prices prevailing in the markets for factors of production.

From this perspective, the assumption of a fixed relationship between the production of consumer goods and the stock of capital goods required to produce them is inconsistent with price theory as applied to factor markets. Changes in relative prices may induce firms to substitute labor for capital, capital for labor, or one form of capital for another. The production process is therefore far more flexible and heterogeneous than the accelerator principle appears to assume.

Quite apart from the numerical examples provided by Samuelson and Nordhaus, the issue may be resolved by moving away from the notion of a presumed automatic mechanism and towards the idea of a *tendency*. The accelerator principle may be interpreted as describing a general pattern or underlying tendency observable at the macroeconomic level, one that emerges through the operation of large numbers rather than through rigid causal mechanisms. In this sense, it seeks to identify broad regularities that may assist in guiding economic policy and informing policy prescriptions.

Austrian economists, however, tend to interpret the accelerator as though it implied a fully automatic mechanism. They argue that it ignores the *Ricardo Effect*, namely the proposition that a decline in the relative price of labor will encourage the production of consumer goods through more labor-intensive methods, thereby reducing the relative use of capital goods. Conversely, an increase in the relative cost of labor will encourage the substitution of capital for labor and thus increase the relative use of capital goods.

According to this criticism, the accelerator principle, by assuming fixed proportions among the factors of production, neglects the role played by entrepreneurship, the price system, and technological change in determining market outcomes.

Now, even assuming that the Ricardo Effect is a genuine phenomenon and that it operates in the short run—though one may reasonably question both the extent of its operation and the duration of the short run itself—the point remains that I have referred to a tendency rather than to fixed proportions. Indeed, the notion of tendency is preferable precisely because Keynes, unlike some of his more mathematically oriented successors, did not ignore the entrepreneurial function. Nor did he ignore the central role played by uncertainty, unpredictability[6], and the occurrence of technological innovations or political events capable of transforming economic conditions and altering decisions already taken, whether in the short run or, even more significantly, in the long run.

Economic reality is characterised by continuous change. Expectations are revised, plans are modified, technologies emerge unexpectedly, and political developments alter the environment within which economic decisions are made. For this reason, it seems more appropriate to regard the accelerator principle not as a rigid and automatic law but as an indication of a broad macroeconomic tendency that may manifest itself under certain conditions while remaining subject to the influence of entrepreneurial judgement, institutional factors, technological developments, and unforeseen events.

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Third, Keynes is criticized on the grounds that, even assuming fixed proportions between consumption and capital, and even assuming the absence of excess productive capacity, it remains unclear how the production of additional capital goods could increase without the corresponding saving required to finance such investment.

An increase in the demand for consumer goods and services is assumed to generate an automatic and virtually instantaneous increase in the production of capital goods. Yet if such production is to be completed, and if no excess capacity exists, it would appear that it can only be financed through an increase in voluntary saving. In that case, however, the increase in saving should itself imply a reduction in current consumption demand.

To me, this objection ultimately returns to the familiar debate concerning whether investment in capital goods may be financed through credit granted on the basis of the anticipated profitability of an investment and the entrepreneurial assessments made by banks. Is it really necessary that investment be supported exclusively by prior voluntary saving, and indeed by saving backed by a 100 per cent reserve requirement? Were such a rule to prevail, the bank would cease to resemble an entrepreneur and would instead assume a very different role.

Fourth, critics of Keynes argue that the only way to generate an increase in investment in capital goods greater than the increase in demand for consumer goods is through a process of credit expansion. The accelerator principle is therefore said implicitly to presuppose credit expansion. At that point, however, the argument becomes circular: the accelerator merely reveals the effects that credit expansion has on the structure of production and, ultimately, on the emergence of recession through its impact on the price system. The underlying assumption is that credit expansion is always and necessarily harmful.

This approach fails to take sufficient account of the operation of the modern banking system, where the security of deposits and the protection of savings depend primarily upon a framework of supervision, regulation, and preventive controls rather than upon a 100 per cent reserve requirement. Nor does it adequately consider the reality of consumption, as illustrated by the Italian data discussed above and broadly consistent with evidence from other countries.

Likewise, it overlooks the fact that the financing of research, innovation, human capital, and physical capital formation is often not directly linked to prior voluntary saving. Were it otherwise, humanity might never have reached the Moon, nor achieved many of the scientific discoveries and technological innovations that have transformed not only production but consumption itself?

Banks must certainly be capable of taking risks, just as those responsible for public expenditure must be capable of making decisions without wasting resources. They should be held accountable when they fail to comply with the rules of the regulatory framework, which should become progressively more effective. Nevertheless, the complete absence of risk is not a feature of the real world and is certainly not characteristic of entrepreneurial activity, including banking and finance.

Fifth, Huerta de Soto considers it absurd to suppose that an increase in the demand for consumer goods and services should *ipso facto* and instantaneously generate an increase in the production of capital goods.

It is argued that during the boom phase, financed through credit expansion, firms producing capital goods and industrial equipment already operate at or near full capacity. Orders accumulate, production bottlenecks emerge, and firms are unable to respond immediately to rising demand—a proposition that itself requires closer examination. Significant increases in the prices of capital goods are therefore observed. One might note, by way of illustration, that the rapid expansion in construction activity associated with Italy's *Superbonus 110%* program generated substantial shortages and price increases in construction materials and equipment, including the well-known case of Innocenti scaffolding tubes. In such circumstances, it would appear difficult to sustain the assumption that the production of capital goods can increase as rapidly as the accelerator principle sometimes seems to imply.

This criticism, however, largely repeats earlier arguments and relies upon assumptions—such as firms operating permanently at maximum capacity—that themselves require empirical verification. Such assumptions may not hold precisely because unused productive capacity often exists.

Sixth, Huerta de Soto argues that the accelerator rests upon a mechanistic form of reasoning. It attempts to establish a relationship between an increase in the demand for consumer goods measured in monetary terms and an increase in the demand for capital goods measured in physical units. Entrepreneurial decisions, however, cannot be based upon comparisons between monetary magnitudes and physical magnitudes; rather, they depend upon comparisons between costs and revenues expressed in monetary terms.

Yet there is no reason why such comparisons cannot in fact be made in monetary terms. Entrepreneurs will take account of increases in the prices of capital goods, changes in labor costs, and variations in the prices of other factors of production. If the price of capital goods rises significantly, firms may substitute labor for capital or adjust production methods accordingly. Ultimately, however, the decision remains one based upon monetary costs and expected monetary returns.

Seventh, critics argue that the accelerator principle depends heavily upon the choice of the time period employed in the analysis. Why, for example, should one year be selected as the relevant period for calculating the increase in the demand for capital goods? The shorter the period chosen, the larger and more dramatic the apparent increase in demand for machinery will appear. If a longer period were considered—such as the expected useful life of the machinery—the large fluctuations suggested by the accelerator would largely disappear.

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Quite apart from the fact that capital goods differ enormously in their characteristics and useful lives, which are themselves often uncertain, the accelerator should be understood as indicating a tendency rather than providing a precise quantitative prediction. The relevant time horizon will vary depending upon the type of capital good under consideration and upon the economic circumstances involved.

What is ultimately at issue here is the attempt to govern the long run. Entrepreneurs do not operate with an exclusively short-term perspective, but neither do they plan indefinitely into the future. This is precisely why they often maintain unused productive capacity: they make decisions by looking ahead while recognizing the uncertainty of future conditions.

Their outlook is neither excessively short-term nor excessively long-term, but rather what might be called reasonable. If they misjudge future demand and investment in capital goods proves excessive, they will incur losses; if their expectations prove correct, they will earn profits.

By contrast, those who propose, as a remedy for all the difficulties discussed above, the imposition of a 100 per cent reserve requirement, the universal adoption of fully flexible prices, a return to the gold standard, and the abolition of central banks risk generating social upheavals that themselves carry important economic consequences. Such proposals minimize the role of the State where, in reality, the State continues to play a significant role. They also diminish the entrepreneurial function of banking institutions, a function that remains important even when exercised within a framework of stringent regulation and supervision.

Moreover, any analysis of credit expansion and its consequences should take into account the position of those who possess assets that may be pledged as collateral, thereby enabling them to borrow more extensively. It should also consider the legal and institutional rules governing collateralization and lending, so that capital can genuinely fulfil its role as security.

2. The Post-Keynesian School, moreover, maintains that money is never neutral, a position that represents an important point of contact with the Austrian School of Economics. Post-Keynesian economists argue that investment decisions are determined by the growth rate of profits and income and that investment depends fundamentally upon expectations regarding future profitability.

Economic units fail when they are no longer able to generate a flow of revenues sufficient to maintain solvency. Yet such failures cannot be attributed solely to credit expansion that has misled firms or artificially inflated their activities. They may also result from increases in interest rates, credit restrictions, or declines in prices. These developments are often unpredictable both for those who receive credit and for those who grant it. They frequently depend upon international circumstances that are difficult to control and involve uncertainty and contingencies that are inseparable from entrepreneurial activity, whether on the side of borrowers or lenders.

There is often an underlying tendency to seek fault or responsibility when a recession occurs. Such an attitude is understandable, but it is frequently misguided. The flow of current profits and revenues may depend upon government *deficit spending*, exports, and, above all, expectations concerning the returns on future investments. Those expectations influence the volume of current investment and, consequently, the flow of profits itself.

All these elements are interconnected. Their relationship to credit is only partial, because bank money is created in response to the demands of firms, which make their investment decisions on the basis of expectations. Those expectations depend only to a limited extent upon current income and much more upon anticipated *effective demand*. Otherwise, products such as the iPhone—and countless other innovations whose success depended upon expectations regarding future demand—would never have been developed.

Entrepreneurs, whether they are recipients of finance or providers of it, necessarily base their decisions upon expectations regarding future market conditions. If they wish to remain entrepreneurs rather than mere accountants, they must take account of anticipated demand and the opportunities that may arise from it. Investment is therefore not driven solely by current saving or by current income, but also by expectations, uncertainty, innovation, and the anticipation of future profitability.

3. As I remarked above, somewhat provocatively, humanity would never have reached the Moon under certain assumptions concerning the creation of bank money. Any discussion of money creation must take account of an economy characterised by ongoing technological progress. Such an economy cannot easily be analyzed in a manner that is both perfectly precise and fully realistic, because entrepreneurship necessarily involves risk and uncertainty.

Nothing in economic reality remains constant over time or provides a fixed unit of measurement upon which precise calculations can permanently rely. Workers acquire new skills and lose old ones. Products change in their physical characteristics, their marketability, and their capacity to satisfy human needs. Needs themselves evolve alongside products; indeed, products often create entirely new needs. The purchasing power of money, whether measured in terms of goods, labor time, or both, changes not only in its general level but also in its internal structure. Above all, capital goods change continuously, so that the means of production required by a more advanced technology often have little or nothing in common with those employed by earlier techniques. An analysis that ignores technological change may be highly precise, but it is unlikely to be particularly relevant.

Within this dynamic process, those who provide finance make entrepreneurial judgements. They may contribute to economic

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development, and they may also contribute to recessions, but in this respect they are no different from entrepreneurs in other sectors of the economy. Indeed, forms of finance based upon very restrictive principles—such as certain models of Islamic finance, with their preference for contractual arrangements such as *murabaha* and their general emphasis on limiting speculation and favoring stable commercial relationships—might in some cases have made it more difficult to undertake highly uncertain and ambitious projects.

Humanity reached the Moon through a combination of public expenditure and credit creation, not through a system based exclusively upon prior voluntary saving and a one-hundred-per-cent reserve requirement. The same process generated innovations that created entirely new needs, new markets, new profits, and new sources of income for countless economic actors. These developments benefited not only firms but society more broadly, and they occurred through a dynamic process of experimentation, investment, and risk-taking.

Will humanity reach Mars thanks to credit expansion? Perhaps. Public expenditure may play a smaller role than it did during the Apollo era. Yet new innovations will undoubtedly emerge, creating new markets, new forms of economic activity, and new streams of income.

