The 2007-2009 Economic and Financial Crisis

An Analysis in Terms of Monetary Circuits

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ABSTRACT. The 2007-2009 economic and financial crisis has been the result of systemic events and failures. Understanding its ultimate origins requires therefore a systemic approach. This is provided by monetary circuit theory, also known as the monetary theory of production, for it considers the workings of a monetary economy of production from a macroeconomic point of view. The selected papers in this issue explain the causes of the 2007-2009 crisis referring to the (disorderly) working of monetary circuits in our finance-dominated capitalist systems. Moving from a positive to a normative analysis, the contributions to this special issue point out a number of economic-policy reforms at a structural level, designed to avert that a further systemic crisis might occur in any monetary economies of production and exchange.

KEYWORDS: Financial crises, Monetary Circuit, Monetary Theory of Production.


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1. Introduction

The subprime crisis that burst in the United States in the summer of 2007 rapidly involved a number of segments of globalized financial markets, and became later on a systemic crisis, therefore affecting investment and production activities all over the world. Fictitious capital, circulating in the financial sector as a result of two decades of financial deregulation, as well as increasingly complex engineering practices have shaped thereby also the so-called “real” economy giving rise to output reduction and growing unemployment in both advanced and emerging countries around the globe. The rising “financialization” of all capitalist economies has made it plain eventually, and dramatically during the 2007-2009 global economic crisis, that for every money unit associated with production, a dozen or far more units of money are issued and circulated in purely financial transactions that have no real stuff behind them.1

The purpose of this special issue is to bring together a collection of cutting-edge theoretical and empirical papers devoted to studying, and explaining, the causes and consequences of the 2007-2009 global economic and financial crisis, by referring to the conceptual apparatus of the modern theory of the monetary circuit, also known as monetary theory of production, which is strongly based on Keynes’s (1933/1979) entrepreneur (or money-wage) economy, and considers in light also of both Wicksell (1922) and Schumpeter (1912, 1917-1918) the vital importance of banks (and their renewed credit lines) for economic activity in any monetary economy of production.

The next section introduces the reader to modern monetary circuit theory briefly. The third section provides a comprehensive overview of each contributed paper, and explains how the latter is a constituent part of the collective research project whose current results are presented in this special issue. The last section concludes with the task ahead of the economics profession, in order to provide a better understanding of monetary economies, upon which sound macroeconomic policies ought to establish the right structures and institutions that can avoid the occurrence of another systemic crisis as the global economy experienced in 2007-2009.

2. Understanding the capitalist economy in light of monetary circuit theory

During “the glorious thirty years” after the end of the Second World War, banks were the key institutions in any growth-oriented capitalist systems of production and exchange. Commercial banks purveyed indeed the required “initial finance” in order for any creditworthy businesses to set out their own production processes, obtaining

1. Financialization refers to the growing dominance of finance in economic activity. This also is captured by the expression “finance-dominated capitalism”, which suggests “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operations of the domestic and international economies” (Epstein, 2005, p. 3). See Pilkington (2009) for analytical elaboration on financialization in a monetary circuit framework. See also Hein (2010) for a post-Keynesian perspective on the same issue.
the necessary credits from banks in advance of sales receipts on the products market. As monetary circuits were opened, and closed, by banks working with businesses in any sectors of economic activity, production, circulation, and consumption of output were carried out through payments settled by the commercial banking sector, on top of which the central bank acted as settlement institution on the interbank market (see Rossi, 2007, p. 32-88). Hence, economic activity was organized across three macro-categories of agents, namely, banks, firms, and wage earners: on the labour market, firms paid out current wage bills to workers through banks’ monetary and financial intermediation; on the goods market, firms sold produced real goods and services in order for them to obtain “final finance”, and thereby reimburse (a part of) their bank debts; on financial markets, firms sold several types of assets, to capture those bank deposits that wage earners disposed of in exchange for any financial assets that paid a rate of interest higher than that on their deposits with banks. Every economic flow was intermediated by the (commercial) banking sector, whose working both had a systemic importance and was instrumental in any production-consumption activities across the economy as a whole.

