Introduction

Sebastian Dullien, Eckhard Hein, Achim Truger, Till van Treeck

The world economy is in crisis. Since the initial turbulences in the U.S. subprime mortgage market in the summer of 2007, we have experienced a global recession in 2008 – 9 and a wave of financial speculation threatening the existence of the European Monetary Union in 2009 – 10. At the same time, there has been a remarkable shift in economic policies and economic thinking more broadly.[1] Hardly anyone would doubt today that the Keynesian stimulus packages which were put in place all over the world have so far prevented an even sharper fall in output and increase in unemployment and poverty.

Only a few years ago, Keynesian theorising was not en vogue, the 'innovations' of the financial markets were considered welfare-enhancing and conventional monetary policies seemed sufficient for good policy management. To quote just one example out of many, Michael Woodford could still argue in a celebrated book in 2003 that macroeconomic policies had become more efficient "as a result of the greater sophistication on the part of financial markets and greater transparency on the part of central banks, the two developing in a sort of symbiosis with one another" (Woodford 2003: 16). The argument was that central banks should restrict themselves to managing expectations about interest rate policy and inflation, while credit controls or other attempts to directly regulate the flow of funds through financial markets and institutions were considered at best useless and at worst distortionary.

In light of the recent global crisis, the old thinking appears very much out-dated. Few would now question the necessity of tighter regulation of the financial markets. Central banks around the world have taken 'un-

[1] See, as an example, "Rethinking Macroeconomic Policy" by Blanchard et al. (2010).

conventional measures' such as the purchase of asset-backed-securities to stabilise the financial system and the real economy. And fiscal policy is again considered a powerful tool for macroeconomic stabilisation policies, while the interest rate channel has become largely irrelevant in the face of the zero lower bound for policy rates and highly risk-averse private borrowers eager to consolidate their balance sheets. But the crisis also has more structural roots, amongst which are the massive increases in income and wealth inequalities over the past three decades or so, and the global imbalances in international trade (see, e.g., Dullien et al, 2009; van Treeck, 2009). At this stage, it is still unclear how far policy makers around the world will be able to live up to these challenges.

The Research Network Macroeconomics and Macroeconomic Policies (FMM) has dedicated several conferences and publications to these structural macroeconomic issues over the past years. In 2005, "Alternatives to the Orthodoxy" were discussed at the annual conference in Berlin, with a special focus on the critique of mainstream New Consensus Macroeconomics (NCM), on the one hand, and European economic policies on the other (see Arestis et al. 2007; Hein et al., 2006; Hein/Truger, 2007). In 2006, the conference on "European Integration in Crisis" (see Hein et al., 2007) was concerned with, amongst other things, the growing imbalances in terms of competitiveness and current account positions, and the lack of policy coordination within the Euro zone. All these issues have come to the forefront of public attention with the crisis of the European Monetary Union escalating in 2009 – 10. The 2007 conference on "Finance-led Capitalism" discussed the macroeconomic effects of changes in the financial sector (see Hein et al., 2008), and in 2008 a more theoretical and methodological approach was chosen to question the "Shaky Foundations" on which much of the macroeconomic policies of the pre-crisis period was based (see Hein et al., 2009). The present book, which contains a selection of contributions presented at the 2009 conference, continues in this direction and offers analyses on both the causes of and potential remedies for the current economic crisis and the crisis in economics more broadly.

The book has four parts. In part I, the underlying structural causes of the crisis are discussed from a Keynesian perspective. Part II provides analyses of the policy responses to the crisis with a special emphasis on Europe. The chapters in part III make concrete proposals for financial market and other structural reforms, and the contributions in part IV as-

sess the perspectives of a Keynesian New Deal more broadly. In the remainder of the introduction, we provide a brief overview of the chapters in this book.

