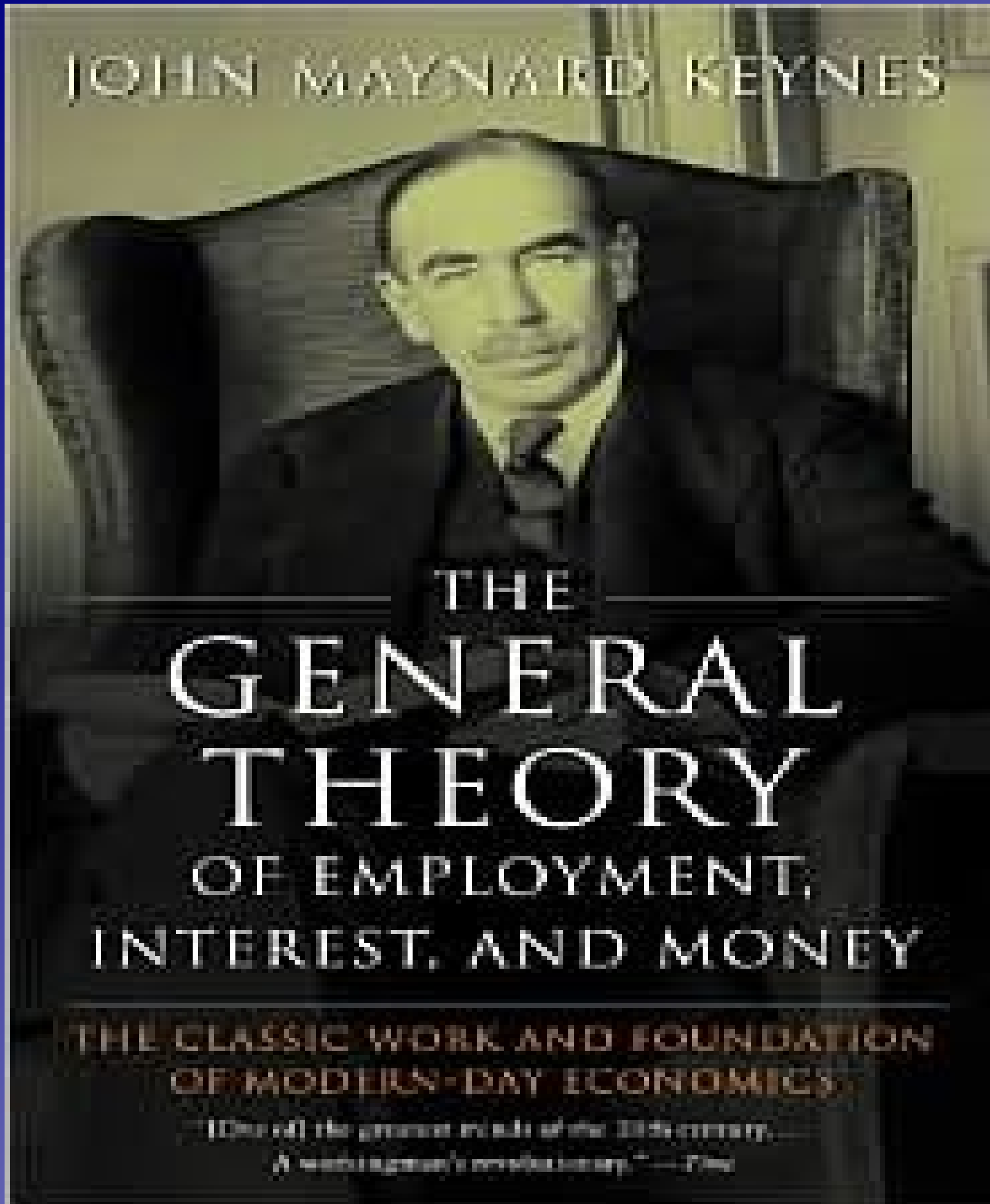
John Maynard Keynes

"The difficulty lies not so much in developing new ideas as in escaping from old ones"