The systemic approach to any economic activity comprised in a monetary circuit perspective can be represented as in Figure 1 (adapted from Seccareccia, 2009, p. 2).

![Figure 1. The traditional role of banks in the pre-financialization era](image)

The bold lines in Figure 1 show the most important flows in the monetary circuit, whose origin and end point is the banking sector. The shaded relation between banks and firms is crucial for the opening of the monetary circuit and formation of national income: banks are special, as the banking system as a whole can grant loans without the need to dispose of any pre-existent bank deposits. In that perspective loans create deposits, as Schumpeter (1970) put it in his famous “banking proverb”. As a result, a
debt–credit relation arises between firms (indebted to banks) and wage earners, who have a credit with respect to banks (as testified by their claims on bank deposits) and to firms eventually, as the banking system is just a “go-between” in that relationship.

Financialization changed this framework dramatically. “Instead of industry being the net borrower in relation to the banking sector, growing profits and retained earnings associated with a relatively weak business investment have slowly transformed (or ‘rentierized’) the non-financial business sector itself into a net lender that seeks profitable outlets that provide high financial returns for its internal funds” (Seccareccia, 2009, p. 3). Owing to financial liberalization and deregulation, banks may and indeed have to compete with non-bank financial institutions, in order for them to keep their market share, reducing both their mark-up or spread on policy rates of interest and the credit standard they used to apply to firms and householders. In that process, banks have become “financial supermarkets” engaged in investment banking first and foremost, which in fact is a misnomer, for it has nothing to do with investment properly speaking – it is nothing else, and nothing more, than speculation on global financial markets, which are, indeed, far away from providing any support to productive investment within the economic system (see Guttmann, 2008). In this new framework induced by financialization over the last thirty years or so, a number of businesses moved from a debtor into a creditor position towards banks, and many wage earners (especially at the bottom of the wage pyramid) moved to the opposite, and for them very problematic, situation, becoming thereby net borrowers from both banks and non-bank financial institutions (among them, mortgage brokers and credit card issuers feature prominently). These transformations of our monetary economies of production and exchange have been accelerated by the emergence of large funds, including hedge and pension funds, which “recycle” on financial markets all around the world the huge liquidity provided by firms’ savings (as the latter are not invested in new production processes, whose output cannot be bought by consumers owing to their stagnating real wages and increasing indebtedness) and which is available also because of pension schemes for an ageing population in many “advanced” or mature economies all over the world.

In these finance-dominated systems, a large and swiftly increasing share of credit granted by both banks and non-bank financial institutions has been directed towards financing consumers’ demand rather than non-financial firms’ investment projects in so far as the latter have been dramatically limited by the working of financialization. This explains the existence and, as a matter of fact, the persistence of involuntary unemployment, since firms find it (more) profitable to lend their profits on financial markets rather than investing them into the production process (see Gnos, 2009).

Figure 2 shows the modified role of banks in a finance-dominated system, whose monetary circuits are driven by financial markets and motives, rather than by labour markets and productive investment (see Seccareccia, 2009, p. 6).
The original relationship between banks and firms, which was at the centre of the orderly working of monetary circuits in the pre-financialization era (see Figure 1), is to a large extent downgraded, to the benefit of the ill-starred relation between banks and globalized financial markets, which become instrumental in the workings of any finance-dominated systems, and dictate the pace and the path of economic growth as well as the very short-term objectives of both financial and non-financial businesses.

