

# KEYNES, MINSKY AND FINANCIAL CRISES IN EMERGING MARKETS

*Book review*

Miodrag ZEC  
Faculty of Philosophy,  
University of Belgrade, Serbia

by Ognjen Radonjić and Srdjan Kokotović  
Faculty of Philosophy, Belgrade, 2014

IN THIS BOOK, OGNJEN RADONJIĆ AND SRDJAN Kokotović analyze a problem of the growing international economic and financial instability from the perspective of Post-Keynesian economic thought. In line with the Post-Keynesians, authors insist on the fact that assumptions of the theoretical model predetermine its implications. Since, authors advocate, assumptions of the efficient markets' model are not realistic, this implies that its implications are not valid, which is a fact repeatedly reiterated in real life last three decades. Again, in real life, this fatal flaw of the theory of efficient markets has still been predominately ignored by economic literature and policymaking circles. On the other hand, Radonjić and Kokotović refuse to follow this ideology. They use theoretical insights of two seminal heterodox economists, John Maynard Keynes and Hyman Minsky as their main research tool in rejecting efficient markets' mantra and explaining the causes of financial crises in emerging markets. I firmly believe that this study presents an undisputable scientific contribution to the current and future analyses of the utmost important issue of the stability of the world financial system.

In *Introduction*, the authors acquaint readers with the issues and objectives of the book. They start by asking the question of why boom-bust episodes occur regularly in both developed countries and emerging markets and why financial crises in last three decades last longer and become more severe. In order to answer these questions, authors emphasize, we need, in the first place, to have a realistic theory. The second step is to prescribe, on the basis of relevant theoretical

insights, economic measures aiming at preventing and ameliorating the negative effects of eventual financial breakdown.

Broadly speaking, there are two relevant theoretical strands pertaining to rationality and stability of financial markets. The first theoretical strand is mainstream financial economics, or as John Kenneth Galbraith named it “the conventional wisdom”. At the moment, mainstream financial theory is predominant; not only in academic, but also in political circles as well – a place where crucial economic decisions are made.

Detailed analysis of the modern mainstream theory of efficient financial markets and its theoretical and policy implications are given in the first chapter *Exegesis of the Conventional Wisdom: Efficient Markets, Rational Expectations and Exogenously Generated Financial Crises*. According to the authors, theory of efficient financial markets is firmly grounded on grossly unrealistic assumptions that future will resemble past and that rational decision-makers are capable, on average, of forming correct expectations. Equally important, humans, like automata, are assumed to have formed homogenous expectations and made decisions independently of decisions made by other market participants. As the proponents of omnipotent free markets see it, the future path of the economic system is predetermined and is not dependent on the past or future choices of economic agents. The direct implication of the efficient market hypothesis is that free decentralized markets, if let alone, inherently, i.e. endogenously generate equilibrium. In this view, ups and downs (boom-bust episodes) are the consequence of an exogenous shock (external to market processes) – most frequently inappropriate and clumsy public policy interventions. In the open-economy model, financial crises can emerge due to a number of factors: inconsistency between the internal and external objectives of monetary authorities; a lack of credibility of the central bank’s and the government’s commitment to fully defend the foreign exchange rate; massive withdrawals from the host country due to irrational behavior on the part of lenders; corruption and cronyism, etc. A superior recipe for avoiding financial crises is to implement and conduct consistently prescribed market-led policies. On the other hand, unless these rules are obeyed and consequently crisis erupts, the only way to regain the confidence of investors, domestic and foreign, is to implement measures of economic austerity. Since the outcome of theory is determined by the reality of its assumptions, Radonjić and Kokotović conclude that invalid assumptions of „the conventional wisdom” lead to invalid theory and

therefore policy implications which are not up to the task of solving a vast array of problems and growing difficulties in the normal functioning of the global economy.