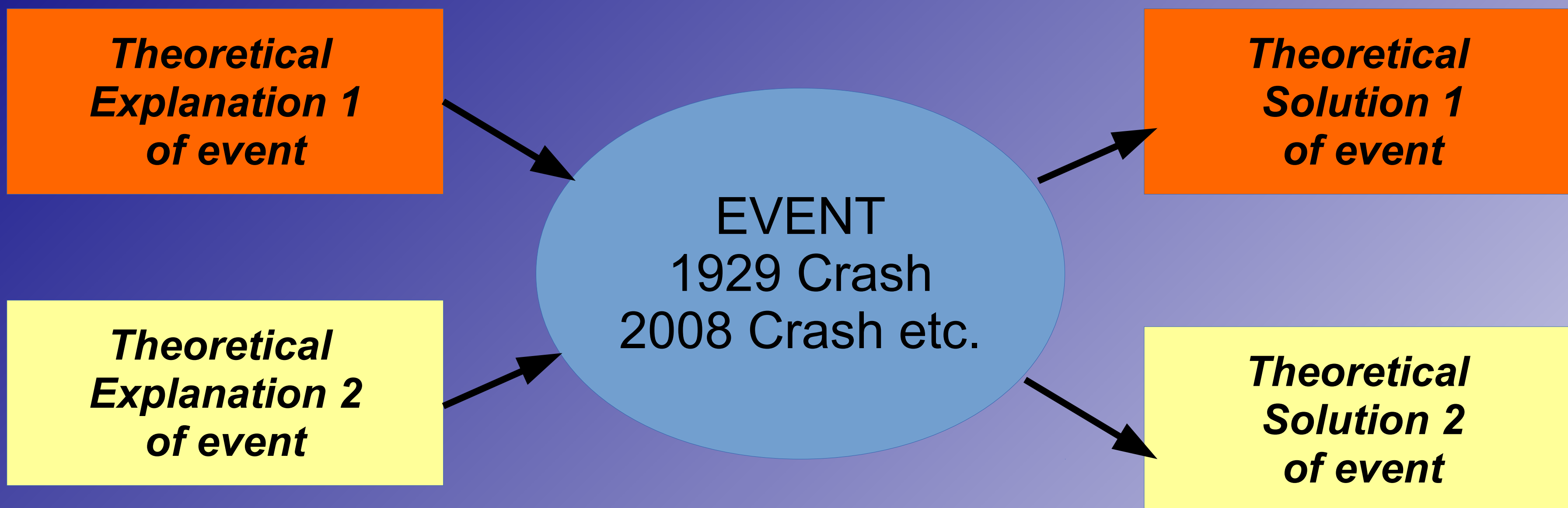
Dr David Rees



1883-1946
British
Founder of Keynesian Macroeconomics
(Western economic paradigm From +/- 1920 - 1978)

Main Keynesian principles

Government should intervene to provide full employment.



The government usually selects the theory of the 'current paradigm' to explain and resolve the event. The paradigm has shifted over the years. Some countries have different paradigms (USA / EU have moved from Keynesian to Neo-Liberal monetarist paradigm;
Ecuador, Chile, Bolivia, Paraguay... moved from imposed Neo-liberalism to Socialism, etc.)

The 2008 Sub-primes Crash. Two different theories

Neo-liberal / Monetarist. (Quantity theory of money) (Chosen solution)

Cause: Collapse due to instability in money supply

Solution: Increase money supply - Quantitative Easing

- provide banks with bailout money (to cover subprime losses) plus liquidity

Keynesian theory. (Employment)

Cause: Collapse due to instability of investment (Fall in industrial investment following the dot.com bubble, de-industrialisation, poorer returns from industry, creation of speculative financial investment)

Solution: Government action to increase aggregate spending (particularly via full Employment) and hence increase industrial output and investment.

Five years since the 2008 crash, over twenty million people remain unemployed or underemployed, while wages continue to fall.

Between 2007 and 2011, the US median household income has plunged by 11.6%, from $57,143 (in 2011 dollars) to $50,502.

