

# The reaction to Keynes in macro: Monetarism I & II and beyond

CeHistMet, November 17, 2021

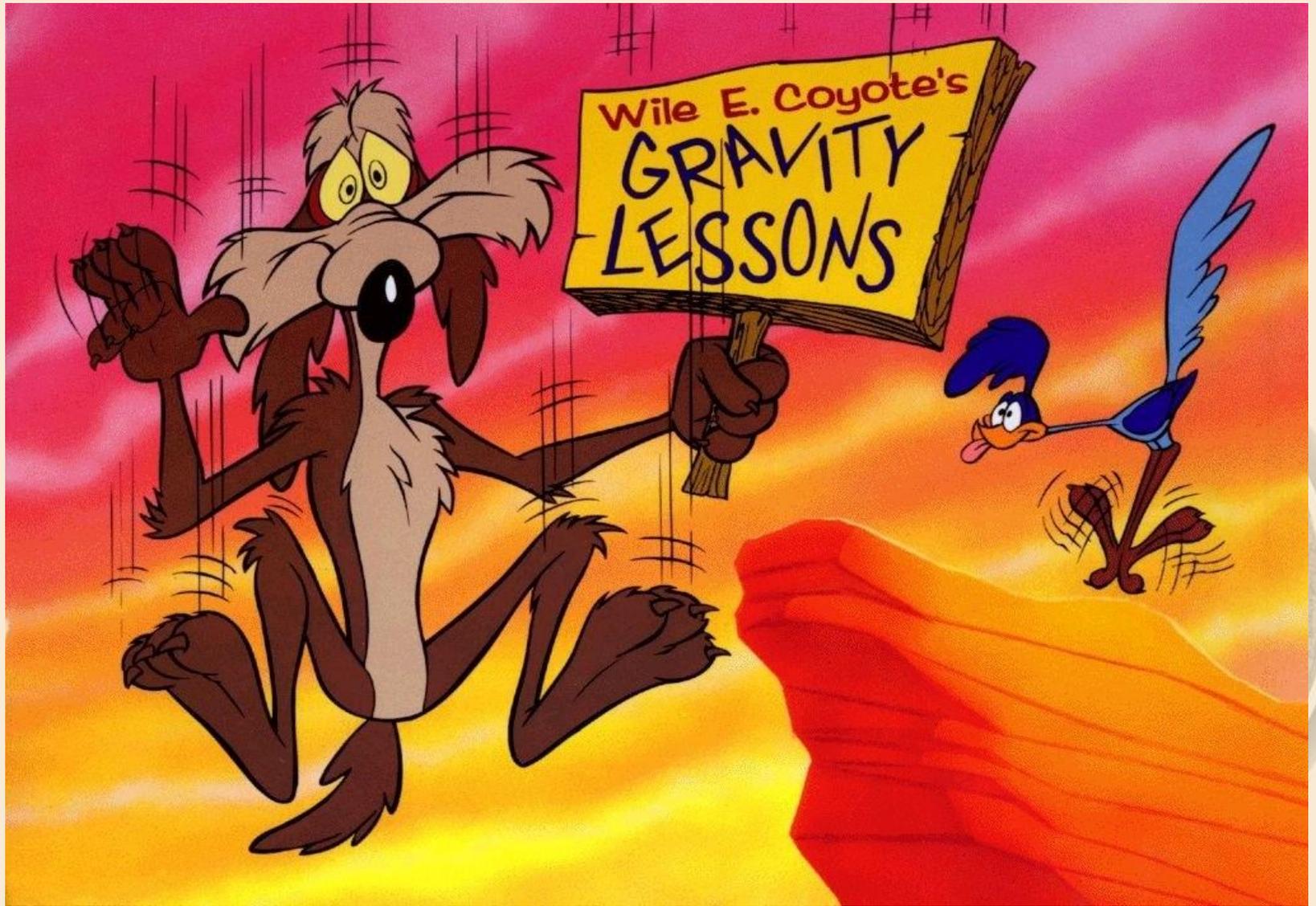
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Another great American philosopher, Vincent Lombardi, who, like George Allen, was a successful football coach, once said «Winning isn't everything, it is the only thing». I would like to paraphrase this sage and make the radical statement that for an analysis of capitalist economies **«Money isn't everything, it is the only thing»**.

