Introduction: moving forward

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The financial crisis that began in 2007 has generally shown the weaknesses of neoclassical theories and policies, in particular by highlighting the irrelevance of modern macro models such as the Dynamic Stochastic General Equilibrium (DSGE) model and its microfoundations, which has come under considerable attack in the last few years, even from the mainstream. Indeed, as Lavoie (2018, p. 15) observes, “there is considerable dissatisfaction with the current state of mainstream macroeconomics”, leading *The Economist* (2009) to refer to the “turmoil among macroeconomists”.

As early as 2009, Krugman (2009a, Internet) was claiming “[t]he economics profession mistook beauty, clad in impressive-looking mathematics, for truth”. More recently, he once again criticised the quest for microfoundations (see 2013, Internet), arguing “so the truth was that microfoundations in macroeconomics had its moment, but failed utterly at the one thing it was sold, above all, as being able to do – namely, give a better explanation of why nominal shocks have real effects. Time, you might think, to reconsider the project”. A few years earlier, Solow, in a 2010 address to the United States Congress, disapprovingly claimed “I do not think that the currently popular DSGE models pass the smell test” (see Solow, 2010).

More recently, the *Oxford Review of Economic Policy* has dedicated two entire issues to the mainstream criticism, although a careful reading of the various contributions reveals the schism is not as deep (see Rochon and Rossi, 2018). Indeed, most articles are of the opinion that the problem with the DSGE model and its failure to predict the crisis or to suggest any meaningful policies since, is because of the lack of the right kind of microfoundations, or what King (2012, p. 150) describes as a debate over “our [microfoundations] are better than yours”. There is no general call for the abandonment or replacement of DSGE models. Far from it. Rather, many are proposing amending the model and nothing more. Indeed, there are calls for the introduction of financial frictions, and other such imperfections, all in the aim of moving away from the RARE (rational expectations, representative agent) DSGE model (see King, 2012). Yet, attempts

to introduce more realistic microfoundations hardly change the picture. As Solow (2008, p. 244) claimed a decade ago, “adding some realistic frictions does not make it any more plausible that an observed economy is acting out the desires of a single, consistent, forward-looking intelligence”. King (2012) has called this the “microfoundations delusion”. In this sense, Vines and Wills’s (2018, p. 2) candid admission that it is “no longer clear what macroeconomic theory should look like”, should not be interpreted as the mainstream’s *mea culpa*, certainly not in the same way as post-Keynesians would mean it.

Yet, while the criticism in those articles may at times appear to be rather tame, there is nonetheless a general conclusion that emerges, one that may give hope to heterodox economists: many authors are calling for greater openness in the conduct of macroeconomic and monetary economics, and for the acceptance of parallel models.

For instance, among the most critical papers, Wren-Lewis (2018, p. 55) wishes to see parallel models exist alongside each other, rather than abandoning the DSGE model itself: “Just as microfoundations hegemony held back macroeconomics on that occasion, it is likely to do so again. Macroeconomics will develop more rapidly in useful directions if micro-founded models and more traditional SEMs work alongside each other, and are accorded equal academic respect”. Wren-Lewis (2016, p. 27) made a similar statement two years earlier:

The problem as I see it is more that in becoming the only accepted way of doing serious macroeconomic research and policy analysis, it [DSGE] (quite deliberately) crowded out other more traditional approaches that – had they persisted – might have left the discipline in a better position to understand the impact of the financial crisis. Furthermore, these alternative approaches might have encouraged the development of DSGE models in what we now know to be more fruitful directions.

Blanchard (2018, p. 51) takes a similar view. His solution is to have “different types of macro models” co-existing at the same time (2018, p. 44): a theory model (DSGE model) but also a number of policy models (data driven models), each with their respected strengths and weaknesses: “Not all models have to be explicitly microfounded. While this will sound like a plaidoyer *pro domo*, I strongly believe that *ad hoc* macro models, from various versions of the IS–LM to the Mundell–Fleming model, have an important role to play in relation to DSGE models. They can be useful upstream, before DSGE modelling, as a first cut to think about the effects of a particular distortion or a particular policy” (Blanchard, 2018, p. 48).

