BOOK REVIEW – BKR

Financial Macroeconomics

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Kregel's book ***Financial Macroeconomics*** (London: Anthem Press, 2024) is a highly interesting collection of papers, originally published in academic (non-mainstream) journals or as book chapters between 1976 and 2013, that explore monetary and financial theory and policy.

The development of a non-mainstream approach is well documented through Post-Keynesian Economics. Despite the substantial expansion of post-Keynesianism since the 1990s—driven by core scholarly activities and its growing prominence in academic circles, particularly within Brazilian economics academia—the fundamentalist post-Keynesian approach has experienced a decline in Brazil. For instance, the opening chapter, originally published in *The Economic Journal* in 1976 and crucial for methodological discussions within post-Keynesianism, may be unfamiliar to younger generations.

To maintain a pluralistic theoretical foundation rooted in Brazil's Post-Keynesian tradition and to extend Post-Keynesian theory to Latin American issues, reading high-quality original interpretations of Keynes is essential. Kregel's interpretation is a lucid and profound contribution, particularly regarding the role of finance in Keynes's thinking. I strongly recommend more than just a superficial Reading. This book is essential for teaching, training researchers and students, as it provides a realistic analysis of the behavior of modern financial economies, making it valuable also for economists, financiers, and financial reformers.

The book consists of 23 chapters, five on methodological issues, five on the analysis of effective demand, ten on price theory, money and theory of interests and financial markets, and three on nonconventional monetary policies and their relation with Keynes's theory.

In the **introduction** Kregel recalls his formative stage, exploring the controversies surrounding capital theory in Cambridge during the 1960s, contrasting it with the American

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approach. The analysis focuses on critiques of marginal theory and the search for alternatives in the growth and distribution theories of Keynes, Kaldor, Robinson, and Kalecki. The author positions himself within the post-Keynesian debate, seeking to integrate monetary theory and liquidity preference as central elements in understanding the economy.

In the first essay, the **chapter 1**, Kregel's main objective is to demonstrate that post-Keynesian theory is a legitimate extension of Keynes's methodology and that the use of the equilibrium concept differs from the orthodox approach. Kregel suggests, to interpret Keynes, three models, which are characterized in terms of three expectational factors. First, the static model assumes that long-period expectations remain constant at a given level, while short-period expectations are realized. In this model, long- and short-period expectations are independent of each other. Second, the stationary model also assumes that long-period expectations remain constant at a given level, but short-period expectations may be disappointed. Despite this, long- and short-period expectations remain independent. Third, the shifting model differs by allowing long-period expectations to change over time. Short-period expectations are disappointed, and, unlike the other models, long- and short-period expectations are interdependent.

Chapter 2 discusses Keynes's economic theory, emphasizing his belief that his work, *The General Theory*, represented a radical new approach to economic analysis. Despite his intention to revolutionize economic thought, Keynes faced challenges in communicating his ideas, which were often translated into the language of traditional economic theory. The author mentions Harrod's concern about the clarity of Keynes's ideas and the need to maintain effective communication with orthodox economists.

In **chapter 3** Kregel points out that Post Keynesian economists have followed Joan Robinson's criticism of general equilibrium theory as abolishing history by allowing all contracts to be executed today for all future contingencies. This was the justification for the support of financial innovation to provide for the completeness of futures markets. The recent crisis has shown that force of history. Instead, many evolutionary and Keynesian economists have suggested the approach of cumulative causation as an approach that includes history and eschews equilibrium. This approach may provide a way to take history seriously in economic analysis.

The aim of **chapter 4** is to address the shortcomings found in most presentations of the "circuit approach." While some "circuitists" have dismissed John Maynard Keynes's liquidity preference theory, Kregel argued that this dismissal undermines the connection between money and capital asset prices, thereby leaving investment theory ungrounded. The analogy with the Hamlet and the Prince of Denmark can be considered remarkably astute. For Kregel (2024, p. 44), "the circuit approach, while it claims to reflect Keynes's conception of a monetary production economy seems to deny the importance of the link between monetary factors and the prices of capital goods, between the rate of interest and investment; it appears to mistake Shylock for Hamlet".

In **chapter 5** Kregel mades critics of the impact of Samuelson's *Foundations of Economic Analysis*. First, the failure to recognize specific limitations to the generality of the approach, particularly regarding the role of expectations and the treatment of monetary theory. Second, the failure to recognize the true applicability of the method to all frameworks where equilibria are defined by maxima, regardless of their theoretical basis. These shortcomings have unnecessarily and inappropriately reinforced a particular interpretation of neoclassical theory, marginalizing alternative analyses rooted in both the classical and neoclassical traditions. This is especially evident in the remarkable lack of success of the major innovations of the 1930s in being integrated into the neoclassical synthesis, as well as in the failure to recognize formal theoretical distinctions and draw appropriate scientific conclusions in debates on the theory of capital.