The second theoretical approach is the one developed by seminal English economist John Maynard Keynes and his Post-Keynesian American follower, Professor Hyman Minsky. Their theory of speculative and inherently unstable financial markets is presented in the second chapter *Keynes' U-turn: Endogenous Expectations, Speculative Financial Markets and Instability of Investment Demand* and third chapter *Hyman Minsky: Endogenous Instability, Debt and Fragile Finance*. Both of them reject economics as a science of abstract and general theoretical principles for all ages, applicable to all occasions independently of the social context. Keynes and Minsky's theory of speculative, as opposed to the theory of perfect self-regulating markets is rooted in realistic assumptions. Realistic assumptions are in the heart of their theoretical explanation of why financial booms and busts are the normal state of advanced capitalistic economies, i.e. why financial crises are endogenous and not exogenous to modern capitalist economies. The kernel of their theory of speculative and unstable financial markets consists of uncertain future, humans as a complex economic, sociological and psychological beings, exaggerated expectations, disappointments and accumulated debts to the extent that they cannot be met by the profits actually materialized in reality. Furthermore, due to the fact that expectations are self-fulfilling even the solid banks and companies are liable to bankruptcy in case tornado of disappointment blows through the market.

The theoretical implication of Keynes-Minsky theory of speculative and unstable finance is that if markets are let alone they will not strive to stability, on the contrary, to instability. Cure lies in timely changes in financial market's regulation as well as in its strict and continuous supervision. Markets are prone to explosive and abrupt ups and downs and the job of regulators is to tame markets and therefore make them predictable as much as possible. Therefore, in the case of increasing financial tension, markets should not be let alone. Timely and decisive fiscal (Big Government) and monetary (Big Bank) intervention is needed. However, Minsky was aware of the fact that government intervention leads to moral hazard, but, as the case of current global financial crisis unambiguously shows, socialization of costs is a precondition for avoiding the Great Depression-like debt-deflation scenario. In a word, the task of financial regulators is financial crisis prevention

and provided they fail, the only possibility left is massive government intervention aiming at escaping vicious circle of devastating debt-deflation episode.

Further on, Radonjić and Kokotović draw on the insights of contemporary Post-Keynesian economic thought in order to expand Minsky's theoretical framework to a developing open-economy case, in which most debt is foreign short-term debt set on a roll-over basis and denominated in hard currency. According to this view, displacement or the key event that triggers massive capital movements towards developing countries is a Minskyan liquidity expansion in rich countries. In other words, movements of capital towards developing countries are exogenous, i.e. the actions of developing countries do not influence movements of international capital. They are rather a result of liquidity changes in the developed world. On the other hand, a liquidity expansion in the developed world and the accompanying capital flows into the shallow financial markets of developing countries produce positive effects only in the short run. In the medium run, unless the external borrowing of local market participants is adequately constrained and controlled, a disastrous debt-deflation episode may take place.

In the fourth chapter, *The Falling Angels: Mexico and the Asian Tigers*, the authors conduct comprehensive Minskyan analysis of the Mexican (1994) and Asian crisis (1997). Here Radonjić and Kokotović conclude that in both cases, massive movements of capital towards these markets were exogenously generated and that a robust period in the host countries led to over-leveraged units, which could not fulfil overly optimistic profit expectations. In the end, the simultaneous effect of endogenous and exogenous shocks within an already fragile environment have pushed those systems into financial instability. Not less important, the authors notice, in contrast to the Keynes-Minsky approach, in both cases international financial institutions transferred the onus of austerity-led adjustments to the crisis-hit countries with devastating consequences.

