Journal of Post Keynesian Economics ›
Volume 16, 1994 - Issue 3

Original Articles

Debt, Aggregate Demand, and The Business Cycle: an Analysis in the Spirit of Kaldor and Minsky

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Pages 371-390 | Published online: 04 Nov 2015

Cite this article https://doi.org/10.1080/01603477.1994.11489991

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Debt, aggregate demand, and the business cycle: an analysis in the spirit of Kaldor and Minsky

Over the last decade interest in the economic consequences of debt has increased significantly. There are numerous reasons for this increase. First, there is the increase in the levels of debt, both private and government, that characterized the decade of the 1980s. Second, there is the widespread belief that the current recession is a "balance sheet" recession, with consumption and investment depressed because households and firms are weighed down by debt service obligations. Third, there is the discovery by Friedman (1983, 1986) of a longstanding stable time-series relation between income and credit, and this in turn has served to redirect attention away from the traditional focus on the money–income relationship.

This growth of interest in the effects of debt ties in with the work of Minsky (1964, 1977, 1982), who has persistently emphasized the role of financial factors in the business cycle. Within the Minskyian framework, the business cycle is characterized by the gradual emergence of "financial fragility," and this fragility ultimately causes the demise of