Kregel criticizes the tendency to relegate effective demand to a "short period" context, in **chapter 6**, emphasizing that analysis must integrate both real and monetary factors to understand the determination of natural values. This integration is fundamental to Keynes's theory, which aims to explain how the economy operates under conditions of uncertainty and change. In summary, Kregel argues that effective demand is a concept with deep roots in the classical economic tradition, remaining relevant and necessary for contemporary macroeconomic analysis. He challenges the view that Keynes's theory is isolated or disconnected from earlier economic debates. In the same line, Kregel discusses, in **chapter 7**, the debate between Ricardo and Malthus, the Say's Law, and the positions of A. Smith and J.S. Mill to develop the concept of Effective Demand and to demonstrate how Keynes diverged from the Classical perspective.

Chapter 8 highlights two main lines of development. The first involves extending Keynes's short-run model to incorporate factors such as capital accumulation and income distribution. Economists like Kahn, Robinson, Kaldor, Harrod, and Kalecki sought to integrate Keynes's analysis with capital accumulation theory, leading to models like the

Harrod-Domar model and theories on income distribution. However, this approach often treated investment as exogenous, overlooking the discussion of effective demand and the monetary elements that Keynes considered essential. The second line of development emphasizes expanding the role of money within the context of interest rates. Keynes and his Cambridge colleagues recognized the importance of integrating his core monetary relationships with Sraffa's analysis. This approach aimed to preserve Keynes's insights into the role of money in determining economic activity, particularly in relation to investment and liquidity preference.

In **chapter 9** Kregel explores the nuances of Keynes's critique of Hicks's representation of interest rates and seeks to offer a clearer understanding of how the multiplier and liquidity preference are interconnected in Keynes's theory. He examines the differences between Keynes's perspective and that of classical economists, particularly concerning the interest rate and the effects of increased economic expenditure. Keynes argues that a rise in the incentive to invest does not necessarily lead to a higher interest rate, directly challenging the classical view that treats the interest rate as a non-monetary phenomenon. The oversimplifications inherent in the IS–LM model are criticized for failing to adequately capture the dynamics of effective demand and the interaction between the multiplier and liquidity preference. The chapter concludes that fully understanding Keynes's theory requires moving beyond the IS–LM framework to account for the complexities of economic relationships.

In **chapter 10** Kregel mentions Keynes's writings on the forward foreign exchange market. For him, this market should be interpreted as an early application of Keynes's "own rate of interest" equation within an international framework. Seeking to demonstrate that Keynes's "own rate of interest" represents a general theory of asset choice, Kregel points out that if the domestic currency (sterling) is considered the "money" of the system and durable assets are viewed as foreign currencies, Keynes's interest parity theorem "explains the 'preference' for liquidity (sterling)" which affects decisions to invest in other (foreign currency) assets based on their spot and forward prices relative to sterling (Kregel, 2024, p. 122). Just as the interest rate reflects the "premium" the market is willing to pay for its “liquidity preference” provided by money in a closed economy, the interest rate on foreign currencies represents the price investors are willing to accept to forgo the security offered by the system's money in an open economy.

Kregel, in **Chapters 11 and 12**, explores the significant influence of Irving Fisher on John Maynard Keynes's economic theories, particularly regarding the role of money in economic equilibrium and the concept of the marginal efficiency of capital. Kregel demonstrates that Keynes acknowledged Fisher's contribution by introducing the idea that investment decisions are linked to a comparison between the rate of return on costs and the interest rate. However, Keynes also recognized that Fisher's theory did not adequately address the complexity of the relationships between money, interest rates, and investment, particularly in a context of uncertainty.

In **chapter 13**, Kregel answers queries about coincidences and correlations between Fisher and Keynes, the Gibson paradox and the idea of duration. The text explores the Gibson paradox, which states that there is a direct relationship between prices and interest rates. Both Fisher and Keynes believed in this paradox but disagreed on its explanation.

Chapter 14 explores Fisher's relations, which connects nominal interest rates, real interest rates, and inflation expectations. Kregel also examines Purchasing Power Parity (PPP), which suggests that exchange rates should adjust to reflect price levels across different countries. Additionally, it addresses Interest Rate Parity Theorem, which establishes the relationship between spot and forward exchange rates based on interest rate differentials between countries. Finally, it discusses interest rate arbitrage, both covered and uncovered. The chapter shows that the combination of these three equations demonstrates that Fisher's theory can explain interest rates, prices, and exchange rates based on the quantity theory of money, the theory of impatience, and investment opportunity.

In **chapter 15** Kregel explores a Post-Keynesian approach to finance, emphasizing the importance of expectations, risk, and uncertainty. He argues that traditional finance theory, which relies on statistical inference and probabilistic models, fails to capture the complexities of real-world economic decisions. This essay highlights Keynes's contributions to modern finance theory, which could be instrumental in developing a Post-Keynesian approach to finance. Three key areas are emphasized: i) the first is the treatment of expectations and, inevitably, the relationship between risk and uncertainty; ii) the second focuses on the significance of this diverse approach to expectations in determining prices, particularly the prices of financial assets; and iii) the third examines the connection between the theory of asset price formation and the theory of interest, with a particular focus on the explanation of the yield curve.