In the fifth section, *Financial Tumbling in Eastern Europe: From the Ashes of Socialism to the Dust of Capitalism*, the authors conduct a rigorous factual analysis of the cross-country pre-crisis and post-crisis developments in fundamental economic indicators in 13 Eastern European countries plus Turkey in order to prove that the current crisis conforms to the Minskyan liquidity model of crisis generation. The authors show that by deployment of Asian current account surpluses, conducting an overly expansive monetary policy and massive securitization of illiquid assets, the U.S. economy, set in motion a global liquidity cycle

at the beginning of the 2000s. In line with a Minskyan liquidity model, liquidity expansion in the most developed economy in the world led, in no time, to massive capital flows towards developing countries. As Keynes and Minsky would expect, simultaneously with dynamic economic growth and progressiveness in enforcing internationally desired market-led policies, developing Eastern European economies built up massive vulnerabilities to sudden capital reversion. Unfortunately, seemingly unexpectedly, the U.S. financial markets contracted sharply in 2007 and the crisis instantaneously spilt over to a large number of developed and developing countries. However, in this case, massive fallout was avoided thanks to the expansion-oriented policy co-ordinated actions of the governments of developed nations and international financial institutions. It seems that we have gained some very useful lessons learned here from the mistakes made in the past (e.g. Mexico and the Asian tigers). This is why negative effects of the Eastern European financial breakdown in 2009 have been mild up to now.

In the sixth section, *Cross-Country Analysis of Individual Vulnerabilities to the Sudden Liquidity Contraction*, the authors detect the macroeconomic and financial factors that determined the strength of the impact of financial crisis on the local economy. According to the authors, macroeconomic indicators, such as the degree of openness of the economy, the degree of credit euroisation, exchange rate policy and the level of budget deficit in the period before the crisis did not significantly matter. Financial indicators were crucial in conjunction with a selected model of economic development. Countries that accumulated excessive debts and at the same time grounded their development on excessive consumption and development of non-tradable sectors experienced more dramatic economic contraction and vice versa. Countries that have successfully limited the level of indebtedness of households and non-financial sector and invested heavily in tradable sectors have relatively painlessly overcame abrupt and sharp decline in the inflow of foreign capital.

Finally, in the seventh section *Financial Turmoil Now and Then: Empirical Comparison of the Eastern European and Previous Financial Crises*, the authors compare the pre-crisis and post-crisis developments in fundamental economic indicators, the accumulation of vulnerabilities and the impact of the current crisis with the previous cases (Mexico in 1994, Indonesia, Thailand, Philippines, Malaysia and South Korea in 1997, Russia in 1998, Brazil in 1999, Ecuador in 1999, Turkey in 2000, Argentina in 2001-2002 and Uruguay in 2002). The authors find

that developing countries in Eastern Europe, though much more vulnerable by previous standards, have experienced a milder crisis compared to other developing countries which have had suffered from a sudden termination of capital inflows in the past. The reason lies in a large-scale and unprecedented financial assistance to Eastern Europe provided by the developed world and international financial institutions.

The authors summarize in *Conclusion* their thoughts and expose recommendations for policymakers in open economies regarding the issue of financial crisis prevention, and, in the case of crisis eruption, minimization of its hazardous effects. The main conclusion is that the objective of macroeconomic policy should be directing capital towards export-oriented productive sectors and strict control and the constrain of: borrowing of domestic economic participants; raising debts denominated in foreign currencies; and debt maturity (the pursuit of long-term borrowing).

To conclude, the manuscript *Keynes, Minsky and Financial Crises in Emerging Markets* by Ognjen Radonjić and Srdjan Kokotović is a book which doubtlessly increases our ability to understand such a complex phenomenon as financial crisis in developing economies has been. As Professor Marc Lavoie rightly claims in his Foreword to this book „Radonjić and Kokotović provide their readers with a unique contribution, by explaining (sometimes in painstaking details) the evolution of the European emerging countries before and after the global financial crisis in light of this Minskyan framework that they have developed.” It is therefore with huge pleasure that I recommend it for reading, not only to Academia and policymakers, but to all economic laymen interested in their future welfare as well.

