ELGAR ENCYCLOPEDIA OF POST-KEYNESIAN ECONOMICS

This *Encyclopedia* is an invaluable reference book for post-Keynesian and heterodox economics. It consists of 300 entries, written by 180 different authors. The volume includes entries on key concepts of interest to post-Keynesians as well as descriptions of some of the seminal books in the post-Keynesian tradition. It will interest both students and scholars of heterodox economics, as well as policy makers around the world looking for a better alternative to mainstream economic policies at national and international levels in the aftermath of the global financial crisis that burst in 2008 and the COVID-19 pandemic crisis that began in 2020.

Key Features:

- Offers a non-conventional understanding of economic analysis on a number of key economic topics
- Provides a deep and convincing criticism of orthodox thinking
- Explains how money, banking and finance are crucial elements of economics today
- Addresses the roots of the 2008 global financial crisis
- Points out the importance of sound economic policies
- Presents the essence of the subject matter concisely

This comprehensive reference work will be a key tool to students, scholars, policy makers and anyone else seeking to understand the world economy through the important lens of post-Keynesian thought.

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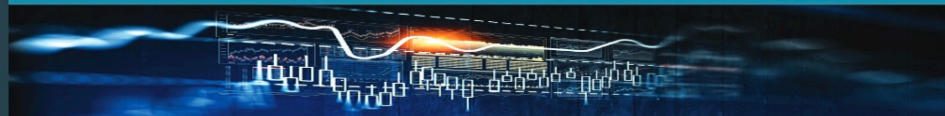

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the government and the central bank achieve the desired target rate of interest. The 'balancing' between spending and taxing is done with this objective in mind – not for the concerns of avoiding a deficit or attempting to achieve a surplus in the public budget, as claimed by neoclassical economists.

The links between fiscal and monetary policies, which are assumed away in the orthodox view, become evident when we understand that deposits of government cheques by private agents increase the balance sheets of commercial banks both on the liabilities side (banks owe the amounts to depositors) and on the assets side (since banks now have claims of equal amounts on the government). These claims are what we refer to as 'reserves'. Banks claim these reserves at the central bank, which executes the operation simply by crediting commercial banks' accounts (that is, by adding to their reserves) and debiting the government's account by an equal amount. Government spending results in an injection of reserves (central bank money) into the private sector.

Similarly, when private agents pay their taxes or purchase government bonds, they order their banks (such as by writing cheques) to transfer a deposit from their accounts to the government's account. The operation is executed by the central bank by reducing commercial banks' reserves (debiting their accounts) and crediting the government's account. The accumulated deposits in the government's account at the central bank can now be tallied against its debts, which will be reduced or eliminated, but this has nothing to do with financing government expenditures, because the latter have already been paid. The resulting public deficit or surplus matters only insofar as it has an effect on the target rate of interest (see Bougrine, 2020). Attempts to balance the budget of the public sector are in fact attempts to stabilize the target rate of interest: adjustments in the target rate of interest can be achieved by manipulating the government's budget. Fiscal and monetary policies are intricately linked and, therefore, it is utterly wrong to claim that they can be analysed and carried out separately.

HASSAN BOUGRINE

See also

Inflation; Interest rate – natural; Monetary policy transmission mechanism; Reserves – role of; Settlement balances

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Interest rates and investment

The idea that investment is negatively affected by the rate of interest is a marginalist tenet grounded on (i) the notion of capital as a single homogeneous factor of production, (ii) the concept of a decreasing marginal productivity of capital and (iii) the idea of a substitution mechanism between capital and labour. Such a negative relationship is extremely relevant for the marginalist theory, because it would guarantee a stable full-employment equilibrium. For a given endowment of production factors, preferences and technical conditions of production, prices and quantities are simultaneously determined by the intersection between demand and supply in all markets. In the market of investment, the equilibrium condition is determined by the interaction of a downward-sloping demand curve for investment and an upward sloping supply curve of savings. In such a representation, the flexibility of the interest rate combined with a downward-sloping investment demand curve allows an economy to reach a full-employment equilibrium in which investment adapts to full-employment savings and the rate of interest gravitates towards its 'natural' level.

Starting from the assumption of a decreasing marginal productivity of production factors and a decreasing marginal utility, the marginalist theory determines the demand for production factors elastic with respect to their rates of return by means of the direct and indirect substitution mechanisms. The inverse relationship between investment and the interest rate appears as a consequence of a demand for capital highly elastic with respect to interest rates, where investment is conceived as the flow that generates the capital stock (Garegnani, 1990). According to the direct mechanism, a decrease

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in the rate of interest leads firms to increase investment and therefore the capital–labour ratio. Firms will save more by increasing the amount of investment and therefore of capital, namely the factor that is relatively cheaper. According to the indirect mechanism, a decrease in the rate of interest leads to a reduction in the price of capital-intensive goods. This in turn increases the demand for those goods that are produced with capital-intensive techniques, thereby raising the demand for capital. Firms cease to invest when the marginal productivity of capital is equal to the rate of interest, a condition which maximizes profits and minimizes costs.

The idea of a downward-sloping demand curve for capital was also shared by Keynes in *The General Theory* through the concept of the marginal efficiency of capital (Keynes, 1936). Indeed, according to Keynes, no relevant differences exist between the marginal efficiency of capital and the demand curve for capital envisaged by classical economists, where the classical economists Keynes referred to are Marshall and Walras (see Petri, 2015). Following Keynes (1936, p. 136), 'the inducement to invest depends partly on the investment demand-schedule and partly on the rate of interest'.

The existence of a negative relationship between the rate of interest and the demand for capital and investment has been questioned by those economists who participated in the so-called 'Cambridge capital controversy'. Specifically, according to Sraffa (1960) and Garegnani (1970), when one assumes several production techniques and heterogeneous capital goods, the possibility of reswitching of techniques and reverse capital deepening invalidates the negative relationship between investment and interest rates. Different levels of the rate of interest can allow producers to use the same method of production and thus the same factor intensity (Garegnani, 1970). Consequently, we cannot draw a downward-sloping investment demand curve, because no automatic mechanism ensures that firms adopt more capital-intensive techniques when the interest rate decreases. For more recent critiques, see Petri (2015).

The alleged negative relationship between the rate of interest and the level of investment would ensure the return to the traditional theory (Garegnani, 1979). The possibility of the investment demand being negatively affected by the rate of interest would limit in the short-run the principle of effective demand, leaving in the long run the level of investment determined by full-employment savings: 'a spontaneous tendency for investment to adjust to the saving capacity of the economy … is the outcome of a theory of interest derived from the idea that the overall demand for "capital" is highly elastic with respect to the rate of interest' (Garegnani, 2015, p. 131).

Matteo Deleidi

See also

Capital theory controversies; Effective demand; Interest rate – natural; Monetary policy; Neoclassical economics

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International clearing union

The idea of an international clearing union (ICU) is quite simple but has far-reaching consequences for the world economy. It is based on the role of a commercial bank in a closed system: it is well known that commercial banks today create money out of thin air simply by accepting to extend credit to creditworthy borrowers who then use these credits to pay for goods and services and to extinguish their debts (see Bougrine, 2017). If both the payer