

Preface to Second Edition

Since 2007, the world has been in the grip of the most severe financial crisis since the Great Depression of the 1930s. When things go wrong, first instincts seem always to blame those in charge: bankers, central bankers, regulators, and government. Rarely, are ideas, or the lack thereof, the object of blame. However, in my view, much of the damage emanating from the housing boom of 2004–2006 could have been lessened, if not avoided altogether, had two key propositions from this book been understood and acted upon by regulators, namely:

1. That, over long periods of time, asset values cannot increase faster than the rate of growth of income.
2. That money should be created only for the finance of current production and the initial finance of investment in new capacity to produce.

In light of current events, a major shortcoming of the first edition was inadequate attention to the interaction between money as a store of value and the mass phenomena of confidence and uncertainty. However, the purpose of this edition is not to rework the main body of the book, but rather to present in two new *postscript* chapters a framework for understanding the root causes of financial crises and why the latter are inevitable occurrences in economies in which money is available to hold as a store of value.

The events since 1970 make it clear that current-day mainstream macroeconomics does not provide an adequate framework for dealing with the financial crises that are increasingly part and parcel of free-market economies. Neither of what are now the two standard textbook macroeconomic frameworks, the New Keynesian and New Classical Models, even admit of the possibility for financial crises to emerge, let alone provide provision for their alleviation. The problem is that neither framework allows for money to play its truly unique real-world role, namely, that of a risk-free store of value in the face of uncertainty. Missing, as well, is any notion in either model of a theory of production in which investment is determined not only by present-value considerations, but also by the availability and terms of finance. The purpose, accordingly, of this edition is to add a framework, based in

substantial part on the long overlooked Chaps. 12 and 17 of the *General Theory* (and the equally slighted work of the late Hyman Minsky), in which money and finance, on the contrary, are center stage in determining the level and pace of economic activity.

Except for minor editing and the addition of a few footnotes, the original text of the book is kept intact as Chaps. 1–14. The new material is presented in Chaps. 15 and 16 and in a new Appendix D.³ Since a number of excellent chronicles of the 2007–2009 crisis already exist, most of the focus in the new chapters is on general characteristics of financial crises and the development of principles for assessing their occurrence. A great deal of attention in the analysis is on the distinction between risk and uncertainty, the interaction of uncertainty, confidence and liquidity preference, and on the need to guard against emergence of “casinos with banks.” However, a section on lessons for reform appears at the end of Chap. 16.⁴ Finally, the focus in Appendix D is on revision of the social-security system that involves replacement of the present system with individually owned (but Social Security administered) accounts that are partially voluntary, heritable, and (most important of all) self-financing and fully funded.

As in the first edition of this book, I am indebted to Barbara Sands and Richard Newcomb for their comments, continuing interest, and support of the basic ideas of the book. I also wish to thank Alan Ker, Teodosio Perez-Amaral, Payam Sharifi, Charles Warden, and Dennis Weisman for their comments and criticisms, and (especially) John Britton for his careful reading of the new postscript chapters and for his insights and counsel on the functioning of current-day financial markets. Finally, I am grateful to Gillian Greenough of Springer-Verlag for initiating the idea of this edition and then seeing it through to publication, as well as to Nancy Bannister for her expert preparation of the manuscript.

Tucson, AZ

Lester D. Taylor

³The original Appendix D is now Appendix E.

⁴For readers who might be primarily interested in financial crises and panics, Chaps. 15 and 16 are essentially self-contained, and can pretty much be read in isolation. However, the concept of fluid capital is central in both chapters, so that those not familiar with this concept are nevertheless advised to begin with the Prologue and Chaps. 1–3.



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Taylor, L.D.

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