*Paper Received: 2. X 2014.  
Paper Reviewed: 23. X 2014.  
Paper Accepted: 30. X 2014.*

## UPUTSTVO ZA AUTORE

Časopis *LIMESplus* objavljuje teorijske, pregledne, originalne istraživačke i stručne radove, kao i prikaze iz svih oblasti geopolitike, društvenih i humanističkih nauka, koji nisu prethodno objavljeni niti su podneti za objavljivanje u nekoj drugoj publikaciji. Rukopisi treba da budu pripremljeni prema standardima časopisa *LIMESplus*. Rukopisi se dostavljaju elektronskom poštom na adresu: hesperiaedu@eunet.rs

### U pripremi rada treba se držati sledećih uputstava:

Rad mora biti napisan u tekst procesiru Microsoft Word, na stranici formata A4, fontom Times New Roman (12 tačaka), latinicom, sa propredom od 1,5 redova. Sve stranice moraju biti numerisane. Rad treba da bude dužine do jednog autorskog tabaka (30.000 slovnih mesta ili 20 strana bez referenci i priloga). Izuzetak su pregledni radovi koji mogu biti dužine do 50.000 znakova i prikazi koji mogu biti dužine do 5.000 znakova. Redakcija zadržava pravo da objavi i radove koji premašuju ovu dužinu u slučajevima kada izlaganje naučnog sadržaja zahteva veću dužinu, odnosno prostor.

Časopis objavljuje radove na **srpskom i engleskom jeziku**.

**Naslov** rada treba da bude što koncizniji. Iza naslova rada sledi ime i prezime autora. i naziv institucije u kojoj radi. Iza imena prvog autora treba staviti fusnotu koja sadrži e-mail adresu autora. Zvanje autora se ne navodi.

**Apstrakt (sažetak)** dužine od 150 do 250 reči treba da bude na početku rada ispod naslova rada. Sastavni delovi apstrakta treba da budu cilj istraživanja, metod, rezultati i zaključak. Apstrakt po pravilu ne sadrži reference. Uz radove na srpskom jeziku treba priložiti i sažetak i ključne reči na engleskom jeziku koji se navode na samom kraju rada, ispod Literature.

Na kraju apstrakta treba navesti do 10 **ključnih reči**. Pri odabiru ključnih reči poželjno je odabrati one pojmove koji se često pominju za pretragu časopisa.

**Tabele i grafikoni** treba da budu sačinjeni u Word-u ili nekom drugom Word kompatibilnom formatu. Isti podaci ne mogu se prezentovati i tabelarno i grafički. Sve tabele, grafikoni ili slike treba da budu označeni brojem, sa naslovom koji ih jasno objašnjava. U tekstu se treba pozvati na svaku tabelu, grafikon ili sliku.

Na kraju rada navodi se **lista referenci** (literatura, bibliografija). Reference se navode abecednim redom po Čikaškom referentnom sistemu i ne prevode se na jezik rada.

Kada se prvi put navodi **strano ime u tekstu**, u zagradi treba staviti ime napisano u originalu.

Napomene (fusnote) daju se pri dnu strane na kojoj se nalazi komentarisani deo teksta, ne bi trebalo da prelaze 100 reči. Numerišu se arapskim brojevima u kontinuitetu u celom tekstu. Izvori se navode jezikom korišćene publikacije. Napomene se koriste samo za komentare.

**Stil citiranja i navođenja napomena** (fusnota) i izrade liste referenci (literature, bibliografije) na kraju rada je Čikaški stil (Chicago Style – Humanities). Detaljno uputstvo

---

za korišćenje ovog stila može se naći na <http://chicagomanualofstyle.org/home.html>. Kada se navode stranice, od jedne do druge, ili kada se navode godine između brojeva stoji crta (–), ne crtica (-).

Nakon slanja radova redakcija će obavestiti autora o prihvatanju rada za objavljivanje najkasnije u roku od dva meseca od isteka roka za predaju rada. Autor čiji je rad prihvaćen ne može da ga objavi u bilo kom obliku i obimu u nekoj drugoj štampanoj ili elektronskoj publikaciji bez saglasnosti urednika časopisa. Redakcija zadržava pravo na jezičke, stilske ili formalne izmene u radovima.