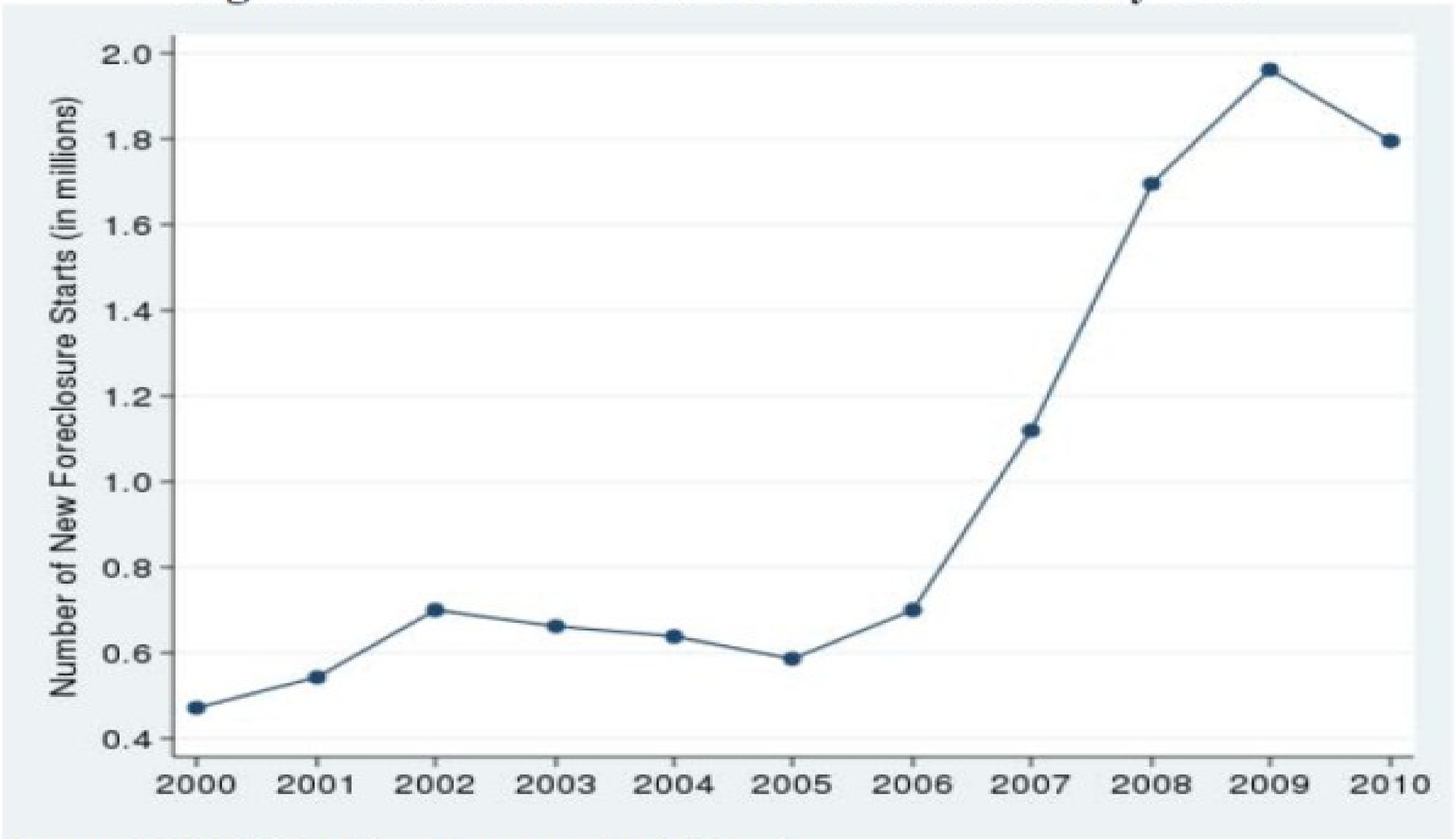
Nearly five years after the economic crash, the Federal Reserve still underwrites the profits of the financial system through $85 billion per month in asset purchases, half of which go to prop up toxic mortgage-backed securities held by Wall Street.

TARP (Troubled Asset Relief Program) allowed the purchase of $700bn polluted assets.

