2. Introduction

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Most of the essays in this volume were first presented in May 2008 at a conference and celebration held in honor of Jane D'Arista at the Political Economy Research Institute (PERI) at the University of Massachusetts Amherst. The Great Financial Crisis had been emerging since at least the winter of 2007, but the full-blown global emergency that hit with the collapse of Lehman Brothers and AIG had not yet occurred. Still, those at the conference were acutely aware that the world was at an economic conjuncture of historic magnitude and that Jane D'Arista had for years been identifying, analyzing and warning against many of the forces that had led to that very moment.

We did not publish these papers earlier partly because so many of those assembled, including Jane herself, have been in high gear trying to understand and, equally importantly, trying to devise responses to the economic crisis, which has persisted since the May 2008 celebration as the responses of governments in the US and Europe grew ever more perverse. Austerity has become the dominant policy in Europe and to some extent in the US even as unemployment remains criminally high and is rising to emergency levels in parts of Europe. One slight sliver of hope has, ironically, come from the response of some key central banks – much too late and timid, but compared with the collapse of stimulative fiscal policy, very welcome nonetheless. The Federal Reserve, the Bank of England, and, reluctantly and inadequately, the European Central Bank launched more expansionary and experimental responses to the continuing crisis. But as Jane D'Arista repeatedly warned before the crisis, the traditional transmission belt of monetary policy has been highly damaged, if not completely broken, and so recovery-oriented monetary policies have not had nearly as much positive impact as needed, or as many officials expected.

Given the open-ended nature of this crisis and the destructive governmental responses, there is no point in waiting further for this chapter of the crisis to end as, it now seems, that may be a bit like waiting for Godot. So we here present slightly revised and in some cases, slightly updated versions

of the papers presented in Jane's honor, most of them written in areas that Jane has made important contributions to during her long career (see Chapter 1).

We have divided the chapters in this volume into four sections (apart from the introductory material) each reflecting, broadly speaking, an area that Jane has been concerned with in her scholarly and policy endeavors. The first part is focused on "Federal Reserve Policy," which has long been a concern of Jane's. Early in her career she authored a path-breaking history, *Federal Reserve Monetary Policy: 1915–1935* (D'Arista, 1994a), and subsequently has written widely about flaws in the current approach to monetary policy-making as well as the need for institutional and structural changes to make it more effective.

FEDERAL RESERVE POLICY

In Chapter 3, James Galbraith critiques the macroeconomic doctrines of Milton Friedman and the so-called "New Consensus" view of central bank policy, showing how they have been wrong-headed, and in the latter case, totally irrelevant to an understanding of what caused the Great Financial Crisis or what should be done about it. Galbraith contrasts these irrelevant or dangerous views with macroeconomic and financial analyses that can be used to constructively diagnose the crisis and fashion genuine solutions: the work of John Maynard Keynes, John Kenneth Galbraith, Hyman Minsky and Jane D'Arista. Discussing the pathways to a restoration of economic stability and prosperity, Galbraith lays out what he calls the "D'Arista Doctrine":

Elements of the D'Arista Doctrine include the reestablishment of effective quantity control over the extension of money and credit, through the application of reserve requirements to the entire universe of financial institutions and activities, based on assets rather than liabilities, and with repurchase agreements as the primary operating tool of monetary policy. The effective use of differential reserve requirements on assets of different types would give the central bank a powerful new regulatory tool against the concentration of financial investment that is the hallmark of bubbles, while the broad application of reserve requirements would equally extend the lender of last resort function, preventing the concentration of banking power that now characterizes financial crisis.

Galbraith's chapter raises several important questions about Federal Reserve policy that connect to Jane D'Arista's work on the Federal Reserve, especially her seminal research on Federal Reserve policy from 1915 to 1935 (D'Arista, 1994a): Why does the Federal Reserve adopt the policies that it does? How do these policies evolve over time? The other two chapters in

Part II address these two questions using the historical and institutional methodologies well employed by D'Arista in her own work.

Chapter 4 analyzes the development of Federal Reserve monetary policy during the post-World War II era. Martin Wolfson explains its evolution as the outcome of a political struggle among the key class forces – labor, finance capital and non-financial capital – contesting the direction of monetary policy. Wolfson argues that the result of this contest led to a policy of “leaning against the wind,” which tried to keep inflation within limited bounds while also moderating interest rates in order to prevent significant slowdowns in growth. This represented a compromise between non-financial capital, which preferred somewhat higher inflation, and finance capital, which preferred to keep inflation lower. However, the factors shaping policy changed in the early 1980s with the growing prominence of Hyman Minsky’s money-manager capitalists (such as pension funds and other institutional investors) and intensified international competition that constrained the ability of non-financial capitalists to readily raise prices. Under these new conditions financial and industrial capitalists coalesced around a desire for much lower inflation. With labor even less powerful in this period than earlier, an implicit low-inflation target was adopted by the Fed. This remained in place until the financial crisis of 2007 hit.