The bigger question, from a post-Keynesian perspective, however, remains to be seen: does this openness toward the existence of parallel

models include post-Keynesian and heterodox models, most notably the agent-based or stock-flow consistency type? This is not an easy question to answer. One thing is certain, what these authors consider “traditional” is what post-Keynesians would call “neoclassical” or “mainstream”, irrespective of whether these are microfounded or not.

THE NEXT CHAPTER

The observation that mainstream economic theory and policy seem to be at best at an eclectic place is not surprising. But in their desperation to appear more relevant and increasingly reflecting of the real world, mainstream authors are increasingly turning to ideas that have traditionally been the purview of post-Keynesians and other heterodox scholars. For instance, the recognition by New Consensus authors that central banks really control the rate of interest rather than the monetary based is a case in point, as is the increasing attention given to the income distributive nature of monetary policy (see Inui et al., 2017). To be sure, this intellectual encroachment is not limited to mainstream dissenters, but seems to be well spread.

Yet, in this new research, post-Keynesians are never, or rarely, cited: mainstream authors are peddling the illusion of scientific discovery. In this sense, there is a growing need to ensure that our views get heard. But how do we do that?

The post-Keynesian relationship with the mainstream is a complicated one, and has always been so. As King (2012, p.1) explains, we can “fight them, cooperate with them, or ignore them”. And while post-Keynesians have done all three with varying degrees of success, the conclusion remains the same: failure. The irony, of course, is that today while post-Keynesians remain marginalized, our ideas are nothing but and are being discovered by the mainstream.

The various authors in Lee and Lavoie (2011) propose a number of ways of engaging with the mainstream, by engaging with research departments in non-academic institutions like the IMF, or with faculty in business departments. But 8 years appears to be a long time: since that book was edited, we believe the time may be right to attempt to reach out (again?) to those doing research in overlapping areas of research, and engaging in a dialogue. The crisis has created an opening that seems to be right and which has not existed before. Of course, post-Keynesians should abandon neither their criticism of neoclassical economics nor the integrity of their work, but the continuous animosity between “us” and “them” is certainly a cause of our continued obscurity. If the argument rests in showing the

mainstream that we matter, that there does exist an alternative, then the very idea that they are discovering long-held post-Keynesian views should make things easier. To be clear, this is not a call to dilute the post-Keynesian message, to the contrary if anything, we need to push the boundaries of heterodox economics even further.

Of course, the mainstream discovery of so many post-Keynesian ideas is wrapped in an unsavoury model, and there is little chance to convince them to abandon their cherished microfoundations. But one thing is certain, however: if we don't attempt a dialogue, we would have missed an enormous opportunity. A few examples of such an openness, for instance, is Wren-Lewis publishing in both the *International Journal of Political Economy* and the *Review of Keynesian Economics*; or Rochon's idea for a meeting on the 50th anniversary of Friedman's 1968 Presidential Address, subsequently published in the *Review of Keynesian Economics* (2018), containing articles by both established mainstream authors, such as Solow, De Long, Laidler, Gordon, Farmer and Forder, and some post-Keynesians.

To accomplish this, post-Keynesians must engage more in policy work and less in methodological navel gazing, such as eternal divisive debates and internal critiques, or never ending exegeses of structuralism and horizontalism.

The above comments will certainly generate further debate and questions, but at the heart of these ongoing reflections is the one, fundamental question "Where do we go from here?"

STRUCTURE OF THE BOOK

This book is the result of a get-together held in Grenoble, France, in December 2017. As editors, we chose a number of papers presented around three overall themes: finance and financialization, distribution and growth, and monetary policy.

The first part of the book on post-Keynesian views on finance and financialization focuses largely on issues of debt, financial flows, financialization and inequality.