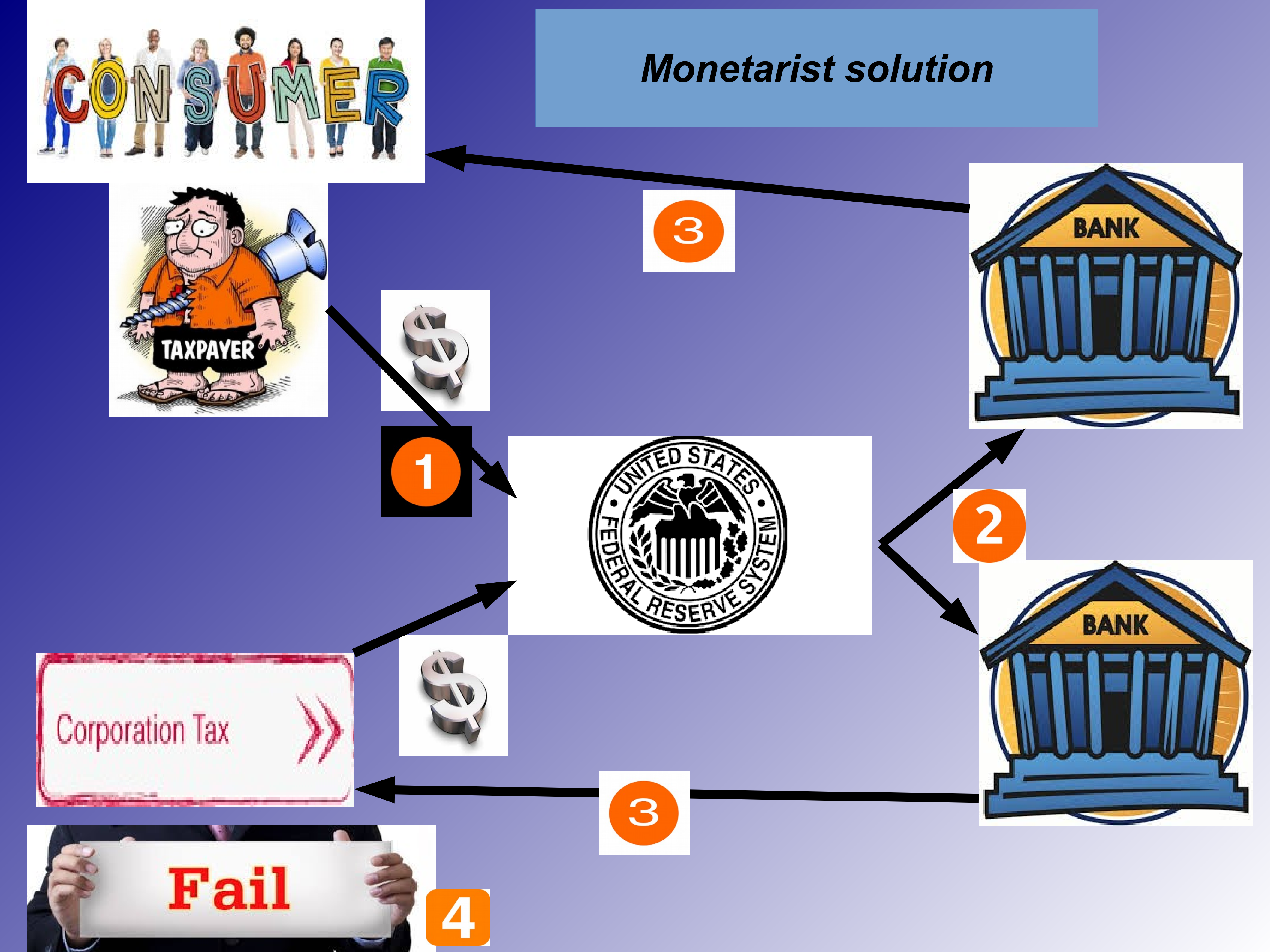
TARP revenue has totaled $441.7 billion on $426.4 billion invested.

House foreclosures (non-payment + loss of house) from 2000 (450,000) to Its peak in 2009 (1,980,000)

Figure 1. Number of New Foreclosure Starts by Year



Source: FRBNY/Equifax Consumer Credit Panel.



