

COMPARING POST-KEYNESIAN AND NEW-KEYNESIAN PARADIGMS IN MONETARY POLICY

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ABSTRACT

The changing global economy often requires a review of monetary policy frameworks, stressing the importance of clear theories and practical use. This paper aims to understand how different Keynesian-based theories tackle modern economic issues, especially in managing inflation, unemployment, and financial stability. Although both Post-Keynesian and New-Keynesian theories stem from Keynesian economics, they offer different methods and policy suggestions based on their unique theoretical bases. This paper addresses a gap in current research by providing a systematic comparative analysis of how Post-Keynesian and New-Keynesian frameworks influence real-world monetary policymaking, especially during financial crises and periods of structural economic change, areas often discussed separately but not directly compared. It outlines the theoretical assumptions, policy tools, and economic impacts of each school, offering a clearer understanding of their practical relevance. This comparison is vital for policymakers and economists facing complex economic conditions who require robust and flexible theoretical guidance. This study reveals that while both approaches contribute valuable insights to economic policymaking, they diverge significantly in their own perspectives on economic stabilization and crisis response. Post-Keynesians emphasize monetary endogeneity and the remediation of structural fragilities, whereas New-Keynesians prioritize market imperfections and expectation management via policy instruments.

Keywords: Monetary Policy, New-Keynesian, Post-Keynesian

INTRODUCTION

Monetary policy is a key tool in managing the economy, affecting national economic trends by regulating money supply and interest rates. Central banks use it to control inflation, manage employment, and ensure economic stability. It also impacts daily life through borrowing costs, savings, and investments. Therefore, considering its theory and practice is important for economists, policymakers, and the public (Boyarchenko *et al.*, 2022).

In recent years, the global economy has faced significant challenges that have tested existing monetary policy frameworks. Reviewing this area is important for

several reasons. The 2008 Global Financial Crisis (GFC) showed that neoclassical economic theory's market mechanisms do not guarantee market stability. The instability of the financial sector also destabilized the real economy. To address the GFC, central banks used monetary policy tools not employed in decades. The liquidity trap, known as the zero lower bound after Keynes, forced central banks to rethink their policies (Norák & Tatay, 2021). The economic stagnation from the COVID crisis also required new economic recovery tools.

The COVID-19 pandemic caused a severe economic downturn, leading to high unemployment rates, disrupted supply chains, and increased financial instability. Central banks worldwide responded with drastic measures, such as cutting interest rates to near zero, large-scale asset purchases, and providing liquidity support to financial institutions (Baldwin & Weder di Mauro, 2020). At the same time, economies are facing rising inflation due to expansive fiscal policies, ongoing supply bottlenecks, and changes in consumer demand (Gopinath, 2022).

The aftermath of the COVID crisis, followed by the 2022 conflict, led to a rapid increase in inflation, prompting economic policymakers to act. However, these monetary policy responses have caused economic stagnation. Many government budgets are heavily indebted, limiting their flexibility. Nearly a century after Keynes's crisis solutions, developed countries face additional challenges such as an aging population (Tatay & Kazinczy, 2023).

In our view, economic policy interventions are needed to ensure the equilibrium of economies and promote growth in a sustainable way. These developments have reignited debates about the effectiveness of traditional monetary policy tools and the theoretical paradigms that underpin them.

This paper explores the economic role of monetary policy by comparing two key schools of thought: Post-Keynesian and New-Keynesian economics. Both are based on Keynesian economics, developed by John Maynard Keynes after the Great Depression. Keynesian theory highlights the importance of aggregate demand and supports active government intervention to manage economic fluctuations, differing from classical economic theories that preferred limited government involvement (Aspromourgos, 2019).

As policymakers tackle post-pandemic recovery, inflation, and financial stability, reassessing monetary policy theories is crucial. Post-Keynesian and New-Keynesian approaches, both rooted in Keynesian economics, differ in assumptions, methods, and policy recommendations. Post-Keynesian economics focuses on uncertainty, money creation, and income distribution (Lavoie, 2014). New-Keynesian economics emphasizes price stickiness, rational expectations, and market imperfections (Woodford, 2003).

The central research question guiding this paper is: How do Post-Keynesian and New-Keynesian approaches to monetary policy compare in terms of their theoretical foundations, methodologies, and implications for economic policymaking? By exploring this question in the context of recent economic challenges, the paper aims to provide a structured comparison of these two paradigms. It will analyze their distinct assumptions, the role they assign to central banks, and their proposed solutions for addressing contemporary issues such as inflationary pressures,

unemployment, and financial instability. Ultimately, this analysis will offer valuable insights into ongoing debates within the field of economics and deepen our understanding of modern monetary policy.