While the traditional link between firms and wage earners still originates income through the banks’ monetization of newly-produced output on the labour market, its contribution to economic growth has been much reduced by stagnation of real wages and increased households’ debt, which is testified by their very low saving rates in a number of “advanced” economies (as a matter of fact, these rates have been negative at times in the United States during the pre-crisis period in the twenty-first century). Banks have thus found it more profitable to extend credit lines to householders, also with respect to mortgage financing, rather than merely to firms, to which they could indirectly sell a variety of new and complex financial products through the financial markets domestically and across the country’s borders. Indeed firms’ retained profits were recycled on global financial markets, in search for the highest return within the shortest period of time, rather than invested on new production processes. The result has been a rapidly inflating asset bubble, both on real-estate properties and financial claims, which in the end burst and ravaged the global economy.
In that framework, “banks have played a key role by being the primary providers of the financial raw materials that have gone into feeding, through securitization, the financial markets via the investment banks […] with new, and ever more sophisticated, speculative derivatives – that are then sold in the financial markets, through hedge funds, etc., to the new corporate rentiers” (Seccareccia, 2009, p. 6). It is that framework that the contributed papers in this special issue investigate deeply, to shed light on the essential causes of the 2007-2009 economic and financial crisis, whose ultimate origins are neither behavioural nor localized in the United States, but in fact structural and systemic, as they encompass the global economic system as a whole – one should call it the first systemic crisis of finance-dominated capitalism.

3. A systemic overview of the contributions to this issue

Analyzing the origins of the 2007-2009 economic and financial crisis in light of monetary circuit theory implies setting off from the relation that generates income in the whole economic system, namely, transactions on the labour market (see, among others, Graziani, 2003). Forges Davanzati and Tortorella Esposito (2010) investigate thus the dramatic consequences of labour-market deregulation on functional income distribution in a framework characterized by restrictive fiscal policies. Their analysis shows that the crisis originated in the wrong economic policies of low wages as well as balanced budgets in the public sector. As a matter of fact, deregulating the labour market implies less State intervention on it and decentralization of wage bargaining. Both increase the downward pressure on wages for two reasons: on the demand side, increased uncertainty for wage earners having a temporary job leads them to reduce their current propensity to consume, in order for them to smooth their consumption, hence their well-being, over time. On the supply side, the “discipline effect” elicited by a reduced bargaining power of workers and trade unions (where they exist) raises labour productivity of those wage earners who fear to lose their job otherwise. These phenomena combine to give rise to a lower employment level, which puts a pressure on any wage earners to reduce their compensation claims. The possibility for wage earners to apply for, and rather easily obtain, consumer credit is an additional factor that explains how the labour-market regime elicited by neo-liberal economic policies has been operating over more than two decades before the 2007 credit crisis burst in the United States.

The monetary circuit (two-sector) model put to the fore by Forges Davanzati and Tortorella Esposito (2010) integrates wage-earners’ indebtedness as well as rentiers’ consumption – both stemming from financialization of capitalist economies – and its originality consists in showing that for the set of firms as a whole profits can only be earned because of rentiers’ expenditure on luxury goods, which elicits instability for the whole economic system as the prices of the latter goods increase in step with the increase in banks’ rate of interest on consumer debt. As rentiers can pledge collateral in the form of real or financial assets, to obtain bank credit and thus purchase luxury goods, this increases profits for firms producing these goods, so much so when there
is asset inflation raising the nominal value of rentiers’ portfolio pledged as collateral to increase their consumption level through bank credit. In this framework, reducing public expenditure aggravates the wage-earners’ situation, which implies an ongoing expansion of their own indebtedness to protract economic growth, in so far as firms’ profits and banks’ interests elicited by rentiers’ consumption can finance those debts that wage earners must contract to preserve their own standard of living over time.

The wage-earners’ problematic position is further investigated by Stellian (2010) in addressing home equity extraction as a decisive support to consumption in the US economy during the pre-crisis period. Home equity extraction, that is, the possibility for householders to obtain consumer credit by pledging their real-estate properties as collateral, has been dramatically increased in the United States owing to the housing market bubble that rapidly inflated over the decade (1996-2005) preceding the crisis that then ravaged the global economy. As Stellian (2010) explains, these phenomena contributed to closing those monetary circuits that banks did open for businesses in the consumer-goods sector, thereby sustaining US economic growth decisively over that decade. As a matter of fact, home equity extraction enables households to obtain purchasing power as a substantial complement to their wages, with a twofold effect: increasing their consumption and reducing their claims for higher compensation for the services they provide on the labour market. The latter effect helps contain social conflicts and also limits production costs for businesses as a whole, while the former boosts the economic system and helps firms’ sale on the products market (increasing sales figures and reducing the time gap between any firm’s expenditure on the factor market and the same firm’s receipts on the products market). The monetary circuit closure-enhancing property of home equity lending, in fact, concerns not only those businesses that sell the particular items (like cars, healthcare, and education) bought by householders exploiting this consumer credit facility. Indeed this property applies to any monetary circuits, because householders do not have to dispose of those bank deposits that they earned via the payment of wages, in order for them to purchase the above-mentioned items. These bank deposits are thus at their disposal for financing an equivalent expenditure on any products market, so that consumption is boosted in the whole economic system rather than just in some sectors of it. To be sure, capital-goods businesses also benefit from home equity extraction indirectly, as firms in the consumption-goods sector record better sales figures and revise their expectations to increase investment, which amounts to capital accumulation in the form of machines and equipment that will have to be produced by firms in the capital-goods sector.

