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Book Review

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Book review

Mazier, Jacques (2020): *Global Imbalances and Financial Capitalism: Stock-Flow-Consistent Modelling*, London, UK and New York, NY, USA (318 pages, Routledge, hardcover, ISBN 978-1-138-34558-4; also available as ebook)

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Jacques Mazier was among the first scholars to recognize the relevance and usefulness of the so-called stock–flow consistent (SFC) modelling method and its simulations to understand the problems arising from open-economy macroeconomics. Thus, nobody will be surprised to learn that his book is devoted to a study of the alternative architectures around which the international monetary system, and in particular the eurozone, could be designed. Mazier has supervised numerous doctoral students who have used the SFC approach to tackle various issues set within models incorporating two, three and even four countries. Indeed, Mazier, as the main author, has put together eight chapters that collect and homogenize previous working papers or published articles where he acted as a joint author along with past doctoral students. The preliminary pages of the book indicate that the additional contributors are Vincent Duwicquet, Luis Reyes, Jamel Saadaoui and Sebastian Valdecantos, all former Mazier students, who now hold teaching positions in various universities. Furthermore, as one reads through the book, one realizes that this collaboration between Mazier and his former doctoral students extends even further, as the book contains or utilizes material published jointly with other former students, such as Mickaël Clévenot, Gnanonobodom Tiou-Tagba Aliti and Myoung-Keun On.

In the introduction, Mazier explains why he believes that the SFC approach is superior to the standard dynamic stochastic general equilibrium (DSGE) approach. Despite the addition of more realistic features, such as asymmetric information or credit rationing, DSGE models remain supply-led models with unreliable assumptions that can barely deal with finance, when finance is so important in the modern world. By contrast, ‘SFC modelling is well suited to take into account the interaction between the real and the financial sectors’ (p. 2), as well as balance-sheet constraints and revaluation effects. In addition, SFC models are mainly demand-led, and their long-run equilibrium arises from the evolution of short-run sequences, as Kalecki would put it. Chapter 3, which presents the first open-economy model, also explains why SFC models are superior to equivalent general equilibrium models *à la* Obstfeld/Rogoff and portfolio models of exchange rate and current account *à la* Blanchard. Both kinds of mainstream models assume constant production while the supply of financial assets and tangible capital is assumed to be exogenous, in contrast to what happens in SFC models. These assumptions, as Mazier says, are rather strange in view of the huge changes in output and government deficits which occurred during the global financial crisis and which we can observe again during the COVID-19 crisis.

To the standard SFC approach and Kaleckian modelling, Mazier adds four features of his own. First, compared to most other SFC authors, Mazier pays more attention to empirical data, providing econometric estimates of various elasticities and using calibration loosely based on European national accounts. Second, when discussing financial regimes of accumulation, Mazier argues in chapter 1 that the rate of return on equities and the growth rate of equity prices are essential determinants of economic activity and explain business cycles. A higher financial rate of return induces households to demand more equities, thus generating capital gains that lead to rising consumption, while corporate investment first declines as firms also go into credit-financed financial accumulation, only to rise later as a reaction to higher rates of capacity utilization and rising profits. Third, in chapter 3, within a two-country eurodollar SFC model, Mazier provides an alternative way of presenting the determination of the exchange rate. Usually in such SFC models, because of the way the exchange-rate equation is written, it seems that only the amount of US bills demanded by eurozone households relative to the amount of US bills supplied to eurozone households determines the exchange rate. This, of course, is not true, as all parts of the model, including trade flows, contribute to this determination. Mazier demonstrates that by making use of the identity involving the current-account balance and the capital-account balance, the exchange-rate equation can be developed into a more intuitive one that explicitly involves the various components of these two external balances.

Fourth, in chapter 2, Mazier explains his preference for the fundamental equilibrium exchange rate (FEER). ‘The FEER is defined as the level of the exchange rate which allows the economy to reach the internal and external equilibrium at the same time’ (p. 39). While the external equilibrium seems to be well justified, the internal equilibrium is based on potential output values estimated with OECD production functions. In any case, we are told that the biggest influence on the FEER is external. In chapters 3 and 4, Mazier provides annual estimates over 35 years of undervaluation or overvaluation of exchange rates for Japan, China, the US, the UK and the eurozone, as well as ten individual countries of the eurozone. The estimated numbers look quite in line with what we know about the situation of these various countries. The misalignments are particularly revealing for the ten eurozone countries and illustrate well the persistent difficulties encountered by the countries of the south of Europe.