Monetarist solution
CONSUMER
3
BANK
TAXPAYER
$
1
UNITED STATES
FEDERAL RESERVE SYSTEM
2
BANK
Corporation Tax
$
3
Fail
4

The monetarist solution fails because

The banks hold on to the money (cover debts, pay bonuses)

Interest rates to business and consumers remain high

Borrowing becomes increasingly difficult

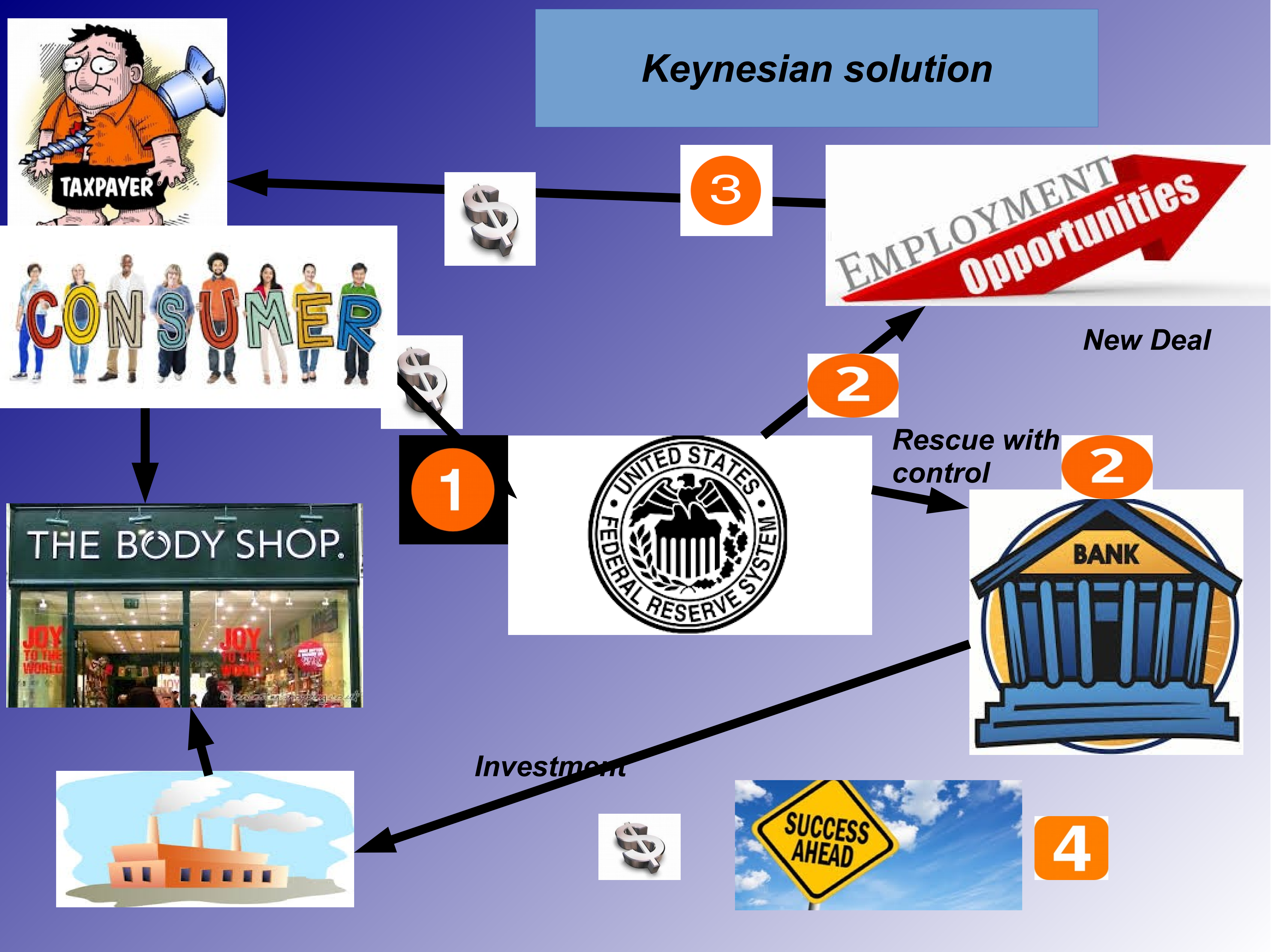
Taxpayers money doesn't go into creating jobs and infrastructure

Country increases deficit and debt

Social services cut to reduce deficit

Weakened companies can't borrow to invest in new equipment

Central banks provide money (QE) that makes banks richer while austerity increases poverty and reduces social services.


