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Understanding the global financial crisis: contributions of post-Keynesian economics

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Abstract

Post-Keynesian economics has greatly improved our understanding of the causes as well as some of the consequences of the Global Financial Crisis. This paper deals with some examples related to monetary issues—namely, the financial instability hypothesis of Minsky and its extension to the household sector, as well as the post-Keynesian theory of endogenous money, with its extension to quantitative easing policies set within a framework where the central bank's target rate of interest is set equal to the rate of interest paid on reserves.

Keywords:

Endogenous money | financial instability hypothesis | Quantitative easing | post-Keynesian economics

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Notes

1 As reported by Earl Peng, “Economics fit for the Queen,” 172.

2 See http://www.huffingtonpost.co.uk/2012/12/13/queen-visit-bank-of-england_n_2294771.html.

3 Blecker, “Post-Keynesian Economics.”

4 Godley et al., “The United States and Her Creditors,” 1 and 8.

5 Ibid.

6 Lavoie, “The Global Financial Crisis.”

7 See Lavoie, Post-Keynesian Economics; King, Advanced Introduction.

8 I have made general remarks about the consequences of the Global Financial Crisis for heterodox economics in the following papers: “Are We All Keynesians?”; “Perspectives for Post-Keynesian Economics”; “Financialization, Neo-liberalism and Securitization,” “Teaching Monetary Theory”; and “Should Heterodox Economics Be Taught.”

9 This refers to the fact that in many states in the United States, the home owner can simply abandon the house and send the keys to the financial institution holding the mortgage, with no recourse.

10 See Minksy, Can It Happen Again?; John Maynard Keynes; Stabilizing an Unstable Economy.

11 Minsky, Can It Happen Again?, 92–93.

12 Minsky, John Maynard Keynes, 128.

13 Minsky, Can It Happen Again?, 101.

14 Galbraith, A Short History of Financial Euphoria. There are many other post-Keynesian contributions to theories of financial instability, among them those of another participant to this forum, Brenda Spotton Visano, Financial Crises; see also Toporowski, The End of Finance.

15 Stabilizing an Unstable Economy, 237.

16 Keynes, The General Theory, 158.

17 See Godley and Lavoie, Monetary Economics.

18 Bezemer, “Understanding Financial Crisis,” 676.

19 Can It Happen Again? 30.

20 Sherman, The Roller Coaster Economy.

21 Brown, Inequality, Consumer Credit.

22 Palley, Post Keynesian Economics.

23 McCauley, “The Shadow Banking System,” 259 and 268.

24 For detailed references, see Lavoie, Post-Keynesian Economics, Ch. 4.

25 Godley, “Macroeconomics without Equilibrium or Disequilibrium,” 91.

26 McLeay et al., “Money Creation in the Modern Economy,” 15–16.

27 Keynes, The Collected Writings, 222.

28 Borio and Disyatat, “Global Imbalances and the Financial Crisis.”

29 Eichner, The Macrodynamics of Advanced Market Economies, 849.

30 See in particular Wray, Understanding Modern Money; and Modern Money Theory.

31 Bindseil, Monetary Implementation, 252.

32 It is sometimes said that capital adequacy ratios, as suggested by the Basel III regulations, restrain the ability of banks to create credit money. But banks are always able to raise their capital ratios by retaining a larger share of their profits or by issuing new shares, or even through accounting manipulations.

33 Lavoie, “Monetary Base Endogeneity.”

34 Lavoie, “Changes in Central Bank Procedures.” The floor system was advocated by some post-Keynesian writers, notably Fullwiler, “Paying Interest on Reserve Balances.”

35 In Canada, starting in April 2009 but continuing for only about a year, a floor system was also adopted by the Bank of Canada as part of its zero interest rate policy (ZIRP) framework. The Bank of Canada also left three billion dollars’ worth of reserves in the banking system, so as to maintain the overnight rate at the floor, but this relatively small amount cannot be considered part of a QE operation.

36 In Canada, some central bankers seemed to believe in this revised monetarist story. See the references found in Lavoie and Seccareccia, “Monetary Policy in a Period of Financial Chaos,” 178. The new governor of the Bank of Canada, Stephen Poloz, also weakly endorses this view. See Poloz, “Prudent Preparation,” 4.

37 Borio and Disyatat, “Unconventional Monetary Policies,” 82.

38 Lavoie, “The Credit-led Supply of Deposits.”

39 Koo, “Balance Sheet Recessions.”

40 Bean, “Quantitative Easing—An Interim Report.”

41 Sheard, “Repeat After Me.”

42 See notably Fullwiler, “An Endogenous Money Perspective.”

43 See Modern Money Theory.

44 Kelton and Wray, “Can Euroland Survive?” 10.

45 Kriesler and Lavoie, “The New Consensus on Monetary Policy.”

46 Spotton Visano, “Gendering a Post-Keynesian Theory.”

47 Ball, “Long-term Damage from the Great Recession.”

48 Wilkins, “Monetary Policy and the Underwhelming Recovery.”

49 Blanchard, “Looking Forward, Looking Back.”