I. Understanding the crisis

In his chapter "What went wrong? Alternative interpretations of the global financial crisis", *Jan Priewe* argues that the financial and economic crisis of 2008 – 9 is not well understood in the media, in politics and in academic discourse. The author proposes to distinguish between proximate and more structural or ultimate causes that made the financial crisis possible. Global imbalances in trade and capital flows, globalisation of financial markets, the trend towards a new finance-led capitalism and the related income distribution form the set of ultimate causes. Against the backdrop of his analysis, the author suggests that policy conclusions have to go in three directions: Coordinated financial sector reforms in the leading OECD countries are necessary that re-regulate banks and non-banks, tighten microeconomic prudential supervision as well as establish some kind of prudential macroeconomic supervision. Furthermore, the global currency system needs fundamental reforms that guarantee less global imbalances and orderly adjustments of exchange rates which support sustainable economic development and growth. Finally, the road to ever more financialisation should be abandoned, giving priority to revitalisation of the real economy, supported by a downsized financial sector better prepared to serve the needs of non-financial enterprises. This includes the departure from excessive export-led or debt-led macroeconomic regimes, and depending more than in the past on sustainable domestic demand dynamics, based on a more equal distribution of income.

Engelbert Stockhammer also focuses on the link between "Income distribution, the finance-dominated accumulation regime, and the present crisis". The author argues that while there is an agreement that the Fordist accumulation regime has come to an end in the course of the 1970s, there is no agreement on how to characterise the post-Fordist regime. In his view, the notion of a 'finance-dominated' accumulation regime is most appropriate to highlight that financial developments crucially shape the pattern and the pace of accumulation. According to the author, the

finance-dominated accumulation regime is characterised by low and fragile growth. In the chapter, the interaction of distributional dynamics and the dynamics of accumulation are highlighted: A polarisation of income distribution has been an important feature of the finance-dominated accumulation regime, even if the macroeconomic effects have been different in different countries. While some countries have compensated for the stagnation of demand with debt-financed consumption, others have compensated for it with increasing net exports. Finally, according to Stockhammer, the present crisis and the stagnation of wages for large parts of the population are intrinsically linked. At the same time, one underlying cause of the present crisis has been the persistent international imbalances and the associated massive capital flows.

In their contribution “Asset price bubble, financial crisis and deflation in Japan”, *Hansjörg Herr* and *Milka Kazandziska* show that Japan serves as an interesting example for asset price bubbles and their consequences. After a period of high GDP growth which began in the 1950s, Japan fell into a deep financial crisis when the real estate and stock market bubble burst in the early 1990s. The bubble and its burst led to a crack in the Japanese development process, and to this day Japan has still not been able to regain the prosperity it had before the bubble. The Japanese bubble has similarities with the subprime crisis, which started in 2007 in the U.S., and heavily affected the world financial system and the world economy. The key question is whether the United States, Europe and other countries will have similar problems overcoming an extended period of potentially low growth or stagnation after the recession is over. The analysis of the development in Japan can help to better understand the dangers that result from bubbles and asset price deflations, and to determine what kind of policies are needed to prevent a ‘Japanese’ development after the subprime crisis.

The chapter “Institutional investors, the equity market and forced indebtedness” by *Jan Toporowski* takes a look at the link between the strategies of financial market institutions and the indebtedness of companies in the real sector. The chapter revisits some of the issues originally put forward by the author as the theory of capital market inflation, in the book *The End of Finance* (2000). The chapter makes much clearer the key assumptions and relationships between the operations of the capital dominated by institutional investors and the balance sheets of companies. In this way, it presents a theory of how macroeconomic dynamics may be

affected by disequilibrium in the capital market. The author concludes that the supply of equity capital from long-term investing institutions, such as pension funds and insurance companies, in practice makes the equity capital market less adaptable to demand for equity capital from companies. The effect of this is to force companies into debt, with adverse consequences for their willingness to invest and for their cash flow. In this way, capital market disequilibrium may initiate and reinforce deflationary tendencies in the economy at large, and destabilise bank balance sheets in particular.