### Primeri za upotrebu Čikaškog stila

**KNJIGE:** u spisku literature: prezime, prvo slovo imena, godina izdanja, naslov knjige, mesto izdanja, izdavač. U tekstu: u zagradi prezime autora, godina izdanja, stranica. U napomeni: prezime autora, godina izdanja, stranica. U napomenama, knjiga se citira isključivo na skraćeni način. Primeri: u literaturi: Todorova, M. 1999. *Imaginarni Balkan*. Beograd: Čigoja štampa.; U tekstu: (Todorova 2006, 33).; U napomeni: Todorova 2006, 33.

**POGLAVLJA U KNJIGAMA:** u spisku literature: prezime, prvo slovo imena, godina izdanja, naslov poglavlja pod navodnicima, „u” naslov knjige u italiku, ime priređivača, broj stranica, mesto izdanja, izdavač. U tekstu: u zagradi prezime autora, godina izdanja, stranica. U napomenama: poglavlje se citira isključivo na skraćeni način. Primeri: u literaturi: Perović, L. 2006. „Srbija u modernizacijskim procesima XIX i XX veka.” U *Žene i deca. 4. Srbija u modernizacijskim procesima XIX i XX veka*, 7–32. Beograd: Helsinški odbor za ljudska prava u Srbiji. U tekstu: (Perović 2006, 7). U napomeni: Perović 2006, 7.

**ČLANCI U ČASOPISIMA:** u spisku literature: prezime, ime, godina izdanja, naslov teksta pod navodnicima, naslov časopisa u italiku, godište časopisa, broj sveske u godištu ukoliko paginacija nije jedinstvena za ceo tom i broj stranice. U tekstu: u zagradi prezime autora, godina izdanja, stranica. U napomeni: prezime autora, godina izdanja, stranica. Ne stavljaju se skraćenice „str.”, „vol.”, „tom”, „br.” i sl. U napomenama, članci se citiraju isključivo na skraćeni način. Primeri: u literaturi: Zec, M., Radonjić, O. 2012. „Ekonomski model socijalističke Jugoslavije: saga o autodestrukciji.” *Sociologija. Časopis za sociologiju, socijalnu psihologiju i socijalnu antropologiju* 4(59): 695–720.; U tekstu: (Zec, Radonjić 2012, 695).; U napomeni: Zec, Radonjić 2012, 695.

**TEKSTOVI IZ ZBORNICA:** u spisku literature: prezime, ime autora, godina, naslov teksta pod navodnicima, slovo „u” (u zborniku), naslov zbornika u italiku, mesto izdanja, izdavač i broj stranice. U tekstu: u zagradi prezime autora, godina izdanja, stranica. U napomeni: prezime autora, godina izdanja, stranica. Primer: u literaturi: Jovanović Popović, D. 2013. „Ekološka bezbednost i bezbednost životne sredine.” U *Zbornik Matice srpske za društvene nauke*, 142: 103–118. Novi Sad: Matica srpska.; U tekstu: (Jovanović Popović 2013, 103). U napomeni: Jovanović Popović 2013, 103.

**WEB DOKUMENT:** treba da sadrži prezime i inicijale (svih) autora, godinu, naslov dokumenta (italik) i adresu internet stranice. Primer: Stojiljković, Z. 2013. *Politička korupcija i slaba država*. Preuzeto sa [http://instifdt.bg.ac.rs/tekstovi/FiD/2013/FiD%20](http://instifdt.bg.ac.rs/tekstovi/FiD/2013/FiD%201-2013/07_Stojiljkovic_2013-1.pdf)



## NOTES FOR CONTRIBUTORS

The journal *LIMESplus* publishes theoretical papers, review papers, original research papers, professional papers and book reviews from all fields of geopolitics, humanities and social sciences, not previously published elsewhere and not already under concurrent consideration for publication in another journal. Manuscripts should comply with the standards of the journal *LIMESplus*. The papers that are not adequately prepared will not be reviewed. Manuscripts should be submitted via e-mail to: hesperiaedu@eunet.rs