LITERATURE REVIEW

Monetary policy frameworks have been shaped by Post-Keynesian and New-Keynesian theories, but some aspects are misunderstood. Post-Keynesian critiques of mainstream policy, focusing on uncertainty and endogenous money creation, are often overlooked. Similarly, the New-Keynesian emphasis on microfoundations and rational expectations can overshadow macroeconomic dynamics, especially during financial instability. Previous studies mainly focus on theoretical differences without fully exploring the practical implications. This review aims to highlight the key differentiations between the two schools of thought while emphasizing the research gaps that this paper seeks to address.

Keynesian Economics

Keynesian economics, developed by John Maynard Keynes during the 1930s Great Depression, revolutionized economic thought and policy. In 'The General Theory of Employment, Interest, and Money,' Keynes critiqued classical theories. His ideas continue to shape economic policy today.

Keynesian economics posits that aggregate demand drives economic activity and employment. Unlike classical economics, which assumed markets naturally reach full employment, Keynes argued that low demand can lead to high unemployment. This perspective shifted away from laissez-faire principles, emphasizing the necessity for government interference to stabilize the economy (Trautwein, 2020).

To provide a concrete representation of the Keynesian framework, the IS-LM model (Investment-Saving and Liquidity Preference-Money Supply) is often employed. This model illustrates the interaction between the real economy (goods market) and the monetary economy (money market). The IS curve represents equilibrium in the goods market and is defined by the equation:

$$Y = C(Y - T) + I(r) + G \quad (1)$$

where Y is the national income (output), C is consumption, a function of disposable income ($Y - T$), $I(r)$ is investment, which is inversely related to the interest rate (r), G is government spending, and T is taxes. The LM curve represents equilibrium in the money market and is expressed as:

$$\frac{M}{P} = L(Y, r) \quad (2)$$

where M is the nominal money supply, P is the price level, $\frac{M}{P}$ is the real money supply, $L(Y, r)$ is the liquidity preference, or demand for money, which depends positively on income Y and negatively on the interest rate r . The intersection of the IS and LM curves determines the equilibrium levels of income Y and the interest rate. This model demonstrates how fiscal policy (changes in G or T) and monetary policy

(changes in M) can influence aggregate demand, and consequently, output and employment.

A fundamental concept in Keynesian economics is the multiplier effect. This principle indicates that an initial rise in spending results in higher income and consumption, which in turn stimulates more economic activity and creates a greater overall impact on the economy.

Another important idea in Keynesian economics is the liquidity preference theory (Bibow, 1998). This theory explains how interest rates influence the demand for money. Keynes proposed that the demand for money L consists of three motives: transactions, precautionary, and speculative, which is a function of income and interest rates:

$$L = L_1(Y) + L_2(r) \quad (3)$$

where $L_1(Y)$ represents the transactions and precautionary motives (dependent on income), $L_2(r)$ represents the speculative motive (dependent on the interest rate). This theoretical framework elucidates the relationship between monetary policy, interest rates, and economic activity, while providing a basis for understanding central bank functions in economic management (Tih, 2007a).

Keynes challenged the neoclassical view of interest rates as solely determined by savings and investment. He argued that collective saving is constrained, as one person's consumption affects another's income, impacting overall savings. While individuals decide their money holdings, they must collectively hold the total money supply. Keynes posited that interest rates have a limited impact on consumption and are instead determined by the balance of money demand (liquidity preference for transactions, precaution, and speculation) and the fixed money supply. Expectations play a crucial role, as shifts in expectations alter money demand and thus interest rates, influencing investment decisions through the relationship between the marginal efficiency of capital and loan interest rates.

Keynes divided the cash holdings of individuals into two parts, denoted M_1 and M_2 . One, M_1 is the stock held for the business and prudence motive, the other, M_2 is the stock held for the speculative motive. A liquidity function was assigned to each of the two money holdings. The L_1 function associated with M_1 , depends primarily on income Y . L_2 , which determines M_2 , depends on the relationship between the current interest rate r and the expectation of its change. If M is the total stock of money held by the individual, then:

$$M = M_1 + M_2 = L_1(Y) + L_2(r) \quad (4)$$

We need to examine how M is affected by changes in Y and r and the shape of liquidity functions. The quantity of money M changes with Y and r , new money generated can buy securities and other assets until r falls to a level where increased income absorbs the new money. This may increase M_2 or M_1 due to higher income. Banks might cut interest rates, leading someone to sell a bond or debt security. Changes in M occur as r changes, establishing a new equilibrium. Speculative demand for money is driven by uncertainty about future interest rates. According to Keynes, M_2 is determined by the deviation of the current interest rate from an acceptable

value, not its absolute value. A fall in the interest rate reduces the premium for foregoing liquidity, as lower rates compensate less for illiquidity risk.