The **chapter 16** contrasts what the author refers to as the standard interpretation of Keynesianism (dubbed "hydraulic Keynesianism") with a more authentic version based on Keynes's financial writings. The standard interpretation emphasized managing the economy's real aggregates through governmental fiscal policy. In his *Tract on Monetary Reform*, Keynes developed the concept of interest rate parity and highlighted the role of forward exchange markets in mitigating exchange rate risks and stabilizing currency purchasing power parity. He viewed the forward price as a reflection of preferences for holding assets in different currencies and demonstrated how interest rate changes would spur arbitrage activities. In the *Treatise on Money*, Keynes examined futures prices[1] and introduced the concept of "normal backwardation", where futures prices are lower than expected future spot prices due to hedging demand. He argued that excess stocks of goods hinder production by eliminating this "normal backwardation" and suppressing future prices. The chapter emphasizes that Keynes transcended the quantity theory of money, asserting that investment decisions ("efforts of producers") are driven by expected future returns in comparison to present costs. Moreover, this chapter presents Keynes's view of money as a debt-credit relationship created by the state through its tax and spending policies, aligning with the modern "chartalist" theory of money. Ultimately, the chapter contends that Keynes's work focused more on how future expectations shape present decisions and the role of financial markets than on real aggregates.

In **chapter 17** Kregel explores Keynes's theory of economic instability, arguing that it's rooted in the inherent uncertainty surrounding long-term expectations, particularly regarding investment decisions. He criticizes the dominant post-Keynesian and New Classical economics for overlooking this crucial element and highlights the irony that while Keynes's theories were designed to address capitalist instability, many economists have shifted towards New Classical and New Keynesian frameworks that overlook this instability. This essay aims to revive and reinforce the relevance of Keynes's insights, particularly in times of economic crisis, drawing on the arguments of Fausto Vicarelli. There is an alignment with Fausto Vicarelli's interpretation of Keynes, which emphasizes the failure of households and bankers to calculate correctly user costs. This leads to multiplier effects and autogressive loops that further destabilize the economy. In short, the chapter argues that Keynes's theory of instability is not about perfect or imperfect information but about the nature of investment

[1] This point appears agian in **chapter 19**, where Kreel mentions General Theory's chapter 17 that provides a general theory of spot and forward prices, demonstrating how money influences expectations and investment decisions.

decisions and the inherent uncertainty of the long-term future. This lack of an objective way to compare expectations to outcomes creates a feedback loop where instability can be self-perpetuating. This inherent uncertainty is fundamental to his explanation of how a capitalist economy works and why it is prone to volatility and crisis.

In **chapter 18**, Kregel provides an in-depth analysis of rational and non-rational economic behavior through the lens of post-Keynesian economics. He emphasizes the crucial role of animal spirits in investment decisions. This concept challenges the classical economic paradigm, which typically assumes that agents act rationally to maximize utility. Additionally, Kregel argues for establishing a macrofoundation for microeconomics, suggesting that understanding broader economic constraints is essential for explaining individual behavior. He references influential economists such as Kalecki and Kaldor for their contributions to theories addressing uncertainty and the role of liquidity preference. These discussions explore how fluctuations in confidence impact decisions related to holding money, which, in turn, affect pricing and market dynamics—factors not solely driven by rational calculations. Keynes's reflections on money and interest in his 1937 paper, cited within the text, exemplify this perspective. Ultimately, this framework invites a re-evaluation of how economics interprets human behavior in uncertain environments.

From Keynes's perspective, Kregel highlights, in **chapter 19**, two distinct methodological approaches: one rooted in Marshallian principles and the other centered on financial instruments, as outlined in Chapter 17. This latter approach served as the foundation for nearly all of Keynes's responses to critics following the publication of the *General Theory*.

In **chapter 20**, about Keynes and New Keynesians, Kregel points out that the New Keynesian perspective emphasizes how incomplete information affects purchasing decisions, creating systemic failures where prices cannot perfectly transmit information. Kregel discusses the challenges of applying perfect competition theory to real-world markets and it is clear that explanations of impediments to price adjustments producing market failures have nothing to do with the kind of supply and demand theory that Keynes thought he was developing.

The final section brings the book to a compelling close, offering well-rounded and insightful discussions on Keynesian economic policies and their applications. **Chapter 21** distinguishes between "offensive" and "defensive" economic policies, while in **Chapter 22**

Kregel revisits Keynes's views on the influence of the central bank's policy rate on long-term government bond yields, investor behavior in financial markets, and fundamental uncertainty. Moreover, Kregel provides a summary of Keynes's monetary policies and their relevance to modern strategies such as Zero Interest Rate Policy (ZIRP) and Quantitative Easing (QE).

In the concluding essay, **Chapter 23**, Kregel examines the challenges faced by the Japanese economy in implementing monetary easing, specifically through the lens of the liquidity trap. He highlights how the horizontal segment of the LM curve imposes a lower bound on interest rates, thereby limiting the effectiveness of monetary policy in stimulating output. Additionally, the essay critiques the reliance on quantity theory models to explain the recession, arguing that these models suggest money has little long-term impact on real output.

Discussing complex topics, Kregel's approach is dense and offers a theoretical edifice that contributes to a Keynesian-Sraffian synthesis. His theoretical and policy contributions continue to inspire and guide many Post-Keynesian scholars.