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Book Review

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Book review of Asensio, Angel: *Macroeconomics After the General Theory: Fundamental Uncertainty, Animal Spirits and Shifting Equilibrium in a Competitive Economy*

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This book is made up of three parts. The first part consists of an introduction and two preliminary chapters. In the second part, Angel Asensio outlines his views of closed-economy macroeconomics, inspired by Keynes's General Theory, as revealed by the title of the book. The third part is devoted to open-economy macroeconomics. The book has something peculiar about it, as the author has decided to leave aside most of the controversies that have surrounded the interpretation of Keynes's General Theory, leaving out as well any reference to modern post-Keynesian works, even those that would be closest to his approach (those from the fundamentalist Post Keynesian branch à la Paul Davidson), with the exception of one Minsky reference. A majority of references deal with behavioural economics and decision-making in an environment of fundamental uncertainty.

The book starts with two preliminary chapters. The first one upholds Keynes's 1937 claim in the *Quarterly Journal of Economics* that the true meaning of the General Theory cannot be understood without considering the foundational role of fundamental uncertainty, associated with the confidence or conviction with which beliefs are being held and constantly modified. Keynes's animal spirits are related to this degree of confidence under conditions of fundamental uncertainty and not to Akerlof and Shiller's (2009) irrational behaviour. The second preliminary chapter, as is often the case in French textbooks, presents the main national accounting concepts, notably the uses and resources of current account, capital account, and financial account operations, the combination of which is equivalent to the transactions matrix of the stock-flow consistent (SFC) approach. The chapter also presents the assets and liabilities of the four main sectors of a closed economy, equivalent to the stock matrix of the SFC approach.

The second part starts with an analysis of money and the interest rate. Asensio endorses the post-Keynesian theory of endogenous money supply, meaning here that 'the supply flow of money associated with new credits is equal to the creditworthy demand flow for new bank loans' (p. 43). The total supply stock of money is thus equal to the past existing stock plus this new flow. As a consequence, the interest rate is also endogenous, since the stock demand for money changes through time with liquidity

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preference, that is, the decision to hold wealth in the form of money instead of securities, an argument that is reminiscent of Randall Wray's (1992) distinction between liquidity preference and the (flow) demand for money. This portfolio decision is prey to fundamental uncertainty and hence subjective beliefs. Changes in the interest rate thus equate the stock supply of money with the stock demand for money as well as the stock of money with the stock of loans, since for Asensio the interest rate on loans cannot (much) differ from the interest rate on securities. The anchor, says Asensio, reflecting the views of the General Theory, is the interest rate that participants find durable or normal – the conventional interest rate. One is left with the impression that the monetary authorities have little sway. This impression is reinforced by a reading of Chapter 5 that deals with monetary policy. It asserts as its main plank that any attempt to reduce (presumably long) interest rates by open-market operations might fail unless the central bank convinces agents that the durable or safe interest rate is now lower. There is little discussion about the fact that central banks today are able to control the short-term interest rate, which is the major determinant of the prime lending rate of banks, by making use of a corridor system or by flooding banks with excess reserves and providing interest on these reserves.

Chapter 2 starts by saying that the level of employment may be too low because the durable rate of interest may be too high. The chapter relies on Keynes's aggregate supply and aggregate demand analysis. It makes use of the infamous Z and D curves, which are functions of employment, as found in Davidson (1994). Asensio justifies this by the difficulties of measuring heterogeneous output aggregates. This framework has generated so many controversies that at some point the *Cambridge Journal of Economics* felt obliged to announce that it would not consider any article based on this approach. The main message of the chapter is that the level of employment, in general different from full employment, depends on the liquidity preference of agents and the subjective views about the future of both consumers and entrepreneurs – what Keynes in his lectures in the 1930s called the 'state of the news'. Besides this, the linear model presented in an appendix relies on a standard mark-up pricing equation and has resemblances with the IS/LM model, with the values of both employment and the interest rate being dependent on the supply of money. Asensio grants this similarity, but he points out that these values are liable to frequent shifts due to the presence of fundamental uncertainty, an assertion which is remindful of a similar claim previously made by O'Donnel and Rogers (2016) when presenting their own 'heterodox' version of the IS/LM model.

