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Introduction

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From 1980 to 1985, the value of the dollar in terms of the Deutsche Mark more than doubled. Immediately thereafter (and in less time) it did a complete reversal. In December of 1994, the Mexican peso lost almost sixty percent of its value against the dollar in just two weeks. The South Korean won plummeted from 891 per dollar on August 4, 1997, to 1,812 by January 9 of the next year. At the time of this writing (spring 2008) the dollar is in the midst of a historic collapse. Each of these extraordinary upheavals was accompanied by macro consequences that went well beyond currency markets and whose impact shifted economic activity onto new paths. These were not trivial events or a sideshow, they were center stage.

Despite the central importance of the market for foreign currency, mainstream economists are unable to agree on how it works. There is no single, well-accepted explanation (as in neoclassical trade theory, for example), but a smorgasbord of choices. These include though are not limited to purchasing power parity, the monetary model, the Dornbusch model, portfolio balance, Mundell-Fleming, currency substitution, fundamentalists versus chartists, microstructure studies, and order flow. While there is some agreement on the general principles that 1) short-run movements may be driven by non-fundamental factors (some going so far as to admit less-than-rational

expectations may play a role) and 2) long-run currency prices move economies toward optimal levels (typically a balanced-trade equilibrium), there appears to be little interest in modeling the former and little agreement on the specifics of the latter.

The simultaneous co-existence of so many approaches along with a general shift to long-run studies is a function of the poor empirical performance of each individual Neoclassical model. First highlighted by Richard Meese and Kenneth Rogoff (1983), these troubles have continued unabated (Rogoff 2001), so much so that it is now common to include a mention of this even at the textbook level.¹ The real problem, of course, is the fact that the Neoclassical paradigm is simply poorly equipped to explain a world marked by less-than-full employment, fundamental uncertainty, endogenous money, historical time, equilibrium trade imbalances, and agents whose preferences and worldviews are a function of social rather than internal and atomistic influences. This is glaringly obvious over the short run, though no less true in the long run.

By contrast, the model developed in this book has no difficulty in explaining modern currency markets. Coming from the Post Keynesian perspective, it resorts to neither “ad hocery” or special cases to account for the salient features of the international financial system and it is a single, coherent explanation. The unique element of the approach adopted here is the assumption that portfolio capital flows are not, in either the short or long run, passive and accommodating, but an independent and dominant force in setting exchange rates. In such a world, subjective speculative pressures can create wild swings in prices and, unless agents happen by coincidence to focus on

trade balances as the primary factor driving their forecast of future exchange rate movements, there is no reason to believe that international flows of goods and services play any more than a secondary role in determining currency prices over any time horizon. Furthermore and in contrast to the mainstream practice, agents' expectations are modeled as a real, causal element in the determination of currency prices and not simply as the source of white noise around a long-term, fundamental trend. This is a strong break and will require forays into Institutionalism and psychology, as well as Post Keynesian economics.

What evidence is there to justify shifting the focus (short and long term) to capital flows? That their absolute volume is extremely large is undeniable. A 2004 *Bank for International Settlements* (BIS) survey of currency markets showed that the average daily value of currency transactions (based on April of that year and net of double counting) was around \$1.9 trillion (BIS 2005: 1)—enough to accommodate world trade 40 times over (BIS 2005: 1; *World Trade Organization* 2005: 3). Even assuming a number of covering transactions for each import and export, it is clear that the overwhelming majority of foreign exchange transactions are related to capital.

Mainstream economics does not necessarily deny this, but assumes that these activities have no net long-run impact on currency prices. Either they are white noise or they are a mere reflection of the trade flows.

Whether or not this last point is true is key. If it is the case that capital flows have no lasting effect on foreign exchange prices then, for all intents and purposes, currency demand arises only from

import-export transactions. In that event, short-term trade imbalances would indeed be as fleeting as argued in mainstream economics. Consider their argument. When a nation imports, they supply their home money in exchange for foreign so that they can use the latter to buy foreign goods and services. Imports thus translate into home currency supply. When they export, this creates a demand for their currency as foreigners buy it to obtain the home country's goods and services: exports are home currency demand. Therefore, any country with a trade deficit must necessarily be experiencing an excess supply of the home currency, driving its price lower and making their products increasingly inexpensive. This process continues until balanced trade is restored. Meanwhile, countries with trade surpluses would be witness to own-currency appreciations until balance was restored.

