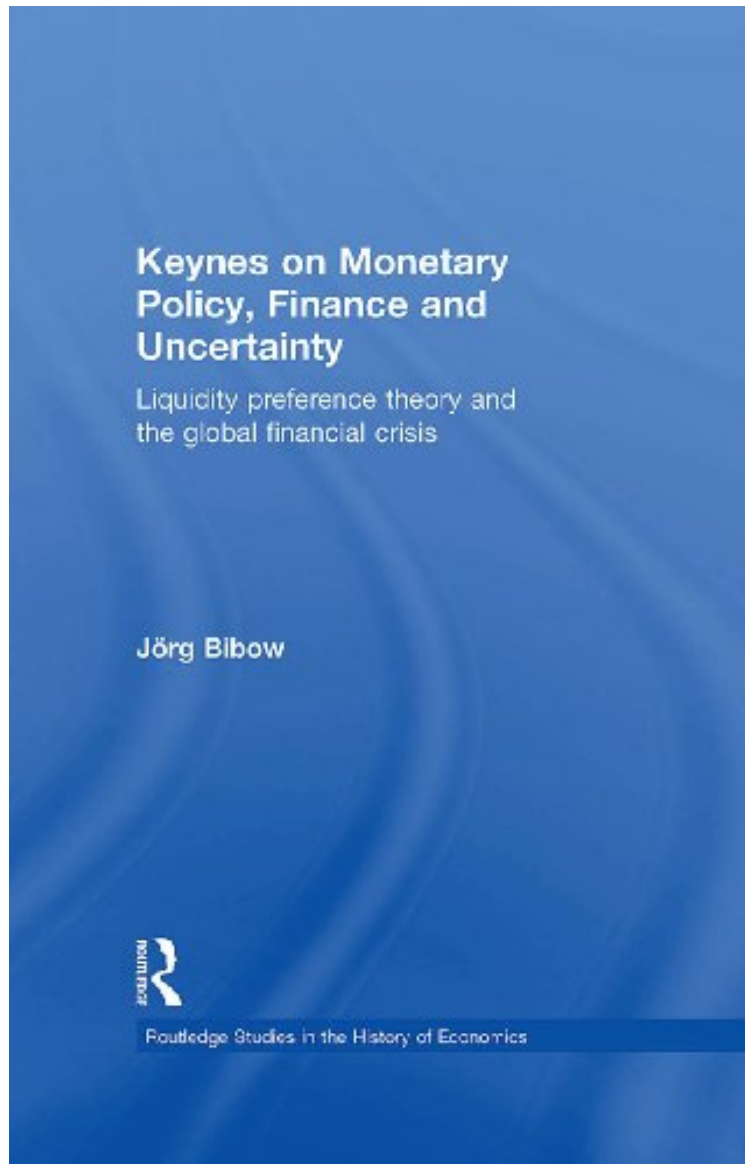


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Keynes on Monetary Policy, Finance and Uncertainty: Liquidity Preference Theory and the Global Financial Crisis (Routledge Studies in the History of Economics)

Jorg Bibow

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Jorg Bibow : Keynes on Monetary Policy, Finance and Uncertainty: Liquidity Preference Theory and the Global Financial Crisis (Routledge Studies in the History of Economics) before purchasing it in order to gage whether or not it would be worth my time, and all praised Keynes on Monetary Policy, Finance and Uncertainty:

2 of 2 people found the following review helpful. Completely overlooks Keynes's upper-lower interval estimate approach to non additive and nonlinear probabilities By Michael Emmett Brady The author is correct that Keynes's theory of liquidity preference in the General Theory (1936;GT) is built on Keynes's theory of decision making in the A Treatise on Probability (TP;1921. See also Keynes's 1908 fellowship dissertation since practically the same material that forms the foundation of Keynes's approach in 1921 appears in 1908). The author is also correct that Keynes's theory of decision making combines his theory of probability and his theory of evidential weight. Unfortunately, the author does not know what Keynes's theory of probability entailed or what Keynes theory of evidential weight entailed. This review will thus concentrate on chapter four and especially pp.77-85. It is these pages that form the foundation for the author's misbeliefs concerning the analysis contained in the TP as it relates to the GT's theory of liquidity preference. Nowhere in the book does the author demonstrate how Keynes operationalized his approach. He can't. The reason he can't is because he believes that Keynes did not make use of any numbers in his theoretical approach. This is due to his misbelief that Keynes's theories of probability/weight of the evidence were ordinal at best. Furthermore, the author follows the standard Post Keynesian belief that Keynes's theory could only be applied some of the time. This is, of course, identical to the Ramsey critique. Contrary to the author, Keynes's theory of probability primarily involved intervals using upper-lower probabilities. Keynes's approach, based on the original Boolean logic contained in Boole's 1854 The Laws of Thought that Keynes modified and used in the TP, has been rediscovered unknowingly by Gilboa and Schmeidler. They use Choquet integration and inequality constraints, formed using upper (concave) and lower (convex) capacities to demonstrate that nonlinear and non additive capacities are the general case. Keynes would agree while gently pointing out that he had already accomplished this feat in great mathematical detail in 1908 and in chapters 15, 17, 20 and 22 of the TP. The capacities approach is thus a footnote to the work of Keynes. A specific example of Keynes's nonlinear and non additive approach of chapters 15, 17, 20, and 22 of the TP was worked out in great detail by Keynes in chapter 26 using his conventional coefficient of risk and weight, c , on p.314 and in Footnote 2 on p.314. Edgeworth, in his 1922 article on "The Philosophy of Chance" in Mind, was certainly correct for asking for the help of Mind readers to figure out the what and the why's involved in the application of Keynes's c coefficient. This will be provided for the author below. The foundation of Neoclassical economics is merely the mathematical development of a theoretical approach first proposed by Jeremy Bentham in 1787. Bentham claimed that all individuals have the capability to calculate the odds and outcomes and act on the expected value (the probability times the outcome) in a rational way. This can be expressed by the following, where p is the probability of success and A is the outcome: Maximize pA . The modern version of this is to Maximize $pU(A)$, where p is a subjective probability that is additive, linear, precise, and exact. $U(A)$ is a Von Neumann-Morgenstern Utility function. The goal is to Maximize $pU(A)$. The modern name for Benthamite Utilitarianism in neoclassical economics is SEU theory (Subjective Expected Utility). Therefore, a microeconomic foundation based on Utility Maximization is just Benthamite Utilitarianism updated with modern mathematical techniques. Bibow is completely unaware about the reasons why Keynes rejected Benthamite Utilitarianism as a very special case that would only hold under the special assumptions of the subjectivist, Bayesian model—that all probabilities were additive, linear, precise, single number answers that obeyed the mathematical laws of the probability calculus. Keynes specifies his conventional coefficient of risk and weight, c , model in chapter 26 of the TP on p.314 and footnote 2 on p.314. Keynes then integrated his c coefficient into the elasticity analysis in chapter 21 of the GT, pp.304-306, in order to show that the standard Equation of Exchange was a special case of his generalized equation of exchange. The crucial elasticities, which play the role of w in Keynes's analysis in the GT, are e and e_d subscript. These must equal 1 in neoclassical theory in the same manner that w must equal 1 in neoclassical theory. Essentially, Keynes's generalized model is given by $c = 2pw / (1+q)(1+w)$, where w is Keynes's weight of the evidence variable that measures the completeness of the relevant available evidence upon which the probabilities p and q are calculated. (Benthamite Utilitarians assume that the value of w is 1.) It is an index defined on the unit interval between 0 and 1, p is the probability of success, and q is the probability of failure. $p+q$ sum to 1 if they are additive. This requires $w=1$. Keynes's c coefficient can be rewritten as $c = p [1/(1+q)] [2w/(1+w)]$. Now multiply by A or $U(A)$. One obtains $cA = p [1/(1+q)] [2w/(1+w)] A$. The goal is to maximize cA or $cU(A)$. The weight $1/(1+q)$ deals with non linearity. The weight $2w/(1+w)$ deals with non additivity. It is now straightforward to see that the neoclassical microfoundations assume that all probabilities are additive and linear. This is nothing but a special case of Keynes's generalized decision rule to maximize cA , or $cU(A)$, as opposed to the neoclassical pA or $pU(A)$. It is now clear that Keynes had created general theories of macroeconomics, probability, and decision making. Keynes's accomplishments, if understood, place him as the only rival to Einstein for the title of the greatest scientist of the 20th century. However, Bibow understands none of this. It was technically impossible for Bibow to accept Keynes's theories because Bibow, like Ramsey, Davidson, and Runde, accepted the standard frequency interpretation of probability view that all probabilities were linear, additive, precise, single number answers which were subject to the addition and multiplication rules of the probability calculus. It is impossible for Bibow to try to develop Keynes's approach because Bibow lacks a basic

