Money and Finance after 2008

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Introduction

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  The US had a commercial surplus.
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- Who will consume Chinese products?
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- Can/should Finance help resurrect the Minotaure?
- What misunderstanding of the economic rôle of money underlies the post-industrial fantasma?
What about the market Inefficiency hypothesis?

Incomplete markets

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- Do you think that markets will ever be complete?
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○ **Second-best** efficiency is the right notion.

○ Incomplete markets are generically not even second-best efficient.
  (Geanakoplos and Polemarchakis (1986))

Too bad... The invisible hand is invisible because it does not exist even within the core of mainstream economic theory!
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- Sunspots never happen in complete markets.
  Incomplete markets can never be immune against sunspots.
  Example: Greece in January 2010 (via CDS).
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- Fama’s hesitations...
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  Uniqueness of the risk-neutral probability.

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○ Pricing theory fails when markets are incomplete.
Application
Marked-to-market principle of Fair Value in the IFRS accounting norms?

- Does not lead to a unique fair value.
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- Imports sunspots into the balance sheet of corporates.
- December 2008. A temporary exception for banks?
- Strong need for a reform of the accounting standards.
- Salamanca school (16th century): market prices need not be fair.
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Money in contemporary economics
A fatal neglect

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**Figure:** Government borrowing and interest rates.
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**Figure:** Monetary base and inflation.
Grasselli (2013) slide.

**Figure:** Fiscal tightening and GDP.
How can we check for the presence of money in a model?

- Non-homogeneity with respect to prices. Dubey Geanakoplos (2003), Drèze Polemarchakis (2003), Giraud Tsomocos (2010), etc.
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- The model should not involve the money multiplier. Holmes (1969); Moore (1979); Moore (1988); *Kydland and Prescott* (1990).
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Money Supply M1 (Index 1990 = 100)

- Euro Zone
- Japan
- United Kingdom
- United States

Source: Ecowin, IMF IFS, Bank of England, ECB
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Credit?

- Banking credit and money creation *ex nihilo* should be made explicit (≠ Diamond-Dybvig (1983)).
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- Liquidity creation \(\neq\) Money creation.
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- Households have debts! ≠ representative consumer.
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○ Banking credit and money creation *ex nihilo* should be made explicit (≠ Diamond-Dybvig (1983)).

○ Liquidity creation ≠ Money creation.

○ Households have debts! ≠ representative consumer.

○ Accounting equation $I = S$ should incorporate banking credit. ≠ IS-LM and *all* neo-classical models.
Categories of bank debt: UK, 2009

- **£bn**
  - Other corporate: 232
  - Commercial real estate: 243
  - Residential mortgage (including securitizations and loan transfers): 1235
  - Unsecured personal: 227

- Primarily productive investment
- Some productive investment and some leveraged asset play
- Mainly purchase of existing assets
- Pure life-cycle consumption smoothing
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- Deflation should be possible.
  (≠ Aghion, Acemoglu, etc.)
  Schumpeter (1927); Schumpeter (1934); Fisher (1933),
  Krugman Eggertson (2012).
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Schumpeter (1927) ; Schumpeter (1934) ; Fisher (1933),
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Krugman versus Aghion on the Eurozone.
Croissance, chômage et taux d'intérêts au Japon

Sources : IMF International Financial Statistics, IMF World Economic Outlook
L'inflation, en glissement annuel

Sources : Eurostat, Ministères des Affaires Intérieures et des Communications - Japon
Évolution des dépenses publiques, de l'endettement public et de la masse monétaire au Japon - Base 100 en 1982

Sources : Bank of Japan; Ministry of Finance, Japan
On financial markets,

- Speculative bubbles should be possible.
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- Crashes should be possible Zame (1990)... Giraud & Pottier (2012).

- But not just as a “black swan”. Giraud & Kockerols (2015)

  Report for the European Parliament on the Cost of the next Banking Crisis within the European Banking Union.
Dow Jones
Moyennes hebdomadaires

Dow Jones Industrial Average
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- **Stock-flow consistency**: accounting rigor. 
  Godley & Lavoie (2007)

- **Lotka-Volterra dynamics**: Goodwin (1967). 
  Minsky instability.

- **Debts** of corporates: Keen (1995). 

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- **Multisectoral** extension (input-output matrix): Giraud & Nguyen-Huu (2015). Energy, natural resources: Ezatsepina, Mclsaac, Pottier, Rostom...