The fiscal authority can set the short-term interest rate effectively because economic agents accept that the policy will not change in the short run, and short-term interest rate changes cause only small losses. Long-term interest rates are harder to control, especially if agents do not consider the rate acceptable in the long run. If the interest rate falls too low, speculative money demand may become endless. However, Keynes believed a reduction in the interest rate is feasible if it is credible to economic agents. He called the interest rate a convention-based phenomenon, with its effective size determined by expectations (Novák & Tatay, 2021).

Keynesian economics acknowledges the influence of expectations on economic behavior. Keynes's concept of "animal spirits" describes the psychological factors influencing economic decisions, such as investment, recognizing the inherent uncertainty in forecasting future economic conditions (Barnett, 2017).

Post-Keynesian Economics

Post-Keynesian economics, an outgrowth of Keynesian thought, arose in the mid-20th century as a critique of both classical economics and early interpretations of Keynes. It sought to address perceived misinterpretations by the neoclassical synthesis. Post-Keynesian economics emphasizes uncertainty, endogenous money, and the roles of financial institutions (Braga & Serrano, 2023a).

A core principle is the focus on uncertainty and the unpredictable future, challenging classical and neoclassical ideas of rational expectations. Post-Keynesians argue that uncertainty requires active government interference to alleviate the economy and guard against fluctuations (King, 2022).

In terms of theoretical models, Post-Keynesian economists critique the traditional money supply function and propose an endogenous money supply model. Unlike the exogenous view where the central bank controls the money supply M , Post-Keynesians argue that M is determined by the demand for loans (credit) and is therefore endogenous:

$$M = D(Y, r) \tag{5}$$

where D is the demand for loans or credit which depends on income Y and the interest rate r . This view emphasizes banks' role in creating money through lending, challenging traditional monetary policy mechanisms. It suggests the central bank adjusts the money supply to meet credit demand at its target interest rate, indicating a demand-driven money supply.

Post-Keynesians share core principles but differ in focus. Davidson highlighted Keynes's emphasis on uncertainty, the link between price elasticity and employment, and money's non-neutrality. Uncertainty hinders predicting the future from the past. Gross substitution fails, so price elasticity doesn't guarantee full employment. Money impacts output and jobs. Davidson supports Keynes's call for active fiscal, monetary, and income policies when demand declines (King, 2013).

Let Y be total income; C be consumption (the suffixes w and p refer to consumption expenditure by workers and capitalists); I be investment; W be wages;

and P be total profit. In the simplest case, when there is no government or foreign sector, $\text{Expenditure} = C + I = C_w + C_p + I$, and $\text{Income} = W + P$.

Assuming that workers do not save, so $C_w = W$, the Equivalence of income and expenditure means that $P = C_p + I$; thus, overall, profit is determined by the expenditure of capitalists.

Total profit now equals capitalists' expenditure plus the budget deficit. Further, let us introduce an open economy, which means that exports X are added to total expenditure and imports M to total income. It is easy to show that:

$$P = (C_p + I) + (G - T) + (X - M) \quad (6)$$

Therefore, aggregate profit is a function of capital expenditure plus budget deficit plus trade surplus. According to Kalecki, business cycles depend on investment fluctuations, but underutilization can also result from income distribution leading to insufficient consumption (*Basile & Salvadori, 1984*).

Minsky's (1992) contributions enriched Post-Keynesian economics with his Financial Instability Hypothesis, explaining how financial markets can cause economic instability. He highlighted the cyclical nature of financial systems, where stability leads to excessive optimism, increased borrowing, and risk-taking, eventually causing financial crises.

Minsky's model categorizes financial behavior into Hedge Finance (repayment via cash flows), Speculative Finance (interest payments met, principal requires refinancing), and Ponzi Finance (reliance on asset appreciation for debt servicing). This framework underscores the importance of financial regulation and government intervention for macroeconomic stability.

Another key principle of Post-Keynesian economics is reflected in Kalecki's pricing model, which ties income distribution to pricing and investment decisions:

$$P = \frac{W}{1-k} \quad (7)$$

where P is the price level, W is the wage cost per unit of output, and k is the markup rate over unit labor costs. Firms set prices by adding a markup over their costs, influenced by their monopoly power. This highlights the role of market structures and income distribution in macroeconomic outcomes, differing from classical models that assume perfect competition and flexible prices.