Hyman P. Minsky, 1985

# Monetarism

- Ambiguous concept
  - 1968: Friedman's AEA Presidential Address
  - back to the 1950s: quantity theory, consumption, method
  - late 1970s U-turn in economic policy => Neoliberalism
  - reaction against 'Keynesianism' – money neutrality, policy ineffectiveness => New Consensus
- loose utilisation outside academia
  - applied to approaches giving a key role to money



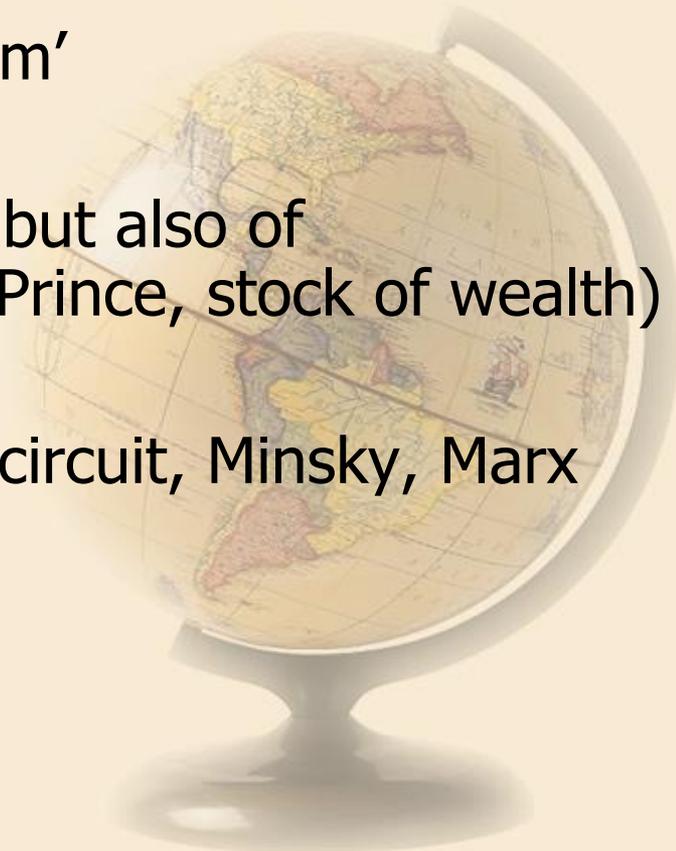
# Anticipations

- Monetary analysis – not Real Analysis
- Credit theory of money
- Macro-social foundation of individual behaviour
- Keynes Treatise on Money (1930), Schumpeter theory of credit (1911) => Wicksell's Interest and Prices (1898)
- forward: 'monetary circuitism', 'financial Keynesianism'
- backward: Marx's monetary theory of capitalist production
- Money in motion => Value in motion => Unbalanced qualitative 'development'
- "Hamlet without the Prince", money relevant only in crisis
- 'fact' (endogeneity of money supply: Cesaratto)? 'institutional pragmatism' (endogeneity of monetary policy)



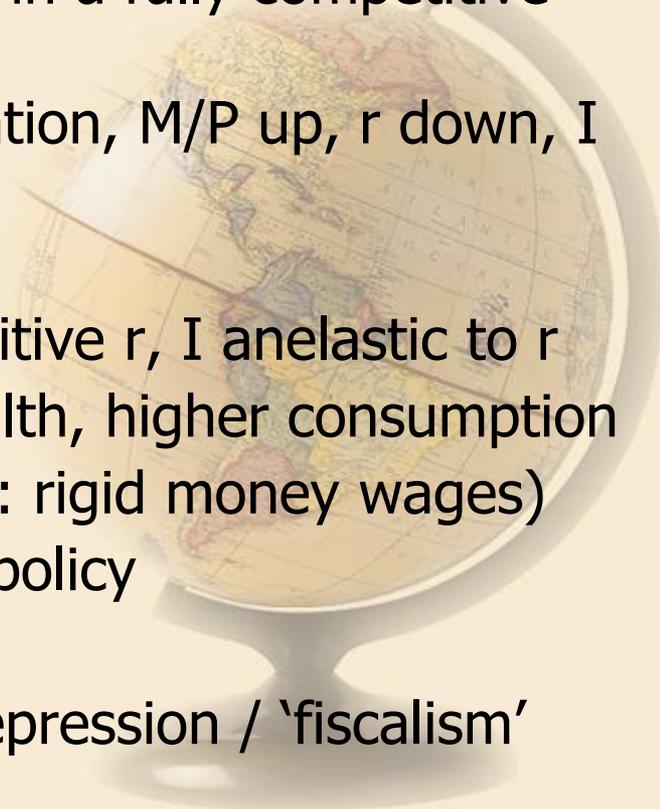
# Monetarism - Neoliberalism

- Neoliberalism? – alleged return to 'laissez-faire'
  - 'real subsumption of labour to finance'
  - financial 'privatised Keynesianism'
- failure of traditional Keynesianism but also of heterodoxies (Hamlet without the Prince, stock of wealth)
- monetary alternative approaches: circuit, Minsky, Marx
- limits & need for innovation



# 'Keynes' versus the 'Classics'

- Neoclassical Synthesis: involuntary unemployment, is it an 'equilibrium'? => 'bastardisation' of Keynes
  - Micro: GEE / Macro: 'Keynesian' economic policy
    - rigidities (ad hoc) – what about in a fully competitive economy?
    - exogenous  $M^s$ , price/wage deflation, M/P up, r down, I up
  - Hicks, Hansen: liquidity trap at positive r, I anelastic to r
    - but Pigou: deflation, rise in wealth, higher consumption
  - Patinkin: disequilibrium (Modigliani: rigid money wages)
    - Neoclassical theory, Keynesian policy
  - Keynes: the theory of the Great Depression / 'fiscalism'