Today, whenever we hold a smartphone in our hands, make a call to another continent, or connect to the Internet, we are indirectly benefiting from technological developments that originated in the space program. This is only the most visible example of the technological spillovers generated by the first space missions.

Microchips and the progressive miniaturization of electronics—necessities for space exploration from the earliest missions onward—made personal computers and modern mobile telephones possible. Investments in computing technology and telecommunications eventually contributed to the creation of today's global digital networks.

The list of technologies that originated in the space program, particularly during the Apollo missions, and subsequently entered everyday life is virtually endless.

In electronics, modern microchips evolved from the integrated circuits developed for the Apollo Guidance Computer, while many of the technologies that underlie contemporary computers and mobile devices can trace part of their lineage to research undertaken for lunar exploration.

In medicine, developments associated with the analysis of advanced materials contributed to technologies that ultimately led to modern computed tomography (CT) scanning, now indispensable in countless medical applications.

Water-filtration systems provide another example. Technologies originally designed to purify water within the confined environment of spacecraft were subsequently adapted for civilian use and today form part of systems employed to provide safe drinking water, particularly in regions where water supplies are contaminated or scarce.

Battery-powered tools also owe much to the requirements of space exploration. From the beginning of the Space Age, engineers developed portable battery-operated equipment for astronauts, including drills and other tools that have since become commonplace in everyday life.

The development of freeze-dried food likewise accelerated as a consequence of the Apollo program. Although often taken for granted today, the techniques used to preserve food through low-temperature dehydration were refined through investments made for space missions and subsequently found applications in numerous civilian contexts.

Even modern insulated snow boots can trace part of their evolution to the original lunar boots designed for astronauts. Likewise, the highly sophisticated spacesuits developed for lunar exploration—with their advanced thermal regulation systems, protective materials, and integrated technologies—contributed to the later development of a wide range of protective clothing, from firefighters' equipment to racing drivers' suits.

The materials developed for those early spacesuits also inspired many of the durable and lightweight fabrics now used in tensile structures, indoor sports facilities, and stadium roofing systems.

These examples illustrate a broader point. Technological innovation often produces consequences that cannot be anticipated in advance. Investments initially undertaken for one purpose generate benefits in entirely different fields. For this reason, a dynamic economy cannot be analyzed solely through static models of saving and investment. Innovation, uncertainty, entrepreneurship, public expenditure, and credit creation interact in complex ways, generating outcomes that are frequently impossible to foresee but that may profoundly transform economic and social life.

4. In promoting innovation and the products that derive from it—products for which no one can guarantee success in advance, either in terms of technical feasibility, practical usefulness, or the timing of their usefulness—both public expenditure and credit play a crucial role. History offers countless examples. The earliest automobiles were unreliable, expensive, and of limited practical utility when compared with established means of transport. The first mobile telephones were bulky, costly, and accessible only to a small minority of users. Yet these initially imperfect technologies ultimately transformed entire economies and societies.

Innovation therefore requires not only resources but also a willingness to finance uncertainty. Credit is often indispensable in this process. The question arises whether a system based exclusively upon prior voluntary saving and a one-hundred-per-cent reserve requirement would be capable of supporting projects of this nature.

Innovation frequently requires large volumes of financing and a willingness to commit resources to projects whose outcome is uncertain. In this sense, financing innovation involves an

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element of entrepreneurial judgement on the part not only of the innovator but also of those who provide credit. To finance innovation is, in many respects, to place a wager on an uncertain future.

The necessary financing may take the form of large amounts of capital concentrated in a few projects, or it may be distributed across a multitude of smaller initiatives. In either case, the availability of funds may depend upon the size and characteristics of the population from which savings are mobilized.

A bank operating in a small country with an ageing or declining population may encounter greater difficulties in attracting savings than a bank located in a larger and more dynamic economy, notwithstanding the reduction of barriers to capital movements and the increasing globalization of financial markets.

Such a system could therefore have distributive consequences. Certain countries, economic sectors, financial institutions, or entrepreneurs might find themselves disadvantaged relative to others simply because of differences in the availability of accumulated savings. Access to finance could become concentrated in those economies already possessing substantial stocks of capital, while economies with fewer resources might struggle to support ambitious projects.

One might ask, therefore, whether only economic systems possessing vast pools of accumulated wealth—historically, for example, the British Empire or other major financial centers—would be capable of generating the volumes of capital necessary to finance large-scale innovation, while others would remain dependent upon them.

Paradoxically, credit expansion may sometimes act as a catalyst for innovative projects and products that require both substantial resources and a willingness to embrace uncertainty. Many transformative innovations have depended upon the capacity of financial systems to mobilize resources toward activities whose success could not be known in advance. Such investments involve risk, but risk is also inseparable from entrepreneurship itself.

This does not imply that all credit expansion is beneficial, nor that every project financed through credit will succeed. Rather, it suggests that the relationship between credit, innovation, and economic development is more complex than a simple opposition between credit expansion and prior saving. A financial system that completely eliminates entrepreneurial discretion in lending may also reduce its capacity to support innovation, experimentation, and technological progress.

The challenge, therefore, is not merely to prevent excessive risk-taking, but to identify institutional arrangements capable of balancing prudence with innovation, financial stability with entrepreneurship, and the protection of savings with the financing of economic progress.

## IV. What May Happen in Political Reality as a Consequence of Certain Economic Prescriptions

Some economists[7], analyzing trends in private-sector productivity across OECD countries between 1980 and 2003, have highlighted the extent to which demand interacts with supply, contributing to efficiency losses within economic systems. They argue that factors already present in the 1980s—most notably a shortage of product innovation—made it increasingly difficult for Italy to benefit from the growth of international demand for new products. The experience of Olivetti is often cited as emblematic in this regard.

For a period during the 1980s, the growth of domestic demand—supported by automatic wage indexation and expansionary public spending, together with periodic currency devaluations—masked many of these structural weaknesses. However, because insufficient attention was devoted to innovation, Italy gradually found itself excluded from the major waves of growth generated by global demand for new products and technologies.

From the 1990s onwards, demand appears to have become an increasingly important factor in explaining both weak productivity growth and the widening productivity gap between Italy and other advanced economies. Fiscal policies associated with the Maastricht framework—preceded by the high-interest-rate policies adopted in Germany to finance reunification—contributed to slower growth in public demand. Likewise, the 1993 agreements between the government and the social partners, which moderated wage growth, may have weakened consumption and domestic demand.

Certain features of European economic governance—without wishing to enter into polemics—may also have contributed to insufficient demand, both from domestic consumers and from Italy's European trading partners. A combination of factors subsequently exerted further downward pressure on demand: participation in the monetary union and adherence to strict fiscal rules; the inability to use exchange-rate adjustments to restore competitiveness when inflation differentials emerged; periods of restrictive monetary policy and limited credit availability; a euro-dollar exchange rate that often disadvantaged Italian exports; and prolonged wage stagnation.

Taken together, these developments contributed to weakening both domestic and external demand for Italian firms. As consumption slowed and income distribution shifted in favor of profits, productivity growth and employment performance were adversely affected. Following the 2008 financial crisis, these issues became intertwined with a broader debate concerning the economic policies adopted by successive Italian governments.

This broader debate reinforces the Post-Keynesian argument that employment is fundamentally a macroeconomic issue and depends primarily upon macroeconomic conditions rather than solely upon labor-market institutions or microeconomic incentives. It is also linked to the question of whether policies

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inspired by the doctrine of so-called *expansionary austerity*—which in some respects resembles the old *Treasury View* of the 1930s—are capable of generating economic recovery.

The debate also raises a deeper question concerning the causes of the 2008 crisis itself and the resulting contraction in demand. Supply-side measures may improve efficiency and productivity over the long term. Their advocates argue that they strengthen firms and enhance the productive capacity of the economy. Yet while waiting for those long-term benefits to materialize, the immediate social and economic consequences—such as reductions in output, employment, or aggregate demand—may alter the very conditions under which the expected benefits are supposed to emerge.

This is precisely the concern that motivates the present analysis. Economic policies do not operate in a political vacuum. Social reactions to economic hardship may fundamentally reshape the political environment and, in doing so, transform the ultimate outcomes of the policies themselves. Measures designed to improve economic performance over the long run may produce short-term social costs that undermine political stability, alter electoral outcomes, or generate demands for entirely different policies.

It is in this sense that economic ideas can have political consequences extending far beyond the intentions of their proponents.

*Carneade, chi era costui?* One might similarly ask: who was Heinrich Brüning?

Brüning served as Chancellor of Germany between 1930 and 1932 during the final years of the Weimar Republic. Faced with a severe economic crisis, he pursued policies centered on fiscal retrenchment, reductions in public expenditure, wage restraint, and budgetary balance. His objective was to restore confidence, preserve financial stability, and demonstrate Germany's creditworthiness. Yet the immediate consequences included falling output, rising unemployment, and increasing social hardship.

Historians continue to debate the extent to which Brüning's policies contributed to the political collapse of the Weimar Republic. What is beyond dispute is that economic distress helped create conditions in which extremist political movements gained support. The lesson frequently drawn from this episode is not that fiscal discipline is always undesirable, but rather that economic policies must be evaluated in light of their broader social and political consequences.

Economic measures that appear rational when viewed solely through the lens of economic theory may generate political outcomes that ultimately undermine the very objectives they were intended to achieve. This possibility deserves careful consideration whenever proposals are advanced that rely upon substantial economic adjustment, prolonged restraint, or the expectation that short-term sacrifices will eventually produce long-term benefits.

In the end, realism requires not only an understanding of markets and incentives but also an awareness of how societies react to economic change. Political reality is itself an economic variable.

Heinrich Brüning was the German Chancellor who governed the Weimar Republic from 1930 to 1932, immediately before the rise of Adolf Hitler. Any comparison between Brüning's policies and contemporary European institutions must be approached with caution, because the historical, institutional, and geopolitical contexts are profoundly different. Nevertheless, certain similarities have often been noted by historians and economists regarding the emphasis on fiscal discipline, debt reduction, monetary orthodoxy, and the belief that economic credibility could be restored through austerity.

Brüning's objective was to demonstrate Germany's financial reliability and thereby obtain a reduction of reparations obligations. To achieve this, he pursued a deflationary strategy consisting of higher interest rates, substantial reductions in public expenditure, cuts in wages and unemployment benefits, tax increases, and measures intended to balance public finances. The underlying assumption was that economic sacrifice in the short term would create the conditions for long-term recovery.

The problem, however, was that the economy was already experiencing a severe downturn following the 1929 crisis. Deflation reduced demand, firms reduced production, unemployment increased dramatically, and social tensions intensified. In economic terms, the adjustment may have possessed a certain internal logic; politically and socially, however, the consequences proved devastating. Between 1930 and 1932 unemployment rose to unprecedented levels, confidence in democratic institutions collapsed, and radical political movements gained support.

This is the point that remains relevant to contemporary debates. Even if one assumes that a policy of fiscal consolidation, wage restraint, or monetary discipline is theoretically justified, a political problem remains: societies do not remain static while waiting for the long-term benefits to materialize. Economic policies operate through social and political systems that react to immediate circumstances.

The issue is therefore not merely whether a policy is theoretically correct. The issue is whether the political and social environment will remain sufficiently stable for the policy to produce its intended results. If the adjustment generates unemployment, declining living standards, insecurity, or a perception of injustice, political reactions may emerge that fundamentally alter the trajectory of events before the anticipated benefits have time to appear.

In this respect, the experience of Brüning is often cited as a warning. His policies may be interpreted as an attempt to restore economic stability, but the social consequences contributed to the delegitimization of the political center and facilitated the growth of extremist alternatives. The lesson frequently drawn is that economic policies cannot be evaluated solely through economic indicators; they must also be assessed in terms of their social sustainability and political consequences.