So, in a world where capital flows are white noise or a reflection of trade flows, current accounts would tend toward balance. Exchange rate models would logically focus on imports and exports as the primary determinants of currency prices, particularly over the long run. In addition, because trade flows change only slowly, the international monetary system would be marked by smoothly adjusting currency prices. In a world where trade flows rule the roost, volatility and trade imbalances would be the exception. Capital flows may add some short-term drama, but they would have no lasting effect.

Now imagine instead if the factors driving those massive financial capital flows were fundamentally distinct from those determining trade flows, undertaken by very different people

with different agendas, worldviews, goals, et cetera. In that event, just because a nation is experiencing a trade imbalance does not mean that its currency price is out of line with its short- or long-term equilibrium. Recall that in the example in the previous paragraph the nation in question experienced a currency price depreciation because the trade deficit was evidence of an excess supply of its currency. But with large and independent capital flows, the trade balance only tells a small part of the story. So long as the nation in question is running a capital account surplus to offset the trade deficit, it is quite possible that their currency price is stable—and it could even be appreciating (as the US dollar was during the rising trade deficits of the early 1980s). The tendency towards balanced trade is gone.² In addition, because the pursuit of short-term capital gain is driven by subjective and potentially unstable factors, the magnitude and direction of capital flows can change very quickly. Bandwagon effects, over reaction, and fluctuating levels of confidence in agents' forecasts combine to create a very different market dynamic than that created by trade flows. This is the world described by the models in this book and, more importantly, it is the one in which we live.

POST KEYNESIAN AND INSTITUTIONALIST ECONOMICS AND PSYCHOLOGY

Institutionalist Economics

Though the Post Keynesian influence on this volume is the most obvious, the analysis is firmly and self-consciously set in an Institutionalist framework. Institutionalists view the economy from a

broad perspective wherein markets are perceived as social institutions...

...like democracy and marriage...not physical phenomena such as light waves or friction. They serve to organize and guide human behavior through sanctions (formal and informal, negative and positive), mores, norms, status, and shared worldviews. Activities of markets are the activities of people and societies.

(Harvey 1993b: 679)

Capitalism (or any form of economic organization) is no more “natural” than the English language, indentured servitude, or Major League Baseball. Each is the result of a particular line of social evolution. In contrast to mainstream suggestions that economic behavior is subject to immutable laws, Institutionalism asserts that we are not dealing with universal phenomena. While there are certainly generalities (as explained below), those are to be discovered and not assumed.

How social institutions recreate themselves is through the constant evaluation of the behavior of its members. Behavior that meets the social standard is rewarded and thus encouraged and perpetuated; that which does not is punished. Because humans are social animals, this is done primarily by the members themselves as they strive to adhere to established convention and thereby gain the approval of the “tribe” (the other members of the gang, fellow Texans, or the subculture of currency dealers, for example).³ According to Institutionalists, the relevant evaluative criteria can be divided into two sets: instrumental and ceremonial. Acts sanctioned by

the former are rational and pragmatic. Something is “right” because it works, without reference to way things were done before. Instrumental values lead to goal-oriented, experimental, and progressive action and they contribute to social provisioning (providing for the basic needs of all members of the economy) and democratic problem solving (resolving the issues faced by the average person). By contrast, ceremony is concerned with tradition and power. A pattern of behavior is justified by appeal to the past and often implies invidious distinction. The tradition in western culture that a woman takes the surname of her husband, for example, is defended simply on the basis of “that is the way it is done” and it is, at least historically, an indication of her status as de facto property.

Societies and subcultures dominated by ceremonial valuing are marked by institutions that tend to be exploitative rather than creative. One manifestation of this occurs when groups and individuals focus on devising means of keeping or taking power, goods, wealth, land, et cetera from others not identified by some culture-specific standard as “us.” This is very common in nations with serious ethnic, religious, political, or other divisions and is a frequent problem in developing nations. Developed economies are not immune, however; and the nature and effect of institutions like sexism and racism can be explained by ceremony. Institutionalists also describe “business” as a ceremonial phenomenon. The goal of business is the accumulation of wealth and hence its orientation is power and exploitation, not democratic problem solving. If policy makers can manage to create an environment in which businesses can only achieve wealth if they have solved some social problem, then it is possible to link the ceremonial to the instrumental. But, in general, it is important to remember that encouraging business is not equivalent to encouraging social