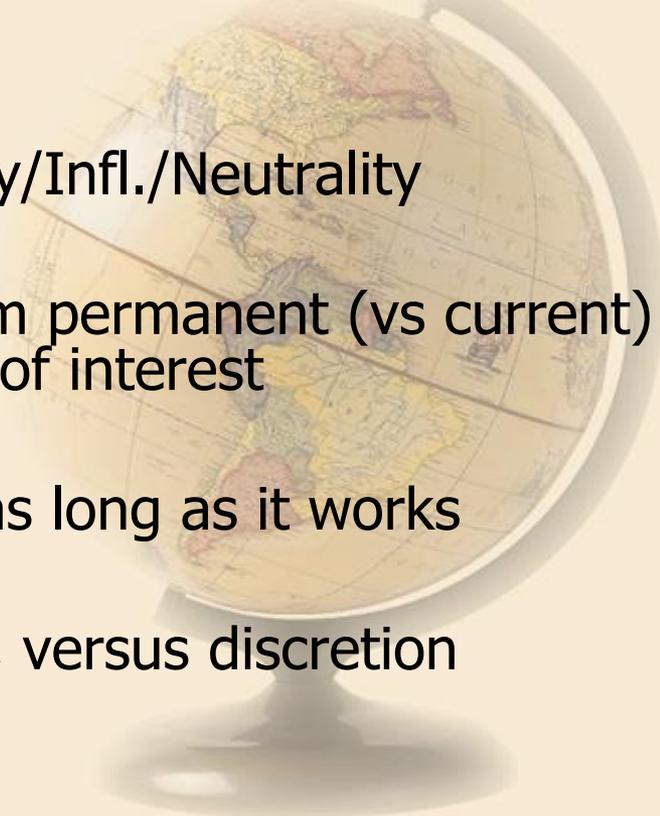


# Second crisis of economics

- Tobin, Friedman: portfolio choice, elasticity of assets v. 'goods' to  $r$ , parameters
- Phillips curve: inverse relation btw rate of unemployment and wage dynamics + through productivity, unemployment and price dynamics / (Lipsey vs. Marxian reading)
- Economic policy menu:  $u$  down,  $p$  up, higher \*level\* of inflation / fine tuning, stop & go in the 1960s
- Joan Robinson 1972 vs the 'Keynesians':
  - 1<sup>st</sup>: 1930s, level; 2<sup>nd</sup>: 60s/70s, composition, distribution
- Full employment: of whom? What for?: "The first crisis arose from the breakdown of a theory which could not account for the **level** of employment. The second crisis arises from a theory that cannot account for the **content** of employment."  
(Joan Robinson)

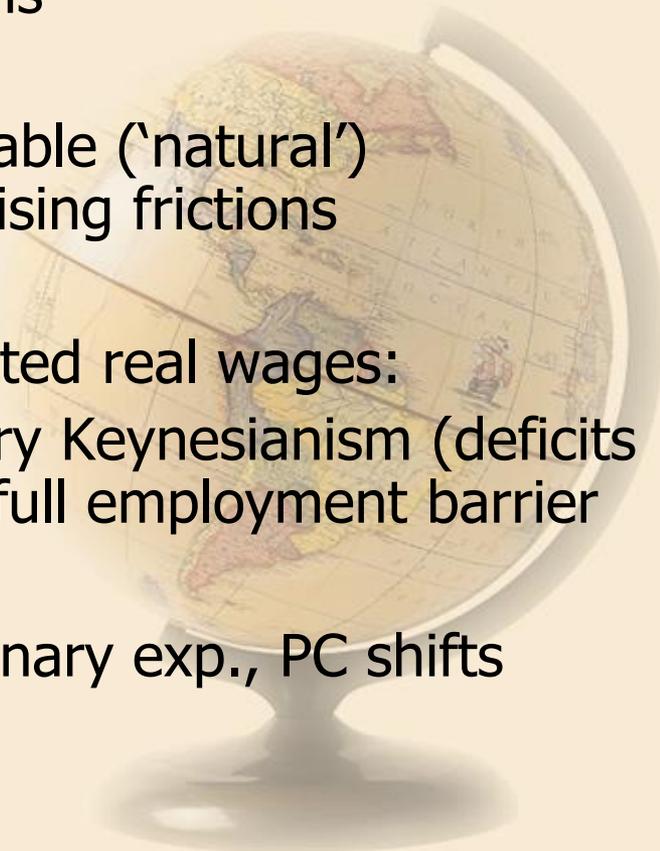
# Enter Friedman

- Milton Friedman, Chicago Un.: Henry Simons, Hayek, Lange – Minsky
  - $M^s$  exogenous,  $V$  stable,  $Y$  at full capacity
  - high elasticity of substitution to  $r$  of both real & financial assets
  - ⇒ Quantity Theory once again: Money/Infl./Neutrality
  - consumption (saving) depends from permanent (vs current) income, thus from wealth => rate of interest
  - instrumentalism: a model is good as long as it works
  - economic policy: follow a (fix) rule, versus discretion