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A similar argument has been advanced in contemporary analyses of European economic governance. According to this view, excessively restrictive fiscal policies implemented after the 2008 financial crisis and during the euro-area sovereign debt crisis risked weakening growth, depressing demand, and increasing political discontent. Whether this interpretation is entirely correct remains debated. What is less controversial is that prolonged economic stagnation has often coincided with the growth of anti-establishment, nationalist, or populist political movements across many European countries.

This dynamic has been analyzed by several scholars of contemporary politics. In France, for example, some observers argue that portions of the traditional working-class electorate gradually shifted their support from parties of the left towards national-populist or national-patriotic movements. According to this interpretation, when center-left parties came to be associated with fiscal restraint, European integration, labor-market flexibility, and policies perceived as insufficiently protective of lower-income groups, part of their traditional social base sought representation elsewhere.

The political evolution of France after the 1990s is often cited in this regard. The disappointment that followed François Hollande's election in 2012 is frequently interpreted through this lens. Elected under the slogan *mon ennemi, c'est la finance* ("my enemy is finance"), Hollande was subsequently accused by many former supporters of abandoning a growth-oriented agenda and accepting policy constraints associated with European fiscal orthodoxy. Critics therefore began to speak of a transition from "Merkozy" (Merkel-Sarkozy) to "Merkhollande", suggesting continuity rather than change in economic policy.

Whether one accepts this interpretation or not, the broader issue remains the same. Economic policies do not produce effects exclusively through markets and statistical aggregates. They also shape political expectations, perceptions of fairness, social cohesion, and confidence in institutions. If those dimensions are neglected, policies intended to promote stability may ultimately generate instability.

From this perspective, the central question is not simply whether austerity, monetary discipline, or structural reforms are right or wrong in the abstract. Rather, it is whether the political and social costs incurred while waiting for their expected benefits may themselves prevent those benefits from ever being realized. Economic history suggests that this possibility should never be dismissed lightly.[8]

This stance on the part of the Left ultimately paved the way for the emergence of a national-patriotic bloc. In the 2017 French presidential election, this bloc had already become a significant political force, although it did not constitute the sole opposition. Four candidates finished with broadly comparable levels of support: Jean-Luc Mélenchon on the Left and François Fillon representing the Gaullist tradition each obtained approximately 20 per cent of the vote, closely behind Marine Le Pen with 21 per cent and Emmanuel Macron with 24 per cent.

Marine Le Pen succeeded in replacing the Left among less affluent voters, while the candidate of the liberal bloc, formally regarded as more left-wing—or at least less right-wing—than the traditional conservative parties, increasingly replaced the Right among wealthier voters.

Regardless of whether contemporary French politics is characterised by a bipolar or tripolar configuration—a national-patriotic bloc, a liberal-progressive bloc, and a social-ecologist bloc, broadly corresponding to the political forces associated respectively with Marine Le Pen, Emmanuel Macron, and Jean-Luc Mélenchon—it is difficult to deny that the growth of the national-patriotic component has been driven less by questions of identity or immigration than by socio-economic factors. These factors have been particularly influential in peripheral and rural areas, where support for such movements has grown most strongly.

Nor can one overlook the responsibility of the Socialist Party and the broader French Left, which governed France for much of the period between 1981 and 2017, in indirectly strengthening the national-patriotic camp among working-class and lower-income voters. This process accelerated when the Left effectively acquiesced to deindustrialization, as reflected in the famous statement made by Lionel Jospin in 1999 following Michelin's announcement of 7,500 redundancies: *"The State cannot do everything."* He concluded with another phrase that became equally famous: *"Everyone recognizes the market."*

Beyond the words themselves, it is their underlying meaning that proved politically significant. Over time, a substantial portion of the popular vote shifted towards the National Rally (*Rassemblement National*), particularly in villages and small towns. These are often areas with fewer public services, whether in education, healthcare, transport infrastructure, or hospital provision, and where poorer municipalities tend to be disproportionately disadvantaged (the contrast between the high-speed TGV network and regional TER services is frequently cited in this regard).

A growing number of inhabitants of these territories came to feel abandoned by both the social-democratic Left and the liberal Right. In this respect, one may discern echoes of dynamics already observed in other historical contexts, including those discussed earlier in relation to Brüning.

More recently, Julia Cagé and Thomas Piketty, drawing upon electoral and statistical data, have argued that the French Left—and particularly the Socialist Party—effectively disregarded both the outcome of the 2005 French referendum and the preferences of much of its traditional electorate. According to their analysis, from the 1980s onwards, and especially under the influence of Jacques Delors, the Socialist Party embraced a broadly *liberal-federalist* orientation. This project promoted European integration through a program based upon the four freedoms of movement and the single currency, the latter being viewed as a means of anchoring Germany more firmly within the European framework.

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At the same time, however, the free movement of capital became increasingly unrestricted, while trade liberalization proceeded with limited constraints. According to this interpretation, these developments contributed both to rising inequalities and to a growing loss of confidence in the Left among large segments of the working classes, particularly industrial workers and the lower-middle classes living in smaller towns and rural areas. These groups were often the most directly affected by deindustrialization, offshoring, and a broader sense of economic abandonment. Industrial workers, in particular, were more exposed to international competition, whereas salaried employees in the public and service sectors retained greater confidence that the Left would continue to defend the welfare state.

The French Left, it is argued, failed to recognize that increased competition alone could not adequately address the insecurity and sense of abandonment experienced by these groups. Nor did it sufficiently appreciate that pricing mechanisms are influenced not merely by competition but also by entrepreneurial decisions and expectations regarding future profitability. At the same time, it failed to respond to the anti-globalization message that many voters believed had been expressed through the rejection of the Treaty establishing a Constitution for Europe (TCE) in the 2005 referendum.

Instead, according to this critique, European policies continued largely unchanged. Under Sarkozy, then under Hollande, and subsequently through the Lisbon Treaty—which many regarded as reproducing substantial elements of the rejected Constitutional Treaty—the same general orientation persisted despite the referendum outcome.

More broadly, Europe, and France in particular, adopted policies that often favored holders of capital through increasingly competitive corporate taxation, despite the fact that taxation revenues could have been used to sustain and strengthen a welfare state considerably more extensive than that found in the United States.

From this perspective, both the narrow approval of the Maastricht Treaty and monetary union in 1992 and the rejection of the Constitutional Treaty in 2005 possess significant predictive value for understanding the rise of support for Marine Le Pen and the national-patriotic bloc, culminating in the presidential election of 2022.

Let us now leave aside these political developments, whether from interwar Germany or more recent French experience, and turn instead to a more technical economic analysis of the issues under discussion.

What, then, are fiscal multipliers in more technical terms? What exactly does this concept mean?

Before the financial crisis, it was commonly assumed that fiscal multipliers were approximately equal to 0.5. During and after the crisis, however, evidence emerged suggesting that fiscal multipliers could exceed 1. What does this imply? It means that a reduction in public expenditure—or, similarly, an increase in taxation—may reduce GDP not by €0.50 for every euro of fiscal adjustment, but by more than €1.00.[9]

This changes the entire picture. If the immediate impact of cuts in public expenditure during a recession is greater than one-for-one, rather than one-half, the effect on output and income is effectively doubled. In such circumstances, certain fiscal consolidation policies may become economically and politically unsustainable. If GDP contracts by more than the amount of the fiscal adjustment itself, the immediate consequence is a significant worsening of economic conditions. The observations of these scholars do not necessarily settle the debate, but they should at least encourage prudence.

Let us now turn to the causes of the 2008 financial crisis.

In 2010, Michael Kumhof and Romain Rancière published a study suggesting that high levels of inequality may contribute to systemic financial crises. They identified striking similarities between developments in the United States prior to the Great Depression and those preceding the 2007–2008 financial crisis. According to their analysis, rising inequality increased the financial fragility of a large segment of the population, thereby creating the preconditions for crisis.

The share of income accruing to the top 5 per cent of the income distribution increased from 24 per cent in 1920 to 34 per cent in 1928. Similarly, it rose from 22 per cent in 1983 to 34 per cent in 2007. During the same periods, household indebtedness relative to GDP increased dramatically: it almost doubled between 1920 and 1932 and again between 1983 and 2008.

In 1983, the top 5 per cent of households exhibited a private-debt-to-GDP ratio of approximately 80 per cent, while the bottom 95 per cent stood at around 60 per cent. Twenty-five years later, the situation had changed dramatically. The ratio for the top 5 per cent had fallen to 65 per cent, whereas for the bottom 95 per cent it had risen to approximately 140 per cent.

What does this signify? Rising inequality tends to increase savings among those at the top of the income distribution, while those whose relative incomes stagnate or decline often resort to borrowing in order to maintain their standard of living and consumption levels. Consequently, the excess savings accumulated by wealthier groups become the source of financing for the growing indebtedness of lower-income households.

The result is an increase in the private-debt-to-GDP ratio and, ultimately, greater systemic vulnerability. At the same time, the financial sector expands as a proportion of both GDP and total corporate profits. Although fraudulent behavior and regulatory failures undoubtedly played a role in the crisis, the growing inequality of income itself contributed to increasing financial fragility among a substantial portion of the population. In this sense, the dynamics of production and income distribution can generate such outcomes almost organically.

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Post-Keynesian economists have long argued that redistribution in favor of higher-income groups—whose marginal propensity to consume is generally lower—tends to reduce demand for consumer goods while increasing aggregate savings. As noted above, these savings may be channeled into property markets, luxury assets, and other stores of value, but they often find their way primarily into financial assets.

This process helps explain the rapid growth of financial activity. If these financial resources were immediately transformed into productive investments—new machinery, technological innovation, infrastructure, and productive capacity—the consequences might be largely beneficial. In practice, however, savings often flow into more complex and speculative investments, including derivatives, foreign-exchange products, futures contracts, and other financial instruments that may offer higher returns than productive investment or real estate.

The consequence is twofold. Alongside rising inequality emerges a deficiency of aggregate demand, which contributes to stagnation and unemployment. Stagnation and unemployment, in turn, generate an underlying instability within the real economy. This instability creates incentives to expand consumer credit and to pursue policies of financial inclusion that extend borrowing opportunities even to households with precarious employment conditions or limited collateral.

For many years, this constituted a central mechanism through which the prevailing growth model was sustained. In the United States, but also in Europe, increasing household indebtedness served as a partial substitute for wage growth and demand expansion, allowing consumption to continue despite widening inequalities. The resulting system appeared stable for a time, but it ultimately proved vulnerable to crisis.

## V. Keynes in Particular

Obviously, one cannot ignore the changes that have taken place in the present-day context compared with twenty years ago, and even more so with eighty years ago, although the similarities between the Great Depression of the 1930s—the context in which Keynes was writing—and the current crisis are numerous, just as the similarities between pre-Keynesian economic theory and contemporary economic theory are considerable.

The return to Keynes that I would advocate, in arguing for his continuing relevance and significance, is first and foremost a return at the level of methodology. In a famous letter to George Bernard Shaw**,** written a few months before the publication of the *General Theory* in February 1936, Keynes announced it as a book that would "revolutionize enormously [...] the way the world thinks about economic problems." In the same letter he added: "when my new theory has been properly assimilated and mixed with politics and feelings and passions [...] there will be a great change".[10]

Instead of appealing to the "scientific" nature of his theory, Keynes relied on "politics, feelings and passions" in the hope that his message would be embraced. A couple of years later, in a letter addressed this time to Roy F. Harrod**,** he referred to the episode said to have inspired Newton's discovery while observing an apple fall from a tree, in order to illustrate the kinds of questions an economist ought to ask. One should ask:

"whether the apple's fall to the ground depends upon the apple's own motives, whether it is to the apple's advantage to fall, whether the earth really wants the apple to fall, and whether the apple correctly or incorrectly calculates how far it is from the center of the earth".