welfare.⁴

What all this means for foreign exchange is that, first, a key consideration must be determination of the manner in which the institution is organized and whether or not this organization is conducive to social provisioning or exploitation. This is a running theme in this book, if often in the background; because of this, the analysis must delve into the specific subculture of currency markets as well as the world views of those therein. It also means that there is no a priori assumption that markets are the best way to solve social problems or that they are inherently flawed or morally wrong. Markets are tools, no more and no less; their propriety is a function of their ability to solve the problem at hand. Nor is it assumed that market behavior is rational (by whatever definition). Markets are people in a particular social setting. What markets reflect, reward, and encourage is a direct function of what is reflected, rewarded, and encouraged in that society. If a culture is racist, an employer daring to hire a member of the oppressed race may find lost sales as customers turn away. If in an asset market agents focus on sun spots in forecasting future prices, those not doing so will find themselves with depreciating portfolios. That markets are people and people are social animals is an important premise of this work and the primary influence of the Institutionalist approach on this volume.

Post Keynesian Economics

While the Institutionalist perspective is vital in understanding the context within which the market

for foreign exchange exists and the manner in which it is organized, this book can best be described as Post Keynesian. The latter is indispensable in this endeavor because it offers unique insights into the working of modern capitalist economies and into the primary factor driving foreign currency prices–asset markets. Post Keynesians trace their intellectual heritage to John Maynard Keynes. Like Keynes, they see as critical to understanding real world economies the assumption that agents view the future to be uncertain. It is because of this that economies can come to rest at less-than-full employment. This is best explained through an example.

Assume a closed economy with no government sector. Let Y represent aggregate output, income, and expenditure (each of which must be equal to the other in a closed system), S aggregate savings, C aggregate consumption, and I aggregate investment.⁵ There are only two sectors, households and firms, and for simplicity let only the former earn income, consume, and save while only the latter may borrow (which, since they do not retain earnings, they must do in order to invest).

Household income (Y) can be either spent (as consumption, or C) or saved (S). This is shown in

1.1:

$$Y = C + S \qquad 1.1$$

Equation 1.2 illustrates the fact that since there are only two types of goods in the macroeconomy, total expenditures (also Y) can only have been on consumption(C) or investment

(I):

$$Y = C + I$$

1.2

Equation 1.2 can also be derived from the fact that all output produced (Y) must either be in the form of consumption goods (C) or investment goods (I).

The clear implication of 1.1 and 1.2 is $S = I$. In other words, in equilibrium, total savings must equal total investment. That this is true under the assumptions made above is not a point of contention within either the mainstream or Post Keynesian schools of thought. Where they differ is in terms of the process by which the economy adjusts so that S and I come to rest at the same point and it is here that the role of uncertainty will become evident.

In the mainstream, interest rates bear the burden of adjustment. The key is that agents are assumed to know the future with at least probabilistic certainty.⁶ This has important consequences. For example, in the absence of worry about unforeseen events agents have little desire to save. Their demand for goods and services is insatiable and so they will spend all current income if they are not somehow rewarded for doing otherwise.

But, they are so rewarded, with interest. When financial institutions offer higher interest, households save more; when they offer lower interest, households save less. Interest is thus the compensation for not consuming. Note that this implies that households never save cash. Rather, all savings would be held (assuming for simplicity a choice between cash and bonds) in the form of interest-bearing bonds, the proceeds from the sale of which can then be loaned out by the issuer

(to firms, who need to borrow in order to invest). To summarize, households only save because they are offered interest, all savings are held in bonds, and the proceeds from bond sales are available to firms wishing to borrow to invest.

Now imagine this economy at full-employment equilibrium with $S = I$. Say that, for whatever reason, firms decide to invest less. This temporarily leaves us at $S > I$ and with the threat of economic contraction. But, given that S , because it is held in bonds, is equivalent to the stock of loanable funds and since I is the sole source of borrowing, $S > I$ also means that financial institutions have excess balances. Since they pay interest on deposits and only earn income if those funds are loaned out, this creates an incentive to lower the interest rate (to both discourage deposits and encourage borrowers). As this occurs, S (deposits) will fall and I (borrowing) will rise, both of which raise spending (since the fall in S means a rise in C) and help stave off the recession. This continues until $S = I$. In short, whenever $S > I$ and recession looms, *interest rates automatically fall to reinvigorate spending* in the form of rising consumption and investment. Thus, in a world where the future is known, the financial sector responds directly to the needs of the real sector and there is never an obstacle to reaching full employment. Finance, money, portfolio capital, and all other monetary factors are irrelevant. It is the “real” side of the economy (those factors associated with output and employment) that rules the roost. In thinking about exchange rates, the implication of the Neoclassical approach is that our focus should be on trade flows rather than portfolio capital. The latter, regardless of its absolute size, is epiphenomenal; it is a result but not a cause.⁷

In Keynes' (and Post Keynesian) analysis, the fact of uncertainty changes the mechanism by which interest rates are determined and breaks the link described above. While it is still true that S will come to rest at the same level as I , the financial sector does not step in to solve the problem to everyone's benefit. Instead, the overall level of economic activity (Y) adjusts, sometimes causing expansion and sometimes recession. There exists no long- or short-run tendency to full employment.