One may wonder, within this context, whether full employment can be recovered through flexible wages and prices. This is discussed in Chapter 3. The author answers in the negative, making use of the arguments provided by Keynes in Chapter 19 of the General Theory: falling wages and prices will induce both consumers and entrepreneurs to postpone their expenditures; it will hurt debtors and compromise the solvency of firms; and it will redistribute income in favour of profit and interest recipients, who have a lower propensity to consume. Asensio concludes from this that nominal wage rigidity is an institutional stabilizing force, in contrast to the orthodox view. Asensio also considers the drivers of the growth of output in Chapter 4. The main driver is said to be the change in the entrepreneurs' expected demand and not the improvements in supply conditions. Changes in the rate of capacity utilization are said to play a role only if they also improve expected profits (or the marginal efficiency of capital). All in all, Asensio has some sympathy for the idea of secular stagnation, as he believes, along with Keynes, that the propensity to consume tends to fall with improved wealth. Asensio also seems to believe in some version of the old Phillips curve, because of diminishing returns and the growing scarcity of labour.

The rest of the book, about half of it, is devoted to international trade and finance. Once more, this part starts with national accounting, based in particular on the IMF Balance of Payments Manual. Chapter 6 devotes several pages to the accounting of uses and resources in an open economy, which ends up rediscovering what several authors have called Godley's three-balance identity, which says that the current account balance is equal to the sum of the financial savings of the domestic private and public sectors. Asensio, however, also provides a short but interesting discussion of accommodating international payments involving banks and their deposits, generating the net foreign assets of the banking system.

Chapter 7 underlines the difficulties in measuring price competitiveness and using price indices. It provides the various determinants of exports and imports and of foreign portfolio and direct investments. It discusses and defines purchasing power parity exchange rates and the Marshall–Lerner condition. Chapter 8 discusses adjustments to the balance of payments, mainly when it is in deficit, on both the current account and the financial account, in both cases of a fixed and flexible exchange rate. Although the author does mention sterilization and the compensation thesis when dealing with fixed exchange rates, the discussion seems to overemphasize the impact on the monetary base of central bank interventions in foreign exchange markets, especially since today it is well-known that monetary authorities take defensive actions to stabilize the overnight rate. A key proposition of the book is that, because of fundamental uncertainty, there is no anchor for the exchange rate, so that a destabilizing loop may emerge. The proposition is reinforced in Chapter 9, where Asensio argues that 'the equilibrium exchange rate is both the one that the markets think will be durable and the one that brings the "overall balance" to zero' (p. 181). The author provides a good critique of purchasing power parity, but his discussion of covered interest parity omits the critique provided by the French Cambist view (Lavoie 2000). In Chapter 10, the author considers the paradoxical belief of several economists who argue that both a surplus current account and a surplus financial account are a good thing, whereas national accounting tells us, as shown in Chapter 6, that a surplus current account is necessarily associated with a negative financial account. The chapter also deals mathematically with the sustainability of external debt dynamics.

Chapters 11–13 extend the analytical framework described earlier for the closed economy to the small open economy. As the author acknowledges, there is some formal similarity with the Mundell–Fleming model. The modelling, however, is done in terms of growth rates, as was done in Chapter 4. Uncovered interest parity is assumed, but mitigated by the moves of an uncertainty premium, which, however, disappears in Chapter 12 where Asensio provides the equilibrium values of the main endogenous variables as well as tables showing the signs of the effects of changes in the exogenous variables on the endogenous ones. Chapter 13 discusses the effects of monetary and fiscal policies, in both fixed and flexible exchange regimes. The last two chapters do the same, but this time within the context of an interdependent two-country framework, with the uncertainty premium reappearing when a flexible exchange regime is dealt with. Interestingly, Asensio shows that 'international monetary cooperation on exchange rates makes it possible to limit externalities and coordination failures compared with the case of floating exchange rate' (p. 265).

Asensio's book is certainly worth reading. It shows how one can improve the IS/LM framework and the Mundell–Fleming model by injecting doses of post-Keynesian analysis, inspired by Keynes's General Theory, making them more complex by taking into account fundamental uncertainty and proper national accounting. While different, the objective of the book shows some similarities with the objective of Basil Moore's (2006) last book, which also questioned and proposed an alternative to mainstream economics while retaining some of its aspects.

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