Once the housing-market bubble burst, however, the growth regime nourished by home equity extraction breaks down, as householders are unable to consume further beyond their wage earning. Lacking such a considerable support to consumption, the set of firms experiences increasing difficulties in closing several previously-opened monetary circuits, which lead them to reassess their sales expectations negatively by deciding therefore to reduce output and employment levels quite shortly. The growth regime based on home equity extraction comes thus to end, with a dramatic increase in both unemployment and the number of working poor: the former is the result of a
reduced number of monetary circuits newly opened, whilst the latter is associated with an increased difficulty for the set of firms to bring to closure existing monetary circuits. As these mechanisms impede any further increase in housing prices, and, in addition, provoke a rapid and severe reduction in the valuation of real-estate assets, the growth regime based upon them is short-circuited, showing the short-sightedness of those economic policies aimed at low wages in the private sector and at balanced budgets in the public sector, thus reinforcing the conclusion of Forges Davanzati and Tortorella Esposito’s (2010) own analysis.

The paper contributed by Bailly (2010) takes this investigation a step further. Its original contribution resides in explaining from a monetary-circuit perspective what Forges Davanzati and Tortorella Esposito (2010) as well as Stellian (2010) observed as background of their analyses, namely, a steady reduction in profitability of firms’ investment in the production process, which leads non-financial businesses to turn to financial markets with hopes to earn higher returns over a shorter period of time than this is indeed possible in any production activities (hence, a decrease in employment levels and wage-earners’ compensation). Bailly (2010) argues that the rate of profits earned on the products market diminishes as a result of firms’ amortization of fixed-capital accumulated with them, which provokes over-investment because of a gap in the process generating national income between the amount of bank deposits newly formed through the payment of all wage earners in the replacement-goods sector and their purchasing power over produced output in the whole economic system. Indeed, this gap stems from fixed-capital over-accumulation, which reduces the profitability of firms’ investment in the production process. As a result, non-financial businesses are led to spend their retained profits on financial markets, rather than on the labour market, contributing thereby to financialization as well as growing unemployment in capitalist economies (see also Rossi, 2008). Focusing on the workings of a monetary economy of production affected by fixed-capital over-accumulation, Bailly (2010) is able to show that financialization is not the result of agents’ behaviour: it is rather an outcome of a structural process, inducing businesses to invest their retained earnings on financial markets rather than in production activities. Job insecurity as well as the rapidly-growing indebtedness of wage earners are therefore the direct consequences of this pathology, affecting any capitalist system of production that reaches maturity in terms of fixed-capital (over-)accumulation.

As the origin of the fall in profit rates is to be found, eventually, in the process of capital over-accumulation, no low-wage policy will ever be able to reverse this trend in firms’ profits, which is due in fact to over-investment. This conclusion of Bailly’s (2010) analysis further corroborates the arguments put forward by Forges Davanzati and Tortorella Esposito (2010). Both analyses converge, to show that the neo-liberal economic policies of labour-market deregulation are, at best, pointless in addressing the structural causes of (involuntary) unemployment and subdued economic growth. Further, both papers point out how unsaleable output as well as huge liquidity in the firms’ vaults provide the incentives for them and financial businesses to practice so-called “predatory lending” to the largest possible number of wage earners, who have
been looking for a way to keep (and whenever possible to raise) their own standard of living since financial liberalization and labour-market deregulation. As regards, in particular, depository institutions, which have to remunerate the huge liquidity firms deposit with them, they are led thereby to lend to an increasing number of subprime individuals whose wages are stagnating or even reduced by the working of economic policies and structural factors that combine, to make the capitalist system even more unstable than this occurs through speculation on any financial markets. Crisis is thus the natural outcome of such a system, which wrong economic policies contributed to exacerbate in the run-up to the 2007 meltdown.

