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The Economics of Instability

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THE ECONOMICS OF INSTABILITY

August, 14, 1988

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August 1988 : FURTHER QUESTIONS

A) FACTS

1) Financial Instability in the Presence of Unemployment and deflation.

- It is derived from Keynes and Fisher
 - Fisher : the role of debts
 - Keynes the role of P_k over w
 - Two Positive conclusions :
 - no point in cutting wages
 - government interventions.
 - Two negative Conclusions:
 - different from IS-LM (w and M)
 - different from Monetarist(money and real aspects interplay)
- Situation of Unemployment + Deflations: '30s.

2) Inflation and Stagflation

- Historical considerations : Keynesian policy has avoided unemployment;
- Wage and oligopoly power : bias towards inflation
- Relationship between wages and monetary Regimes.
- In turbulent periods expectations are not necessarily backward.
- The system experiences "regime switching", discontinuity... which are important for expectation formations : anticipated changes and learning.
- Difference from IS-LM : money wages is linked to monetary conditions which ,however, are not neutral.
- Changes in P_k / w

- In this case, the problem is not wage downward flexibility as were in the thirties.

- Severe monetary policy caused stagnation + inflation
- the vengeance of rentiers

3) The aftermaths

- Political changes + technical changes affected unions
- wage moderation
- financial innovations

B) THEORY

Financial instability under A) 1. is clear. You cut wages more than debts...

More difficult financial instability under A) 2.
Wage increases: reactions :

- i) price increase and inflation;
- ii) investment and productivity;
- iii) profit reductions.

Suppose that the three happens and that productivity lags, there can be an increase in indebtedness and hence in fragility.

Or wage increase may intervene after investment boom.

C) POLICIES

- Constraints :
 - world interdependence
 - fiscal policy : debt and supply siders
 - monetary policy : innovations

D) CONCLUSION

- A diagnosis without a therapy?

Would Keynesism + ecology ?

because of either

a) analysis → policy

b) analysis → policy
but political pessimism: How can one be an

optimist when Thatcher and Reagan are
brutely chosen and the choice is
between Bush and Dukakis