# Enter Friedman

- 1967 Lecture: against Phillips curve, still working at the time
  - it questioned the logic: PC disregards agent expectations
  - MF introduced adaptive expectations
  - background: labour market with stable ('natural') unemployment equilibrium, recognising frictions
  - money wages bargaining for expected real wages:
  - workers are 'fooled' by expansionary Keynesianism (deficits monetarily financed) => breaking full employment barrier
  - errors are corrected, higher inflationary exp., PC shifts
  - inflation accelerates



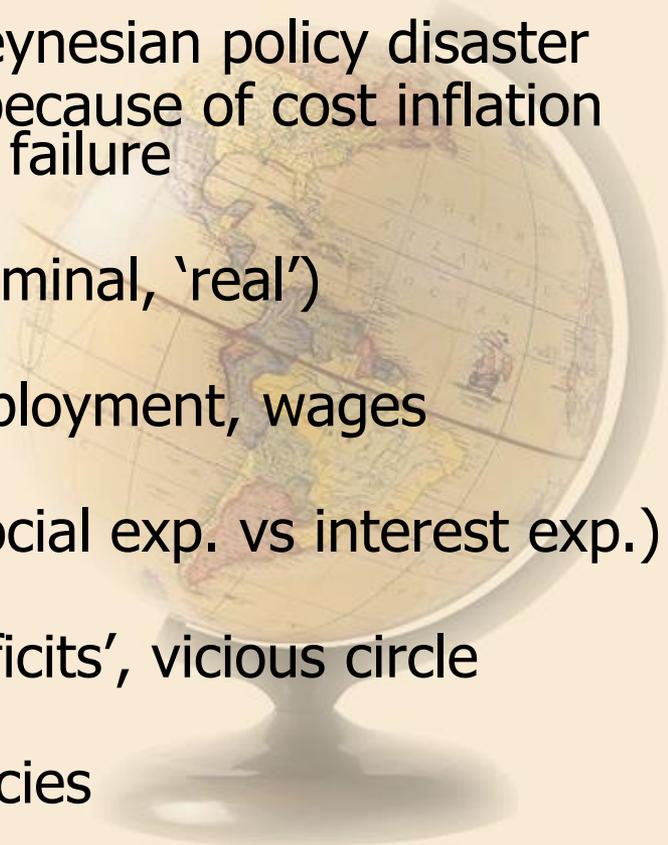
# Friedman seemingly wins

- In 5 moves:
  - (i) explaining temporary success of Keynesianism and apparent validity of PC, after WW2
  - (ii) conservative account (in advance!) of instability and crisis of US and advanced capitalisms, since mid 1960s/early 1970s
    - Vietnam war, War on poverty: deficits (in US!) & liquidity; Bretton Woods collapse; intercapitalist rivalries
  - (iii) implosion of PC (once again, beforehand) since late 1960s
    - strikes and struggles on wage and productivity, later oil crises
  - (iv) understanding stag-flation: rising prices, increasing unemployment



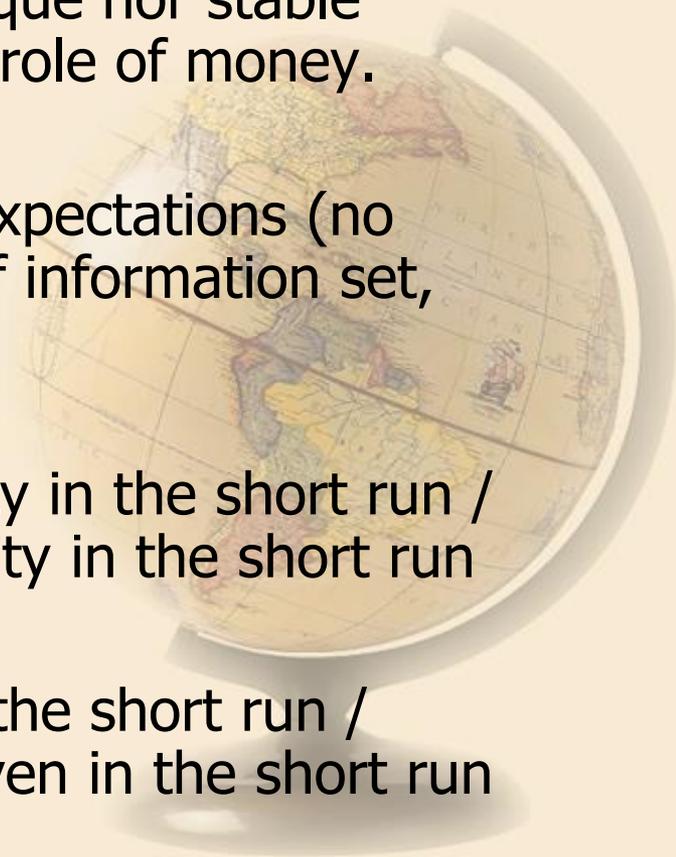
# What is to be done?