Keynesian solution
TAXPAYER
3
EMPLOYMENT
Opportunities
CONSUMER
New Deal
2
Rescue with
control
2
1
UNITED STATES
FEDERAL RESERVE SYSTEM
BANK
THE BODY SHOP
JOY TO THE WORLD
Investment
SUCCESS AHEAD
4

<u>The Keynesian solution should work because</u>

The banks are rescued but govt. on the board (cover debts, no bonuses)

Interest rates to business and consumers are low (Fed guarantee keeps inter-banking loans cheap)

Borrowing becomes increasingly easy

Bank regulation (Glass-Steagall) increased

Taxpayers money goes into creating jobs and infrastructure

Improved infrastructure benefits everyone

Country increases deficit and debt (money supply still increases)

Social services increased to create employment

Mortgage rescue to avoid / reduce housing collapse

Consumption increases due to security of employment

Strengthened companies borrow to invest in new equipment

Employment leads to consumption leads to investment leads to recovery.

Rescue Plan – the Neo-liberals suddenly become Keynesian !
President Obama announces $787 billion fiscal stimulus (>5 % GDP)

- Tax cuts
- Subsidies
- Infrastructure spending
- Energy investment
- Emergency unemployment benefit
- Health care
- Food aid

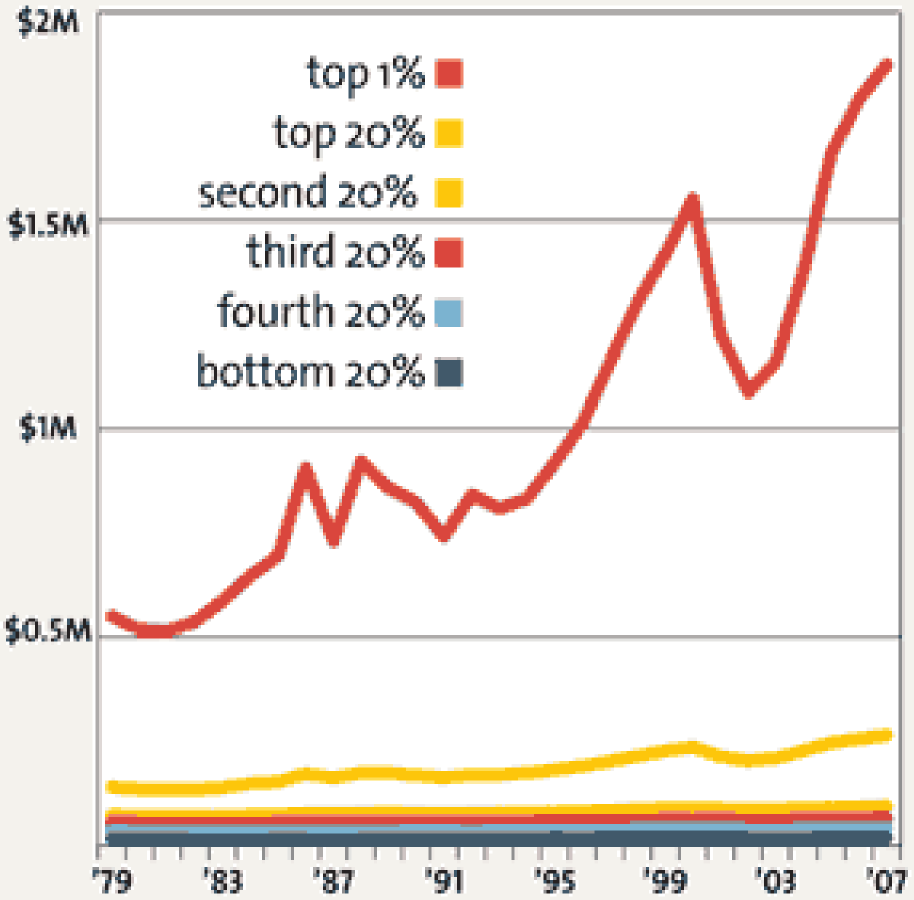
Quantitative Easing – the Central Bank buys government bonds from banks at a higher than market price hence providing the banks with liquidity to lend.

For Keynes, it is the spending of money not its creation which provides the stimulus.