II. Policy responses to the crisis – a European perspective

Andrea Terzi, in a chapter on “The ‘Keynesian moment’ in policy making and the perils ahead”, discusses the question of whether the alleged ‘Keynesian moment’ has marked a deep reconsideration of a policy regime that Post-Keynesian economists have long criticised. The author places special emphasis on the Euro zone countries which accept an institutional structure that removes monetary sovereignty from all existing fiscal authorities. While making these countries repellent to ‘Keynesian moments’, this also meant that the degree of tolerance with fiscal deficits is even lower than in nations that use their domestic currency. According to the author, this has moved the Euro zone, without a deep political reform of fiscal authorities, on a deflationary, if not implosive, path. In his contribution, the author contrasts the long-run character of the policy implications of Keynes’s *General Theory* with the short-run character of current policies; discusses the question of the limits of fiscal deficits and the nature of the question ‘where does the money come from?’ from a functional finance perspective; and touches the shortcomings in the institutional structure of the Euro zone and argues that the euro has been ailing from ‘too much virtue’. It is concluded that the global crisis may become a turning point, in that those countries that will boldly use fiscal actions will find a way to strengthen their economic welfare and power, while others may be doomed to economic and social decline.

Catherine Mathieu and *Henri Sterdyniak*, in “Global financial crisis: the French policy answer in a EU perspective” then look more specifically at the ‘return of Keynesianism’ in France. The authors state that the 2007 – 2009 crisis has led to a return of Keynesian analyses and policies,

which contrasts with the 1980 – 2007 period when liberal analyses and policies were prevailing. However, this return of Keynesian analyses and policies is seen to be problematic, since the pre-crisis mainstream liberal views matched the interests of the new leading classes, the beneficiaries of financial and economic globalisation. The authors explain that the French President Nicolas Sarkozy had the objective of introducing a break in the French model – based on large redistribution, public spending and taxation – which was assumed to be detrimental to labour, saving, investment and competitiveness. But the crisis has led him to call for a re-foundation of capitalism, which would reduce the weight of finance at the benefit of entrepreneurs and workers. Nicolas Sarkozy endorses French traditional views on the importance of world governance, financial regulation and government support for domestic industries. French stimulus measures have been limited, and hardly targeted on the victims of the crisis: the unemployed – especially the young – and companies and industry sectors in difficulty. But the French economy was less affected than other economies thanks to the size of its automatic stabilisers, and to its financial and economic *archaisms*. Yet, the government has not abandoned the objective of large public expenditure cuts, which it could impose in the coming years under the EU commitments on bringing budgetary positions into balance and under rating agency threats.

In the contribution "Financial crisis, global recession and macroeconomic policy reactions – The case of Germany" *Eckhard Hein* and *Achim Truger* analyse the long-run imbalances underlying the present crisis with a focus on developments in the U.S. and Germany. From this analysis it is argued that, for the near and not so near future, the U.S. will no longer be able to act as the driving force for world demand. This will have major implications for economic policies far beyond immediate responses to the crisis, in particular for those countries which in the past have benefited from soaring U.S. demand – i.e. countries with huge current account surpluses, in particular China, Japan and Germany. Against this background the short-run economic policy reactions towards the crisis are analysed, with a special focus on the question whether the German economic policy regime will tend to meet the long-run requirements for economic policies to prevent sustained deflationary depression in major parts of the world. It is shown that, whereas in the short run German fiscal policy has quite unexpectedly played a sensible and stabilising role, in the medium and longer term a relapse into the traditional neo-

mercantilist policy regime will be an obstacle to the necessary rebalancing in the Euro area and the world economy. Therefore, the elements of a Keynesian New-Deal are sketched, consisting of a re-regulation of the financial and the real sector, a re-orientation of macroeconomic policies, and a re-construction of international macroeconomic policy co-ordination.

III. Which reforms for the financial markets?

In the first contribution in the third part of the book, *Jan Kregel* asks: "Is this the Minsky Moment for reform of financial regulation?" Although the financial crisis was soon christened a 'Minsky Moment', Kregel stresses that those who are acquainted with Minsky's work will recognise that his approach had little to do with 'moments'. The author argues that regulation of the system cannot be effective if it is simply based on measures produced to remedy and reverse the conditions generated by the current 'moment'. Rather, it needs to reformulate the structure of the financial system. The chapter therefore seeks to use a Minsky process analysis, rather than a Minsky moment analysis, to identify two types of structural changes in the system that reforms must seek to redress and reverse. The first is the way the financing of business by means of capital market instruments, in particular structured securitisation, has led to an integration of banking and finance functions. The second is the way these securitised products have reduced the liquidity of the financial system and increased fragility by increasing financial layering. This analysis leads to the conclusion that in a purely privately-owned financial system it may be impossible to fully separate deposit-taking 'commercial' banks from capital market activities if securitisation is maintained as the basic structure used to provide financing to business and to other financial institutions. Nonetheless, it is possible to prevent banks from engaging in particular types of financial activities, in particular proprietary trading and the financing of certain types of arbitrage trading that are not strictly related to the financing of business. The author makes a number of detailed proposals in this direction.