Economics, Keynes explained, "deals with introspection and with values [...], with motives, expectations and psychological uncertainties" (*ibid.*), a field of inquiry that is "neither constant nor homogeneous".[11]

There can be no true analogy with the physical sciences, because whereas the aim of physics is to discover regularities from which general laws may be derived, the aim of economics is to explain decisions taken under conditions of uncertainty and with differing degrees of information. The objective of the economist should therefore be to develop a logical way of reasoning about elements that are "transitory and fluctuating".

When, in *The General Theory*, Keynes explains why the level of employment fluctuates around an "intermediate position", below the level of full employment and above that corresponding to mere subsistence, he makes it clear that this position "is a datum of observation concerning the world as it is or has been, and not a necessary principle incapable of modification". In economics, indeed, "we cannot hope to make completely accurate generalizations", because the economic system is not governed by natural forces that economists must simply discover. Rather, the economist's task is "to select those variables which can be deliberately controlled and managed by a central authority in the kind of system in which we actually live".

Keynes's criticism is directed against the conception of economics as a social science modelled on the physical sciences. Instead, he argues that economics should become an inquiry aimed at bringing about desirable states of affairs. Only by exposing the false analogy between economic causes and physical causes can economists hope to promote values and attitudes capable of improving society.

As Keynes wrote:

*"Many generations have passed since individual men began to substitute reason and morals for blind instinct as the springs of action. The time has now come to do so collectively".*

Let us now turn to the multiplier**,** to which I have already referred.

The multiplier—the cornerstone of Keynesian effective demand theory—has enjoyed a fluctuating intellectual fortune over the eighty-five years since its formulation.

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It is a concept showing how any increase in autonomous expenditure (for example, investment or exports) generates—through induced expenditure (consumption, net of taxation and imports)—an increase in national income greater than the initial expenditure itself, provided that unused productive capacity and unemployment exist within the economy.

Hence the term multiplier, whose value is typically greater than one. Deficit-financed spending—that is, public expenditure exceeding tax revenues—thus becomes justified on two grounds: (a) because it creates income; and (b) because it generates the savings and tax revenues (both of which are functions of income) required to finance the initial investment.

The broad acceptance of this proposition lasted for almost thirty years, until it came under sustained attack during the monetarist challenge of the 1960s.

Drawing in part on the work of Franco Modigliani**,** Milton Friedman argued, on the basis of empirical analysis, that the independent variable in the consumption function is not current income but rather what may be regarded as an individual's permanent income over the course of his or her lifetime. Under this interpretation, the value of the multiplier is considerably lower, since consumption does not respond significantly to increases in current income. The seeds of renewed skepticism regarding the effectiveness of fiscal policy were thus sown.

This development, which became known as the Monetarist Counter-Revolution**,** was pursued even more radically by Robert Lucas and the economists of the New Classical School throughout the 1970s, 1980s and into the 1990s. The response of the so-called New Keynesians was theoretically weaker. They confined the effectiveness of the multiplier to the short run, a situation characterised by sticky prices and wages**,** which prevent the economy from reaching the long-run equilibrium associated with full employment.

Nevertheless, the multiplier returned to prominence in the aftermath of the financial crisis. During the 1950s and 1960s, at the height of Keynesian influence, the multiplier was generally estimated to be approximately two. By contrast, econometric estimates produced during the 1990s and 2000s suggested much lower values, typically in the range of **0**.5–0.7**.**

In 2009, the IMF and the European Union revised their estimates of the multiplier, placing it within a range of 0.9 to 1.7[12]. At last, we once again had a multiplier that actually multiplies, something that becomes impossible to ignore—as was the case in austerity-era Europe—when autonomous expenditure declines.

This provides an example not only of the strong connection between empirical results and the models chosen to obtain them, but also of the importance of the behavioral assumptions used in constructing those models. Orthodox economic theory assumes that consumers are guided by perfect information and complete knowledge of all possible future states of the world over an infinite horizon.

This stands in sharp contrast to the macroeconomics inspired by Keynes, for whom perfect foresight and complete rationality are unacceptable assumptions. Keynesian economics describes a world in which probability calculus is not always applicable, because where genuine uncertainty prevails, such calculations simply cannot be made.

The assumption of perfect information in markets, common in mainstream economic theory, was seriously undermined by the events of 2007–2008. In response, some macroeconomic models underwent substantial revision in an attempt to incorporate notions of bounded rationality**,** limited knowledge**,** and market imperfections**,** particularly in financial markets, but also in goods and labor markets.

These modifications, however, were introduced within a theoretical framework that remained largely unchanged and still far removed from Keynes's understanding of economic behavior. Keynes never assumes the existence of anonymous "agents"; rather, he analyses individuals performing specific functions and possessing distinct characteristics.

For Keynes, the behavior of consumers, entrepreneurs, and speculators under conditions of uncertainty cannot be reduced to the optimizing rational choice model of the utilitarian tradition.

Every economic decision requires an assessment of information. Yet information is often contradictory—or at least ambiguous—and frequently insufficient to enable us to predict the future with confidence.

Therefore, information must be "weighed" against our knowledge and experience. Decision-making under conditions of uncertainty should not, however, be interpreted as a renunciation of reasoned choice, even if such choice is not "rational" in the sense understood by traditional economic theory. Keynes was not only a great economist but also a highly successful investor, managing investments for himself, for his College, and for insurance companies. Unpublished documents relating to his investment activities show that he based his decisions on a careful and considered assessment of the available information.

The concept of rationality employed by Keynes—which differs significantly from the optimizing rationality of conventional theory—can also be found in other contexts. It becomes a form of reasonableness**,** applicable to situations in which behavior that appears rational from a narrowly economic perspective may nevertheless lead to disastrous outcomes. We find it, for example, in the way Keynes approached the issue of war reparations to be imposed on Germany after the First World War, in the negotiations he conducted concerning the repayment of Britain's wartime debts to the United States after the Second World War, and we may apply it today in assessing more recent events, asking whether it was a "reasonable" decision to allow Lehman Brothers to fail.

Yet Keynes was not an advocate of the indiscriminate use of public investment financed through budget deficits. The *General Theory's* call for state intervention should instead be

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understood as referring to the need for public authorities to exercise influence over the overall level of investment, whether directly or indirectly through public or semi-public institutions, while always remaining attentive to market incentives and to the creation of a climate of confidence conducive to entrepreneurial activity.

This point is stated explicitly in *The General Theory*:

*"If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments of production and the basic rate of reward to those who own them, it will have accomplished all that is necessary".*[13]

Even in relation to the welfare state, views have often been attributed to Keynes that were not in fact his own[14]. He did not believe in high levels of taxation as a means of financing pensions and social security. Rather, he held that the costs of social protection should fall primarily upon employers, whose own interest lay in maintaining a workforce in adequate conditions[15].

Keynes also favored the greatest possible economy and transparency in public finances. In his view, governments should clearly disclose which public goods and services are actually provided, in what quantities, at what cost, and by what means they are financed, because this is *"the only way to keep proper accounts, to measure efficiency, to achieve economies, and to keep citizens continually informed of what everything costs"* (*ibid.*, p. 225).

## Conclusion

From a broader perspective, although in certain respects De Soto's analysis may at times converge with Keynesian insights, his position remains open to criticism, particularly because of the legal premises from which it proceeds. Here, perhaps, the lawyer in me comes to the fore. Lawyers are often more inclined towards realism than economists, especially when assessing the practical consequences of theoretical constructions and their compatibility with the institutional and legal framework within which economic activity actually takes place.

From this broader perspective, it is evident that, beyond its technical apparatus, De Soto's work pursues a clear political objective.

Indeed, his argument proceeds from legal premises that are historically questionable, at least from the standpoint of the history and philosophy of law. According to De Soto, there has been a departure from a universal and permanently valid legal principle. Yet such a principle is not a divine commandment. Legislators, jurists and commentators throughout history have repeatedly departed from it, because what is legal and legitimate is not determined *a priori*, but emerges from concrete decisions, historical experience and political debate.

As Herodotus famously observed, customs and laws vary profoundly among peoples. The Massagetae**,** for example, dismembered and consumed their deceased parents, believing that to be buried within one's children constituted the noblest form of burial; the Greeks regarded such a practice as abhorrent. The Persians considered it both natural and admirable for men to adorn themselves in ways similar to women and accepted forms of consanguineous unions that Greeks considered shameful. Such examples illustrate the extent to which legal and moral norms are historically contingent rather than immutable.

The body of rules that binds a community together, which occupied a central place in political life from the written legislation of Solon and Cleisthenes onwards, was not regarded as the product of superior commands, but rather as an artificial construct arising from human interests and social needs. Law thus became an object of criticism and transformation, acquiring a contingent character in contrast to the supposed necessity of the natural order.

From the Sophists onwards—Antiphon**,** Thrasymachus of Chalcedon**,** Gorgias and others—there emerged the principle that would later be famously expressed by Hobbes as *auctoritas, non-veritas, facit legem* ("authority, not truth, makes the law"). Although subsequently qualified and refined through centuries of legal and philosophical debate, and reconsidered in the light of the tragic experiences of the Second World War by jurists such as Gustav Radbruch, this principle remains one of the foundations of modern social and legal life.

Accordingly, whatever the merits of his economic arguments, De Soto ultimately reveals the political—and therefore contingent rather than necessary or immutable—character of his project. This becomes particularly evident when he advocates the abolition of central banking and complete freedom of currency choice, proposals designed to diminish, almost to the point of elimination, the role of the State.

Under such a framework, the State would not merely lose the ability to finance its debt; automatic rules would replace discretionary political choices, including those arising from democratic processes, public debate and the inevitable conflict of interests and ideas characteristic of democratic societies.

Yet can the State truly be dispensed with? Whether one considers the Roman Empire, whose coins bore the image of Caesar, the British Empire, or contemporary powers such as the United States, China or Russia, economic history is inseparably intertwined with political authority, national traditions and broader cultural developments. Whether this is desirable or not is a different question; the historical reality is that economic and political institutions have continuously shaped one another.

Trade relations, monetary arrangements and the economic consequences of political decisions all demonstrate the impossibility of entirely dispensing with the State. The issue is therefore not whether the State should exist, but what kind of State is required: limited rather than unlimited, authoritative rather than authoritarian, and capable of protecting citizens not only from public power but also from large economic organizations whose influence may rival that of governments themselves.

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Article 16 of the Declaration of the Rights of Man and of the Citizen of 1789, one of the foundational texts that broke the chains of absolutism in defense of individual liberty, states that:

*"Any society in which the guarantee of rights is not secured, nor the separation of powers determined, has no Constitution."*

This provision is meaningful only if the separation of powers is effective rather than merely formal, a distinction that becomes particularly relevant whenever judges assume functions that properly belong to legislators. Yet, irrespective of the role of jurisprudence, it remains evident today that the legislature determines the fundamental principles of law and that representative institutions, above all Parliament, shape those principles in accordance with changing circumstances rather than eternal truths.

The Romans expressed this idea through the maxim *ex facto oritur ius*—law arises from facts. They placed little faith in immutable principles detached from social reality.

The legal philosopher H.L.A. Hart**,** in *American Jurisprudence through English Eyes: The Nightmare and the Noble Dream*, contrasted what he termed the "nightmare" and the "noble dream" conceptions of law. Hart recalled John Chipman Gray's *The Nature and Sources of the Law* (1909), which in turn cited the words of **Bishop Hoadly*:

*"Whoever hath an absolute authority to interpret any written or spoken laws, it is he who is truly the lawgiver to all intents and purposes, and not the person who first wrote or spoke them."*

Ultimately, whatever one's jurisprudential position, the historical lesson remains that there are no eternal legal principles standing outside time and society. Law is the product of human institutions, historical development and collective choices, and it evolves as those choices evolve.

Hart concludes that one should avoid embracing the more extreme versions of legal realism[16].

Returning to De Soto, and indeed to other thinkers of a similar persuasion, the question arises whether, without exaggerating the role of the State but rather speaking more broadly of public authority, it is possible—given the needs and problems of a modern society composed of billions of individuals—to imagine either the absence of such authority or a role reduced to the minimal dimensions they envisage.

