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Book Review

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Book Reviews | Rezensionen

Claude Gnos, Louis-Philippe Rochon (eds.) (2011): Credit, Money and Macroeconomic Policy. A Post-Keynesian Approach, Cheltenham, UK (350 pages, hardcover, Edward Elgar, ISBN 978-1-84844-067-8)

Many economists dislike policy advice, preferring their clean theoretical models to the complexity of the real world. But it is without doubt the mainstream that realized the exploit of imposing as the core of the economic discipline a set of completely unrealistic but extremely consistent hypotheses that guarantee that the only possible policy advice be: »Sire, laissez faire, laissez passer.«

This third collection of papers from the »Dijon conferences« presents a set of major policy-relevant economic analyses conceived for a non-Panglossian world, where money counts. It follows the first two that were published in 2006 and 2009 (Gnos/Rochon 2006 and 2009). Despite the inevitable lack of homogeneity typical of a collection of essays by different authors and the inherent difficulty of giving consistent policy advice when the usual mainstream simplifying assumptions are rejected, the volume provides a consistent message that post-Keynesian economics reached maturity and starts representing a true policy alternative.

Four themes are developed in the light of modern monetary theory: the crisis, monetary policy rules, Basel II and inflation targeting.

1. Endogenous money and the financial crisis

Riccardo Bellofiore and Joseph Halevi set the tone of the collection offering a »big picture« of the financial crisis in terms of their by now famous triptych of traumatized workers, indebted consumers and manic-depressive savers. In so doing, they adapt Minsky's financial instability hypothesis to the reality of contemporary finance, which has decoupled completely from the real economy, still the main preoccupation of Minsky.

Robert Dimand contrasts Bernanke's and King's response to the credit crunch sparked by the turmoil in the subprime mortgage markets in August and September 2007. He argues that Bernanke, despite being a less assiduous reader of Minsky than King, gave more emphasis to preserving the stability of a fragile financial system rather than defending the exchange rate or avoiding a moral hazard problem of acting as liquidity suppliers of last resort.

Robert Guttman provides a detailed account of the dynamics of the crisis and raises the question of the reforms needed for the BIS, the IMF, the World Bank and other multilateral financial institutions so that they contribute productively to the stability of the economic system. These reforms should be conceived for a world that will move from six decades of US dollar domination to a more multipolar system of several currencies competing for global leadership and for the benefit of *seignorage*.

2. *Monetary policy and policy rules*

Theodore Koutsobinas discusses the mainstream monetary policy of the ›New Consensus‹ and the alternative post-Keynesian fiscal policy rule based on functional finance and full employment. He argues that Japan's recession during the 1990s demonstrates the failure of the New Consensus. He suggests that EU structural policy instruments should be assigned in part to anti-cyclical objectives.

Alain Parguez offers a fundamental update of the theory of the monetary circuit he developed over the last forty years, showing with his usual lucidity that a rigorous understanding of money brings to supporting a long-run full employment policy sustaining the growth of consumption and state expenditures.

Louis-Philippe Rochon and Sergio Rossi discuss the monetary policies of countries that have eliminated reserve requirements such as Canada. They show that in these countries there is still an endogenous demand for central bank money for interbank settlements. This implies that the central bank can keep the full control of the short-term interest rates, as when reserve requirements are used. Contrary to the claim of the Chartalists, this implies also that tax liabilities are not a necessary or a sufficient condition for the control of the short-term interest rates. It also means that both the old monetarism and the New Consensus can be confidently rejected.

Louis-Philippe Rochon and Mark Setterfield discuss interest rate ›parking rules‹ which are advocated by post-Keynesians who reject inflation targeting and point out that the interest rate is a distributive variable that should not be used to regulate output and employment. The latter should instead be controlled by fiscal policy. The three main alternatives they examine are to ›park‹ the interest rate at zero in real terms, at zero in nominal terms or at the level of productivity growth in real terms, which the authors call respectively Smithin rule, Kansas City rule and Pasinetti rule. They build an interesting post-Keynesian macroeconomic model that allows assessing the distributional consequences of these three rules.

3. *Basel II*

Robert Guttman discusses Basel II changes in comparison to Basel I. He notes that Basel II abandons the ›one size fits all approach‹ to regulatory capital. The latter must now be matched more closely to the actual risk of the asset portfolio, which can be estimated under different methods, including internal rating methods for the more sophisticated banks. However, in so doing, Basel II gives more weight to the ratings produced by the rating agencies. Guttman also discusses in some detail the other two elements of the risk pillar component of Basel II (market and operational risk), as well as the other two pillars, which are supervision and market discipline. Guttman thinks that Basel II goes in the right direction (sounding a little bit apologetic at times), but concludes that, due to the presence of financial instability and systemic risk, Basel II is not sufficient and what is needed is an effective lender of last resort mechanism with the possibility of unlimited injections of liquidity by central banks and the IMF.

