Has "It" Happened Again?

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Abstract: The ongoing global financial crisis, which originated in the United States, quickly spread to a number of countries around the world. Since it began to unravel in the summer of 2007, it has spread with an intensity rarely seen and claimed a great number of victims. The rise of a finance-dominated capitalist system implies profound changes in the way domestic economies operate. In particular, financialization contributed to the decoupling of finance from production as we moved away from a Keynesian production economy to a “predatory” type of financial capitalism, in which the role of banks in particular changed significantly: the bank–firm relationship inherent in the monetary circuit was replaced with a bank–financial market relationship. The financialization of the economy had many important consequences, notably on income distribution, and it is particularly through income distribution that financialization affects economic activity. Throughout this crisis, the profession has rediscovered both Keynes and Minsky, or so it seems. It is against a backdrop of financialization that the Keynesian/Minskyian dimension of the current crisis is discussed in this issue.

Keywords: financial crisis, financialization, income distribution, Minsky.

The ongoing global financial crisis, which originated in the United States, quickly spread to a number of countries around the world. Since it began to unravel in the summer of 2007, it has spread with an intensity rarely seen and claimed a great number of victims, from households to firms and banks, indeed affecting whole countries. What began originally as a sectoral problem in the subprime market in the United States, itself a result of predatory lending, quickly became a systemic crisis spreading to all sectors of economic activity. As a result, many economies
faced increased unemployment, collapsed investment, lower output growth, and a serious threat to their long-term performance. In its wake, this crisis revealed a very fragile banking and financial system. In many ways, economic policy has also been strongly affected by the current crisis. Central banks have adopted a number of innovative measures (so-called quantitative easing), and governments have initiated a number of fiscal measures aimed at stimulating their economies.

Further, at the time of this writing, it appears that the crisis is far from over: in Europe, we are witnessing unprecedented turmoil in real and financial activities. Indeed, Greece is on the verge of bankruptcy (as a result, we are told, of years of living beyond its own means), salvaged only by the unprecedented—not to say reluctant—actions of the European Union as well as the European Central Bank, fearing that their inaction may lead to the Greek crisis spreading to many other countries in the euro area. Yet there is still some doubt about whether these actions can prevent the crisis from spreading to other countries. The draconian cuts in public spending demanded of Greece may leave it too weak to recover, as aggregate demand will be gravely deflated for many years to come in that country. For the time being, it appears that the same fate may be hanging over other countries, in particular Spain and Portugal. In its wake, the crisis continues almost unabated, and the existence of the euro itself hangs in the balance.

We can draw a great many conclusions from the crisis, in terms of both economic policy and economic analysis. On the theory side, it is now plain that neoclassical economics has failed and stand in complete disarray. Professional economists of all stripes should indeed accept the conclusion that the idea of efficient markets is nothing but a myth. Financial markets are, in fact, destabilizing and chaotic by nature, which can only be reconciled with the self-adjusting properties neoclassical economists claim they have with great difficulty, if at all. Uncertainly plays a dominant role, and the future is unknowable.

On the policy side, we have witnessed the unprecedented rise of Keynesian or Keynesian-friendly policies, with governments around the world adopting rare stimulus packages to save fledging economies. Further, central bank policies have also been deeply transformed, to become increasingly interventionist. Can this last? Already, countries are succumbing to orthodox thinking about public deficits and debts and are scrambling to show their leadership in proposing bold steps to reduce public deficits incurred during the crisis. In this sense, Keynesian policies have been reduced, once again, to mere short-term or crisis solutions. As a result, the macroeconomics of Keynes has not been so much rediscovered as conveniently borrowed. In fact, policymakers continue to think that Keynesian policies should not be adopted permanently.

But, in addition to having rediscovered Keynes, the economics profession seems to also have stumbled on the views of Hyman Minsky, a central figure in post-Keynesian economics. Minsky’s financial analysis of cycles seems to be, at least at first glance, well suited to explain the current financial crisis. If this is so, then “it” has certainly happened again.
The purpose of this issue of the *International Journal of Political Economy* is, in fact, to bring together a number of selected papers discussing the Minskian and Keynesian dimensions of this crisis, to show its deep roots and pave the way for structural reforms upon which policymakers should concentrate their efforts, and to avoid “it” from happening again in the not-so-distant future.

**Finance and Capitalism**

It can be difficult—if not virtually impossible—to identify the precise event that triggered the current financial crisis. Undoubtedly, the causes of this global crisis are many, interrelated, and complex. There is no doubt that the role played by deregulation cannot be overemphasized, but neither can the growth of specific and complicated financial instruments, the predatory lending practices of banks, and the apparent fraudulent practices of several investment banks. Whether these phenomena on their own can explain one of the biggest crises in postwar history is a question that needs to be discussed more fully. Were these events sufficient to cause a crisis or were there other, more fundamental causes?