Despite theoretical value, Post-Keynesian economics is underrepresented in policy. Its views on monetary policy during instability and uncertainty, plus endogenous money, challenge central banking but are misunderstood. Its implications for crises and inequality are not integrated into policy debates.

New-Keynesian Economics

New-Keynesian economics emerged in response to New Classical economics, which emphasized rational expectations and efficient markets, minimizing policy intervention. New-Keynesians integrated rational expectations with market imperfections like sticky prices and wages to explain persistent unemployment and inflation. Key figures like Mankiw, Fischer, and Blanchard merged micro foundations with Keynesian insights (*Gordon, 1990*).

New-Keynesian economics emphasizes price and wage stickiness. Unlike New Classical models with instant adjustments, New-Keynesians acknowledge that slow adjustments due to factors like contracts and information issues. This stickiness allows demand shifts to impact output and employment, justifying stabilization policies. (Taylor, 1999). A fundamental equation in New-Keynesian models is the New-Keynesian Phillips Curve (NKPC), which describes the relationship between inflation and economic activity:

$$\pi_t = \beta E_t \pi_{t+1} + \kappa y_t^{\text{gap}} \quad (8)$$

where π_t is the rate of inflation at time (t), $E_t \pi_{t+1}$ is the expected inflation at the time ($t + 1$) based on information available at the time (t), β is the discount factor, κ reflects the degree of price stickiness and how inflation responds to the output gap, y_t^{gap} is the output gap (the difference between actual output and potential output). This equation implies that current inflation depends on expected future inflation and the current output gap, highlighting the roles of expectations and real economic activity in the inflation process. It incorporates rational expectations while acknowledging that due to price stickiness, markets do not always clear instantly.

New-Keynesians emphasize market imperfections like monopolistic competition, where firms set prices. This contrasts with perfect competition and explains how demand shifts affect output and employment through firms' production and pricing adjustments (Taylor, 1999).

New-Keynesians incorporate rational expectations but acknowledge market imperfections and information asymmetry can cause suboptimal outcomes like persistent unemployment or inflation. This justifies active policy interventions to correct market breakdowns and stabilize the economy (Gordon, 1990).

In their modeling approach, New-Keynesians often utilize the Dynamic Stochastic General Equilibrium (DSGE) framework, which provides micro-foundations for macroeconomic analysis. Within this framework, the behavior of consumers and firms is derived from optimization problems. For instance, the representative household maximizes utility over consumption C_t and labor supply N_t , leading to an Euler equation for consumption:

$$C_t^{-\sigma} = \beta E_t \{ C_{t+1}^{-\sigma} (1 + r_{t+1}) \} \quad (9)$$

where σ is the coefficient of relative risk aversion, β is the discount factor, r_{t+1} is the real interest rate. This equation captures the intertemporal choice of consumption, linking present and future consumption decisions to interest rates and expectations. In terms of monetary policy, the Taylor Rule is a policy guideline that suggests how central banks should set nominal interest rates in response to deviations of inflation and output from their targets:

$$i_t = r^* + \pi_t + \phi_\pi (\pi_t - \pi^*) + \phi_y (Y_t - Y^*) \quad (10)$$

where i_t is the nominal interest rate, r^* is the equilibrium real interest rate, π_t is the current inflation rate, π^* is the target inflation rate, y_t is the logarithm of actual output, y^* is the logarithm of potential output, ϕ_π and ϕ_y are the parameters indicating how strongly the central bank responds to deviations in inflation and

output. These models embody how monetary policy can stabilize the economy by influencing expectations and responding systematically to economic fluctuations. They acknowledge that due to price stickiness, such policy interventions can have real effects on output and employment.

New-Keynesian models, though central to central banks, face criticisms. Rational expectations and representative agents may oversimplify economic diversity and financial markets, hindering crisis understanding. Price/wage stickiness as the primary imperfection may also oversimplify real-world frictions (*Caballero, 2010*). These aspects suggest New-Keynesian models might not fully capture dynamics during economic turbulence, which this paper aims to investigate further.

Much of the existing literature focuses on the theoretical distinctions between Post-Keynesian and New-Keynesian frameworks without fully exploring their empirical applications in recent crises. While studies have examined the effectiveness of New-Keynesian policies in inflation targeting regimes (*Beck & Wieland, 2009*) and Post-Keynesian approaches in managing financial instability (*Fontana & Palacio-Vera, 2007*), few have directly compared how these paradigms influence central bank decision-making during crises such as the 2008 Global Financial Crisis, the Eurozone crisis, and the COVID-19 pandemic.