As Hobbes would put it, are there not compelling reasons why a sovereign authority should exist?[17] Should there not be an agreement authorizing such a sovereign? Does not each individual have a "predominant and fundamental interest" in supporting an effective sovereign authority? Would not everyone, as Hobbes argues, possess a sufficient reason, grounded in self-preservation and in the protection of their fundamental interests, to enter into a covenant with others authorizing a sovereign to continue exercising power indefinitely? Such a covenant, Hobbes maintains, would be rational for all: it is, so to speak, collectively rational, because it is rational for each individual and therefore for everyone together[18].

Certainly, Hobbes's attempt to avoid anarchy ultimately leads him towards absolutism. Yet the significance of his thought does not lie primarily in that conclusion. Modern constitutional democracy owes more to Locke, Montesquieu, and other liberal theorists than to Hobbes. What remains important, however, is that even in Hobbes—a thinker generally regarded as far from democratic—the necessity of a State capable of enforcing laws and maintaining social order is treated as indispensable. One need not accept Hobbes's excesses to recognize the force of that insight.

Even if one sets aside Hobbesian and Lockean theories of the social contract, whether real or hypothetical, and instead adopts a utilitarian justification of the State of the kind associated with Hume and Bentham, a tradition particularly influential in the Anglo-Saxon world, the conclusion is not substantially altered for present purposes. On this view, the State is justified not by consent or natural right, but by its utility—its capacity to satisfy the general interests and needs of society.

Hume, for example, regarded duties such as justice, allegiance to government, and respect for the property of others as artificial virtues: institutions recognized and maintained because of their public utility. They would neither exist nor be observed were they not perceived to serve the common good. Although this utilitarian approach differs fundamentally from contractarian theories—because it abandons the notion of intrinsic rightness and focuses instead on the satisfaction of human interests and desires—it nevertheless leads to a similar conclusion regarding the necessity and indispensability of the State.

Today, moreover, the central issue is no longer how to protect society from the tyranny of monarchs or rulers. That problem has largely been addressed through constitutional restraints on government power, political rights, and legal immunities.

The contemporary challenge often concerns abuses committed by democratic governments themselves, particularly the potential abuse of power by majorities against minorities. It also concerns the regulation of public discourse and the rules governing the relationship between individuals and society, including the increasingly influential role of social media. If the State shapes its laws and institutions in a manner that fulfils an educative and formative function, it may help citizens realize their interests while upholding principles that prevent the suppression of dissent and individuality.

As John Stuart Mill famously wrote:
*"Suppose, therefore, that the government is entirely at one with the people and never thinks of exerting any coercive power unless in agreement with what it conceives to be their voice. But I deny the right of the people to exercise such coercion, either by themselves or through their government. The power itself is illegitimate. The best government has no more title to it than the worst. If all mankind minus one were of one opinion, and only one person were of the contrary*

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*opinion, mankind would be no more justified in silencing that one person than he, if he had the power, would be justified in silencing mankind. If the opinion is right, they are deprived of the opportunity of exchanging error for truth; if wrong, they lose what is almost as great a benefit, the clearer perception and livelier impression of truth produced by its collision with error".*[19]

The issue today is that only the State, or institutions exercising public authority, can effectively protect citizens' rights against large corporations that have acquired a degree of power comparable in some respects to that of States themselves. Indeed, because such corporations often operate beyond territorial boundaries, they may be even more pervasive and difficult to regulate.

Only the State can realistically adopt policies designed to:

- mitigate income inequality through anti-poverty programs;
- reduce economic insecurity through systems of social insurance;
- alleviate poverty and guarantee access to healthcare.

Moreover, only the State can today provide guarantees in the field of healthcare, as demonstrated by the functions performed by entities such as the Italian Medicines Agency (AIFA), regardless of the more or less privatized structure through which the relevant services are delivered. Certain public goods can only be provided by the State, from sewerage systems to countless other essential services. Reducing absolute poverty remains important, but for the stability and cohesion of society it is no longer possible to disregard either redistribution and welfare policies or the issue raised by Marx, even if the solutions he proposed were flawed.

In the *Economic and Philosophic Manuscripts of 1844*, Marx cites a passage from *The Movement of Production* by the German economist Schultz, who observed:

"Even if it were true—which it is not—that the average income of all classes of society has increased, the relative differences and disparities in the distribution of income may nevertheless have widened, and the contrast between wealth and poverty may therefore appear even more pronounced. Indeed, precisely because total production increases, and insofar as it does so, needs, desires and claims also increase. Relative poverty may therefore worsen even while absolute poverty declines. The Samoyed is certainly not poor, living on whale oil and rancid fish, because within his closed society everyone has the same needs. In a progressing State, however, which over the course of ten years increases its total output by, for example, one-third relative to its population, the worker who earns the same wage at the end of the decade as at the beginning has not maintained his standard of living but has become poorer by one-third."

A well-ordered State[20] is also capable of addressing Marx's concerns regarding the effective existence and protection of fundamental liberties, ensuring that such rights are not merely formal or grounded solely in individual self-interest.

In this respect, Pericles remains a powerful example of what democracy means. His Funeral Oration, delivered before the relatives of the fallen, provided an opportunity to explain the nature of democratic government. As he stated: "It is called a democracy because power is in the hands not of a few but of the many. The laws afford equal justice to all in their private disputes, while public esteem is awarded not according to social rank but according to merit".

Equal treatment and merit: these constitute the essence of democracy.

The following is a summary and excerpt from Pericles' *Funeral Oration to the Athenians* (431 BC):

"Here in Athens we do things differently. Here our government favors the many instead of the few, and for this reason it is called a democracy. Here in Athens we do things differently. Our laws guarantee equal justice for all in their private disputes, yet we never fail to recognize excellence. Whenever a citizen distinguishes himself, he is called upon to serve the State, not as a privilege, but as a reward for merit; nor does poverty constitute an obstacle. Here in Athens we do things differently. The freedom we enjoy extends to everyday life; we are not suspicious of one another, nor do we interfere with our neighbor simply because he chooses to live as he wishes. We are free—free to live as we please—and yet we remain ready to face every danger. An Athenian citizen does not neglect public affairs when attending to private concerns; above all, he does not engage in public affairs in order to advance private interests. Here in Athens we do things differently. We have been taught to respect magistrates, to respect the law, and never to forget our duty to protect those who suffer injustice. We have also been taught to respect those unwritten laws that reside in the universal sense of justice and common decency. Here in Athens we do things differently. A man who takes no interest in the affairs of the State is not regarded as harmless but as useless; and although only a few are capable of formulating policy, all of us are capable of judging it. We do not regard discussion as an obstacle to democracy. We believe that happiness is the fruit of freedom, and that freedom is the fruit of courage. In short, I proclaim that Athens is the school of Hellas, and that every Athenian develops within himself a happy versatility, self-confidence, and readiness to face any circumstance. It is for this reason that our city is open to the world and that we never expel the foreigner. Here in Athens we do things differently".

Moreover, today only the State is capable of providing guarantees in the field of healthcare, as demonstrated by the functions performed by the Italian Medicines Agency (AIFA) and similar regulatory bodies, regardless of whether the actual provision of healthcare services is organized through public or private arrangements. Certain public goods can only be supplied by the State, ranging from sewerage systems to countless other essential services. Reducing absolute poverty remains important; however, if social cohesion is to be preserved, neither redistributive and welfare policies nor the problem identified by Marx can be ignored, even if the solutions he proposed were mistaken.

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In the *Economic and Philosophic Manuscripts of 1844*, Marx quoted a passage from *The Movement of Production* by the German economist Schultz, who observed:

"*Even if it were true—which it is not—that the average income of all classes of society has increased, the relative differences and disparities in the distribution of income may nevertheless have become greater, and the contrast between wealth and poverty may therefore appear even more pronounced. In fact, precisely because total production increases, and to the extent that it does so, needs, desires, and claims also increase, so that relative poverty may worsen even while absolute poverty declines. The Samoyed is certainly not poor with his whale oil and rancid fish, because in his closed society everyone has the same needs. In a progressive state, however, which over the course of ten years has increased its total production by, for example, one third relative to its population, the worker who earns the same wage at the end of the decade as at the beginning has not maintained his standard of living; rather, he has become one third poorer*".

A properly regulated State also responds to Marx's concerns regarding the effective existence and protection of fundamental freedoms, ensuring that such rights are not merely formal concessions or expressions of individual egoism.

Pericles remains an enduring example of what democracy means. His Funeral Oration, delivered before the relatives of those who had died in war, became an occasion to explain the nature of democratic government. As he stated[21]:

"*It is called a democracy because administration is conducted in the interests not of the few but of the many. The laws provide equal justice for all in private disputes, while public esteem and advancement depend not upon social origin but upon merit and distinction*".

The essence of democracy is therefore equality before the law combined with recognition of merit.

The following is a summary and adaptation of Pericles' famous Funeral Oration to the Athenians (431 BC):

"*Here in Athens, this is how we do things. Our government favors the many rather than the few, and for this reason it is called a democracy. Here in Athens, the laws secure equal justice for all in private disputes, yet we never disregard excellence. When a citizen distinguishes himself, he is called upon to serve the State not as a privilege but as a reward for merit, and poverty is no obstacle. Here in Athens, the freedom we enjoy extends to everyday life. We do not look suspiciously upon one another, nor do we interfere if our neighbor chooses to live according to his own preferences. We are free to live as we please, yet we remain ready to face any danger. An Athenian citizen does not neglect public affairs while attending to private matters; above all, he does not use public affairs to advance private interests. We have been taught to respect magistrates and the laws, and never to forget our duty to protect those who suffer injustice. We have also been taught to respect those unwritten laws that reside in the universal sense of justice and common decency. A man who takes no interest in the affairs of the State is not regarded as harmless, but as useless. Although only a few may be capable of initiating policy, all of us are capable of judging it. We do not regard discussion as an obstacle to democracy. We believe that happiness is the fruit of freedom, and that freedom itself is the fruit of courage. In short, I proclaim that Athens is the school of Hellas, and that every Athenian develops a happy versatility, self-confidence, and readiness to face any situation. For this reason our city is open to the world, and we never drive away foreigners. Here in Athens, this is how we do things*".

Public intervention in the economy has always been present, notwithstanding certain statements of principle to the contrary. Quite apart from contemporary American protectionist policies, or earlier British policies, even the United States Supreme Court stated in 1853:

"It is a grave error to suppose that the duties of the State are exhausted by the creation of those institutions necessary for the existence of government, such as the administration of justice, the preservation of peace, and the protection of the country against external enemies. … To encourage and promote commerce, both domestic and foreign, is a duty of the sovereign State as evident and as universally acknowledged as any other".

During the twentieth century, the State became a central actor in economic life, including in the United States. In 1900, local government expenditure accounted for more than half of total public expenditure in the United States, while the federal government accounted for approximately 35 per cent and the states for about 10 per cent. By 1940, the federal share had risen to 55 per cent of total public expenditure, local governments accounted for 20 per cent, and the states for 25 per cent. By 2005, against a backdrop of overall growth in public expenditure relative to GDP, the federal government accounted for approximately 60 per cent of total public spending, while state and local administrations each represented around 20 per cent.

It has been observed that:

"The broader economic and social responsibilities assumed by the federal government from the 1930s onwards were accompanied by a different interpretation of the Constitution. Drafted in the eighteenth century, the Constitution gradually opened itself to interpretations more compatible with the implementation of public intervention and forms of social democracy".[22]

The motto of the Founding Fathers might be summarized as follows:

"Do not do what the English tell you to do [as many Italian economists would advise]. Do what the English actually did".