### **The manuscript should conform to the following preparation guidelines:**

Papers should be written in text processor Microsoft Word, page format A4, in Times New Roman font (12 pt), in Latin alphabet, 1.5 line spacing. All pages must be numbered. Contributions should have length of one author's sheet at the most (30.000 characters with spaces or 20 pages without references and appendices). Exception is made for review papers that may not exceed 50.000 characters with spaces and book reviews that may not exceed 5.000 characters with spaces. The Editorial Board retains discretion to publish papers beyond this length in cases when clarity of scientific content presentation requires greater length, that is, space.

The journal publishes papers in **Serbian and English**.

Paper **title** should be as concise as possible. Author's full name and affiliation should follow the title. The footnote containing the e-mail address of the author should be inserted after the full name of the first author. The positions of authors should not be cited.

**Abstract** ranging between 150 and 250 words should be submitted at the beginning of the paper. It must include research goal, method, results and conclusion. As a rule, summary must not contain references. If the paper is written in Serbian, summary and key words should be submitted in English as well at the end of the work below References.

Up to 10 **key words** must be supplied at the end of the summary. When choosing key words, it is desirable to opt for those concepts that are often used in searching journals.

**Tables and figures** should be made in MS Word or MS Word compatible format. Same data may not be presented both in tables and figures. Each table, figure or picture should be numbered, with a self-explanatory title. Reference to each table, figure or picture should be made in the text.

**Footnotes** should be avoided. Abbreviations should be avoided as well, except the fairly usual ones. The abbreviations used in tables and pictures should be explained.

In papers in Serbian, **foreign authors' names** are cited in Serbian transcription, with surnames written phonetically, thereafter surname is quoted in parentheses in its original spelling.

**References** should be listed at the end of the paper, in the section entitled "References". The list should include only the references mentioned in the text, ordered alphabetically by the authors' surnames. References not mentioned in the text should not be listed.

---

The basic reference formats are listed in the following way by Chicago Manual of Style <http://chicagomanualofstyle.org/home.html>

a) **Book** should contain surname and initials of (each) author, year of publication, book title (in italic), place of publication and a publisher. Example: In references: Todorova, M. 1999. *Imaginarni Balkan*. Beograd: Čigoja štampa.; In text: (Todorova 2006, 33).; In footnote: Todorova 2006, 33.;

b) **Chapter from a book or an edited book** should contain surname and initials of (each) author, year of publication, chapter title, name initial and surname of the editor, book title (in italic), chapter pages in parentheses, place of publication and a publisher. Example: Schwartz. S. H. 2007. „A theory of cultural value orientations: Explication and applications.“ In Y. Esmer & T. Petterson (Eds.), *Measuring and mapping cultures: 25 years of comparative value surveys*, 33–78. LeidenBoston: Brill. In text: (Schwartz 2007, 33).; In footnote: Schwartz 2007, 33.

c) **Article from a journal** should contain surname and initials of (each) author, year of publication, title of the article, journal title in full (in italic), volume and pages. Example: Zec, M., Radonjić, O. 2012. „Ekonomski model socijalističke Jugoslavije: saga o autodestrukciji.“ *Sociologija. Časopis za sociologiju, socijalnu psihologiju i socijalnu antropologiju* 4(59): 695–720.; In text: (Zec, Radonjić 2012, 695).; In footnote: Zec, Radonjić 2012, 695.

d) **Web document** should contain surname and initials of (each) author, year, document title (in italic) and Internet site address. Example: Foa, R. 2007. *Socioeconomic development and parenting values*. Retrieved from [http://www.roberto.foa.name/Parenting\\_Atitudes\\_Foa](http://www.roberto.foa.name/Parenting_Atitudes_Foa).