The key question moving forward is whether the Federal Reserve has now developed a new approach to monetary and financial policy, given its failure to prevent the massive financial crisis of 2007, and its struggles to overcome the destructive aftermath. As Matías Vernengo and Esteban Pérez Caldentey show in Chapter 5, at least some key central bankers made fundamental re-assessments of basic economic doctrine in the 1930s and radically transformed the policies they proposed in light of this reassessment. Following in Jane D'Arista’s footsteps, Vernengo and Pérez Caldentey use original archival material to study the theoretical and policy evolution of Marriner S. Eccles in the United States and Raúl Prebisch in Argentina. As they show, the Great Depression created a need to rethink the principles of central banking, as with economics in general, drawing largely on the Keynesian Revolution. They show that “the role of the monetary authority as a fiscal agent of government and the abandonment of the view of the economy as self-regulated were the central changes in central banking” in the rich countries. Meanwhile, according to Vernengo and Pérez Caldentey, central banks in the periphery tried to insulate themselves from balance of payments crises through the use of capital controls and other measures. As they show, “Marriner S. Eccles, in the United States, and Raúl Prebisch, in Argentina, are paradigmatic examples of those new tendencies of central banking in the 1930s.”

FINANCIAL HISTORY AND INSTITUTIONS

Part II, Financial History and Institutions, reflects a second area of Jane D'Arista's research and interest. Jane's classic study *The Evolution of US Finance: Restructuring Institutions and Markets* (D'Arista, 1994b) focuses on how government policy helps shape these financial institutions and their impacts on income distribution, financial stability and growth, for good or ill.

Robert McCauley's essay (Chapter 6) is a study in the D'Arista mold of the interaction between government policy and US securities firms, a topic obviously of great importance in light of the Great Financial Crisis of 2007 but one which has been largely neglected. McCauley shows the myriad ways in which the Federal Reserve and other government-connected institutions helped to nurture securities firms over the last 100 years. In many cases these efforts related to legitimate public policy purposes, such as helping the government sell US Treasury debt or helping finance foreign trade. However, too often these initiatives became entangled with efforts to support the profitability of particular institutions. And sometimes they may have contributed to significant macroeconomic problems, including those traceable to the asset-securitization practices that ultimately blew up the financial system in 2007–08. It is in this fascinating, richly detailed tale of public and private purpose that we see the work of Jane D'Arista so well reflected in Robert McCauley's chapter.

Ellen Russell's fascinating chapter (Chapter 7) on the origins of the Glass–Steagall Act is also an exercise in institutional financial history that bears the valuable marks of Jane D'Arista. Russell, as she puts it, “emulates [. . .] important attributes of D'Arista's contributions to the heterodox political economy of finance by exploring one of the most prominent examples of a sweeping regulatory reform in American financial history: the Glass–Steagall Act.” Based on extensive archival research, she argues that Glass–Steagall's separation of commercial and investment banking, alongside other reforms in the Banking Acts of 1933 and 1935, “created a domestic regulatory framework which was supportive of the subsequent experiment with welfare state Keynesianism in the United States.” She also contends that these reforms were crucial to the creation of:

a long period of relative tranquility in financial markets, vigorous investment and the relative economic prosperity which characterized the “golden age” of the Keynesian welfare state. The erosion of this regulatory framework coincided with an era of increased domestic financial innovation and instability which culminated in the repeal of Glass–Steagall in 1999.

Robert Wade, in Chapter 9, provides a global perspective on the breakdown of the Glass–Steagall system that Ellen Russell depicted, and takes a snapshot of the global regulatory apparatus that prevailed just prior to the Great Financial Crisis. He describes the rise of what he calls the “Standards-Surveillance-Compliance System” (SSC), which was adopted in rich countries and imposed on developing countries. It was designed to open up and facilitate the harvesting of financial profits by financial institutions located primarily but not exclusively in the wealthy developed countries. Wade notes:

The shift from “liberalize” to “standardize” is not just a tweaking of the “Washington Consensus.” While the new consensus continued to accept the theory that markets allocate resources efficiently, it emphasised more than before the need for national and global *political* authorities to reshape and standardize markets, as distinct from government just getting out of the way. This amounted to turning classical liberalism on its head, because it gave normative sanction to a big *increase* in governmental and multilateral “intervention” to effect the standardization.