In the opening chapter of the first section on finance, Marcello Spanò proposes an analysis of the composition of the yearly changes that occurred in sectorial balance sheets in fourteen founder countries of the European Union, from 1995 to 2015. He proposes a methodology based on stock-flow consistent accounting to analyze how superfluous financial flows grow and how they are allocated between sectors with different functions (purchasing power creators vs. users) and between different

activities (real production vs. wealth appropriation), while also examining the impact of market revaluations on sectorial balance sheets.

He reaches three important conclusions. First, an increasing amount of credit creation has not been allocated to the generation of real income; second, a prevalent and growing share of the excess finance has circulated within the domestic and foreign financial sector only. Third, financial asset revaluations, which are of the same order of magnitude as private sector transaction flows, have a high incidence on the sectorial net financial position.

In Chapter 2, Óscar Dejuán and John McCombie discuss how credit explosions leading to asset bubbles and an increasing burden of debt are an endemic disease of advanced capitalism. Indeed, even the traditional originate-to-hold model of banking is not free from such a virus. The novelty of the originate-to-distribute model of finance, based on the securitization of mortgage loans, is that it has assembled the machinery to accelerate the process. The limit to credit expansion derives from the potential (full capacity) growth of output. If there is a systematic gap between both rates, the credit-led growth will eventually become a debt-burdened growth.

In Chapter 3, Bruno Bonizzi and Diego Guevara elaborate on the links between financialization and private pension funds in emerging economies. Firstly, they show how public pension systems (PAYGO) began to be replaced by private pension funds (AFP) under the mainstream argument that savings generate investment. In the second part of the chapter, the authors show how the promises of the AFPs in the emerging countries have not been accomplished in terms of coverage, low pension values and reductions of fiscal pressures. Finally, they analyze how AFP can be understood as a financialization enhancer in emerging economies, by increasing risk and dependence of global financial markets on local economies.

Chapter 4, by Alicia Girón and Marcia Solorza, is part of a greater study to explain how Argentina, Brazil and Mexico, through the processes of deregulation, liberalization and reform of the financial systems structure, were enrolled worldwide in the process of financialization, while the national banking industry insertion in the international financial circuits went deeper. Their research contextualizes the financialization process in the period after the breach of the Bretton Woods Agreement of the international monetary system, and the presentation of the degree of financial opening reached by those countries. The growth of financial services, current regulatory standards, and the levels of capital market deepening are analyzed.

In Chapter 5, Jonathan Perraton begins by acknowledging the growing recent literature examining the macroeconomic implications of household

debt linking it to rising inequality across developed economies, which in turn contributes to stagnant or declining real incomes for middle- and lower-income households. Wages stagnated with their decoupling from productivity growth and rising inequality; households maintained consumption with falling savings and rising indebtedness. This consumption behaviour can be understood in terms of the emulation of consumption patterns through a relative income effect. A range of authors have argued household debt was central to the global financial crisis. More generally it has been argued that with rising inequality, aggregate demand was only being sustained by rising household indebtedness before the crisis, and since then held back by limited growth in household incomes. Thus, economies are prone to stagnation offset by periodic unsustainable credit booms.

To date, though, specific studies have focused almost exclusively on the US. There are a number of reasons why it may be useful to extend this analysis to European economies, allowing comparative tests of key hypotheses in this field. This chapter provides a comparative analysis across European economies to test the key hypotheses here, examining how far changes in inequality across these economies can explain debt levels and how far aggregate demand was sustained by rising household debt.