CORE CONCEPTS OF MONETARY POLICY

Interest Rates and Inflation

The connection between interest rates, inflation, and the economy is crucial for monetary policy and is viewed differently by Keynesian, Post-Keynesian, and New-Keynesian economics. Each provides a distinct perspective on monetary policy dynamics and their impact on economic stability and growth (*Rochon, 2007*).

Keynesian economics uses interest rates to influence aggregate demand. Lower rates reduce borrowing costs, boosting investment and spending, while higher rates increase costs, slowing economic activity. Inflation is seen as a result of excessive demand, so managing interest rates and inflation involves adjusting demand to sustainable levels without causing excessive inflation (*Coibion et al., 2010*).

Post-Keynesians challenge the monetarist view, believing inflation originates in the real economy, especially in labor and raw materials markets. They oppose independent monetary policy institutions, arguing high interest rates harm the economy and increase unemployment. They emphasize macro-prudential supervision to prevent crises, a practice adopted after the 2008 crisis, changing oversight of major financial players in the US and EU (*King, 2013*).

Post-Keynesians emphasize uncertainty and endogenous money in the interest rate-inflation-economy relationship. Central banks influence interest rates indirectly, as money supply responds to loan demand. They stress sectoral monetary policy impacts and cost-push inflation (wages, commodities) over demand-pull, advocating a wider policy approach (*Bastian et al., 2024*).

New-Keynesian economics combines Keynesian thought with rational expectations and micro-foundations, explaining how interest rates affect the economy through expectations and market imperfections. Nominal rigidities (e.g.,

sticky prices/wages) cause output and employment fluctuations from monetary policy. Central banks manage inflation and activity by adjusting interest rates to guide inflation expectations, highlighting the importance of clear communication and credibility (*Salimi et al.*, 2025). New-Keynesians often favor inflation targeting, where interest rates maintain inflation within a range. (*Ball et al.*, 1988).

Central Banking and Monetary Supply

Post-Keynesian and New-Keynesian perspectives diverge on central banking's role in monetary policy (*Rochon & Rossi*, 2007). Post-Keynesians argue against direct money supply control, emphasizing its endogeneity driven by loan demand and bank lending (*Kriesler*, 2011). They see central banks as influencing the economy through interest rate policy, prioritizing credit conditions, financial stability, and addressing financial crises (*Rochon & Rossi*, 2007). New-Keynesians highlight central banks' influence through interest rate adjustments and expectation management, leveraging rational expectations to impact economic activity (*Beck & Wieland*, 2009). Additionally, they support inflation targeting as a crucial monetary policy to anchor expectations and stabilize prices (*Piazzesi et al.*, 2019).

Endogenous and Exogenous Money

Post-Keynesian economics focuses on endogenous money, where the banking system's response to loan demand controls the money supply. Banks create new money when issuing loans, driven by credit demand and economic conditions (*Tihy*, 2007b).

Post-Keynesians believe central banks influence the money supply through interest rates, affecting borrowing costs and loan demand. This makes the money supply a bottom-up process based on the economy's needs. They emphasize credit dynamics and challenge monetarist inflation control via money supply (*Rochon & Rossi*, 2013). They link inflation to cost factors, not monetary aggregates.

Conversely, New-Keynesians see money supply as exogenous, controlled by central banks via policy tools like open market operations (*Chung et al.*, 2015). While acknowledging bank lending's role, they emphasize central bank influence through monetary policy and regulation, viewing the central bank as actively managing both money supply and demand (*Desai*, 1989).

Policy Tools and Effectiveness

Post-Keynesians advocate for a broader monetary policy than interest rate adjustments, emphasizing the interconnectedness of money, banking, and financial stability (*Kriesler*, 2011). They support stricter bank regulations and targeted credit controls, alongside quantitative measures and direct lending, especially during financial instability (*Pressman*, 2011).

New-Keynesians, focusing on market imperfections and expectations, primarily utilize interest rates and forward guidance to influence inflation, output, and employment. Inflation targeting is a core strategy for anchoring expectations and promoting price stability (*Chung et al.*, 2015).

COMPARATIVE ANALYSIS

Post-Keynesian and New-Keynesian monetary policy approaches differ significantly in theory, assumptions, and implications for economic management, stemming from their contrasting views on economic systems, central banking, and monetary policy's impact (*Table 1*).