An additional, but largely ignored, factor that induced the 2007-2009 unwinding of the financial sector resides with systemically important pension funds, since they must provide financing for retirement of an ageing population and are confronted, as a result, with ever complex financial markets, products, and institutions. Analysis of retirement finance in a macro-financial model of monetary production economies is the original contribution of Piffaretti’s (2010) paper. This investigation suggests that the set of existing incentives for large retirement institutions are not in line with the macroeconomic needs of financing for retirement, which elicits a further cause of an intrinsic fragility in the financial sector. Adopting a macroeconomic perspective, the paper contributed by Piffaretti (2010) sets off noticing that financing for retirement requires generating future streams of income from past income flows through capital accumulation. The financial-sector role of transferring resources across time is then introduced into a monetary-theory-of-production model explicitly, which shows that financing for retirement in advanced economies requires reaching a determined level of future capital. This amounts to saying that effective finance for retirement implies enough investment (rather than savings) in previous periods, in order to generate the necessary level of future capital from which income flows may reach retired workers eventually. In light of this, Piffaretti (2010) argues that all individual saving-oriented institutional structures of retirement finance miss the point and, more important for a correct understanding of the causes that led to the 2007 meltdown, are responsible to a large extent for the upward pressures on asset prices noticed during the first decade of the twenty-first century, as pension funds look for high financial yields on capital assets existing in the present rather than contributing to productive investment for an increase in future capital up to the level needed for effective retirement finance.

The current institutional emphasis on savings and transfers of financial resources to fund future streams of income out of accumulated savings is therefore responsible for both speculative activities on financial markets and insufficient investment in the production process, which is the sole economic activity that generates income in the system as a whole logically and as a matter of fact. Piffaretti’s (2010) contribution is seminal in showing that a mature monetary economy of production with a complex, and globalized, financial market has to provide financing for retirement that does not induce asset bubbles but which is capable of fostering new investment leading to the level of future capital out of which the necessary income can flow to retired workers in due time.
The structural fragility of capitalist systems of production is also the focus of the paper contributed by Figuera (2010), who addresses, in particular, the drawbacks of traditional monetary policies in light of a fundamental critique to the so-called “New Consensus Macroeconomics” (NCM) considered from a monetary-circuit standpoint (see also a number of contributions in Fontana and Setterfield, 2009, in this regard). Figuera’s (2010) original contribution resides in showing that appropriate monetary policies (to avert financial crises) require understanding the monetary essence of any capitalist economies of production and exchange. As Figuera (2010) shows, the role played by both money and banking is crucial for macro-prudential regulation of both banks and non-bank financial intermediaries in any economic systems. In the debate on financial markets’ regulation spurred by the 2007-2009 systemic crisis, in fact, a large number of contributors overlook the macroeconomic dimension of the problem at hand, notably the fact that the origins of this crisis are systemic and structural, and do not have merely a microeconomic-behavioural dimension. After a radical critique of the monetary policy strategies inspired by the NCM, Figuera (2010) argues that in order to avoid another systemic crisis of our capitalist economies, money and credit, as provided by banks endogenously, have to be framed within a refined structure for the recording of payments, domestically as well as across any country’s borders. The now well-known Taylor rule for modifying a central bank’s policy rate of interest, in an attempt to hit a CPI-measured inflation target principally, is indeed pointless for a proper and effective control of structural-macroeconomic disorders like inflation and unemployment: as Figuera (2010) argues, interest-rate policies provoke an undesired effect of income redistribution in favour of firms, for they induce both financial and non-financial businesses to reduce the investment of profits in production processes, to increase their spending on financial markets, looking for the highest return during a period of time as short as possible.