The contribution by *Karl Aiginger* "Post crisis policy: Some reflections of a Keynesian economist" also presents a detailed choice of measures that can *ex ante* increase the resilience of economies, which is par-

ticularly important given that the policies applied after a crisis has started are limited by their implementation speed and structural content. These regulatory proposals are embedded in a discussion of important stylised facts about the current crisis, the role of economic policy and what we could learn from the policies applied. The author then makes the point that a future-oriented stabilisation policy should rely on a broader set of measures to make economies more resilient *ex ante*, and to provide the necessary conditions for making anti-crisis policy feasible, if the next crisis should occur. The chapter also assesses the effect of the policy reaction to the crisis and how it can be seen as a triumph for the Keynesian approach of an anti-cyclical policy. Furthermore it outlines what a Keynesian approach to the crisis means for the exit period.

IV. Perspectives on a Keynesian New Deal

Philip Arestis develops a theoretically founded proposal for "Economic policies after the New Consensus Macroeconomics". Recalling that the NCM, along with its policy implications, has been heavily criticised at FMM network conferences and elsewhere, the main purpose of this contribution is to discuss economic policies that could potentially replace the NCM ones. The alternative perspective in terms of economic policies advanced here is summarised by the author as follows: Use fiscal policy in the short term and in the long term to address demand issues. Interest rate policy should be such that the real rate of interest is in line with the trend rate of growth in the economy. But above all, coordination of fiscal and monetary policies should be pursued. The central bank's objective should be financial stability. Major central banks' cooperation and intervention in the foreign exchange market is necessary to control the exchange rate. Employ regional and industrial policies to create the required capacity. The author's analysis of inflation and its relationship to growth implies that inflationary pressures should worry economic policy makers only when they are substantial. When inflation reaches such high rates a relevant economic policy suggestion is to develop incomes policy to contain such serious inflationary pressures.

The contribution by *Barry Z. Cynamon* and *Steven M. Fazzari*, "The Great Recession and perspectives on Keynesian policy", also places particular emphasis on the role of fiscal policy. The authors suggest that al-

though there has been a shift toward Keynesian thinking, there are deeper lessons from the Great Recession that remain outside the mainstream. The authors argue that modern capitalism has yet to find a *general* solution to the problem of generating long-run demand growth adequate to fully employed supply-side resources. They develop the theme that demand growth in recent decades, at least in the U.S., came from a spending and borrowing binge of unprecedented magnitude. The Great Recession marks the end of this era. Events since late 2007 raise serious questions about where demand will come from to generate a robust recovery and renewed growth over the longer term. The authors conclude with a proposal for a 'Keynesian New Deal' for the 21st century. This paradigm proposes a much more active role for national governments in creating demand growth. They also argue that modern governments, and the citizens they serve, need to adopt a much different perspective on fiscal deficits. This New Deal, however, should not be a blank check for any government project that a vote-seeking politician can dream up in the name of demand stimulus. Cynamon and Fazzari propose the need for a set of institutional structures to channel government activity in directions that shore up demand, enhance productivity, and promote a decent society worthy of the high material living standards achieved by modern capitalism.

In a similar vein, *Robert Pollin* develops a proposal for "Building the Green New Deal in the United States". The author starts his analysis by observing that the Obama Administration's economic stimulus programme that was passed into law by the U.S. Congress in February 2009˜ despite being too small and too loaded with tax breaks for corporations˜ is still among the most progressive pieces of U.S. economic legislation since the 1960s. The green investment features alone stand as a major advance toward building a clean-energy economy. In the author's view, doubly significant is the fact that this legislation represents the first large-scale attempt to combine protection of the environment with development of a clean-energy economy, job creation, and economic opportunity. For a generation, the opposite idea was assumed: You could protect the environment, or you could promote economic growth and job creation, but not both. It has been known since World War II ended the 1930s depression that large-scale government spending can generate millions of jobs and push the economy out of a slump. But of course, in the 1940s, it was the expansion of military spending, not social or environmental pro-

grammes, that served as the engine of job creation. The author raises the question: Can we expect that a green investment programme today can have an effect comparable to military spending in the 1940s? In other words, is it viable to think about building a Green New Deal today? And indeed, in Pollin's assessment, the most important and most clearly established economic benefit of such a Green New Deal is that clean-energy investments can be a substantial source of new employment opportunities throughout the United States.