Table 1: Post-Keynesian vs. New Keynesian Monetary Policy: Key Differences

Feature	Post-Keynesian View	New-Keynesian View
Role of Government	Strong state intervention in markets	Limited government role; markets self-correct
Inflation Control	Cost-push factors (e.g., wages, supply chains)	Demand-side focus (monetary policy adjustments)
Monetary Policy	Credit regulation, direct interventions	Interest rate targeting, inflation expectations
Crisis Response	Coordination of fiscal and monetary policy	Independent central bank action
Money Supply	Endogenous (credit-driven)	Exogenous (controlled by central bank)
Policy Flexibility	Adaptive to economic conditions	Rule-based monetary frameworks
Empirical Application	Advocates unconventional tools (e.g., MMT, fiscal dominance)	Prefers conventional central bank-led approaches

Contrasting Key Concepts and Assumptions

Post-Keynesians challenge conventional views on money supply and economic stability. They emphasize endogenous money, where the banking system determines the money supply based on credit demand, while contrasting with the traditional exogenous view. They highlight inherent uncertainty and financial instability in capitalist economies, viewing crises as inherent. They stress the importance of income distribution in shaping economic outcomes, arguing that it significantly influences aggregate demand and stability. This perspective provides insights into the structural factors affecting economic activity and wealth distribution (*Pressman, 2011*).

New-Keynesian economics combines microeconomic foundations with macroeconomic phenomena, emphasizing rational expectations and their influence on collective behavior. Price/wage stickiness causes short-term deviations from full employment following economic shocks (*Melmies, 2010*). However, New-Keynesians believe monetary policy, through interest rate adjustments and expectation management, effectively mitigates these shocks and promotes stability (*Chung et al., 2015*).

Implications for Monetary Policy

Post-Keynesians advocate for a broader role for central banks, extending beyond conventional mandates to include direct credit regulation and financial stability measures (Bibow, 1998). They are skeptical of interest rate policies in the past, emphasizing the link between endogenous money and financial uncertainty. They argue for direct financial market interventions to address structural issues. Post-Keynesians believe monetary policy alone cannot resolve economic instability. They stress the importance of structural reforms, such as reducing income inequality, to complement monetary interventions. This approach reflects a detailed understanding of economic challenges, necessitating comprehensive policies for sustainable growth and stability (Hein & Lavoie, 2019).

New-Keynesian monetary policy emphasizes clear objectives, effective communication, and inflation targeting to steady expectations and promote stability. Providing credible and forward-looking information is crucial. While traditional interest rate policy is fundamental, unconventional tools are also valued, demonstrating adaptability (Castelnuovo & Pellegrino, 2018). The following section analyzes Post-Keynesian and New-Keynesian responses to the 2007–2008 financial crisis and the 2010 European debt crisis to illustrate these theoretical differences in practice.

Global Financial Crisis of 2007–2008

Post-Keynesians attribute the worldwide financial crisis to financial instability and endogenous money creation, fueling extreme lending and asset bubbles. They contend that adjusting interest rates alone could not have averted the crisis, underscoring the limitations of conventional monetary policy. In response, they call for stricter financial regulation and direct lending controls. They emphasize central banks preventing systemic failure by acting as lenders of last resort and advocate coordinated fiscal policies to stimulate demand, recognizing the interplay of monetary and fiscal measures (Keen, 2013).

New-Keynesians attribute the global financial crisis partly to irrational optimism and misaligned expectations, highlighting the limitations of traditional monetary policy at the zero lower bound. They advocate for unconventional monetary tools and forward guidance to manage expectations during such crises. (Galí, 2018).

European Sovereign Debt Crisis

Both Post-Keynesians and New-Keynesians offer insightful interpretations of the European sovereign debt crisis and offer suggestions for resolving its primary causes. Post-Keynesians attribute the European sovereign debt crisis to Eurozone structural imbalances (e.g., trade disparities, lack of fiscal union) exacerbated by unified monetary policy without fiscal coordination (Tirole, 2012).

New-Keynesians emphasize the role of expectations, particularly sovereign debt concerns and contagion risk, criticizing the Eurozone's inadequate crisis framework. Post-Keynesian solutions include debt restructuring and fiscal integration, while New-Keynesians advocate for ECB interventions and credible communication to manage expectations (Galí, 2018).

Recession

Post-Keynesians support straight government intervention and fiscal stimulus during recessions, prioritizing public spending and tax cuts to boost demand and employment alongside financial stability measures (*Stockhammer, 2022*).

New-Keynesians, on the other hand, favor combined monetary and fiscal policies, highlighting interest rate reductions to stimulate investment and consumption (*Gali, 2018*).

Inflation

Post-Keynesians address inflation via cost-push features (e.g., wages, raw materials), advocating targeted interventions and income policies to manage expectations and avoid contractionary monetary policy (*Braga & Serrano, 2023 b*). New-Keynesians prioritize inflation targeting, relying on central bank credibility and interest rate adjustments to maintain price stability, supplemented by forward guidance (*Coibion et al., 2010*).