Chapter 6, by Hanna Szymborska, reviews policy proposals to reduce economic inequality in the context of the current institutional structures in the financial sector. It focuses on advanced economies, and the USA in particular. The chapter considers the impact the transformation of financial sector operations since the 1980s has had on income and wealth inequality. It provides an account of how this impact has undermined the effectiveness of policy instruments to tackle inequality. Having discussed why economic policy has failed to reduce income and wealth disparities in the USA, the author reviews policy proposals put forward in the inequality literature. These proposals are assessed in light of recent institutional changes in the US economy. The chapter calls for an explicit strategy to address wealth inequality alongside income, and highlights three areas of policy action to achieve sustainable reductions in economic inequality, focusing on wealth taxation, measures shaping the distribution of market wealth, and broader macroeconomic policy.

Hélène de Largentaye and Renaud du Tertre, in Chapter 7, argue that the casting aside in the 1970s and 1980s of economic policies inspired by Keynes's theory highlighting the role played by aggregate demand, in favour of policies inspired by neo-liberal postulates, laid the foundations for a neo-liberal growth regime in France in the 1990s. "Ordo-liberal" economic policies, a European brand of neo-liberalism, were carried out throughout the European monetary integration process (1993–2007).

Financial variables played a key role, replacing wages and job creation, which became adjustment variables. Consequently, employment and output growth were sacrificed. In the last period (2007–16), the same economic policies did not succeed in dealing with the Great Financial Crisis and the subsequent European Sovereign Debt crisis, so that employment and output continued to perform poorly and debt kept increasing. Recovery from this depressed situation would require a major European investment programme which could lay down the foundations for a new “sustainable development regime”.

In Chapter 8, Pablo G. Bortz, Gabriel Michelena, and Fernando Toledo argue that starting in the early 1990s, several advanced and developing countries have adopted fiscal rules as their framework for determining their expenditure and tax policy, with the stated objective of securing the long-term solvency of the public debt. The adoption of ever-stricter fiscal rules has not been unchallenged. The authors extend the criticisms by differentiating between conventional and unconventional fiscal rules, and by adding to the discussion the importance of balance-of-payments considerations, particularly relevant for developing countries. Within an open economy Kaleckian model of growth and distribution, they conduct simulations to analyze the impact of changes in external lending when governments have rules constraining their expenditure rates. Results show that, with balance-of-payments dominance, public expenditures tend to be procyclical to changes in external lending, with an overshooting reaction, leading to cyclical dynamic patterns.

In the second part of the book, on post-Keynesian views on monetary policy, authors take a closer look at the nature of monetary and financial policies before and after the crisis.

Nathan Perry and Carlos Schönerwald, in Chapter 9, revisit the horizontalist (accommodationist) and structuralist debates and test the causality for the endogenous money hypothesis in the United States from 1980 to 2017. The authors employ Granger causality tests in order to determine the causality of loans to various bank level variables. The results show evidence for the endogenous money hypothesis. The combination of the results suggests that the demand for loans is the ultimate driver of bank activity, which is consistent with the endogenous money hypothesis.

In Chapter 10, Cristiano Boaventura Duarte explores corporate debt expansion in emerging countries after the 2008 crisis, emphasizing the growth of leverage, net foreign exchange exposure, and the deterioration in firms’ debt repayment capacity. Next, the author does a panel regression to identify the main changes in the determinants of emerging market corporate debt expansion before and after the 2008 crisis. The conclusion suggests that the exchange rate was one of the most important

determinants through the period 2000–16, and also in the period before 2008. But after 2008, beyond some country level factors (exchange rate, national GDP growth, firms' higher liquidity levels), other factors that have global origins (more accommodative monetary policy stance in USA, lower financial market volatility, higher commodity prices, global GDP growth) have become increasingly important. Duarte identifies a factor not previously emphasized in the literature, which investigates the determinants of corporate debt in emerging economies: the interaction between higher commodity prices and more appreciated exchange rates. Combined with a particularly uncertain international scenario, this rising indebtedness generated many challenges for enterprises in emerging economies: currency mismatch, firms' susceptibility to creditors'/banks'/institutional investors' interests, macroeconomic volatility. In addition, although several lines of defense have been developed by governments at national level, the capacity of these lines to provide the necessary support for private agents is still unclear, raising concerns with financial instability. Those concerns would be better addressed if emerging countries and international institutions took additional initiatives, such as an improvement in regulatory frameworks, as well as coordinated macro and micro-prudential measures. In this sense, an enhancement of the available instruments to face new financial crises would take place, opening space to pursue a better strategy towards sustainable growth in the medium/long-term.