Even those who, like Robert Nozick in *Anarchy, State, and Utopia*, maintain that nothing may legitimately compel individuals to protect or sacrifice themselves for others, and who argue that distributive justice unjustifiably interferes in people's lives by correcting inequalities at the expense of

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individual rights in the name of society; even those who regard the individual as an end rather than a means of society, who consider justice to be a matter of rights rather than outcomes, who hold that "every person deserves what he gets, unaided by the efforts of others," and who believe that only in this way can the more fortunate and capable cooperate with the less fortunate; even those who contend that the best form of government is one that leaves individuals free to pursue whatever projects and ways of life they choose—a vision that undoubtedly contains a considerable degree of abstraction—would find it difficult to deny that even the ideal of a minimal State requires not only that the State itself respect individual liberty to an unprecedented degree, but also that citizens respect the liberty of others to a similarly high degree.

Yet such a project, however libertarian and intellectually respectable, appears to be utopian. The formation of individuals capable of sustaining such a social order presupposes the existence of an extensive and effective system of civic education. In other words, the very functioning of a minimal State would seem to depend upon cultural and educational conditions that cannot arise spontaneously, but require institutions capable of transmitting and reinforcing the norms of cooperation, tolerance, and respect for the rights of others. Paradoxically, therefore, even a radically libertarian society may depend upon forms of collective organization and public action that are difficult to reconcile with a purely minimal conception of the State.

The 2008 financial crisis, if further evidence were needed, demonstrated the limitations of the view that it is sufficient merely to leave individuals free to pursue their own life projects, as though they were so many Robinson Crusoes living in isolation from their social and economic context. The rescue of AIG was justified precisely because of the systemic consequences that its collapse would have produced: the fire would not have consumed only AIG itself. While the managers of Lehman Brothers or AIG may have deserved moral or other forms of sanction, many others certainly did not. Yet the vicious cycle of deleveraging affects the innocent as well as the guilty; ultimately, it affects everyone.

A financial institution under pressure attempts to sell its assets in order to obtain liquidity. Because these assets must be sold quickly, they are often disposed of at substantial discounts. Contagion arises because other financial institutions hold similar assets, whose market prices decline as a result of these "fire sales". Falling prices trigger a destructive spiral. The decline in asset values damages the balance sheets of other institutions, inducing their creditors to curtail lending. Those institutions, in turn, are forced to liquidate their own assets in order to obtain cash, thereby further depressing prices.

During the 2008 crisis, prices also collapsed for corporate bonds and securities backed by student loans. Students who had merely borrowed money to finance their education became indirect victims of the Lehman collapse. The TED spread—the difference between the interest rate on three-month interbank loans and the interest rate on three-month United States Treasury bills, regarded as risk-free securities—increased from its normal level of approximately 0.25 per cent to 4.58 per cent. The TED spread measures the risk banks perceive in lending to other banks and is therefore a widely used indicator of confidence within the financial system.

The truth is that, in today's world, reality appears closer to the reflections of the Italian politician Giovanni Amendola than to the libertarian philosophy of Robert Nozick. Following the First World War, Amendola wrote:

"*The old bourgeois society, upon which history passed its relentless judgment in August 1914, was founded upon the dogma of individualism, the cornerstone upon which rested the particularism of individuals, classes, and states, and the resulting anarchy of private interests and international relations*".

He further observed:

"*The war has enlightened us. The individual possesses no absolute rights against tradition and society, because tradition and society themselves largely contribute to his formation. Consequently, the autonomy of the individual, upon which civil liberty is founded, does not absolve him of his responsibilities towards the past, the present, and the future of the society in which he lives; rather, it renders those responsibilities more precise and more imperative*".

Accordingly, Amendola advocated a form of communitarian and solidaristic liberalism. Within this framework, while fully respecting private property as a fundamental social institution, he maintained that property rights should not be exercised against society itself. Society, in turn, should be able to supervise private interests whenever their unrestrained pursuit threatens the common good. Individuals should be required to take account of the bonds of solidarity that unite them, because the actions of each person are never isolated but inevitably affect all others, either positively or negatively.[23]

In this respect, Warren Buffett was perhaps correct when he remarked that his principal talent was the allocation of capital—and little else. Yet the possibility of exercising that talent depended entirely upon the society into which he was born. Had he been born into a hunter-gatherer tribe; his particular abilities would likely have had little value. As Buffett himself observed, society "values my talent, gave me a good education to develop it, and created laws and a financial system that allowed me to do what I enjoy doing. I have made a great deal of money as a result. The least I can do is contribute towards paying for all that".

This argument has often been invoked in response to the views of economist N. Gregory Mankiw. It highlights the fact that the socio-economic environment influences not only the outcome of individual effort but also the level of effort itself. Individuals are not solely responsible for the fact that society may assign a low value to a particular talent they possess. Moreover, personal effort itself may partly depend upon factors lying beyond the individual's control and independent of personal merit.

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Mankiw, drawing upon assumptions that ultimately trace back to John Locke, argues that it is just for individuals to enjoy the income generated by their own productive efforts. He maintains that, in the absence of market failures—that is, distortions preventing the economy from functioning efficiently—each factor of production receives an income equal to its marginal productivity. Income therefore corresponds to the contribution made to the economic system and reflects individual ability. From this perspective, income tax rates should never become excessively high, not only because of the behavioral response of high earners, but also because such taxation would be unjust, amounting to an expropriation of those whose efforts have generated substantial wealth.

According to this view, if inequality increases because individuals exploit monopoly rents, privileged positions, or political favors, high incomes lack moral justification. If, however, inequality increases because markets reward talent, education, skill, or merit without reliance on privilege or political influence, then high incomes are justified and progressive taxation becomes difficult to defend.

Opponents of this position respond that market income often depends upon numerous factors outside the control of those who earn it. Consumer preferences, the legal protection of property rights, and the prevailing level of technological development all play a decisive role. Many celebrated football players, for example, would likely have remained impoverished manual workers in the nineteenth century. Similarly, a decline in the income of a particular category of workers may result not from diminished merit, but from changing consumer preferences or broader social and technological transformations.

My general approach is inspired, on the one hand, by the belief that aggregate demand may at times prove insufficient; that it is not always true that every decision to save necessarily implies a corresponding decision to invest; and that the so-called Say's Law must therefore be reconsidered. On the other hand, it is based on the view that economic theory cannot be regarded as universally valid and equally applicable across different historical periods characterised by profoundly different social structures.

Furthermore, in order to understand how an economic system functions, it is not always useful to begin at the level of the individual consumer or the individual firm, as though human nature and human behavior existed prior to cultural formation. Human nature and behavior cannot be understood as antecedent to culture, as is demonstrated even by the social organization of so-called primitive societies. Human conduct is not predetermined independently of culture and society. Consequently, any genuine understanding of the economic system must also incorporate a historical perspective.

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114. **Thaler, R.H. (2018).** *Misbehaving: The Making of Behavioral Economics*. **Einaudi.**
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[i] *F. Carbone, La Scuola Austriaca di Economia. Lezioni del professor Jesús Huerta de Soto liberamente trascritte e rielaborate, Usemlab, 2012; Jesús Huerta de Soto, Moneta, Credito Bancario e Cicli Economici, Rubbettino, 2012; Yanek Wasserman, I rivoluzionari marginalisti: come gli economisti austriaci vinsero la battaglia delle idee, Neri Pozza, 2019; G. Piombini and G. Gagliano, Riscoprire la Scuola Austriaca di Economia. La sfida di Mises, Hayek e Rothbard a Marx e Keynes, GoWare–Leonardo Facco Editore, 2018; E. Butler, La Scuola Austriaca di Economia. Un'introduzione, IBL Libri, 2014; P. Monsurrò, Introduzione alla Scuola Austriaca di Economia. Menger, Böhm-Bawerk, Mises, Hayek, Rothbard e altri, GoWare–Leonardo Facco Editore, 2017; Victoria Chick, "The Evolution of the Banking System and the Theory of Monetary Policy", in S. F. Frowen (ed.), Monetary Theory and Monetary Policy: New Trends for the 1990s, Macmillan, London, pp. 79–92; John Maynard Keynes, The General Theory of Employment, Interest and Money, annotated edition edited by Giorgio La Malfa, Mondadori.*

*With regard to price formation, in addition to the considerations advanced by Huerta de Soto and Keynes, reference should be made to the Post-Keynesian literature, which maintains that wage flexibility is neither sufficient nor effective in itself. From a historical perspective, the persistence of poverty despite employment and the phenomenon of subsistence wages are discussed in Jean-Paul Bertaud, La vita quotidiana in Francia ai tempi della Rivoluzione, Gedi News Network/Rizzoli, 2024, pp. 54 ff.*

*See also Deirdre Nansen McCloskey, Humanomics: Why the Future of Economics Is a Human Science, Luiss University Press, 2023; and Deirdre Nansen McCloskey and Art Carden, La Grande Ricchezza. Come libertà e innovazione hanno reso il mondo migliore, with a postscript by Paolo Silvestri, Luiss University Press, 2021. The authors argue that the "Great Enrichment" experienced in the North Atlantic world since the early nineteenth century was the result of human liberty, ideas, and a conception of human dignity that accorded greater social esteem to the middle classes. In their view, it was not primarily the product of coercion, science, investment, or savings alone. The approximately 3,000 per cent increase in prosperity experienced in certain parts of the world was ultimately the consequence of ideas and human freedom.*

*Similarly, in Il liberalismo funziona. Come gli autentici valori liberali rendono il mondo più libero, equo e prospero per tutti (IBL Libri, 2023, pp. 182 ff.), McCloskey argues that ideas, innovation, and what she terms "innovism" played a greater role in generating the Great Enrichment than either investment or saving alone. She also criticizes the egalitarian conclusions of Thomas Piketty (pp. 232 ff.), emphasizing the importance of human capital and of the "Bourgeois Deal", which, in her estimation, increased prosperity by approximately 1,900 per cent. This interpretation is broadly consistent with the historical data assembled by Angus Maddison in The World Economy from Year 1 to 2030 (Pantarei, 2008, pp. 71 ff.) and, above all, The World Economy: A Millennial Perspective (Giuffrè, 2005, pp. 19, 53–55).*

*Maddison notes that while per capita income grew only slowly between the years 1000 and 1820, after 1820 it increased more rapidly than population growth and by 1998 was approximately 8.5 times higher than in 1820. Unlike McCloskey, however, he also stresses the importance of the state, citing examples ranging from public investment in the Venetian Arsenal and Portuguese navigation systems to legislative and governmental interventions, including state support for research in Britain and the mercantilist restrictions imposed on colonial trade during the eighteenth century.*

*McCloskey also highlights the importance of economic growth in improving the historical condition of the poor and*

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*challenges Piketty's assumption that r (the rate of return on capital) is systematically greater than g (the rate of growth of income and output). While such situations have occurred, she argues that they are neither universal nor adequately account for human capital or for the diverse growth experiences observed across different regions of the world. See also pp. 436–443 on the effects of technological change on employment. Liberal authors further emphasize the dramatic reduction in absolute poverty and the greatly increased access to goods enjoyed by even the poorest social groups (see Deirdre McCloskey, I peccati dell'economia, Istituto Liberale, Turin, 2020).*

*An indirect response may be found in Stefano Petrucciani's discussion of Marx. Petrucciani observes that social satisfactions are inherently relative. The fact that workers have access to a greater quantity of goods does not necessarily mean that they are better off. Drawing on well-known passages from Marx, he argues that the relevant issue is not whether the worker's share has increased in absolute terms, but rather how that share compares with that of the capitalist class. The central concern is therefore relative rather than absolute poverty (Stefano Petrucciani, Marx in dieci parole, Carocci, 2020, pp. 158–160).*

*Yet the notion of relativity may extend beyond poverty and income. Relative development also matters. In the mid-eighteenth century, the Netherlands was far richer in absolute terms than it had been a century earlier, yet it was considerably less powerful because neighboring France and Britain had advanced even further. Likewise, France in 1914 was more powerful in absolute terms than it had been in 1850, but this was of limited consolation in the face of a much stronger Germany. Modern Britain possesses greater wealth and military capabilities than during the Victorian era, yet its share of world output has fallen from approximately 25 per cent to around 3 per cent.*