- (v) what is to be done?
    - eradicating inflationary expectations => deflation
  - the U-Turn:
    - Volcker, Thatcher/Reagan, after Keynesian policy disaster
      - fighting rising unemployment because of cost inflation as if it was to effective demand failure
    - violent surge in rate of interest (nominal, 'real')
    - attack against trade-unions: unemployment, wages
    - alleged reduction of gvt deficits (social exp. vs interest exp.)
- ⇒ 'kill the beast': turning into 'bad deficits', vicious circle
- ⇒ conditioning future progressive policies



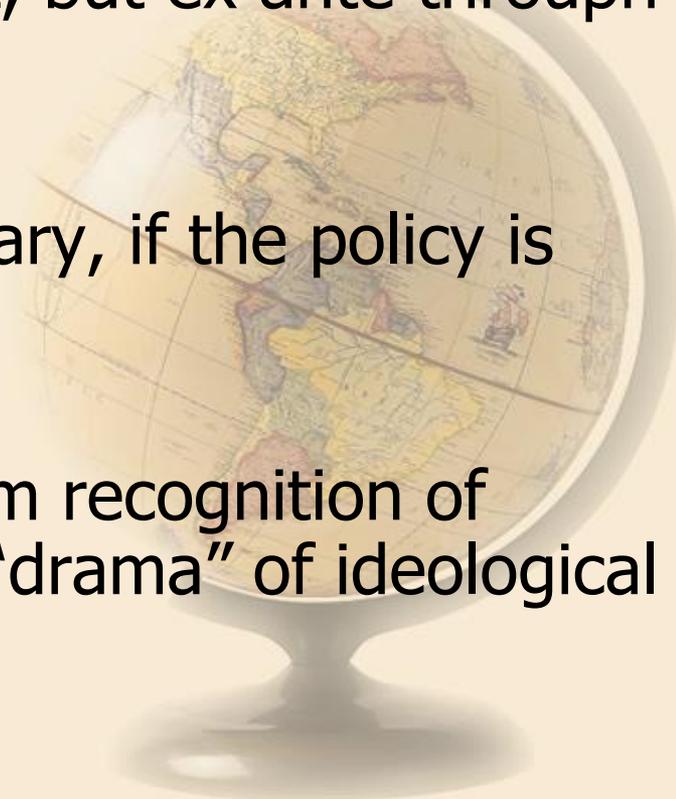
# Monetarism Mark 2?

- Already in the 1970s Friedman is radicalised by Lucas
  - but this is actually an internal critique.
- Rigorous microfoundation of macro in Walrasian GEE
  - *nota bene*: for scholars like Debreu/Hahn, in the intertemporal GEE there is no unique nor stable equilibrium; no room for essential role of money.
- Rational behaviour requires rational expectations (no systematic errors, using the totality of information set, including monetary policy rules)
- Monetarism I: monetary non-neutrality in the short run /  
Monetarism II: monetary non-neutrality in the short run
- Monetarism I: policy effectiveness in the short run /  
Monetarism II: policy effectiveness even in the short run



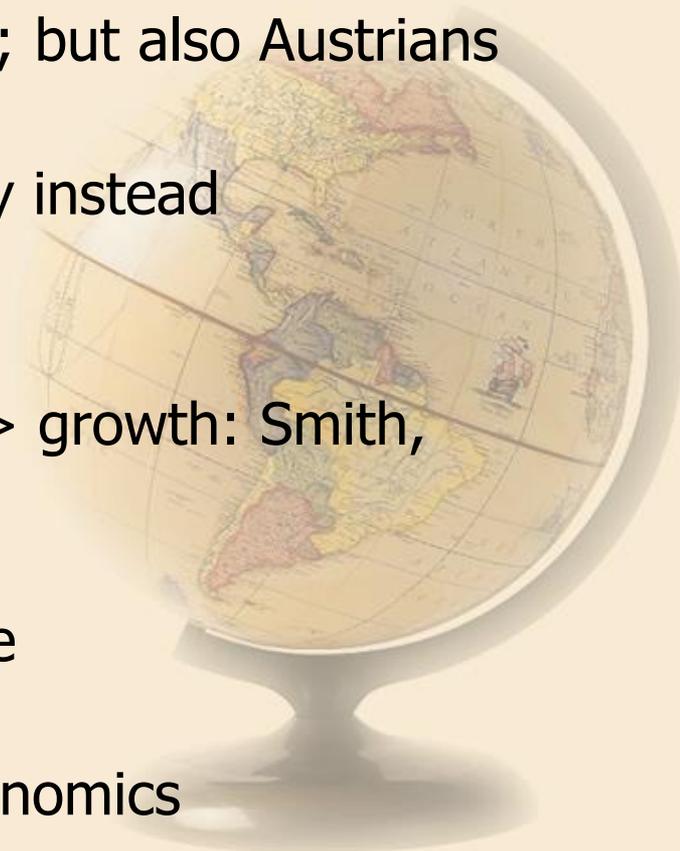
# New (monetary) policy

- Non systematic monetary POLICY may induce stochastic errors, so that the barrier to full employment may be surpassed again
- Central bank policy: not ex post, but ex ante through manipulation of expectations
- Deflation is allegedly un-necessary, if the policy is credible.
- Class struggle 'from above': from recognition of conflict to demonisation of the "drama" of ideological conflicts.

