La dette, l'instabilité financière et la finance fonctionnelle : quelle place pour un changement de paradigme ?

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*(based on: **Faruk ÜLGEN** "Functional finance and financial stability: two faces of Janus?")*

ENJEUX:

2 défis majeurs suite à la crise de 2007/08 :

1. Rise of unemployment notwithstanding growing budget deficits

2. Monetary and financial instability ► threat to economic development

Orientation-réponse de l'article :

In face of growing unemployment and atonic economic activity, relevant and consistent economic policies can be designed through an integrated reappraisal of Lerner FF and Minsky FIH.

PLAN

I. Common grounds of FF and FIH

II. FF: *PRINCIPLES* of an anti-austerity economic policy framework

III. Consistent FF rests on stable finance

I. Common grounds of FF and FIH

I. 1. What is at stakes in the aftermath of the 2007/08 crisis?

- Ill-finance, weak distribution, worldwide persistent turmoil: huge public spending to sustain banking and productive systems against financial/demand/supply failures
- But supportive policies failed to counterbalance negative effects of the crisis and resulted in increasing deficits without dispelling the black clouds.
- Conservatism's comeback: "sound finance" (but nothing new under the sun. God will protect us if not free markets!)
- Facing this, developing the specific analyses offered by Lerner (Functional Finance, FF) and Minsky (Financial Instability Hypothesis, FIH), usually studied separately from each other.

I. 2. FF and FIH are developed out of common theoretical principles

- Rejection of major neoclassical propositions: no full-employment equilibrium reached by market mechanisms (faced with difficulties individuals' reactions result in (micro-rational) perverse behavior and (macro-irrational) systemic imbalances).

- Lerner's FF: endogenously chaotic functioning of markets because of the lack of collective consistency (Lerner, 1943/1951).

  Market failure to full-employment → external corrective interventions (public spending and its financing to reach a desired level of employment).

- Minsky's FIH: endogenous instability of financialized economy → major macro concerns (u-p) call for public intervention and regulation.

  In a world where the internal dynamics imply that coherence will break down "semblance of coherence can be achieved by constraints and intervention" (Minsky, 1985).

But « grand policy paradox »

"While most policy makers now tell a Classical story, their practice still reflects many of ideas of functional finance…" (Colander, 2002; Minsky, 1982).

Authorities run some so-called unconventional policies in times of crisis without modifying their beliefs or their theoretical references, letting financial/monetary breaches subsist on markets (anti-crisis interventions are event-led policies, not structural reforms).

THESIS: Active employment policies depend on consistent monetary policy as they involve changes in public spending, interest rate, public deficit funding and financing conditions of private investments.

Then, strong relation between the FF and "money".

II. FF: PRINCIPLES of an anti-austerity economic policy framework

II. 1. FF: No sound policy prescription but macro-adjustment tool through the total spending

Employment-oriented principles to guide public spending - financing when market mechanisms fail to give economy a sustainable level of activity.

- 1^{st} law of FF: regulation of economic activity throughout government spending and taxation: total spending increase (decrease) by more (less) gvt spending or by reducing (raising) taxes so that the taxpayers have more (less) money left to spend.

- 2^{nd} law of FF: public borrowing to regulate r, I and Δp. Choice between the “monetary financing” of public spending and the rising of taxes depends on whether it would be desirable that the tax payers should have less money to spend (to prevent inflation) or it would be desirable that the public should have less money and more government bonds.

II. 2. The FF purpose

"to shift thinking about government finance from principle of sound finance that make sense for individuals – such as a balanced budget – to sound finance principles (FF) that make sense for the aggregate economy in which government spending and taxing decisions affect levels of economic activity. These two differed because the secondary effects of spending decisions and savings decisions – macro externalities – had to be taken into account in the aggregate economy" (Colander, 2002)

The public spending is thought as a contribution to provide full employment when the private spending is insufficient (through monetary policy = adjustment of public holdings of money and government bonds by government borrowing or debt repayment to modify r according to the desirable level of I.

- The government becomes the employer of last resort and then a spender of last resort (Kaboub, 2007).

III. Consistent FF rests on stable finance

III. 1. Big government, employment and stable environment

- FF coupled with consistent macro environment→"big" government (BG) to prevent short-sighted speculative positions (especially on public debt).
- BG-three way stabilizer: demander of g&s; generator (through deficits) of business profits; provider to fin. markets of high-grade liabilities (Minsky, 1982).

"The policy problem is to develop a strategy for full employment that does not lead to instability, inflation, and unemployment. The main instrument of such a policy is the creation of an infinitely elastic demand for labor at a floor or minimum wage that does not depend upon long- and short-run profit expectations of business. Since only government can divorce the offering of employment from the profitability of hiring workers, the infinitely elastic demand for labor must be created by government" (Minsky , 2008a).

But the ways of reaching full employment are not always consistent when *"high investment and high profits depend upon and induce speculation with respect to liability structures, the expansions become increasingly difficult to control (…)"* (Minsky, 2008b).

III. 2. Debt monetization and stable finance

Opposite to IS-LM, FF needs a debt monetization framework through **coordination between fiscal and monetary authorities**.

"Policy to control the aggregate performance of the economy needs a handle by which it can affect profits. One such handle is monetary policy [which] affects income and employment by first affecting asset values and the liquidity and solvency of firms, households, and financial institutions." (Minsky, 2008a).

However, inappropriate financing of investment and capital-asset ownership are the major destabilizing influences in a capitalist economy. Thus, sustainable employment policies call for financial reforms that aim at decreasing instability:

"*The policy problem is to design a system of financial institutions that dampens instability. Recent experience shows that the institutional lines cannot be sustained when there are large profit opportunities from breaching the lines"* (Minsky, 2008a).

FIH is related to the impact of debt on system behavior and incorporates the manner in which debt is validated.

→If public spending to enhance employment, then financing of public debt should not be left to the vicissitudes of markets.

→Consistent financial structure to allow government to be financed without speculative attacks

→A macro-prudential regulatory framework to replace the free-market-based financial systems and to make FF consistent.

- Private spending units and public spending units have not the same aim and cannot be guided according to same principles since the efficiency of public debt is not the economic efficiency (maximizing profit).
- Then the financing of public debt cannot rest on the same criterion (expected private profits), but on the social utility of public expenditures.

Therefore, the market evaluation throughout the financing of public debt on markets has no meaning.