, fundamental understanding of the nature of Keynesian probability. Keynes's views on subjective expectations, which were based on a w

This book provides a reassessment of Keynes's theory of liquidity preference. It argues that the failure of the Keynesian revolution to be made in either theory or practice owes importantly to the fact that the role of liquidity preference theory as a pivotal element in Keynes's General Theory has remained underexplored and indeed widely misunderstood even among Keynes's followers and until today. The book elaborates on and extends Keynes's conceptual framework, moving it from the closed economy to the global economy context, and applies liquidity preference theory to current events and prominent hypotheses in global finance. Joerg Bibow presents Keynes's liquidity preference theory as a distinctive and highly relevant approach to monetary theory offering a conceptual framework of general applicability for explaining the role and functioning of the financial system. He argues that, in a dynamic context, liquidity preference theory may best be understood as a theory of financial intermediation. Through applications to current events and prominent hypotheses in global finance, this book underlines the richness, continued relevance, and superiority of Keynes's theory of liquidity preference; with Hyman Minsky standing out for developing Keynes's vision of financial capitalism.

"I do not think anyone has exceeded, let alone matched, Bibow's ability to think within Keynes's own multi-dimensional, rich approach to economic theory and the provision of policies based upon it. The end result is a volume of profound scholarship and fundamental analysis of the workings of the modern interrelated capitalist world, emphasising especially the central role of Keynes's liquidity preference theory of the rate of interest in theory and in the design of appropriate policies with which to tackle the fall out from the present crisis and its long-term aftermath." Geoff Harcourt, University of Cambridge

Over the years, Joerg Bibow has built a substantial reputation as a champion of Keynesian liquidity preference theory. This book brings together many of the papers on which this reputation is founded, together with applications to recent and ongoing events in global finance. The papers range from contributions on the history of economic ideas, through to economic history, contemporary monetary policy and recent travails in the banking sector. Lord Skidelsky, perhaps the most famous of Keynes's biographers, has recently written that 'We do not need a new Keynes; we do need the old Keynes, suitably updated'. This collection provides one of the best examples of what Skidelsky has in mind, an up-to-date body of analysis directed at contemporary issues that is not only Keynesian in name, but also reflects the spirit, analytical sophistication and appreciation of empirical data that can only come from a deep and intimate engagement with Keynes's work in economic theory, economic policy and as an investor. Jochen Runde, Judge Business School, Cambridge University

This is a book for the times. It revisits Keynes's ideas on money, banking and monetary policy in a way which illuminates our understanding of the current crisis and how policy should address it. In particular, Bibow demonstrates the central role of liquidity preference, a cornerstone of Keynes's theory which has been paid inadequate attention in the renewed focus on Keynesian fiscal policy. This is a scholarly contribution which directly addresses important policy issues in a compelling manner. Sheila Dow, Emeritus Professor of Economics, University of Stirling, August 2010

"This book on the relevance of Keynes's insights into the complex workings of finance and monetary policy, when uncertainty is taken seriously, is timely and very well done. The global financial crisis revealed the inadequacy of the mainstream 'New Consensus Macroeconomic' theoretical framework. In this very well written book, Joerg Bibow offers a clear exposition of a much richer Post-Keynesian alternative that applies liquidity preference theory to current events and prominent themes in global finance. The New Consensus Macroeconomics does not even address liquidity preference or money." Philip Arestis, Cambridge University, August 2010

About the Author: Joerg Bibow is Associate Professor of Economics at Skidmore College, New York, USA and Research Associate at the Levy Economics Institute of Bard College, Annandale-on-Hudson, New York, USA