[. . .]

The central thrust of this effort was further to *constrain policymaking and institutional arrangements in developing countries in order to ensure they fitted the preferences of international investors* for full openness, arms-length relations between firms, banks, financial markets, and government, and no government guarantees to banks that might give them an “unfair” competitive advantage.

[. . .]

The SSC system [. . .] is just one part of a larger complex of international regimes, backed by the authority of the leading western states (often delegated upwards to interstate organizations), which helped to sluice opportunities and income towards (a) the financial sector, and (b) the top percentile of world income distribution.

While these policies worked to sluice income to the One Percent they pushed the economy off the precipice.

Gary A. Dymksi makes related points in Chapter 8, but applies these in more detail to the United States and Latin America. Remaining true to the institutional specificity of Jane D’Arista’s work, Dymksi notes that the imperatives facing the US and Latin America are quite different. For developing Latin American countries, the constraints of the “Post-Washington Consensus” system described by Robert Wade substantially impact their capacity to manage their economies to avoid financial crises:

The ability of financial regulators to control banking behavior is caught between the imperatives required for domestic stability and for reliable cross-border flows of bank loanable funds or bank capital. Specifically, the ability of these nations to impose rules that would pull banking systems in the direction of being more socially productive and economically functional is constrained

both by regional economic compacts (in the case of Mexico, NAFTA) and by having a large share of the domestic banking market operated by multinational banks.

The United States faces different dilemmas, according to Dymski: key among them is the “huge structural divide between Wall Street megabanks and the remainder of the US banking system.” But the crisis creates possibility for change: “The 2007–08 global financial crisis provides a good opportunity for thinking anew about the economic functions and social impacts of banking and finance.” Dymski proposes “a future that begins by renewing a broad-based discussion among all segments of society about the economic goals and social functions that financial institutions should meet.”

Korkut Ertürk and Gökçer Özgür, in Chapter 14 (Part V), also analyze consequences of the massive financial changes that have occurred in the last 50 years. In doing so they tie together three key themes of Jane D’Arista’s work: the role of financial liberalization; the rise of the “parallel” or “shadow” banking system; and the transformation of the monetary transmission mechanism that dramatically alters the way the central bank policy works. Describing the decline of the traditional banking system’s role as a commercial-loan provider, Ertürk and Özgür note: “While traditional banking contracted, non-bank sources of credit experienced an explosive increase. It is no exaggeration to say that the very landscape of financial intermediation has been totally transformed in the last couple of decades as credit became increasingly market-driven rather than bank-driven.” They then assess the implications of this transformation for post-Keynesian analysis of the money supply process, particularly “endogenous conceptions of money.” They conclude that the central insight of endogenous monetary theory – namely “that credit creation causes monetary growth, makes much better sense than the other way around” – should be revised to address two important issues:

First, financial deregulation has fundamentally transformed bank behavior as it drastically altered what a bank is. Thus, it is hardly persuasive to depict credit creation as a passive, solely demand-driven process. Secondly, at the level of empirical analysis it can no longer be taken for granted that total bank credit “statistically” causes broad money.

In particular, activities such as “asset securitization and portfolio choice can no longer be ignored in understanding how the money supply process works,” a lesson that Jane D’Arista has also made central to her work for many years. In particular D’Arista has long argued for regulatory adjustments to enhance the transmission belt for monetary policy in light of these and other financial changes.

GLOBAL FINANCE

Jane D'Arista has written extensively on global finance. Indeed, her earliest published work concerned US bank lending abroad (see Chapter 1). D'Arista pioneered the use of a flow of funds framework for understanding capital flows among countries; and she has written extensively about international monetary reform that would avoid the instability and deflationary biases of the privatized global financial system. In this part of the book, the authors explore a number of these themes.

In Chapter 10, Robert A. Blecker and Mario Seccareccia ask whether regional monetary arrangements are a promising avenue for solving domestic and regional financial problems, and, in addition, whether a collection of such arrangements can help solve global financial problems: these include real exchange rate misalignments, financial instability, and restrictions on the ability to use monetary and fiscal policy to address insufficient or excessive aggregate demand.