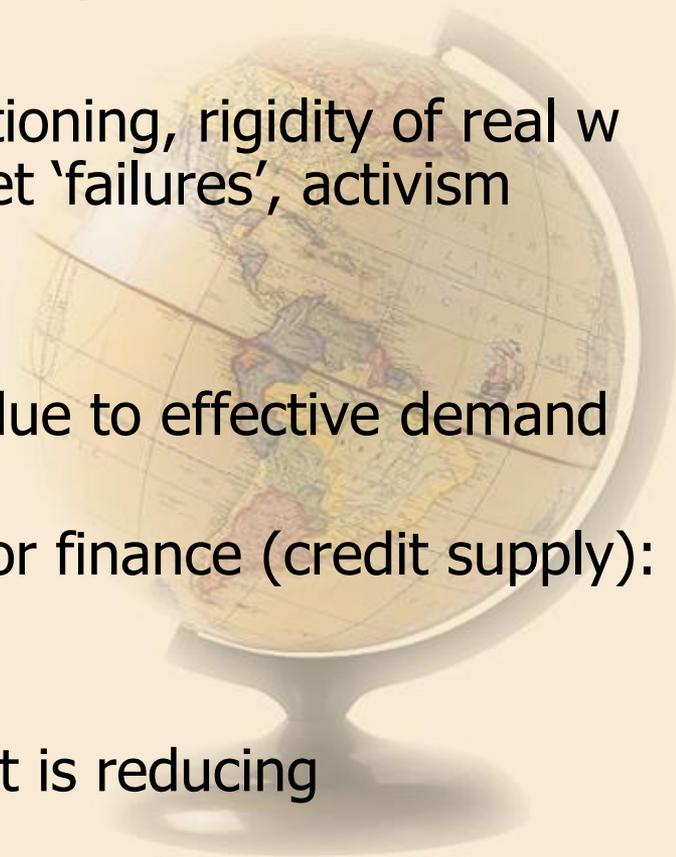


# RBC and New Consensus

- hegemony? Real Business Cycle and Endogenous Growth Theory
  - so-called endogeneity of money supply:
    - Wicksell, monetary heterodoxy; but also Austrians
    - endogeneity of monetary policy instead
      - targeting the interest rate
  - endogenous technical progress => growth: Smith, Schumpeter
  - from demand to supply dominance
- opposition? New Keynesian Macroeconomics



# New Keynesian Macroeconomics

- same starting point: Walrasian GEE, with complete spot & forward markets, no asymmetries.
  - they introduce rational expectations, BUT with 'imperfections'
    - principal-agent in labour market (firms/workers) and in credit market (especially, banks/firms)
  - price & quantity constraints, credit rationing, rigidity of real  $w$   
=> involuntary unemployment, market 'failures', activism
  - no Keynes in NKM:
    - the fault of unemployment is not due to effective demand failures on the commodity market
    - rather to workers (labour supply) or finance (credit supply): rigidities
  - economic policy: social-liberalism, that is reducing imperfections
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# New Consensus

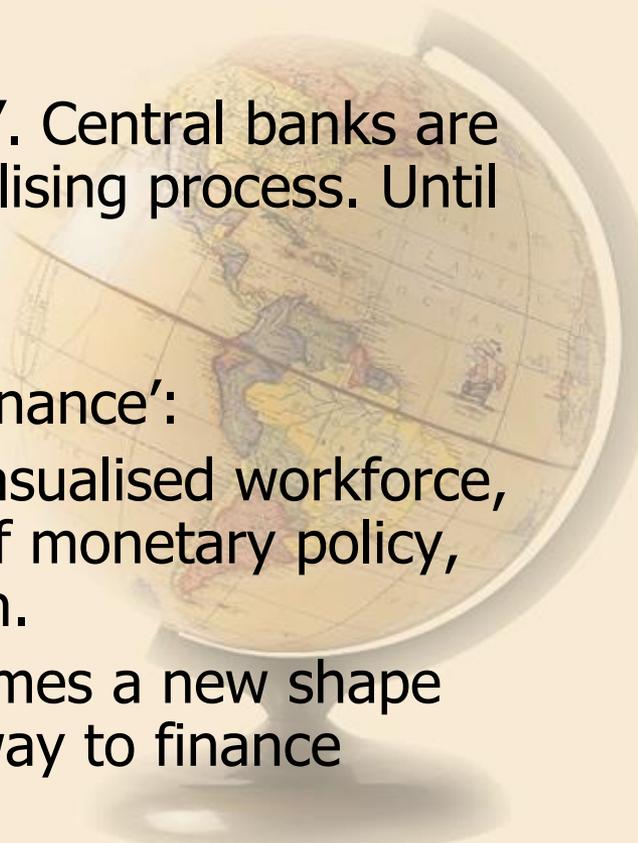
- New Consensus as the New Neoclassical Synthesis
- the 3-equations model
  - no LM, but MM
    - money provided according to some policy rule)
  - IS
    - but through consumption function of interest rate
  - PC
    - short run rigidity of nominal wage