In a world where the future is unknown, agents' insatiable demand is for wealth (goods, services, and assets) and not just goods and services. When one does not know what the future may bring, a stockpile of purchasing power for future eventualities will be forthcoming even without there being a reward for not consuming. As incomes rise, so households set aside more savings (and vice versa); but the volume of savings does not respond to interest rate movements. What interest does do is determine the manner in which savings are held. Agents face the tradeoff of holding cash, which is barren but provides quick and easy access to purchasing power (a priority if the future is unknown), or bonds, which yield interest but require time and possibly other transactions costs to liquidate. Interest is the reward for parting with the liquidity and safety offered by cash. Financial institutions offer higher interest not as a means of tempting agents to stop consuming and start saving, but to stop saving cash and start saving bonds. As the demand for liquidity rises (which it might do when agents become more concerned about the future and want to hoard cash or when they are eager to spend and temporarily hold money in anticipation of doing so), so interest rates rise as financial institutions must offer higher rates to attract buyers for bonds; as the demand falls, interest falls. Likewise, interest is affected inversely by the supply of liquidity, a

supply that is partly exogenous (as governed by the central monetary authority) but largely endogenous. Discussing the latter will take us a little off track, so suffice it to say for now that Post Keynesians argue that money creation in modern capitalist economies is primarily private-market driven, rising and falling as financial institutions grant and destroy credit. In equilibrium, interest comes to rest at the point where the market for liquidity clears. Most important for the current discussion is the fact that S (savings) does not represent the stock of loanable funds; the latter is a multiple of the former because bank loans create money.

Returning to the scenario above, say that once again, having started in a position where $S = I$ and full employment prevails, I falls. This time, there is no reason to expect an accommodating adjustment in the interest rate (which might in fact be facing upward pressure in light of the deteriorating conditions in the economy). Instead, the fall in investment induces recession.

Workers are laid off, incomes fall, and, therefore, so does saving. Eventually, $S = I$ once again, but at a lower level of Y and with less-than-full employment. Interest rates do not automatically fall as in the mainstream view, and even if they did they do not affect savings and have only a secondary effect on investment (the primary driver of which is the expectation of profit from investment). The financial sector is driven by a separate logic from the real economy. It might react in a manner that would help (with falling interest rates and easy access to liquidity), and it might hurt (with rising interest rates and a liquidity squeeze). The bottom line, however, is that—unlike in the mainstream perception—it cannot be assumed that the financial sector quietly and obediently acts to solve problems arising in the real sector. In fact, the financial sector itself can be the source of problems. Changes there can have a long-run effect on output and

employment. Back in the currency market, though of course trade flows (the real sector) can impact the currency price, it is the far larger and more volatile movements of short-term capital that take center stage in today's economy. They are cause and not effect and we must understand them if we are to understand exchange-rate determination. This is an absolutely fundamental premise of the explanation of currency prices in this volume and is the most important component of the Post Keynesian contribution.

Post Keynesians also believe that history matters. This means that they believe that the past has a real, qualitative impact on the future, that economic agents' decisions are affected by past events. As economic outcomes are realized, market participants' behavior adjusts and institutions evolve. This contrasts with the general equilibrium framework favored by the mainstream, within which everything happens simultaneously. That is, prices are set, contracts are struck, wages are earned, inputs are purchased, capital is built, incomes are spent, and output is produced all at the same instant (allowing for as much re-contracting as necessary, without cost, before the final agreements are struck). The economy reaches a state of equilibrium and stays there until one or more parameters change. The realized equilibrium does not somehow affect future ones by changing parameters (and therefore the underlying behavior). The parameters, the outcome, the equilibrium, and, therefore, the economy are assumed stable in the general equilibrium approach.