Economic Growth

Post-Keynesians emphasize long-term growth via structural improvements, investments, and income equality policies, arguing that equitable wealth distribution boosts aggregate demand (*Kriesler, 2011*). They prioritize financing productive investments through targeted credit policies.

New-Keynesian economists highlight the significance of monetary policy in promoting economic growth. They aim to keep inflation low and steady by regulating interest rates and targeting inflation. Furthermore, they suggest improving market efficiency and reducing imperfections through regulatory reforms and policies that encourage competition and innovation (*Trautwein, 2020*).

Empirical Evidence

To evaluate the practical applicability of Post-Keynesian principles and New-Keynesian monetary policy tools, it is crucial to examine empirical studies assessing their effectiveness. This analysis provides insights into how these theoretical approaches perform in real-world central banking scenarios, highlighting their strengths and limitations.

In the 1990s, most large central banks, including the Federal Reserve, adopted an inflation-targeting regime, shifting the focus from monetary aggregates to inflation targeting, in line with New-Keynesian theory. The European Central Bank also adopted this regime, aiming to achieve the inflation target primarily through interest rate changes. These changes were implemented in a rule-based manner, based on the output gap, which is the difference between potential and actual output (*Beck & Wieland, 2009*).

Major central banks like the FED and ECB began using neo-Keynesian models for monetary policy in the early 2000s, with DSGE models becoming standard. These models were tailored to specific economies, emphasizing accurate parameter estimates.

After the 2008 crisis, the zero lower bound limited central banks' scope. With rates at zero, they influenced economic agents through expectations, ensuring transparency and forward-looking communication. This required discretionary tools inspired by Keynesian thinking. Asset purchases influenced the yield curve, and the roles of liquidity provision and lender of last resort became prominent from 2010 to 2020 and during the COVID crisis (Szabó-Bakos, 2007).

A comparative analysis of policy responses during the 2008 Global Financial Crisis (GFC), the Eurozone crisis, and the COVID-19 pandemic reveals the differing applications of Post-Keynesian and New-Keynesian paradigms in real-world policymaking. During the 2008 GFC, the FED implemented multiple rounds of quantitative easing (QE), expanding its balance sheet from approximately \$900 billion in 2008 to over \$4 trillion by 2014. This approach aligned with New-Keynesian principles of managing expectations and influencing long-term interest rates. The ECB, however, initially resisted QE due to concerns over moral hazard and fiscal discipline but later introduced the Securities Market Programme (SMP) and Outright Monetary Transactions (OMT) to stabilize financial markets. Post-Keynesians criticized these delayed interventions, arguing that stronger fiscal-monetary coordination could have mitigated the downturn more effectively (Taylor, 2009).

During the Eurozone crisis, the ECB's monetary policy was constrained by the Eurozone's structural limitations, leading to austerity-driven responses that deepened economic contractions in several member states. Post-Keynesians argue that the ECB's strict focus on price stability prolonged the crisis, while a more flexible approach, involving direct central bank financing, could have supported recovery. In contrast, the FED continued its expansionary policies, further highlighting the divergence in theoretical applications (Taylor, 2009).

The COVID-19 pandemic tested these monetary frameworks once again. Both the FED and ECB launched large-scale asset purchase programs and liquidity measures, but their strategies reflected distinct theoretical influences. The FED responded with rapid fiscal-monetary coordination, while the ECB faced internal debates over debt mutualization. Post-Keynesian critiques highlight the necessity of stronger fiscal coordination within the Eurozone, whereas New-Keynesians emphasize the importance of maintaining central bank independence and inflation control.

Empirical Evidence from Post-Keynesian Approaches

Post-Keynesian monetary policies have been used to address financial instability and promote sustainable growth, focusing on credit controls, financial regulations, and fiscal interventions.

Japan's post-war growth benefited from direct credit controls by the Bank of Japan, aligning with Post-Keynesian emphasis on endogenous money and strategic credit allocation (Werner, 2005). Similarly, Malaysia's response to the 1997 Asian Financial Crisis involved capital controls and financial regulations, aiding faster recovery compared to traditional policies (Epstein & Yeldan, 2009).

However, the effectiveness of Post-Keynesian policies depends on the institutional and economic context. For example, in the European Monetary Union, the lack of fiscal integration and the ECB's focus on price stability limit the application of these policies (Fontana & Palacio-Vera, 2007).

Empirical Evidence from New-Keynesian Approaches

New-Keynesian monetary policies, such as inflation targeting and interest rate adjustments, are widely used by central banks globally. Empirical studies have assessed their effectiveness in achieving macroeconomic stability.

