

# The current economic crisis: A solution that “lies buried and obscured in a mass of false theory”

VoxEU Debate: [Institutional reform](#),<sup>1</sup> a [Global Crisis Debate](#)<sup>2</sup>

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When we want that economic policy is effective towards recovery then it must be based upon the right theory. A doctor without the proper diagnosis is at risk of giving the wrong treatment. Hapsnap ways, muddling through, unreliable forecasts, international bickering, are a recipe for a prolonged recession. Sound theory is key for recovery. Recovery will be greatly helped when the true diagnosis, treatment and prognosis can be explained and understood in clear manner that will be convincing to the general population.

A. Loveday, director of the Financial Section and Economic Intelligence Service of the United Nations, wrote, in his 1936 Preface to Gottfried Haberler (1946) “Prosperity and depression”:

*“It is apparent from the persistence with which depressions occur, from the gravity of their economic and social effects, and from the growing consciousness of that gravity, that – however abundant the literature on the subject, however elaborate and specious the theories – our knowledge of the causes of depressions has not yet reached a stage at which measures can be designed to avert them. This failure of society to control its own destinies may be due to one of three causes. It may be due to the fact that the causal relationship of events has not up to the present been ascertained; it may be due to the fact that, although the truth has been discovered and stated, it lies buried and obscured in a mass of false theory; finally it may be due to the fact that, although the truth is known and recognised, depressions are as inevitable a phenomenon of our present economic structure as famines were of a more primitive economy which lacked means of transport and storage.”* Loveday (1936)

For the current economic crisis the second case holds: although the truth has been discovered and stated, it lies buried and obscured in a mass of false theory.

## What is at stake

This Fall, the authorities have prevented the collapse of the financial system but they have not dealt fully with the consequences for the economy as a whole. Modern economic relations are very tight, with “just in time” logistics, “24 hour a day” service, flexible / temporary employment, etcetera. It is no surprise that what many called the “credit crunch” actually is the severe crisis that many recognize only now. It can get much worse very quickly. Leijonhufvud (2009) states for good reason: “Instead, we are threatened by a veritable disaster.”

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<sup>1</sup> <https://web.archive.org/web/20100613060001/http://voxeu.org/index.php?q=node/2837>

<sup>2</sup> <https://web.archive.org/web/20100613060001/http://voxeu.org/index.php?q=node/2824>

<sup>3</sup> <https://web.archive.org/web/20100613060001/http://voxeu.org/index.php?q=node/3087>

Last September, Colignatus (2008) already pointed to various competing theories and suggested that all theories failed except Colignatus (1990, 1992, 2005). Unfortunately this suggestion was not taken up and six precious months have been lost. Colignatus (2009) provides an additional suggestion for dealing with the situation six months later. The latter suggestion however should not distract from the fundamental proposition.

1. The true crisis concerns our system of democracy, with the separation of powers in the Executive, Legislative and Judicial branches. This arrangement allows insufficient breathing space for independent economic science. Advisable is an Economic Supreme Court (ESC) with the power to veto a budget when it contains inadequate information (according to the ESC). See Colignatus (2005) for the most recent arguments and a draft Constitutional Amendment for an ESC open to the scientific community. Parliaments around the globe are advised to have their own Parliamentary Enquiries on this.
2. When countries each adopt their own ESC then those national ESCs can provide a base of scientific co-ordination for national policy making.
3. The standard example argument supporting the conclusion for the ESC concerns unemployment. It can be shown how full employment can be restored in a neutral way with respect to inflation or deflation. See Colignatus (2005) for the required concepts of the tax void, the dynamic marginal rate and the implications for the Phillipscurve and NAIRU. Obviously, the standard percolation processes from science to policy from 1990 to the present day have not succeeded in the resolution of unemployment while the theory was available.
4. The current economic crisis may be added as another piece of evidence supporting the argument for an ESC. The crisis is actually wider than just this economic crisis. It would not do to think that only information with respect to the “credit crunch” would have been blocked by the current imbalance of powers and that all other economic scientific information is processed in good order. The reasoning applies as well to the economics of the environmental challenge, world population growth, international defense spending, world poverty, infectious diseases and comparable issues. The case for an ESC is logically sound and imperative from the theory of democracy.

### **A solution from the shelf**

This solution approach for the current economic crisis thus can be taken from the shelf. The values of variables and parameters will have to be adjusted but the logical framework already exists. This should not come as a surprise. The Dutch Central Planning Bureau (1992) study “Scanning the future” on the long run 1990-2015 already contains a wide range of scenario’s, one called “Global Crisis”. The structure is very simple: the US en EU can grow or decline, and this gives  $2 \times 2 = 4$  scenario’s. But when you start wondering about the basic economic mechanisms that cause these processes then the reasoning takes off and you end up with the ESC as the missing link in the required feedback. Hence, Colignatus (1990) is the logical statement, with Colignatus (2005) as an elaboration.

### **The moot point of education**

The moot point is that a solution that has a long shelf life and that has been buried under layers of false theory requires a good deal of re-education on existing views. The true theory agrees with 99% of the false theories but there is a difference of 1% that is crucial. One author may have a different

1% of difference than another author. Society depends upon the willingness of economists to study, read with an open mind, revise their views, re-edit the volumes of "Introduction to Economics" taught at our universities. The existence of "schools of economic thought" would make us skeptic. Let us hope for the best that science can offer. And let us hope that society is willing to take economic scientific advice seriously. As economists, we can only take our example in Jan Tinbergen and then hope for the best.

Thomas Colignatus,  
Samuel van Houten Genootschap

## References

Note: Colignatus is the name of Thomas Cool in science. Some archives may not recognize that name.

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