# The short happy life of Milton Friedman

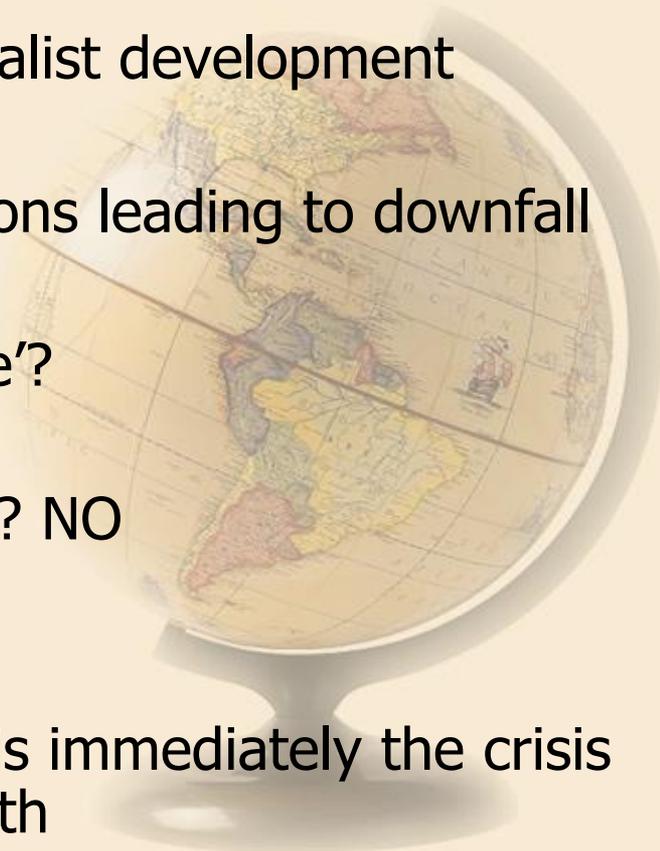
- Monetarist economic policy, born in 1979, died in 1982
  - Latin America debt crisis => the lender (US banking system) got in trouble!
  - spread of bankruptcies in commercial banking
- why IT (a 'Great Crash' like in 1929/1930s) did not happen again?
  - 1st counterendency: Reagan's weaponised Keynesianism, twin deficits
  - 1987 stock exchange crisis, second counterendency: Greenspan's financialised privatised Keynesianism
- background: money manager capitalism (pension funds, etc.)
  - true nature of 'neoliberalism' (1987-2007): a very active politically managed form of capitalism, driven by autonomous indebted consumption thanks to a new monetary policy + 'neo-mercantilist' Kalecki/Luxemburg.

# Real subsumption of labour to finance

- Three pillars: (i) workers traumatisation; (ii) manic[-depressive?] savers; (iii) indebted consumers
  - Funds going into stock exchange => capital assets inflation (key role of housing). 'Households' go into more and more debt. Consumption becomes divorced from income.
  - Firms can finance themselves 'cheaply'. Central banks are lenders of first resort. It seems a stabilising process. Until bubbles explode.
  - \*Real\* subsumption of \*labour\* to \*finance\*:
    - key changes: full employment of casualised workforce, flattening of the PC, endogeneity of monetary policy, centralisation without concentration.
    - but also: the monetary circuit assumes a new shape (Graziani: indebted cons. indirect way to finance production), Seccareccia.
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# The Marx-Minsky half-century

- 'something happens':
  - rate of interest goes up, the bubble collapses
- versus the canonical Minsky model of Financial Instability
- rather, Minsky's stages theory of capitalist development
- each upswing nurtures the contradictions leading to downfall
- the Great Recession: what's the 'cause'?
  - real vs. financial?
    - low consumption of the masses? NO
    - falling rate of profit? NO
  - financial?
    - specificity: the crisis of finance is immediately the crisis of the 'real' mechanism of growth