Bernanke et al. (1999) found that inflation targeting in countries like New Zealand, Canada, and the UK reduced inflation rates, anchored expectations, and supported macroeconomic stability without harming output growth. This supports the New-Keynesian view that clear policy frameworks and credibility enhance monetary policy effectiveness.

During the Global Financial Crisis, studies examined unconventional monetary policies like quantitative easing (QE). *Joyce et al.* (2012) found that the Bank of England's QE program lowered long-term interest rates and supported asset prices, stabilizing the financial system and promoting recovery. This aligns with the New-Keynesian emphasis on managing expectations and using various tools when conventional policies are limited.

However, some studies highlight limitations. *Blinder et al.* (2017) noted that while QE had positive effects, its impact on stimulating real economic activity was less than expected, suggesting diminishing returns and raising concerns about long-term reliance on unconventional tools. The divergence in how the FED and ECB responded to the COVID-19 crisis further underscores the importance of integrating insights from both monetary paradigms to develop more effective crisis management strategies.

Critiques and Limitations

While both Post-Keynesian and New-Keynesian approaches offer valuable insights, they also face criticisms and have limitations that need to be acknowledged to provide a balanced view.

Critiques of Post-Keynesian Approach

Critics argue that the Post-Keynesian focus on endogenous money and financial regulation may underestimate the challenges of implementing policies in globalized financial systems. The lack of a unified framework complicates precise policy recommendations (*Bonizzi & Kaltenbrunner*, 2020).

Opponents also highlight that heavy reliance on government intervention can cause inefficiencies and market distortions and question the effectiveness of direct credit controls in liberalized markets (*Palley*, 2013).

Empirical critiques point to mixed results of Post-Keynesian policies, such as capital flight from stringent regulations without international coordination and the varied success of credit controls in developing countries (*Arestis & Sanjey*, 2006).

Critiques of New-Keynesian Approach

The New-Keynesian framework faces criticism for relying on rational expectations and representative agent models, which may not capture real-world behaviors like agent heterogeneity and irrational decision-making (*Caballero*, 2010).

Critics argue that price and wage stickiness oversimplify market dynamics, leading to potentially ineffective policies. For example, *Taylor* (1999) questioned the impact of low interest rates during liquidity traps.

The Global Financial Crisis revealed limitations in the New-Keynesian focus on price stability, as economies with low inflation still faced severe crises, suggesting an underestimation of financial factors and systemic risks (*Blanchard et al.*, 2010).

Additionally, prolonged use of unconventional monetary policies like QE has raised concerns about asset bubbles, income inequality, and challenges in unwinding central bank balance sheets without market disruption (*Rogers et al.*, 2014).

CONCLUSION

This comparative investigation of Post-Keynesian and New-Keynesian monetary policy shows critical distinctions with implications for current economic challenges. Post-Keynesians prioritize financial instability, endogenous money, and income distribution, while New-Keynesians emphasize rational expectations, price/wage stickiness, and interest rate/inflation targeting efficacy. These theoretical divergences yield varied policy recommendations, particularly regarding financial crises, inflation, growth, and distribution.

In today's complex financial landscape, understanding these perspectives is crucial. Recognizing individual theoretical limitations enables policymakers to develop more comprehensive monetary policies. The 2007–2008 crisis and subsequent sovereign debt crisis demonstrated the shortcomings of solely relying on traditional New-Keynesian approaches, highlighting the necessity for incorporating Post-Keynesian understandings on financial instability and income distribution. More recently, the post-2021 inflationary period has challenged the effectiveness of conventional monetary policy, raising concerns about how to manage inflation dynamics amid global supply disruptions and structural economic changes. Addressing these challenges requires a broader policy perspective that integrates supply-side factors, global value chain disruptions, and income distribution effects—elements that pose challenges to both New-Keynesian and Post-Keynesian frameworks.

From a policy perspective, different macroeconomic conditions call for different theoretical approaches. In times of financial instability and economic downturns, Post-Keynesian tools—such as active fiscal-monetary coordination and direct credit regulation—can play a vital role in stabilizing the economy. Conversely, in more stable economic environments, New-Keynesian policies—such as rule-based monetary frameworks and inflation targeting—are well-suited for maintaining long-term price stability and anchoring expectations. Rather than viewing these paradigms as mutually exclusive, policymakers should consider an integrated approach that balances demand management, financial stability, and inflation control. A more pragmatic and flexible policy framework, drawing from both traditions, would allow central banks and governments to respond more effectively to evolving economic challenges, including climate finance, fintech innovations, and digital currency adoption.

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