

Book review

Jan Kregel, *Financial Macroeconomics* (Anthem Press, London, UK and New York, NY, USA 2024) 318 pp.

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Financial Macroeconomics is what Keynes was really about. This, in a nutshell, is the message of this fascinating book. And Keynes' spelling out of the financial nature of the macroeconomic process continues to inform theory and policy today – or should do, in any case. As Kregel notes, Keynes' mature financial macroeconomics 'has been completely ignored by most professional economists' (p. 209). Kregel leaves the reader in no doubt that this is a major reason why 'mainstream' (New Keynesian) macro often seems futile and out of touch. For anyone needing fresh inspiration to do macroeconomics that is exciting, meaningful and relevant to today's challenges, this volume is a go-to source.

The book is a collection of papers published from the late 1970s and in the 1980s and 1990s, with three of the 23 chapters written in the 21st century. It is organized in four sections: 'Methodology', 'Effective Demand', 'Price Theory, Theory of Interest, and Financial Markets' (by far the longest, with ten papers) and 'Unconventional Monetary Policy, Quantitative Easing, Yield Curve Twisting and Liquidity Traps'. *Financial Macroeconomics* is more than a setting straight of the historical record on Keynes' ideas in economics, though also that. The helpful publication history shows, tellingly, that the oldest chapter is a 1976 article in the prestigious *Economic Journal*, while virtually all of the newer contributions are Post Keynesian or other heterodox journal articles and (mostly) book contributions, or Kregel's class notes at the University of Missouri, Kansas City (UMKC). This reflects how Post Keynesian thought was sidelined in the profession (perhaps also, how Post Keynesians retreated into their own biotope).

And yet the papers are anything but dated. Yes, the topics they are concerned with do not engage the profession as much as they once did. But by focusing on the actual arguments, also beyond their contemporary context, Kregel continually demonstrates that they are still relevant beyond the world they were written for and written in. As Mark Hayes (2020) reminds us, Keynes himself was always developing new models to fit new realities. Kregel does so by applying Keynesian analysis to post-2007 Quantitative Easing (QE), and to late 1990s Japanese stagnation. But there is so much more in this bundle.

Some of Keynes' early contributions to financial macroeconomics made it into standard analysis, such as his early 1920s derivation of the forward premium on a currency, discussed in chapter 18. Many of his contributions were adopted as buzzwords whilst their substantive innovativeness was lost – think of the frequent use of terms like 'animal spirits', 'uncertainty' and 'expectations'. Introducing expectations, Kregel

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stresses, is irrelevant to the outcome of the economic process once full employment is assumed (as is standard in New Keynesian models), and thereby, implicitly, a systematic tendency in the economy to generate investment that produces full employment. It is this assumed tendency, rather than the imperfections of expectations, which Keynes questioned – for, as Kregel lucidly observes, even with perfect expectations, the economy would be unstable without this stabilizing tendency.

The great merit, then, of this book of essays is that it recaptures afresh Keynes' key insights in financial macroeconomics – a tautology we will have to put up with, until it is widely understood that Keynesian macroeconomics is nothing if not financial. Not psychological, not fiscal: financial. Readers who thought they sort of understood Keynes (including this one) will be surprised and challenged to follow Kregel's erudite excavations of arguments and meaning, written in a style that is both accessible and precise.

For instance, contrary to a common view, Keynes proposed that investors follow animal spirits not as the alternative to probability calculus, but only after other, non-probabilistic but rational decision processes have been exhausted. These processes generate subjective knowledge of objective facts – so that the objective world rather than 'human caprice' (p. 224) shapes beliefs. There is a universal and stable external world, but different agents have differential access to facts and frameworks to interpret the facts. This is Keynes' theory of probability. Financial decision-makers are in the business of increasing the confidence regarding their own beliefs, rather than increasing their certainty about the external world. That world is not fixed independent of those beliefs 'since the events to be predicted are the results of the decisions of other individuals making predictions'.

So, where does investors' confidence come from? This introduces the need for macrofoundations – that is, the theory of individual (financial) decision making must be built on the recognition that it depends on an environment characterized by a generalized state of expectations informing those decisions in a non-probabilistic way. For instance, the values of forward rates relative to spot rates are the outcomes of decisions under uncertainty, rationally based on confidence rather than probability, and on the weight of arguments rather than calculations. Without this recognition, attempts to ground aggregate outcomes in individual decision making ('building on microfoundations') are circular. One then has to assume as an exogenous starting point for individual decision making precisely the prices that result from individual decision making. Keynes proposes a better anchor: the objective, generalized state of expectations working on subjective rationality. It is interesting that this concept, first published in his 1921 *Treatise on Probability*, would find echoes in Bourdieu's (1977, p. 86) notion of habitus as 'a subjective but not individual system of internalised structures [and] schemes of perception'. It is these rational but indeterminate perceptions that lead investors to form prices.

Importantly, the interest rate is one such price. Therefore, it is a monetary phenomenon, an outcome of financial market processes rather than a variable reflecting the marginal productivity of capital, the level of non-consumed income (saving) or other real-sector variables. Interest rates, in turn, are benchmarks for investment decisions, which drive employment and macroeconomic fluctuations. It is in this sense that Keynesian macroeconomics is inherently financial.

How different this is from adding 'sticky prices' to equilibrium processes determined in real terms, or from IS–LM analysis where prices are inflexible (and anyway exogenous to the liquidity–money curve). To readers of the *Review of Keynesian Economics (ROKE)*, it will not be news that these instances of 'bastard' Keynesianism,

as Joan Robinson called them, are indeed not Keynes' brain children. But Kregel's book goes beyond the well-trodden ground of easy juxtaposition, disparaging the wrong turns that New Keynesian macro took. He takes the reader deep into the argumentation and the intellectual coherence of Keynes' wide-ranging ideas on macroeconomics and finance. Kregel's lifelong mission has been to explicate and develop this other, financial side of Keynesianism, while Joan Robinson initiated the much better known Post Keynesian analysis of investment, capital and distribution. It is in making these kinds of connections – between Keynes' theory of decision making and his macro-financial results on the role of investment and fiscal spending – that Kregel's logical powers and his precision of analysis stand out.

Kregel wrote these papers mostly before the asset market inflation of the 2000s. But his lucid exposition of Keynes' forward market foundations of macro-finance, leading on to his imaginative use of Irving Fisher's own-rate-of-interest analysis that explains asset investments, is surely relevant to understanding today's macro-economic puzzles. Looming large amongst them is the puzzlingly low rate of investment by companies operating in a sea of liquidity during the low-interest rate years since the financial crisis, until 2022. This is puzzling if liquidity is viewed as constraining investment, as commonly assumed. One Keynesian response is that in an uncertain world, liquidity and capital goods investment are alternatives rather than complements so that liquidity preference rather than interest rates determines capital goods investment. But that cannot be the whole story, as if investors have been continuously nervous until 2022, with high liquidity preference and hence low investment.

Keynes' (and Kregel's) analysis in terms of investment in capital goods (through securities purchases) vs hoarding money can be updated by recognizing that in fact, there is a third option beyond liquid money/bonds and illiquid securities/capital goods. Investment in financial (and real estate) assets today is no longer clearly linked to capital goods investment. We live in what Minsky called 'money manager capitalism', where the expectation of capital gains (speculative value increases of securities and real estate) is a key driver of financial position taking, discouraging capital goods investment. Since asset values rise inversely to interest rates, this is consistent with low capital goods investment in a low-interest environment. Keynesian macro-finance continues to clarify the world we live in.

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