Stelios Karagiannis, Yannis Panagopoulos and Aristotelis Spiliotis study econometrically the equity-loans nexus in the balance sheets of US and European banks. The causality test they run between equity and loans shows the presence of feedbacks between the two

variables, which the authors interpret in terms of a structuralist explanation of the money supply process. However, their multivariate analysis concludes that this interpretation only applies to Europe, whereas for the US data is better interpreted in terms of horizontalism.

Rogério Sobreira and Patricia Zendron raise the point that in practice capital regulation promoted under Basel II could have hindered the activity of National Development Banks (NDB), by rendering more expensive the activity they develop in favor of small and medium sized and in general more risky borrowers, including the support they give to longer-term credit. The authors come to interesting and strong conclusions, such as that the adoption of the Basel Accord is conceptually incompatible with the function of NDB.

4. Inflation targeting

Angel Asensio introduces non-ergodic uncertainty into an essentially neo-Keynesian model to show that inflation targeting in an environment of fundamental uncertainty has pernicious effects through the ›unemployment trap‹, the ›fighting distributive conflict‹ and the ›conflicting fiscal policies‹ effects. The author attributes the relatively better growth results of the US with respect to Europe to the fact that in the US inflation targeting has been followed more pragmatically than in Europe, whose monetary policy has been more dogmatic.

Eckard Hein and Achim Truger remind that New Consensus Models (NCM) admit short-term departures from equilibrium, but assume stable long-run equilibria determined by supply side factors only (the non-accelerating inflation rate of unemployment or NAIRU). These equilibria can be reached by monetary policy, from which they are independent (path dependence of the NAIRU is excluded). Post-Keynesians are critical of the ability of monetary policy to attain the NAIRU, think that in any case the latter is path dependent (i.e. inflation targeting increases the NAIRU) and they reject the complete neglect of demand management and fiscal policy implicit in the NCM, as well as the corollary treatment of unemployment, which consist in wage moderation and ›structural reforms‹ enforcing labour flexibility. Their subtle empirical analysis covers the period 1996–2005, looking at the comparative experience of France and Germany, taken as ›Maastricht economies‹, as well as Sweden and the UK, taken as alternative cases of non-Maastricht economies with different attitudes towards the welfare state. To assess the exclusive assignment of monetary policy as a short-run stabilizer of output and employment and a long-run stabilizer of inflation they develop interesting and original new indicators of the fiscal policy stance with which they obtain for instance that ›a fiscal drag of about 1% of GDP in Germany and a boost of 0.8% in the UK (...)‹ is ›the dominating factor in explaining the two economies differing performances‹ (p. 205). Interest rate and wage policies also contribute to explaining the different performances of these economies by their effect on external competitiveness, tracked through the effective exchange rate. They qualify Germany as a ›dysfunctional mercantilist‹ (extreme wage restraints and high unemployment associated with current account surpluses destabilizing for the Euro area), France as an ›innocent victim‹ of German mercantilism (which is very noble from German authors, but might be too kind), UK as an ›unbalanced growth machine‹ (wage growth, real exchange appreciation and current account imbalances) and Sweden

as a ›functional mercantilist‹ (wage moderation coupled with an expansionist monetary policy resulting in current account surpluses). They conclude that their data shows that fiscal policy has an impact in both the short and the long run, but that the full policy mix must be considered in order to understand the actual performance of the main European economies over the period.

Malcolm Sawyer presents a theoretical model that he uses to illustrate several arguments in favor of a Kaleckian approach to the assignment of macroeconomic instruments as alternatives to the New Consensus. While the latter consists in: a) using interest rates to address demand issues, with fiscal policy left out; b) use the credibility of the central bank to hold down inflationary expectations; and, c) to reform labour markets to lower the NAIRU; the Kaleckian alternative entails: a) using fiscal policy in the short and in the long runs to address demand issues; b) using regional and industrial policies to create the required capacity; and, c) developing an income policy to keep inflation low.

Ulaş Şener looks at the interesting case of Turkey and the peculiar form of New Consensus applied there since 2000–1, which essentially consists of a mix of inflation targeting and positive primary surpluses generating a strong real appreciation of the exchange rate, but without actual central bank independence. This mix generated growth above EU average, a substantial decrease in inflation and a significant currency appreciation, which created rising unemployment, an increasing current account deficit and a near doubling of the total domestic and foreign debt, i.e. a growth regime financed by external debt that does not benefit employment and wages, a result which is not uncommon in the EU periphery.

Andrea Fumagalli and Stefano Lucarelli end the volume by presenting a theoretical model of ›cognitive capitalism‹: a socio-economic regime characterized by »private appropriation of the ›commons‹ such as tacit and codified knowledge« (p. 328). In their model the abandonment of the Fordist indexation of wages on productivity gains entails the precariousness of labour, which decreases network and learning economies, productivity and output and leads to the crisis. The solution is thus a new viable social compromise based upon a fair distribution of productivity gains.

The volume is very well edited, with a very limited number of minor typos. It provides a very useful collection of major post-Keynesian policy essays, providing evidence that the consensus around mainstream economic policies is not based on solid facts and that alternative theories can help devising better policies. It obviously requires careful study to be read and understood. It is nonetheless hoped that decision-makers will take note and act.

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