- Banks should hold on to their mortgages – hence subprimes would never have happened

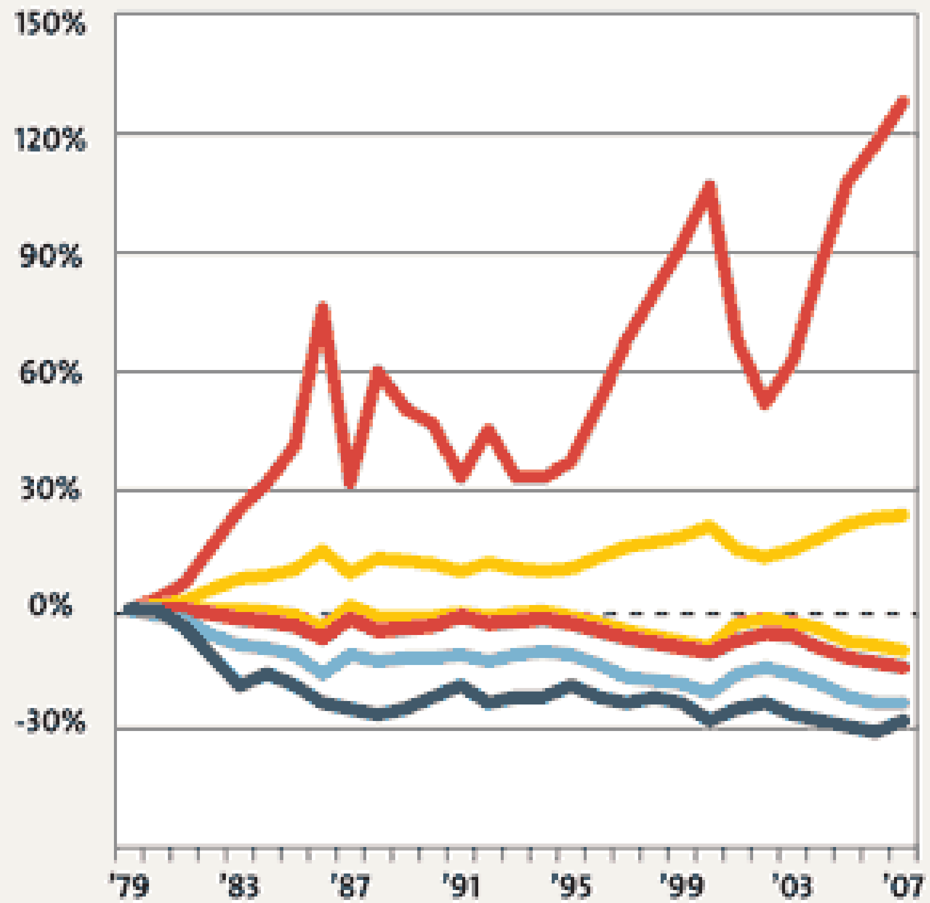
The bankers' fault? Part of a wider intellectual and regulatory failure
Reagan-Thatcher era exalted finance and humbled industry. Wealth was distributed disproportionally to the rich and the super rich.

AVERAGE HOUSEHOLD INCOME
before taxes



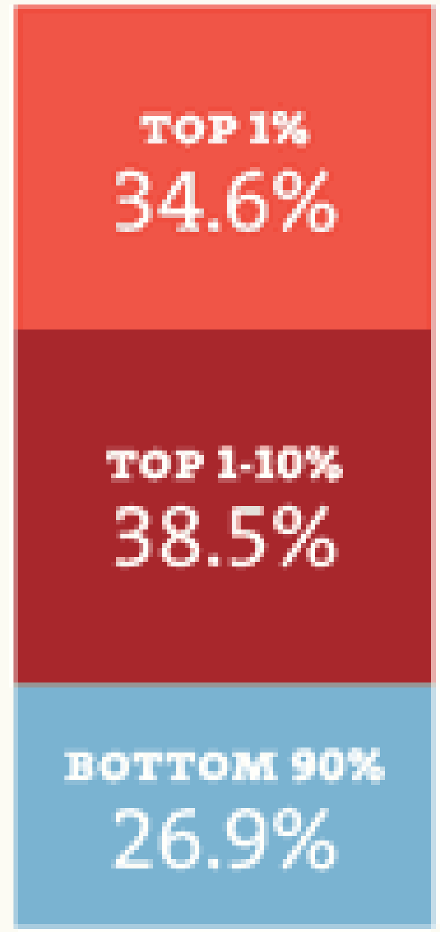
2007 dollars. Source: Congressional Budget Office