In Chapter 11, Hasan Cömert argues that many economists see the concept of trilemma (where out of an independent monetary policy, free capital movement or a fixed exchange rate regime only two can exist at the same time) as a strong tool to explore the effectiveness of monetary policy during the Bretton Woods (BW) regime and afterwards. However, under this regime, beside capital controls, regulated domestic financial markets and diversity in central bank instruments contributed to the existence of independent monetary policy. After the collapse of the BW system, capital controls were lifted, domestic financial markets were deregulated, existing regulations were not implemented properly, and short-term interest rates became the sole instrument of central banks. Given the size of financial flows and financial markets has reached unprecedented levels, the author argues the effectiveness (either short- or long-term) of a central bank mainly depends on the institutional framework in which the central bank operates. Since there have been very dramatic changes in the institutional structure enabling domestic and international financial markets to be much more decisive in determining asset prices and credit expansion, the ability of central banks in both developed and developing countries has weakened although this is much more apparent in developing countries. This process can be considered a gradual transition from trilemma to dilemma implying

that under current conditions exchange rate regimes become irrelevant for the effectiveness of central banks especially in developing countries. The unorthodox policies implemented after the global financial crisis in both advanced and developing countries can be considered partial realization of this dilemma by central banks.

In Chapter 12, Max Nagel and Matthias Thiemann argue that unconventional and highly accommodative monetary policies deployed by central banks after the financial crisis of 2007, reduced pressures on the economy and on financial markets. However, integrated monetary and financial systems transmit loose monetary and financing conditions across the globe, evoking volatile international capital flows and the unsustainable build-up of foreign-denominated debt. The authors trace the discussions in the international expert debate regarding these negative spillover effects, analyzing speeches and texts by the Federal Reserve, the International Monetary Fund (IMF) and the Bank for International Settlements (BIS). International debates among policymakers and experts could neither agree on the size of these negative spillovers nor how to counter them via adjustments of global monetary governance and monetary policy frameworks. However, they find that particularly the adoption of insights from international macro-finance induced a shift in the discourse of IMF and BIS towards the acknowledgment of the need to account for the role of monetary policies in affecting (international) financial stability. They conclude post-Keynesians could make a substantial contribution to this debate as alleys towards reform of global monetary governance and monetary policy frameworks open up.

The third part of the book addresses a topic of increased interest in post-Keynesian and heterodox economics: the dual economy, where two distinct sub-economies develop. On the one hand, there is a dominant economy, and on the other hand, a subservient economy, such as skilled vs unskilled labour, or even profit (or rentier) vs wage (or worker) economies. The fundamental question is whether such economies are sustainable or are they more prone to crises?

In Chapter 13, David Leadbeater offers “notes” on the dual economy, and presents a historical overview of the concept of dualism, before offering a critique of it. In his historical discussion, the author argues that the concept of dualism in labour market first appeared over discussion over race and gender, in the 1960s, along with the decline in unions.

Finally, in Chapter 14, Arpita Bhattacharjee and Gary Dymksi begin by asking a number of questions. From their introduction, they ask how will the increasing presence of robots and artificial intelligence (AI) affect production and consumption processes? Do they constitute a threat to the human workers whose roles and tasks they increasingly replace, or a source

of liberation from drudgery? Debate over these questions in journals and policy forums the world has exposed contradictory views, and led primarily to still further questions. Do robots create the conditions for a new human renaissance or endanger the rights of humans? And do robots threaten “us” because we don’t know precisely what they can do, or what they can do that we can’t? The profound uncertainty thus exposed constitutes a key aspect of this area of inquiry.

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