The conclusion reached by Figuera’s (2010) investigation revives Keynes’s own distinction between “industrial circulation” and “financial circulation” put to the fore in *A Treatise on Money* (Keynes, 1930/1971, Ch. 15), combining it with the Ricardo proposal that led to the 1844 Bank Charter Act, in order to provide a more stable and growth-enhancing banking system: rather than increasing (up to a 100% ratio with respect to assets under management) the own capital, or compulsory reserves, of banks, which could increase the costs of borrowing for firms, and thereby reduce production activities as well as economic growth, Figuera (2010) argues for a truly structural monetary policy in so far as any banks will have to structurally divide the recording of their activities into three functionally distinct bookkeeping departments. The emission of money will thus be booked in a (first) department separating it from the (second) department within which all savings formed during the period will have to be entered, whose total sum will provide the limit beyond which the relevant bank will not be allowed to lend for any financial-market operations – for these operations generate no (new) income but only transfer pre-existent income between the relevant parties involved. Elaborating on the Peel Act passed in 1844 with regard to the Bank of England, Figuera (2010) suggests introducing a (third) fixed-capital department in any banks’ bookkeeping, within which those profits that firms do invest in any new
production activities must be transferred, leaving the (second) financial department. As a matter of fact, being fixed in capital accumulation, in the form of machines and equipment, these savings define a macroeconomic investment, whose corresponding bank deposits should not be still available (within the second department) to finance activities on any financial markets\(^2\) – which is the case to date owing to an unrefined structure of any banks’ bookkeeping. Operationalizing a three-department structure for the recording of any bank’s payments will thus be instrumental in distinguishing “industrial circulation” from “financial circulation”, in Keynes’s language, thereby enabling any regulators as well as monetary policy makers to implement an effective macro-prudential supervision across the whole domestic banking sector – making it impossible for cross-border activities of banks to impact on monetary and financial stability negatively. This will solve the otherwise still open question of co-ordinating financial market supervision across borders (a co-ordination that is, in fact, a wishful thinking because of the loopholes in any multi-nationally designed and implemented network of supervisory agencies).

The distinction between “industrial circulation” and “financial circulation” in the sense of Keynes (1930/1971, Ch. 15) is forged ahead by Jespersen (2010), who puts this distinction in perspective with the 2007-2009 economic and financial crisis. The original contribution of his analysis resides in arguing for a clear-cut separation from both a functional and institutional point of view between, on the one hand, “business banks” (that is, banks issuing credit-money as initial finance for production activities and therefore generating national income) and, on the other hand, “financial banks”, including non-bank financial institutions, which operate on financial markets and do not have to enjoy the right to issue money to finance their activities, as the latter do not create national income but only transfer existing property rights on pre-existent income. As Jespersen (2010) maintains, modern monetary circuit theory does not yet emphasize the importance of bank deposits as a liquid store of wealth in explaining both the origin and inflation of asset bubbles on financial markets. According to his analysis, the economic crisis of 2007-2009 is the outcome of “financial circulation” contributing, to a large extent, to the asset bubble that inflated in the first decade of the twenty-first century, giving rise to a credit crunch later on because of a frozen interbank market essentially. The policy proposal stemming from Jespersen’s (2010) investigation is thereby to make sure, at a structural level, that no savings deposited with “financial banks” can be used beyond financial markets, in order not to impinge on macroeconomic stability, as defined by the relationship between produced output and the means of payment that “business banks” issue for the purposes of “industrial circulation”.

The relevance of Keynes’s analysis, both of *A Treatise on Money* (1930) and *The General Theory of Employment, Interest, and Money* (1936), is a thread that runs all across this special issue. Jespersen’s (2010) paper has the merit to bring to light that, in fact, both books contribute to explaining the 2007-2009 crisis as well as curing its

\(^2\) See Bailly (2009) for analytical elaboration on this point.
most dramatic consequences on wage earners, bringing the public sector back in that strong position that it has to occupy in order to face an equally-strong market set-up, making the best out of the dynamic interaction between the State and the market in a monetary economy of production. This collective task is what unifies so-called post-Keynesian economists, among which Ayati (2010) includes a little-known author as Vickrey, who during the last years of his life became absolutely unsatisfied with the mainstream approach to economics, to which he contributed so much to deserve the 1996 prize in economic science in memory of Alfred Nobel, just before he died.