Open-economy SFC models in general demonstrate that the lack of adjustment in foreign-exchange rates generate global imbalances that can only be remedied by disastrous austerity policies. The particular models developed in the various chapters of the book by Mazier and his collaborators repeatedly come to the same conclusion, and so highlight the importance of correcting exchange-rate misalignments. Another feature of open-economy SFC models that gets underlined in the book is that a country may find itself in a dire situation through no fault of its own when some of the exchange rates are fixed. At least two instances appear in the book. With a fixed exchange regime between the US and China, if there is a loss of US competitiveness that leads to a rise in foreign reserves held by China, followed by a diversification of these reserves towards more euros, European output is likely to be badly hurt as a consequence of the depreciation of the dollar relative to the euro. Similarly, if northern eurozone countries improve their competitiveness relative to the US, this will generate an appreciation of the euro, which will end up hurting exports and economic activity in the south of the eurozone, and create government deficits there.

Three chapters are devoted to the eurozone and what Mazier calls ‘the single currency trap’. After having recalled the difficulties of the eurozone in the aftermath of the global financial crisis and as a result of its unfinished construction which has generated disinflation policies, Mazier splits the possible solutions into two chapters, devoted respectively to

alternative policies and alternative exchange-rate regimes. In chapter 5, he looks at various proposals that have been made and assesses them within various variants of a two-country SFC model where one of the two eurozone areas has suffered a negative shock. He finds that intra-zone credit will make no difference relative to financial autarky, unless there exists credit rationing by banks. Full financial integration will only moderately help to stabilize economic activity, thus showing that ‘integrated capital markets do not constitute a powerful adjustment mechanism’ (p. 292). On the other hand, a federal budget with fiscal transfers will provide much improvement, as would euro bonds with a European investment programme. However, just like Malcolm Sawyer (2018) in a recent book which I reviewed in this journal (Lavoie 2019), Mazier fears that these more efficient stabilizing mechanisms are unlikely to ever be put in place.

Various exchange-rate regimes involving eurozone countries are examined in chapter 6, this time within a four-country model, with two eurozone countries (Germany and Spain, respectively running surplus and deficit current accounts), the USA and the rest of the world. Mazier and Valdecantos – his co-author for this chapter – compare the current set-up to (i) one where countries return to the previous European Monetary System; (ii) a situation where Germany returns to the deutschmark but where the remaining eurozone countries remain on a fixed exchange rate with the deutschmark; (iii) a situation where Germany returns to the deutschmark but where the euro floats against both the German currency and the dollar; (iv) a eurozone combining regional euros with a global euro, with governments issuing either domestic euro bonds to residents and global euro bonds to non-residents; and (v) a euro-bancor based on the existing TARGET2 system combined with some adjusting features advocated by Keynes, where countries running both negative and positive intra-zone balances would need to adjust, thus helping to avoid the existing asymmetric adjustments. I must admit that I had a very hard time in understanding what these last two configurations entailed, especially the fourth one. The authors conclude that ‘in all the cases the re-introduction of exchange rate adjustments when external imbalances within the euro zone become unsustainable appears as a key point’ (p. 233), thus reasserting what was said above about this systematic feature of open-economy SFC models.

The last two chapters go beyond the eurozone. Chapter 7 deals with several variants of a multiple-country SFC model, which in some configurations mimic the eurozone variants examined earlier, with for instance an Asian Currency Unit, a yuan block, or an Asian bancor regime. The FEER method is also once more put to use to study the extent of the exchange-rate misalignments in East Asia, which would have diminished over time. Finally, chapter 8 studies the Stiglitz proposal designed to enhance the role of the IMF’s special drawing rights (SDRs) within a four-country SFC model initially suggested by Valdecantos/Zezza (2015). The results show that regular or counter-cyclical emissions of SDRs would indeed allow for more expansionary fiscal policies, thus mitigating the effects of a global recession.

All in all, Mazier’s book is a dazzling example of the usefulness and flexibility of the stock–flow consistent approach in an open-economy setting, which was first demonstrated by Wynne Godley (1999) in a working paper containing three different closures of such an open-economy SFC model, which he appropriately called ‘Open economy macroeconomics using models of closed systems’.

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