The recent experience of the euro does give pause to even the most ardent supporters of monetary unions. Well before the euro problems became so evident, Blecker and Seccareccia identified similar concerns about forming a "North American Monetary Union." Arguing against those who ascribe exchange rate over-valuation in Canada entirely to the so-called "Dutch Disease Problem" the authors identify the role of speculative financial flows as also significant. They also emphasize the constraints on monetary and fiscal policy that we now know can wreak havoc on the ability of countries to deal with recessions and depressions when they are part of a monetary union, as the Eurozone's current malaise demonstrates. In the end, Blecker and Seccaraccia counsel strongly against the formation of monetary unions. Instead, they adopt a position more closely aligned with Jane D'Arista's writings on these issues. They write: "What is needed is a more fundamental reform of the global payments system that would maintain intact the ability of national governments to pursue independent macroeconomic policies while still retaining their respective national currencies."

Thomas Palley's chapter (Chapter 11) raises fundamental questions about the nature of capital mobility in the modern global economy and what policy tools might be able to manage it. He explores and critiques the mainstream economics defense of "free" capital mobility and then analyzes the impacts of capital flows from the perspective of Keynesian, "neo-Walrasian" and Marxian perspectives. Palley concludes that these perspectives provide multiple explanations for unfettered capital mobility creating microeconomic, macroeconomic and distributional problems and they provide a strong rationale for capital flow management. Palley

concludes with the important point that capital controls give nations a significant tool of macroeconomic management, but for them to be fully effective, international cooperation is required. In relation to Jane D'Arista's work and Chapter 9 by Robert Wade, Palley's chapter reinforces the idea that global financial reform is necessary to provide an appropriate context for effective national economic management.

Chapter 12, by Patrick Bond, views the Great Financial Crisis of 2007 through a global lens, with a focus on two sets of interactions: one, between the global "North" and "South"; and two, between financial accumulation and "real" accumulation. He notes that, "the expansion of the global economy's financial sector in the context of relative productive sector stagnation tendencies can be read as a classical over-accumulation crisis." Bond assesses the way in which elites and "policy makers" reacted to the crisis and argues that they did so "through 'devalorization' of large parts of the Third World alongside the write-down of selected financially volatile and vulnerable markets in the North (for example, dot.com, real estate and other derivatives bubbles)." He argues that the devalorization occurred through "intensified extra-economic coercion, including gendered and environmental stresses. The result is a world economy that concentrates wealth and poverty in more extreme ways, geographically, and brings markets and the non-market spheres of society and nature together in a manner adverse to the latter."

Bond goes on to ask whether the types of financial reforms advocated by Jane D'Arista (and many other authors in this book) will be sufficient to solve this complex set of problems; he concludes that they will not be sufficient:

Is reform of the system possible? If so, Jane D'Arista's ideas for revitalized multilateral financial institutions, following various of Keynes' proposals, are worth revisiting. However, what such ideas "from above" require for consideration are states and socio-political movements "from below," like Ecuador (which defaulted) and Occupy, in order to change the many unhealthy relationships between society, state, economy, and financiers.

THEORETICAL CONSIDERATIONS: LIQUIDITY, CYCLES AND INCOME DISTRIBUTION

Most of Jane D'Arista's research and writing is grounded in a historical, institutional and empirical foundation; still, implicit in her approach is a strong theoretical commitment to certain key theoretical ideas which have their roots in Keynes, Kindleberger, Minsky and J.K. Galbraith. Part V gathers chapters that reflect this more theoretical orientation.

Lance Taylor links his theoretical essay (Chapter 13) explicitly to key themes in Jane D'Arista's work:

The financial events beginning in 2007–08 underlined points that Jane D'Arista has always emphasized – that the behavior of the financial system is strongly influenced by its structure, that the structure can change in unexpected ways, and that the nature of regulation has a big effect on the direction and stability or instability of the changes.

Taylor pursues a set of themes underlying other chapters in this section, notably the role of liquidity and leverage in the generation of economic cycles and crashes. He draws on historical experience in the industrialized countries and more or less contemporary shifts in the developing economies to analyze the increasing role of liquidity in the financial system as it has evolved over time and space. Taylor notes: “More liquidity has historically been associated with greater leverage, and this linkage was a key factor underlying the crisis in the industrialized world. Its destabilizing effects were exacerbated by the pro-cyclical character of contemporary approaches to financial regulation.” Taylor pays close attention to accounting principles in his work, drawing on the flow of funds account, again echoing an important aspect of D'Arista's work. Liquidity is defined by Taylor in the following way: “*Liquidity* is often interpreted as a measure of the financial flexibility of an individual actor, group of actors, or the financial system as whole. It constitutes ‘wherewithal’ – the resources readily available for purposes of capital formation or financial transactions.”