CHANGE IN SHARE OF INCOME
vs. 1979, after taxes



Source: Congressional Budget Office

The richest 10% controls 2/3 of Americans' net worth:



2007 data. Includes home equity. Sources: Edward Wolff, Bard College; Federal Reserve

Keynes :

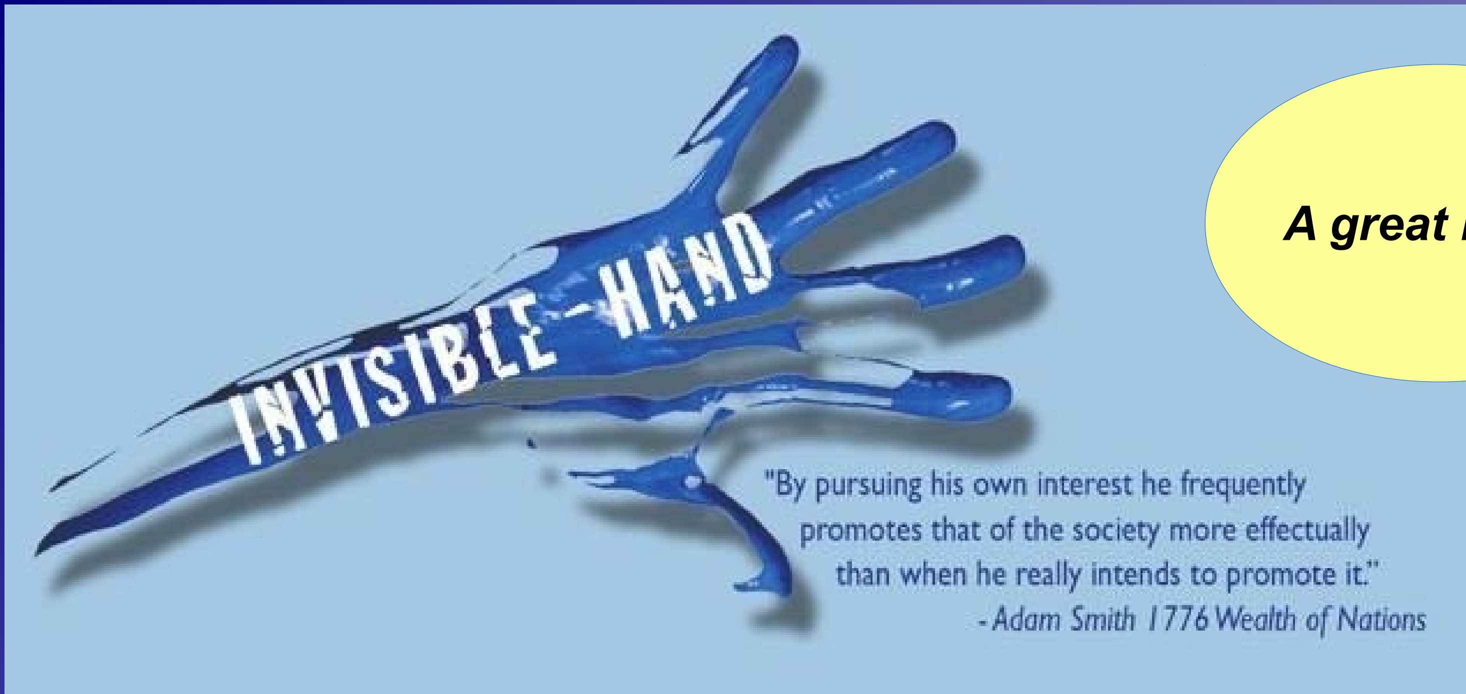
The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly supposed. Indeed the world is ruled by little else'
JMK, Collected Writings, vii, p.383

At the root of the 2008 crisis was not failures of character or competence, but a failure of ideas. The present crisis is the fruit of intellectual failure of the economics profession.

From Adam Smith's 'invisible hand' to the current neo-liberal trend (1980s – now) with The Efficient Market theory, there is the assumption that shares and goods are always correctly priced via market forces.

EMT assumes that all risks are measurable (refuted by Keynes)

Keynes hated the 'mathematisation' of economics because it wasn't related to the real world and had no moral or philosophical input.



A great idea...

that doesn't work in the real world