The original contribution of Ayati’s (2010) paper, in fact, lies in proposing a key for understanding the 2007-2009 economic and financial crisis as originating in two shortcomings of mainstream analyses and policy proposals, namely their lack of real insights into the complex workings of modern monetary economies of production, in which financial systems, as well as institutions, are crucial for economic dynamics, and in which State interventions, most important public expenditures, are required to avoid systemic risk and instability. Referring to the works of Michał Kalecki on the dynamics of capitalist systems, Ayati (2010) shows that Vickrey completes Keynes, but also Kalecki, in bringing to the forefront of macroeconomic analysis the function of financial motives, markets and institutions in the working of monetary economies of production in modern times. In light of the “assets-based macroeconomics” put to the fore by Vickrey – to use his own words – Ayati (2010) elaborates on a monetary-theory-of-production approach in which the agents’ desire to hold financial assets is the starting point of macroeconomic analysis. This investigation shows that within a growing economic system, in which households express the desire (hence a demand) to increase their savings for different reasons (ageing, their higher standard of living, and a bigger income share for high-wage earners), their demand for financial assets, whatever their origin, rises as time goes by. A problem arises, however, when firms’ supply of financial claims (which they sell in order for them to borrow the amount to invest in a new production process) is not enough to satisfy the households’ demand for them. This implies a mismatch between actual savings and desired investment, as the latter does not absorb the former entirely. Along Keynes’s (1936) lines, Vickrey, as Ayati (2010) shows, argues in this regard that the saving-investment identity does obtain via a contraction of national income, thereby adjusting savings downwards to the level of desired investment in the economic system as a whole. Discarding trade surpluses as a logically-impossible way to avoid persistent unemployment within the (closed-system) world economy, Vickrey points out the logical requirement to have (bigger) public deficits as the sole means to obtain full employment in any growing economic system: government bonds will thus complete the supply on the financial market, up to the level required by the agents’ desire to save in their acquiring these assets.

As Ayati (2010) points out, the assets-based macroeconomic approach argued by Vickrey helps understanding the causes of the 2007-2009 systemic crisis as well as its cure adopted by a number of national governments, which have been issuing their own bonds at a dramatically rising pace to finance several rescue plans of banks and
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non-bank financial institutions first, and later on to sustain the economic system as a whole (notably, householders and non-financial businesses). In a nutshell, to put it in the own words of Vickrey (2004, p. 134), a fiscal deficit “is not an economic sin but an economic necessity” in any monetary economy of production. This rejoins indeed one of the arguments noted in the first paper in this issue, as Forges Davanzati and Tortorella Esposito (2010) pinpoint restrictive fiscal policies as a contributing factor for the 2007-2009 economic and financial crisis. We have thereby come full circle, noticing how the monetary-circuit approach unifies the set of papers gathered in this special issue, which should highlight the route that remains to be travelled to carry out a deeper understanding of any monetary economies of production and exchange, capable of delivering right policy advices, to avoid repeating the drama of the 2007-2009 systemic crisis in the present century.

