Keynes offers us the best way to think about the financial crisis

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We are all Keynesians now. When Barack Obama takes office he **will propose a gigantic fiscal stimulus package**. Such packages are being offered by many other governments. Even Germany is being dragged, kicking and screaming, into this race.

The ghost of John Maynard Keynes, the father of macroeconomics, has returned to haunt us. With it has come that of his most interesting disciple, Hyman Minsky. We all now know of the "Minsky moment" – the point at which a financial mania turns into panic.

Like all prophets, Keynes offered ambiguous lessons to his followers. Few still believe in the fiscal fine-tuning that his disciples propounded in the decades after the second world war. But nobody believes in the monetary targeting proposed by his celebrated intellectual adversary, Milton Friedman, either. Now, 62 years after Keynes' death, in another era of financial crisis and threatened economic slump, it is easier for us to understand what remains relevant in his teaching.

I see three broad lessons.

The first, which was taken forward by Minsky, is that we should not take the pretensions of financiers seriously. "A sound banker, alas, is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional way along with his fellows, so that no one can really blame him." Not for him, then, was the notion of "efficient markets".

The second lesson is that the economy cannot be analysed in the same way as an individual business. For an individual company, it makes sense to cut costs. If the world tries to do so, it will merely shrink demand. An individual may not spend all his income. But the world must do so.

The third and most important lesson is that one should not treat the economy as a morality tale. In the 1930s, two opposing ideological visions were on offer: the Austrian; and the socialist. The Austrians – Ludwig von Mises and Friedrich von Hayek – argued that a purging of the excesses of the 1920s was required. Socialists argued that socialism needed to replace failed capitalism, outright. These views were grounded in alternative secular religions: the former in the view that individual self-seeking behaviour guaranteed a stable economic order; the latter in the idea that the identical motivation could lead only to exploitation, instability and crisis.

Keynes's genius – a very English one – was to insist we should approach an economic system not as a morality play but as a technical challenge. He wished to preserve as much liberty as possible, while recognising that the minimum state was unacceptable to a democratic society with an urbanised economy. He wished to preserve a market economy, without believing that laisser faire makes everything for the best in the best of all possible worlds.

This same moralistic debate is with us, once again. Contemporary "liquidationists" insist that a collapse would lead to rebirth of a purified economy. Their leftwing opponents argue that the era of markets is over. And even I wish to see the punishment of financial alchemists who claimed that ever more debt turns economic lead into gold.

Yet Keynes would have insisted that such approaches are foolish. Markets are neither infallible nor dispensable. They are indeed the underpinnings of a productive economy and individual freedom. But they can also go seriously awry and so must be managed with care. The election of Mr Obama surely reflects a desire for just such pragmatism. Neither Ron Paul, the libertarian, nor Ralph Nader, on the left, got anywhere. So the task for this new administration is to lead the US and the world towards a pragmatic resolution of the global economic crisis we all now confront.

The urgent task is to return the world economy to health.

The shorter-term challenge is to sustain aggregate demand, as Keynes would have recommended. Also important will be direct central-bank finance of borrowers. It is evident that much of the load will fall on the US, largely because the Europeans, Japanese and even the Chinese are too inert, too complacent, or too weak. Given the correction of household spending under way in the deficit countries, this period of high government spending is, alas, likely to last for years. At the same time, a big effort must be made to purge the balance sheets of households and the financial system. A debt-for-equity swap is surely going to be necessary.

The longer-term challenge is to force a rebalancing of global demand. Deficit countries cannot be expected to spend their way into bankruptcy, while surplus countries condemn as profligacy the spending from which their exporters benefit so much. In the necessary attempt to reconstruct the global economic order, on which the new administration must focus, this will be a central issue. It is one Keynes himself had in mind when he put forward his ideas for the postwar monetary system at the Bretton Woods conference in 1944.

No less pragmatic must be the attempt to construct a new system of global financial regulation and an approach to monetary policy that curbs credit booms and asset bubbles. As Minsky made clear, no permanent answer exists. But recognition of the systemic frailty of a complex financial system would be a good start.

As was the case in the 1930s, we also have a choice: it is to deal with these challenges co-operatively and pragmatically or let ideological blinkers and selfishness obstruct us. The objective is also clear: to preserve an open and at least reasonably stable world economy that offers opportunity to as much of humanity as possible. We have done a disturbingly poor job of this in recent years. We must do better. We can do so, provided we approach the task in a spirit of humility and pragmatism, shorn of ideological blinkers

As Oscar Wilde might have said, in economics, the truth is rarely pure and never simple. That is, for me, the biggest lesson of this crisis. It is also the one Keynes himself still teaches.

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