Rania Antonopoulos and *Kijong Kim* conclude the final section with their contribution "Responding to the crisis, promoting gender equality: Stimulus packages, public job creation and lessons learned from South Africa's expanded public works programme". The authors remind us that we must not lose sight of the fact that while the current crisis is reversing trends in prosperity enjoyed by some, for the vast majority of the world's population they are simply adding insult to injury: Poverty and inequality have shown remarkable persistence, and reducing them has remained elusive – including in countries experiencing a healthy growth rate over the last decade or so. According to Antonopoulos and Kim, these challenges, poverty and income inequality, originate in several distinct processes, and policy must be mindful of the fact that one size will not fit all: a growing earnings gap between skilled and unskilled workers; the shift in the functional distribution of income away from earned income and in favour of profits; the eminent threat of landlessness due to low agricultural productivity or the adverse effects of world market prices; international trade practices that put pressure on staple food prices; and a disappearing state social safety net. The authors conclude that public job creation is an integral part of the policy mix needed to address unemployment and poverty. Drawing in marginalised segments of the population via the types of job creation proposed in this analysis has the strong potential to contribute to many policy objectives, including reversing outward migration and crime trends, revitalising marginalised communities, increasing human capital, and promoting social inclusion. Moreover, by reducing the unpaid care burdens of poor women, the specific jobs they propose are said to contribute toward the goal of gender equality.

Acknowledgements

The chapters in this volume are based on presentations at the 13th conference of the Research Network Macroeconomics and Macroeconomic Policies (FMM) on "The World Economy in Crisis – The Return of Keynesianism?". The conference took place in Berlin, 30th – 31st October 2009. Further contributions to this conference will be published in a special issue of "INTERVENTION. European Journal of Economics and Economic Policies". We would like to thank the contributors to this volume for their cooperation and the participants in the conference for the stimulating discussions. Special thanks go to Rory Finch and Sebastian Türk for the assistance in the editing process, and to the Hans Böckler Foundation for organisational and financial support fort both the conference and this publication.

References

Arestis, P., Hein, E., Le Heron, E. (eds.) (2007): *Aspects of Modern Monetary and Macroeconomic Policies*, Basingstoke: Palgrave Macmillan.

Blanchard, O., Dell'Ariccia, G., Mauro, P. (2010): Rethinking macroeconomic policy, IMF Statt Position Note, February 12th, 2010, SPN/10/02, Washington D.C.: IMF.

Dullien, S., Herr, H., Kellermann, C. (2009): *Der gute Kapitalismus ...und was sich dafür nach der Krise ändern müsste*, Bielefeld: Transcript.

Hein, E., Heise, A., Truger, A. (eds.) (2006): *European Economic Policies. Alternatives to Orthodox Analysis and Policy Concepts*, Marburg: Metropolis.

Hein, E., Niechoj, T., Spahn, P., Truger, A. (eds.) (2008): *Finance-led Capitalism? Macroeconomic Effects of Changes in the Financial Sector*, 2nd edition 2009, Marburg: Metropolis.

Hein, E., Niechoj, T., Stockhammer, E. (eds.) (2009): *Macroeconomic Policies on Shaky Foundations. Whither Mainstream Economics?*, Marburg: Metropolis.

Hein, E., Priewe, J., Truger, A. (eds.) (2007): *European Integration in Crisis*, Marburg: Metropolis.

Hein, E., Truger, A. (eds.) (2007): *Money, Distribution and Economic Policy. Alternatives to Orthodox Macroeconomics*, Cheltenham: Edward Elgar.

van Treeck, T. (2009): The macroeconomics of 'financialisation' and the deeper origins of the world economic crisis, IMK Working Paper, 9/2009.