*The importance of relative comparisons extends beyond economics into everyday life. Melanie Klein's essay Envy and Gratitude (1957) provides an illuminating illustration. She recounts the parable of a man who envied his neighbor. A fairy offered to grant him any wish on the condition that his neighbor would receive twice as much. After some reflection, the man replied: "Then take out one of my eyes." A market liberal might instead have wished for one million euros, thereby increasing both his own wealth and total wealth. Would a socialist have responded differently because being worse off than his neighbor would still be intolerable? The example highlights the enduring importance of relative comparisons in human behavior.*

*Finally, wage levels and employment rates are not always reliable indicators of living standards or well-being. The pioneer of real wage analysis, Thorold Rogers (1823–1890), Professor of Economics at Oxford and Liberal Member of Parliament, distinguished between wage income and national income. As cited by Maddison, Rogers observed that "society may make substantial progress in health while wages remain low" (Angus Maddison, The World Economy from Year 1 to 2030: A Quantitative and Macroeconomic Profile, Pantarei, 2008, p. 361). By extension, even in the contemporary world, high wages or low unemployment may be of limited value if healthcare systems fail to provide adequate treatment. Under such circumstances, individuals might paradoxically be better off with lower wages combined with universal and effective healthcare provision than with higher wages and inadequate access to essential medical services.*

*For the development of the common law, see A. Gambaro and R. Sacco, Sistemi Giuridici Comparati, Utet, 2000, pp. 74–75. For the Keynes–Hayek debate, see N. Wapshott, Keynes o Hayek. Lo scontro che ha definito l'economia moderna, Feltrinelli, 2015.*

*[2] John Maynard Keynes, La riforma monetaria, Mondadori, 2024, p. 33, where Giorgio La Malfa's introduction also refers to Keynes's well-known distinction between the short and the long run. At p. 66 of the same work, after setting out the quantity theory of money and acknowledging that it is probably valid in the long run, Keynes formulates a maxim that should be borne in mind when assessing the political implications of economic theories: "But this long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." One might argue that this observation is relevant not only in exceptional circumstances but in economic policymaking more generally. See also the original formulation in John Maynard Keynes, A Tract on Monetary Reform (1923), in The Collected Writings of John Maynard Keynes, Macmillan, 1971, p. 65, from which the celebrated expression "In the long run we are all dead" derives.*

*[3] J. M. Keynes, The General Theory of Employment, Interest and Money, Italian annotated edition edited by Giorgio La Malfa, Mondadori, p. 523.*

*[4] Jesús Huerta de Soto, Moneta, Credito Bancario e Cicli Economici, cited above, pp. 478 ff.; F. Carbone, La Scuola di Economia. Lezioni del professor Jesús Huerta de Soto liberamente trascritte e rielaborate, cited above, pp. 206 ff.*

*[5] P. A. Samuelson and W. D. Nordhaus, Economics, McGraw-Hill, 1986. The discussion of the accelerator principle cited here was subsequently removed from later editions of the textbook, beginning with the 1992 edition.*

*[6] Anna Maria Carabelli, John Maynard Keynes: il ragionamento economico. Complessità, incertezza, felicità, dilemmi tragici, Carocci, 2024, pp. 11, 22, 85.*

*[7] Julia Cagé and Thomas Piketty, A History of Political Conflict: Elections and Social Inequalities in France, 1789–2022, La Nave di Teseo, 2024, pp. 733–736: "With hindsight, most observers agree on one point: these rigid, poorly calibrated, and ill-timed fiscal policies merely contributed to stalling the European recovery and caused a second recession in the euro area in 2011–2012, one that was entirely unnecessary and avoidable, whereas the United States, thanks to its pragmatism, continued its recovery efforts and*

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*ultimately emerged from the crisis—which it had, moreover, helped to cause—much sooner than Europe."*

*If the bankers and central bankers of the 1930s, shaped by liberal orthodoxy and by the myth of a return to the pre-1914 gold standard, allowed the financial system and the economy as a whole to collapse, their twenty-first-century successors did not repeat the same mistakes. This was largely because the crisis was addressed pragmatically, particularly in the United States. The Federal Reserve provided liquidity on a massive scale to ensure the solvency of banks and insurance companies and to finance the State, even going so far as temporarily to nationalize General Motors. As a result, by 2010 the engine of the American economy had already begun to restart.*

*The European response was markedly different. The euro had been introduced only a decade earlier, and in the initial phase a less interventionist approach prevailed. In particular, Jean-Claude Trichet's decision not to guarantee the totality of euro-area sovereign debt—especially Greek public debt, which in any event represented only a limited proportion of the overall stock of eurozone debt—reflected a more restrictive policy stance.*

*Mario Draghi's whatever it takes approach was subsequently criticized on the grounds that it amounted to a socialization of losses combined with a privatization of gains, benefiting bankers, shareholders, and economic elites who, according to critics, rarely bear the consequences of their own mistakes. It was argued that substantial public resources should be devoted not only to rescuing financial institutions but also to addressing climate change, public health, and education, particularly at a time when household incomes were being eroded by inflation and labor-market insecurity.*

*Yet, whatever the merits of these criticisms, there remains a broader consideration. Pragmatic policies are often necessary when immediate action is required. When a house is on fire, the priority is to extinguish the flames. Otherwise, the fire may spread and consume the entire city, producing damages far greater than those associated with the emergency measures adopted to contain it. Indeed, a systemic collapse would not resolve problems relating to health care, education, inequality, or declining real incomes; on the contrary, it would almost certainly exacerbate them.*

*The episode therefore illustrates a broader point relevant to the present discussion. Economic policy is often forced to choose between theoretical purity and practical necessity. In moments of crisis, governments and central banks frequently act not according to ideal models but according to what appears necessary to preserve the functioning of the economic system as a whole. Whether such interventions are desirable in the long run remains open to debate. What is less controversial is that, in the midst of a systemic crisis, the failure to act may generate political, social, and economic consequences that are considerably more severe than those associated with intervention itself.*

[8] *Julia Cagé and Thomas Piketty, A History of Political Conflict: Elections and Social Inequalities in France, 1789–2022, cited above, pp. 872 ff.*

[9] *O. Blanchard and D. Leigh, "Growth Forecast Errors and Fiscal Multipliers", IMF Working Paper 13/1; M. Kumhof and R. Rancière, Inequality, Leverage and Crises, IMF Working Paper 268.*

[10] *J.M. Keynes, The Collected Writings of John Maynard Keynes, Vol. XIII, The General Theory and After: Part I – Preparation, edited by E. Johnson and D.E. Moggridge, London: Macmillan.*

[11] *J.M. Keynes, The Collected Writings of John Maynard Keynes, Vol. XIV, The General Theory and After: Part II – Defense and Development, edited by E. Johnson and D.E. Moggridge, London: Macmillan.*

[12] *J.M. Keynes, The Collected Writings of John Maynard Keynes, Vol. VII, The General Theory of Employment, Interest and Money, edited by E. Johnson and D.E. Moggridge, London: Macmillan.*

[13] *J.M. Keynes, The Collected Writings of John Maynard Keynes, Vol. VII, The General Theory of Employment, Interest and Money, edited by E. Johnson and D.E. Moggridge, London: Macmillan.*

[14] *R.E. Backhouse and B.W. Bateman, "Keynes and the Welfare State", History of Economic Thought and Policy, Vol. 1, No. 1 (2012), pp. 7–19. Available at: https://doi.org/10.3280/SPE2012-00100.*

[15] *J.M. Keynes, The Collected Writings of John Maynard Keynes, Vol. XXVI, Activities 1941–1946: Shaping the Post-War World: Bretton Woods and Reparations, edited by E. Johnson and D.E. Moggridge, London: Macmillan, 1980.*

[16] *"With a stroke of the legislator's pen, entire libraries become waste paper," runs the famous aphorism coined by Kirchmann in the mid-nineteenth century. Hart's essay was republished in A. Schiavello and V. Veluzzi (eds.), Contemporary Legal Positivism: An Anthology, Turin: Giappichelli, 2005, pp. 229–248. See also, more generally, Brian H. Bix, Jurisprudence: Theory and Context, Turin: Giappichelli, 2016; S. Petrucciani, Democracy, Turin: Piccola Biblioteca Einaudi, 2014; R. A. Kagan, Adversarial Legalism: The American Way of Law, Bologna: Il Mulino, 2009, pp. 65–79, 89–123, 417; M. J. Horwitz, The Transformation of American Law, 1870–1960, Bologna: Il Mulino, 2004; G. D'Amico, "Il giudice e la legge", I Contratti: Bimonthly Review of Doctrine, Case Law and Contractual Practice, No. 6/2024, Ipsoa; M. Barcellona, "Il diritto neoliberale dell'economia globalizzata e della società liquida", Europa e Diritto Privato, 2020, p. 757.*

*The empirical reality—remaining within the field of private law, where political controversy is less virulent but where the adverse consequences for the economy and business may be greater—is that described by two distinguished civil law scholars in what has been termed the "eclipse of private law": is judicial intervention excessively intrusive and liable to unduly restrict the contractual autonomy of the parties? Eminent jurists have provided the following answers:*

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*G. B. Ferri, in Autonomia privata e poteri del giudice (Diritto e Giurisprudenza, 2004, especially pp. 8 ff.), criticizes in particular the excessively functionalist philosophy according to which— in the author's view—there ultimately exists a judicial power to modify contractual arrangements in order to realize an "objective interest of the legal system".*

*P. Schlesinger, in L'autonomia privata e i suoi limiti (Giurisprudenza Italiana, 1999, p. 231), states that "as a matter of principle [...] the judge cannot 'put his feet in the dish' and alter by fiat the terms of an exchange, even where this is done in pursuit of the substantive 'fairness' of the transaction".*

*The value of legal certainty is also an economic value. Contrary to certain Gadamerian fashions, if a society is to achieve both social cohesion and economic efficiency, predictability and reliance upon legal decisions are essential. Hence Max Weber referred to the "need for calculability and reliability in the functioning of the legal order and public administration" as a "vital requirement of modern capitalism".*
*Natalino Irti emphasizes that calculability may be pursued through deciding according to statute, according to precedent, according to facts, or according to values. The Italian Constitution, however, has chosen adjudication according to law as the primary guarantee for all citizens, thereby "making calculability possible" and protecting "our freedom of action, since freedom consists in knowing what consequences one may expect".*

*The choice between deciding according to legislation and deciding according to precedent—which may appear innocuous and is common in other legal systems—is not merely a doctrinal matter but, as Irti correctly argues, a question of power: whether we live in a State governed by laws or move towards a State governed by judges.*

*As Paul Koschaker observed, "judge-made law is the work of jurists, but it develops where the political center of the State is located".*
*The primary criterion of interpretation is therefore the literal interpretation of statutory provisions. The second criterion, subordinate to the first, is teleological interpretation, namely the search for legislative intent, as reflected in Article 12 of the Preliminary Provisions to the Italian Civil Code.*
*This issue has clear political implications. Indeed:*