Taylor develops a series of models in the form of stages showing how the co-evolution of liquidity creation and debt creation can lead to various forms of financial and real crises. He uses this Keynes–Minsky–Kindleberger–D'Arista framework to describe some of the key forces that led to the Great Financial Crisis. Lance Taylor then turns to policy alternatives. Acknowledging the important contributions by D'Arista, Taylor strongly criticizes the Basel frameworks of capital regulation showing, among other things, their highly permissive and pro-cyclical nature. In terms of a better regulatory framework, he suggests: “So how could the financial system be run more effectively, in particular for developing countries? A combination of capital controls, prudential regulations affecting cross-border flows, and long-term state-backed funds could be appropriate.”

Chapter 13 ends on a cautionary note, especially ominous in light of the evident failure of post-crisis regulatory reforms to be adequately developed or implemented in the US or abroad:

Prudential regulation has become much more difficult, and in the best of times it did not always work. It involves discretionary interventions (both quantitative and price-based), which may be subject to abuse. Information lacunae are rife and ever-changing. But as Jane D'Arista has always emphasized, an unregulated financial system is prone to crisis. It can truly turn into a weapon of mass destruction.

James Crotty and Gerald Epstein explore the uses and abuses of the term “liquidity” in the fight over financial reform and reconstruction in the aftermath of the Great Financial Crisis. Jane D'Arista has dealt with these issues extensively in her work with Stable, Accountable, Fair and Efficient Financial Reform (SAFER) and the Americans for Financial Reform (AFR) (see Chapter 1). In Chapter 16, James Crotty and Gerald Epstein dissect financiers' and mainstream economists' claims that financial regulations such as the Volcker Rule bans on proprietary trading, or proposed bans on naked credit default swaps, or other derivatives regulations, will necessarily limit the useful provision of “liquidity,” and that, as a result, these regulations should be dramatically loosened or not implemented at all. Mainstream observers claim that more market liquidity is always better because it leads to lower asset trading costs and therefore a reduced cost of capital, and facilitates “price discovery.” In discussions of policy, they almost always add a further proviso that more liquidity leads to assets being sold at the “appropriate price.” Crotty and Epstein show that the mainstream view relies on vague and inconsistent definitions of liquidity, and cannot provide a convincing basis for the claims that recent proposed financial regulations harm the economy by reducing liquidity. By contrast, they discuss Keynes–Minsky (KM) perspectives on liquidity, showing that from a KM perspective there can be good and bad liquidity and that in general, the relationship between liquidity and capital accumulation is non-linear. Keynes argued that liquidity should be regulated, for example, through a financial transactions tax. The real solution, according to Keynes, is more social control over investment.

Perry Mehrling and Daniel Neilson, in Chapter 15, focus on a different aspect of “liquidity:” the liquidity “premium” that measures the value of liquidity. Their chapter goes into some institutional detail about how banks provide liquidity to futures markets to help offset mismatch and other risks. These are the kinds of services that Crotty and Epstein refer to as useful liquidity provision. In their analysis, Mehrling and Neilson show that this service provision by the banking system results in a residual liquidity premium in even the most “liquid” of markets, because the banks themselves cannot offset all the residual risk. In the Great Financial Crisis of 2007, however, the banks provision of “liquidity” services went well beyond trying to help others offset risks, as Jane D'Arista has shown in

detail in her work with SAFER and AFR (see Chapter 1) and as indicated by Taylor and Crotty and Epstein in Part V.

In the final chapter, Codrina Rada analyzes the impact of demographic changes on income distribution. Writing in the tradition of Jane D'Arista, who always starts with concrete, important stylized facts to frame questions and analyses, Codrina Rada starts with some stark demographic arithmetic. She notes that: "Unprecedented demographic changes are set to unfold in most of the industrialized world. They are relevant not only because of the diminishing pool of workers, but also because of the increasing importance of retirees as an economic class." Rada then incorporates this stylized fact into a Kaldorian growth model to identify some key issues that may be important for growth and distribution. She argues that:

Retirees' consumption and saving patterns can differ considerably from those of wage earners and capitalists, as retirees tend to consume more services and save less or in fact dis-save. From this perspective of changing aggregate consumption and saving patterns I argue that population aging together with existing constraints to growth and the institutional framework in place leads to a reconfiguration of income distribution and therefore to possible changes in the growth rate of the economy. Understanding how future income distribution may look like and the behavior of different economic classes, helps in designing the right policies to accommodate the demographic transition.

Though these considerations seem to be somewhat distant from those addressed by Jane D'Arista, in fact, throughout her career, D'Arista has maintained a razor-sharp focus on big issues that, as recent events have proven, will sooner or later come to dominate our economic lives. As Codrina Rada shows, demographics is such an issue and one that we ignore at our peril.

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