With historical time, however, events evolve and emerge, and how they do so changes over time and is path dependent. Like the Austrians, Post Keynesians see the economy as a dynamic system

rather than a static one. The short run is vitally important in the sense that it changes the possibilities for the long run. This is not to say that general equilibrium models are not appropriate or enlightening in some contexts. In general, however, it is important to bear in mind the dynamic nature of the economy and the limitations of modeling techniques that do not reflect this. This is why when it comes to explaining agents' currency-price forecast determination in chapter five the general equilibrium approach is abandoned in favor of a schematic. In addition, Post Keynesians do not expect their models to be deterministic predictors of the real world. Our analysis is a guide and it helps us create a common vocabulary and organize our thoughts. But the real world is too complex and changing to assume more than this. The evolution of history and institutions must be taken into account and they must be allowed to lead us to change our minds about how the economy works.

The Post Keynesian approach takes a different view of expectations than that found in Neoclassical economics. Because of their contention that financial markets play only a passive role, mainstream economists have never really seen the need for a sophisticated expectations-formation model for asset-market participants. In their view, what asset market participants expect is not a causal factor (Davidson 1982-3). The forecast and the objective thereof are independent and thus the only question of concern is how accurate the prediction was (hence the role of rational expectations in the Neoclassical approach). But in the Post Keynesian world, the financial sector plays an important and independent role and agents' aggregate expectations drive the asset markets therein. Understanding how currency market participants decide that they should buy sterling rather than yen is absolutely vital.

Note that the fact that some mainstream models allow agents' expectations (and other financial factors) to play a causal role in the short run—but not the long run—is not seen by Post Keynesians as truly taking adequate account of their effect. This is because Post Keynesian economists see the long run as simply the accumulation of short runs. Drawing a distinction runs the risk of obscuring how crucial events in the short term have pushed the economy onto new paths or altered magnitudes or parameters in a significant and long-lasting manner. Short run fluctuations are not only the most challenging to explain, they are the most important.

Psychology

The Institutional and Post Keynesian approaches suggest that it is important to develop a clear understanding of market participants behavior. While Keynes provided insights in the *General Theory*, a clear picture cannot be had without reference to the work of psychologists Amos Tversky and Daniel Kahneman (1974). Their core argument is that in the real world, people make decisions based on heuristics or rules of thumb. While these may sometimes lead to choices consistent with those mainstream economists would expect (as guided by rational expectations and rational choice theory), there exist significant and not uncommon deviations and biases. These are not white noise. They are incorporated into the time series of the prices and shift economic activity onto new paths. In addition, they contribute to perceived patterns such as bandwagons, volatility, and profit taking. All of this is addressed in chapter three.

ORGANIZATION

Taking as it does elements of Institutionalist, Post Keynesian, and psychological theory, this book offers a unique perspective on the post-Bretton Woods currency market. Rather than ignoring or explaining away the massive rise in financial capital flows, it uses them as the central reason for volatile exchange rates that refuse to bow to central-bank pressure or respond to trade imbalances. Massive swings in currency prices are too common to be treated ad hoc. For those planning to use this book in the classroom, it is my hope that the students will emerge with a much more realistic and useful conception of how the international monetary economy works.

This book is organized as follows. The next chapter, “Mainstream Approaches to Exchange Rate Determination,” reviews the most popular approaches to exchange rate determination. Special attention is paid there to the manner in which capital flows are (or are not) modeled and the empirical performance of each theory. It will be shown that all Mainstream models are based on the (implicit) assumption of continuous full employment, which then leads to the conclusion that only real factors (generally trade flows) drive the exchange rate. While some models allow for financial factors and expectations to have an impact in the short run, in the long run it is “real” variables that drive currency prices.

The next two chapters present the tools of analysis necessary for the construction of the Institutionalist/Post Keynesian approach. Chapter three, “Psychology and Decision Making in the

Foreign Exchange Market,” takes the first step in creating an alternative exchange rate theory based on Institutionalist/Post Keynesian principles. One of the basic premises of this approach is that if portfolio capital flows dominate the market, and if portfolio capital flows are driven by agents’ forecasts of future asset values, then any successful explanation of exchange rate movements must detail the manner in which market participants form expectations and make decisions. The chapter looks to the psychology literature for the basic building blocks of this view. In the process it is shown how social and psychological factors lead to bandwagons, cash in, price volatility, and the popularity of technical analysis. The concept of a mental model, or the theoretical understanding of the market that each agent uses to interpret events and predict the future, is also introduced in this chapter.