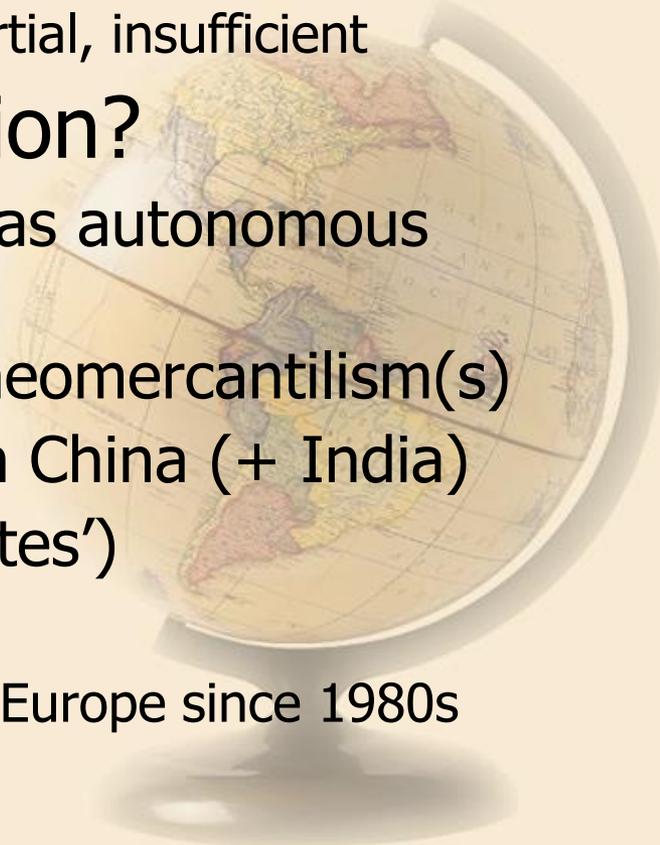
# Neoliberalism beyond the myths

- Neoliberalism I (1980s); Monetarism + Reagan
  - policy driven:  $M^s$ ,  $N$ ,  $w$ ,  $I$ ,  $G$ ; Reagan as a 'Keynesian' (the twin deficits)
- Neoliberalism II (1990s): Greenspan era
  - traumatized workers, manic savers, indebted consumers
  - money manager capitalism, pension fund capitalism => Capital Asset Inflation
  - real subsumption of labour to finance => Centralization without Concentration
  - Horizontal Phillips curve (fragmentation of labour); horizontal  $M^s$  (endogenous money supporting CAI)
- 'Privatized Keynesianism': financial, asset-bubble driven configuration of economic policy



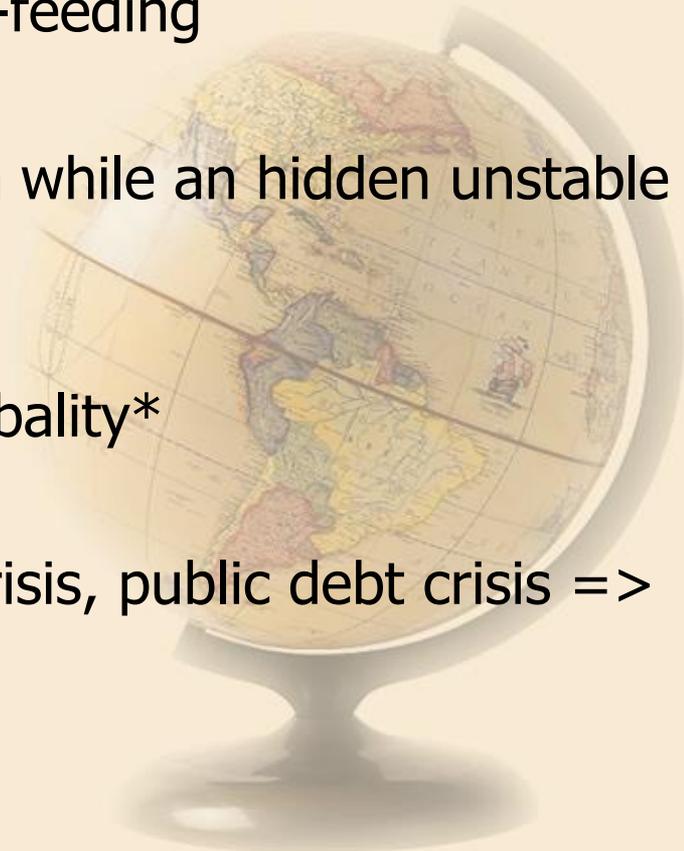
# A dynamical capitalism

- A 'new' capitalism: US, debt driven
  - private debt, other face of shrinking public deficits
  - household debt, no leverage of 'industrial' firms
  - CB lender 1st resort, originate & distribute banking
    - Schumpeterian 'new' economy: partial, insufficient
- counterdendencies to stagnation?
  - internal: indebted consumption as autonomous demand
  - external: providing demand to neomercantilism(s)
    - Asia: Japan + East Asia, then China (+ India)
    - Europe (Germany and 'satellites')
    - Latin America, Russia
      - Japan stagnating since 1990s, Europe since 1980s



# 'Stabilising' disequilibria

- finance: self-feeding disequilibria
- financial disequilibria hamper correction of current account disequilibria, which becomes also self-feeding
- financial configuration stabilising for a while an hidden unstable capitalism
- until the break up for its \*unsustainability\*
- financial crisis (private debt) => real crisis, public debt crisis => unemployment



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