4. Research and policy agenda for a crisis-averting monetary macroeconomics

The papers selected for this special issue on the 2007-2009 systemic crisis share a common research and policy agenda. At a theoretical level, they show how money and banking are crucial for the (orderly or disorderly) working of a capitalist system, within which production needs finance, either through the banking system (in a pre-financialization era) or principally by “globalized” financial markets (as in finance-dominated systems). When monetary circuits are opened (and closed) through any creditworthy relationships established between commercial banks and non-financial businesses, as this occurred during the glorious thirty years after the Second World War, monetary order and macroeconomic stability contribute – as political-economy structural levers – to real economic growth and well-being for the whole population living within the relevant monetary economy of production. If however this orderly-working capitalist system comes to be dominated by financial markets, motives, and institutions, looking, first and foremost, for the highest returns in the shortest period of time, to the principal benefit of rentiers and firms’ shareholders, then, unless the State is able, and willing, to intervene in order to make sure that economic dynamics and functional income distribution are not dramatically unbalanced, crises are likely to occur and to ravage the whole economic system more and more frequently. In this theoretical perspective, the 2007-2009 economic and financial crisis did not come as a surprise, but has been the dramatic result of wrong neo-liberal policies of so-called “market integrists”. On labour markets, to begin with the income-generating relation in the economy as a whole, flexibility, deregulation, and low-wage policies have had a deflationary impact on global demand, which has only been masked by the variety of home equity extraction practices sustaining consumption in an unsustainable way. On the markets for produced goods and non-financial services, predatory lending to (over-)indebted householders, restrictive fiscal policies, wrongly-targeted monetary-policy strategies, and non-financial businesses’ over-accumulation of fixed capital in the form of machines and equipment have further aggravated the situation, of both wage earners and the economic system as a whole, inducing asset bubbles in the real
estate market as well as in any “globalized” financial markets, whose liberalization, deregulation, and computerization have accelerated the systemic disruption of any monetary production economies within which the banks’ crucial role with respect to firms has been emasculated to the benefit of the destabilizing relationship between a few transnational financial conglomerates and a variety of non-bank financial actors, aiming at purely nominal profits over the shortest period of time.

On the research agenda of monetary macroeconomics there ought therefore to be first and foremost a better understanding of the systemic, and specific, role of banks within any capitalist system. This will enable the economics profession to assess the crucial role of the banking system as a structural factor making the 2007-2009 crisis global and systemic. It will thereby allow regulators and monetary policy makers to have a truly systemic view of the dangers and shortcomings of financialization, thus providing them with the right set of tools and regulations, impacting on the structure of financial systems rather than merely on the behaviour of financial institutions and their managers. The priorities in the policy agenda are thereby fixed clearly and wait to be operationalized with the technical assistance of micro-prudential supervisors in so far as their insight sheds light on the complexity of individual financial societies, products, and operations that were involved in the 2007-2009 crisis.

The policy agenda stemming from the monetary-circuit perspective unifying the contributions to this special issue is straightforward. Its building blocks can be put to the fore as follows:

– Low-wage policies ought to be replaced by labour-market policies promoting the workers’ compensation in line with productivity, and a minimum wage level that avoids wage-earners’ necessity to enter into consumer debt is required in order to make sure that economic growth is nourished by households’ income rather than by their (over-)indebtedness.

– Pension schemes and retirement institutions have to be redesigned in order not to increase upward pressures on the prices of real or financial assets, and to provide – by financing productive investment – the level of future capital required to pay out rents to future retired workers. Pension funds should finance macroeconomic investment rather than nourish financial market speculation.

– Monetary policies ought to consider that inflation, in a finance-led system, stems more from financial markets’ structures, mechanisms, and institutions rather than from agents’ behaviour on the product market. Central banks’ policy instruments have therefore to be completed by structural reforms of the banking system, as it is the current structure of the latter system that originates systemic crises.

– Fiscal policies should go beyond the narrow view of balanced budgets and public debt reduction in any case, to consider that in an assets-based capitalist system of production, economic growth depends on debt–credit relationships: there can be, in fact, no credit without a corresponding debt in the economy as a whole, which implies that beyond private sector agents (first and foremost non-financial
firms), also the general government sector ought to enter into some debt in order to have sustainable economic growth and no further systemic crisis.

The route to achieving monetary and financial stability in our capitalist systems, that is to say, macroeconomic order in monetary production economies, is quite long and intellectually demanding. The contributions to this special issue ought to provide the red line along which economic theory and policy should make sure that a systemic, and dramatic, crisis such as the 2007-2009 global recession will not occur anymore. It takes indeed a systemic approach to avert systemic crises. Monetary circuit theory offers such an approach. Let us hope that the economics profession will follow suit, to make the world a better place to live in for its whole population, which deserves it even more so that an important part of the socio-economic burden of financial crises is usually borne by innocent people, who did not benefit from irrational exuberance (to use Greenspan’s own words) when the relevant asset bubble was in the making.

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5. References