Indeed, although these events may have contributed in some way to the crisis, many post-Keynesian economists would argue that this crisis was long in coming and that it was largely inevitable in view of the dynamics of our economic systems in the financialization era. Because of some fundamental changes in the workings of our economic systems, it was really only a question of time before a systemic crisis like this occurred, given the increased financial fragility of our economies.

As we argue elsewhere (Rochon and Rossi 2010), the rise of a finance-dominated capitalist system resulted in very profound changes to the way domestic economies operate. In particular, as Baragar and Seccareccia (2008) argue, financialization contributed to the decoupling of finance from production: we moved away from a Keynesian production economy to a “predatory” type of financial capitalism. In other words, the monetary circuit has been profoundly altered, and the role of banks in particular changed significantly: the bank–firm relationship inherent in the monetary circuit was replaced with a bank–financial market relationship that is crucial for the working of our finance-dominated economic systems.

The financialization of the economy had many important consequences, notably for income distribution, and it is particularly through income distribution that financialization affects economic activity. In this regard, one can distinguish two transmission channels. The first concerns the distribution of national income between wages and profits. In the past two decades, we have witnessed a steady decline in the wage share in favor of the profit share. However, it is through the second channel that financialization is more devastating. Indeed, although a larger profit share may increase productive investment, and hence output and employment, this has not occurred in the real world, as the part of profit that goes to rentiers (in the form of interest and dividends) has been rising to the detriment of nonrentier profit. This result is interesting, because it underlines precisely the growing influence
and power of financial actors and financial interest. Hein (2009) outlines a number of examples in this regard, from shareholder valuation policies to dividend-elastic price strategies. Further, a strong drop in investment coupled with increased profits transformed the private sector into a net lender (Seccareccia forthcoming). Hence, although income distribution has favored the profit share, investment has not keep pace, because it has increasingly favored rentiers over nonrentiers: profits have not been reinvested but distributed to rentiers to a very large and growing extent during the past three decades. The motto “retain and reinvest,” which characterized the precrisis and prefinancialization era, has been replaced with “downsize and distribute” (Lazonick and O’Sullivan 2000), which largely dominates now.

The impact of financialization on households is even more important, actually. As a matter of fact, households ended up carrying much of the brunt of the changes in income distribution. Indeed, over the past two decades, we observed a steady decline in the wage share as well as a decline in the savings rate of households. In some countries the effective savings rate is even negative. This carries some quite evident implications for aggregate demand and output growth. So, although we witnessed some economic growth in the decade before the crisis, this growth was credit led and mortgage–debt fueled, as households borrowed increasingly against the steady rise in valuation of their homes. Over the short run, this may indeed benefit aggregate demand and output growth, but it does so by making the whole economic system increasingly fragile.

This all suggests that although there was a definite financial dimension to this crisis, there was nevertheless an important economic dimension as well. Because of their precarious nature, the precrisis growth prospects were unsustainable, and the system was bound to collapse. The many financial innovations that took place, such as deregulation and securitization, were the financial straw that broke the economic camel’s back, so to speak.

Yet economic policy also played a very important role in this regard. First, the adoption of inflation-targeting strategies meant that central banks were using interest rates to target inflation directly. This resulted in higher rates of interest, giving rise to the ultimate “revenge of the rentier,” which favored rentiers and affected the wage share negatively (see Rochon and Rossi 2006) but the rentier share positively. Second, governments have been determined to reduce public deficits. Indeed, a number of states have succeeded in either balancing their budget or reducing public expenditures considerably. Both have had the perverse effect of transferring the debt burden from the public sector to the private sector, and in particular to the household sector. Indeed, since the 1980s we have witnessed a steady increase in the indebtedness of households, accompanied more recently by a lower (and in some cases negative) savings rate; households have thus carried the weight of fiscal austerity measures. Such fiscal austerity measures must be seen once again as a perceived noninflationary policy that favors wealth holders, to the detriment of low- and middle-income people.
Minsky and the Crisis

It is against a backdrop of financialization that the Minskian dimension of the current crisis is discussed in this special issue. But is financialization reconcilable with Minsky’s analysis? This is an important question that the selected papers address in depth. In Minsky’s analysis, it is the nonfinancial business sector that is typically overindebted, not the household sector. Does this fact invalidate Minsky’s analysis, or is this too strict an interpretation of Minsky’s seminal work? On the other hand, Minsky puts financial innovations squarely at the heart of his analysis, and innovations certainly played a role in the current systemic crisis.

Undoubtedly these are not easy questions to answer and depend largely on two issues. First, all depends on our interpretation of Minsky’s analysis and what we consider to be his key insights. Second, it also depends on how we understand the current crisis and whether financial innovations were the cause or just what allowed an already fragile economic system to break and spread the crisis to all its constituent parts.

So, in the end, the question is simply this: Has “it” happened again? We hope that the papers in this special issue will help the understanding of the crisis in this light and whether this was indeed a Minskian crisis of global reach.

References