Chapter four, “Exchange Rates and Trade (Im)Balances,” takes a short detour to show how exchange rates are related to balance of payments accounts. This is necessary because a central theme in Mainstream economics is that exchange rates tend to move in a way that cause countries to become equally competitive and net trade flows equal zero. Using a very basic graphical analysis, this chapter shows otherwise. The idea that there exists a “balance-trade exchange rate,” or currency price at which balanced trade will prevail, is introduced here and then referenced in the next chapter.

Chapter five is the heart of the book. Entitled “Post Keynesian Exchange Rate Models,” it develops two full-scale models. The goal of the first is to set the currency market inside a larger

macroeconomy and show the interactions among the domestic macroeconomy, the financial market, trade and capital flows, and exchange rates. It is designed in such a way as to make it directly comparable to Mainstream approaches (a feature that is very helpful in the classroom). The product market is based on Keynes' aggregate supply-aggregate demand apparatus and the financial market is easily adapted to reflect money endogeneity and horizontalism versus verticalism. It assumes neither full employment nor balanced trade over any time horizon (although these states are possible).

While the first model allows changes in currency market participants' expectations to have real impacts on economic variables, explaining how and why the former might change in the first place is left to the second. At its core is the mental model introduced in chapter three. This is agents' conception of the workings of currency market, which then generates their forecast of future movements of currency prices. This model is presented in a schematic format so that all variables and their interactions can be viewed at once. In addition, the key feedback loops in the market can be identified, particularly those associated with bandwagons, technical analysis, and the cash-in effect. The reader will be taken through a number of examples with each model. Interest rate parity is also discussed and a separate model to explain currency crises is presented. It includes factors from the mental model and incorporates Minsky's Financial Instability Hypothesis. Crises are seen as the inevitable consequence of agents' tendency to overreact to economic signals and to their proclivities for overconfidence and unfounded optimism.

Chapter six, “Placing the Model into History,” shows how foreign exchange markets since the collapse of Bretton Woods can be explained using the models developed in chapter five. Looking primarily at the dollar-Deutsche Mark/euro market, it does not simply suggest how one might use the models in understanding these events. Fresh graphs are drawn for every historical incident with each shift and flow illustrated. I hope that this is particularly useful to students since we so often leave them with little more than a hearty “good luck!” when it comes to showing them how to apply the theories we have taught them. Also described in detail and in the context of the theory developed in chapter five are the Mexican and Asian financial crises.

Chapter seven, “Problems and Policies,” reviews the various manners in which the international monetary system as currently designed frustrates our goals and suggests policy to overcome these obstacles. The core conclusion of the book is that portfolio capital flows must be reduced and controlled. This will not be sufficient to solve all the world’s problems, but it may make them more manageable. The market is **not** always right, and Keynes’ admonition that “...the position is serious when enterprise becomes the bubble on a whirlpool of speculation” still applies today, perhaps more than ever (Keynes 1964: 159).⁸

Chapter eight offers conclusions and thoughts on how Post Keynesians and Institutionalists can make their voices heard.

HOW TO USE THIS BOOK

Scholars

I have tried to make this book complete by supporting each element of my argument. However, many of those elements are already well-known and accepted in Post Keynesian and Institutionalist economics. Hence, the experienced researcher might find such passages less interesting and may want to skip ahead. In that event, I would suggest starting with chapter five. Chapter two is a critique of Neoclassical approaches and is therefore not essential to the central thesis, and chapter five begins with a quick review of what was covered in chapters three and four. If questions arise, then one can always go back to the earlier sections and catch up where necessary.

Students

Students were never far from my mind when I wrote this book. Not only did I hope to take what I learned from this experience and use it to help teach my courses, but in over twenty years of teaching I have always found students to be very open to the Post Keynesian approach. I believe this is because of its strong real-world focus. Students want to hear precisely how the financial system operates in a modern, industrial economy, not stories about helicopters. They share instinctively the Post Keynesian suspicion that the latter is not likely to be terribly helpful past the final exam date.

As a consequence, I hope that students buy this book and, particularly, that professors assign it in class. I included chapter two, wherein I review the Neoclassical perspective, especially for those instructors who feel an obligation to cover mainstream material (an obligation that I, too, felt until very recently). This way, you do not have to assign two books (and the internet is an incredible source of any supplemental materials you may need). I also hope that the instructor schedules sufficient time to cover chapter six. It is there that the student will gain practice in using the model and they will, therefore, learn it properly and perhaps be able to take the lessons with them past graduation.