*"Teleological interpretation is admissible only where there is a manifest contradiction between the literal meaning conveyed by the words, according to their connection, and the legal system as a whole. It is not admissible where the literal meaning merely fails to satisfy expectations concerning the protection of certain interests deemed worthy of protection on the basis of socially perceived needs. A legal provision cannot be attributed a broader meaning than that legitimately derivable from its literal interpretation merely for the purpose of extending its scope in response to interests regarded as predominant. Such a function belongs properly to the legislative act, which is free in its objectives insofar as it expresses popular sovereignty through the institution of political representation embodied in legislative assemblies."*
*Admittedly, this approach has not been consistently embraced in recent case law.*
*See A. Carleo (ed.), Legal Calculability, Bologna: Il Mulino, 2017, which highlights the relationship between the predictability of judicial decisions, legal certainty and economic activity, treating predictability as an economic value and both certainty and predictability as constitutional values. See also R. Guastini, Syntax of Law, 2nd ed., Turin: Giappichelli, 2014, pp. 383, 408, 412; R. Guastini, Philosophy of Positive Law, Turin: Giappichelli, 2017, p. 220 (on constitutional over-interpretation as an increasingly widespread practice), p. 228 (on interpretation in conformity with the Constitution and the constitutionalizing of the legal order), p. 356 (on the application of constitutional principles), and p. 383 (on judicial interpretation and the creation of law); R. Guastini, The Interpretation of Normative Documents, Milan: Giuffrè, 2004, pp. 35, 49–61, 259–266; G. Tarello, The Interpretation of Statutes, Milan: Giuffrè, 1980, pp. 39–153; G. Tarello, "Legal Realism", Novissimo Digesto Italiano, Vol. XIV, Turin: UTET, 1968, pp. 923–933; G. Tarello, American Legal Realism, Milan: Giuffrè, 1962; G. Tarello, Law, Statements and Practices: Studies in Legal Theory and Meta-Theory, Bologna: Il Mulino, 1974; Conti, Di Lizia, Ferrajoli and Jori, Philosophy of Law, 2nd ed., Milan: Raffaello Cortina Editore, 2013, p. 487; G. Tarello, Omaggio a Carlizzi. Ermeneutica e interpretazione giuridica, Turin: Giappichelli, 2010.*

*[17] John Rawls, Lectures on the History of Political Philosophy, Milan: Feltrinelli, 2012, p. 38, for a reconstruction of a possible interpretation of Hobbes's social contract. See also Nicola Matteucci, The Modern State, Bologna: Il Mulino, 2011, p. 22, who argues that with the emergence of the State there occurred a secularization of political culture and, following the disintegration of medieval ethics, ethics retreated into the sphere of individual private life. At the same time, the rise of the territorial State fostered trade and the rapid expansion of markets from the city level to the national and international spheres:*
*"This economic development had deep roots. Despite recurrent crises, that great transformation which was to separate Europe—once a barbarian land—from the other continents, now comparatively underdeveloped in relation to it, found in the State and in raison d'état its strongest support and its political defense against incursions from non-European powers. The modernization of Europe ultimately depended upon the growth of the State."*

*[18] John Rawls, Lectures on the History of Political Philosophy, Milan: Feltrinelli, 2012, p. 37. According to Rawls (p. 61), Hobbes further maintains that there are laws of nature in the state of nature inspired by reasonable principles and grounded in mutual cooperation. It is rational for individuals to comply with them, provided that everyone else does so as well. Consequently, the state of nature becomes a condition of mutual warfare only when individuals choose not to follow those reasonable principles, thereby making it*

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*irrational for others to comply with them. The state of nature is therefore not, in itself, a state of war.*

*The purpose of the sovereign—today, one might add, of the liberal-democratic State—is to ensure, as Hobbes himself argued, albeit in a very different historical context, that "others (in sufficient numbers) comply with them [the reasonable principles of cooperation], thereby making it rational for each person to comply as well." The sovereign, according to Hobbes—or, in contemporary terms, the liberal-democratic State—"provides everyone with the assurance that the laws of nature will be enforced" (p. 79).*

*Rawls also notes that Hobbes maintains that even if the sovereign were to enact bad laws—and indeed possesses the authority to do so, since subjects have relinquished the right to challenge the sovereign's discretion—"his bad laws are never as bad as the state of war" (p. 92).*

*[19] J. S. Mill, On Liberty, Milan, 1981, p. 20.*

*[20] Rodrik (see D. Rodrik, The Globalization Paradox, Laterza, 2015) has argued that hyper-globalization, democracy and national sovereignty are ultimately incompatible. First, if all restrictions on capital movements are removed, democracy and national sovereignty cannot be fully preserved; at the very least, they may come into conflict with the unrestricted freedom of capital mobility. Second, if a legislative measure—or, more generally, a policy arising from a democratic or political process—is adopted which financial markets disapprove of, capital may leave the country. Third, if capital flight occurs, interest rates must often be raised in order to retain capital by offering higher returns to savers and, where possible, attracting additional savings from abroad. Fourth, such policies frequently contribute to recession, since capital may continue to leave despite higher interest rates, while the increased cost of borrowing raises financing costs for businesses. In a world of unrestricted capital mobility, markets can therefore hold governments hostage.*

*Indeed, under the Bretton Woods system, restrictions on capital movements were permissible.*

*With regard to equality of opportunity, one may ask whether individuals are genuinely concerned with fairness and whether they value it as an absolute principle. A number of experiments suggest that people do attach importance to fairness, but only up to a certain point. In practice, fairness appears to matter less than public rhetoric often suggests. Individuals are willing to punish unfair offers when the personal cost of doing so is low, but become significantly less willing when the cost increases. Once the cost becomes sufficiently high, concerns for fairness tend to take second place.*

*Does fairness really matter? A well-known economic experiment—the **Ultimatum Game**—provides a useful framework for exploring this question. In the game, one participant (the proposer) makes a "take-it-or-leave-it" offer, while the other participant (the responder) must either accept or reject it. Many real-world economic decisions resemble this structure: a monopolist setting prices, an oligopolist proposing a collusive arrangement, or any negotiation in which one party presents a non-negotiable offer.*

*In many Ultimatum Game experiments, responders reject offers perceived as unfair, even though doing so leaves both parties with nothing. At first glance, this might suggest that people genuinely care about fairness. However, less is known about whether such preferences persist when the stakes become substantially larger. Standard economic theory predicts that individuals will demand fairness more strongly when the personal cost of punishment is low.*

*Since the 1980s, the Ultimatum Game has become one of the most widely used laboratory experiments in economics. It has been conducted with participants ranging from university students to indigenous communities in Peru. In some studies, participants' brain activity was monitored during play. The results generally show that proposers offer approximately 40 per cent of the available sum, while responders reject around 16 per cent of offers. Low offers are rejected significantly more often than generous ones.*

*Yet rejecting a positive offer entails a monetary cost. If behavior changes as that cost increases, the issue acquires considerable economic significance. Individuals may be willing to reject unfair offers when the amount at stake is small, but far less willing when substantial sums are involved. Many people might reject an offer of 1 per cent of ten dollars, but relatively few would reject 1 per cent of one million dollars.*

*To investigate this issue, researchers conducted Ultimatum Game experiments in poor villages in India, where substantial incentives could be offered without becoming prohibitively expensive for the researchers. The stakes were varied by a factor of one thousand, ranging from 20 to 20,000 rupees. At the time, these amounts corresponded approximately to US$0.41, US$4.10, US$41 and US$410 respectively, while the average daily income in these villages was around 100 rupees (approximately US$2.05).*

*The results showed that when the stakes were low, proposers tended to make more generous offers. When the stakes were high, proposers recognized that responders would find it more difficult to reject an unfair offer. In the highest-stakes treatment (20,000 rupees), the average offer was only slightly above 10 per cent of the total amount available.*

*What happened to these very low offers when the stakes became substantial? Were they rejected? The evidence suggests otherwise. Although participants frequently rejected low offers when the sums involved were small, very few did so when the amounts became significant. In the 20,000-rupee treatment, for example, only one out of twenty-four offers below 20 per cent was rejected. This rejection rate was dramatically lower than the 40–50 per cent rejection rates observed when the stakes were much smaller.*

*These findings cast doubt on the proposition that fairness is regarded as an absolute value. This observation is also relevant to broader debates concerning equality and inequality of opportunity, as well as equality of outcomes.*

*Consider a society divided equally between two groups: the rich and the poor. Imagine two possible scenarios. In the first, the rich earn US$50,000 per capita while the poor earn*

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*US$1,000. In the second, the rich earn US$5,000 while the poor earn US$500.*
*In which society would one prefer to live?*
*If the only concern is average income, the answer is straightforward. In the first scenario, average income is US$25,500; in the second, it is only US$2,750. The first society is clearly preferable.*

*If, however, one is concerned exclusively with distributive fairness, the conclusion changes. In the first scenario, the ratio of rich to poor income is 50:1, whereas in the second it is only 10:1. On this basis, the second society appears more equitable.*
*Yet it is also substantially poorer. Although inequality is lower, poverty is greater. In the first scenario, despite the wider income gap, the poor are materially better off than in the second. Confusing inequality with poverty is therefore a serious analytical mistake. Greater equality does not necessarily imply less poverty, nor does greater inequality necessarily imply greater poverty.*
*(….)*
*See K. Arrow, Social Choice and Individual Values, Milan: Etas, 2003; P. Krugman, R. Wells and K. Graddy, Essentials of Economics, cited above, p. 260; M. Magrini, "L'habitat dei geni teenager", Il Sole 24 Ore, 19 May 2013, Nova section; J. E. Stiglitz, The Price of Inequality, Turin: Einaudi, pp. 113–114; National Center for Education Statistics, The Condition of Education, 2003, p. 47, cited in P. Krugman and R. Wells, Microeconomics, Bologna: Zanichelli, 2013, pp. 477–479; J. E. Stiglitz, The Price of Inequality: How Today's Divided Society Endangers Our Future, Turin: Einaudi, 2013, pp. 45–46, 55, 113, 114 and 121; D. Acemoglu, D. Laibson and J. A. List, Principles of Economics: Theory and Evidence, 2nd ed., Pearson, 2020, pp. 492–495 and 593; Steffen Andersen, Seda Ertaç, Uri Gneezy, Moshe Hoffman and John A. List, "Stakes Matter in Ultimatum Games", American Economic Review, 101(7), 2011, pp. 3427–3439.*

*Beyond the Ultimatum Game evidence, which suggests that fairness may not be regarded as an absolute value, a significant debate developed in the United States concerning equality of opportunity. One side of this debate was represented by Professor* ***N. Gregory Mankiw****, who defended the economic position of the top one per cent of earners, while the other was represented by Nobel laureate* ***Robert Solow****.*
*The debate forms part of the broader question of how a tax system should balance efficiency and equity. Mankiw asks readers to imagine a society characterised by perfect economic equality. One day, however, an entrepreneur develops a revolutionary product—perhaps like Steve Jobs with the iPod, J. K. Rowling with Harry Potter, or Steven Spielberg with his films. The innovation makes the entrepreneur vastly richer than everyone else.*

*How should public policy respond? Should the existing framework remain unchanged because the entrepreneur has improved social welfare? Or should government intervene through taxation and redistribution in order to reduce the resulting inequality?*

*According to Mankiw, this thought experiment captures what occurred in the United States in recent decades: average incomes increased, but the gains were distributed unevenly. In his article Defending the One Percent, he suggested—implicitly rather than explicitly—that many of the super-rich are socially valuable innovators whose contributions generate substantial benefits for society.*
*Critics, however, found this argument unconvincing. Robert Solow observed that the top one per cent are already well placed to defend their own interests and therefore require little external assistance. He challenged the assumption that most extremely high incomes derive from socially productive innovation, pointing out that a significant share of such incomes originates in the financial sector. As Solow remarked, while he could accept the term "innovation", he was far less willing to accept that many of these innovations were socially productive.*
*See E. Granaglia, Equality of Opportunity: Yes, But Which Equality?, Laterza, 2023, which appropriately examines the concept of equality of opportunity and the ease with which it may be conflated with equality of outcomes or with simple egalitarianism.*

[21] *Pericles, Funeral Oration to the Athenians, 431 BC. Adapted from* ***Thucydides, History of the Peloponnesian War****, Book II, 34–36.*

[22] *Daniela Felisini, in Tommaso Fanfani (ed.), Economic History, Milan: McGraw-Hill, 2010, pp. 249 ff., 258, 260 and 271.*

[23] *G. Bedeschi, The Factory of Ideologies: Political Thought in Twentieth-Century Italy, Rome-Bari: Laterza, 2002, p. 146, discussing and reproducing the quotations from Amendola.*

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