Post-Keynesian Economics: An Introduction

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Literature


1. Introduction
2. Heterodox and post-Keynesian economics as alternatives to mainstream orthodox economics
3. Strands of post-Keynesian economics, commonalities and implications for macroeconomics and macroeconomic policies
4. What has been achieved?
5. Perspectives and tasks for the future
1. Introduction
The 'third (?) crisis of economics' and the failure of mainstream (macro)economics in the face of the 2007-?? Crises

1. Crisis: Great Depression (1929 ff.)
   ➔ Keynes‘s and Kalecki‘s 'principle of effective demand'

2. Crisis: early 1970s, end of golden age
   (Robinson 1972)

   (Steindl 1979)
Mainstream/Orthodoxy
Neoclassical, Monetarist, New Classical, New Keynesian economics

New Consensus Model / DSGE modelling:
• Utility maximising representative agent(s) with rational expectations
• Frictions allow for short-run Keynesian results
• Absence of aggregate demand
• Absence of banks + financial sector
• Long-run neutrality of money and self-stabilisation of markets

⇒ But there have been alternatives!!
2. Heterodox and post-Keynesian economics as alternatives to mainstream orthodox economics
Table 1.1  Presuppositions of the heterodox and orthodox research programmes

<table>
<thead>
<tr>
<th>Presupposition</th>
<th>Heterodox schools</th>
<th>Orthodox schools</th>
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<tr>
<td>Epistemology/Ontology</td>
<td>Realism</td>
<td>Instrumentalism</td>
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<tr>
<td>Method</td>
<td>Holism, organicism</td>
<td>Individualism, atomicism</td>
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<tr>
<td>Rationality</td>
<td>Reasonable rationality, satisficing agent</td>
<td>Hyper model-consistent rationality, optimising agent</td>
</tr>
<tr>
<td>Economic core</td>
<td>Production, growth</td>
<td>Exchange, allocation, scarcity</td>
</tr>
<tr>
<td>Political core</td>
<td>Regulated markets</td>
<td>Unfettered markets</td>
</tr>
</tbody>
</table>

Source: Lavoie (2011: 11)
Epistemology (science of learning), Ontology (basic categories and their relations): Realism vs. Instrumentalism

**Instrumentalism**: Economic hypothesis is sound, if it allows for accurate predictions and for calculation of new equilibrium (i.e. M. Friedman)

**Realism**: Objective of economics is to tell relevant stories and to explain actual working of the economy in the real world

⇒ start with „stylized facts“ (Kaldor) rather than hypothetical idealistic position or assumptions
Method
Holism/organicism vs. Individualism/atomicism

**Individualism/atomicism**: Analysis starts from pre-social individual and his/her preferences
- representative agent as a utility and/or profit maximiser under constraints
- microfoundation of macroeconomics (and of institutions)

**Holism/organicism**: Individuals are social beings under the influence of their environment (culture, class, gender, institutions, history)
- micro-macro paradoxes
# Micro-macro paradoxes – 'fallacies of composition'

<table>
<thead>
<tr>
<th>Paradox of thrift (Keynes, 1936)</th>
<th>Higher saving rates lead to reduced output</th>
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<tbody>
<tr>
<td>Paradox of costs (Rowthorn, 1981)</td>
<td>Higher real wages lead to higher profit rates</td>
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<tr>
<td>Paradox of public deficits (Kalecki, 1971)</td>
<td>Government deficits raise private profits</td>
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<td>Paradox of debt (Steindl, 1952)</td>
<td>Efforts to de-leverage might lead to higher leverage ratios</td>
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<td>Paradox of tranquillity (Minsky, 1975)</td>
<td>Stability is destabilising</td>
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<td>Paradox of liquidity (Nesvetailova, 2007)</td>
<td>New ways to create liquidity end up transforming liquid assets into illiquid ones</td>
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<td>Paradox of risk (Wojnilower, 1980)</td>
<td>The availability of individual risk cover leads to more risk overall</td>
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Rationality

Reasonable rationality vs.
Hyper model-consistent rationality

Hyper model-consistent rationality: individuals possess quasi-unlimited knowledge and ability to calculate economic outcomes applying the 'true' model (perfect information, rational expectations, optimising agents)

Reasonable rationality: individuals face severe limitations in their ability to acquire and process information, because the latter maybe simply non-existent (known unknowns, unknown unknowns) ➔ expectations based on radical uncertainty ➔ norms/institutions (conventions, customs, rules of thumb) as rational responses (satisficing agents)
Economic core:
Production, growth + abundance vs.
Exchange, allocation + scarcity

Exchange, allocation + scarcity: Efficient allocation of scarce resources (Robbins), prices reflect scarcity, exchange as the starting point of economic analysis, production + growth as an extensions

Production, growth + abundance: creation of scarce resources by means of accumulation of (part of) the surplus and technical progress (classicals + Marx), reproduction prices, utilization of resources, because economy usually operates below full utilization (Keynes)
Political core
Regulated markets vs. unfettered markets

Unfettered markets: perfect markets (perfect information, flexible prices) generate optimal results, state intervention generates inefficiencies, exception: external effects, price rigidities

Regulated markets: markets generate instabilities irrespective of price (in-)flexibility, unacceptable inequalities and inefficiencies; free markets are impossible, tendencies towards oligopoly + monopoly; market regulation and aggregate demand management by the state are required
3. Strands of post-Keynesian economics, commonalities and implications for macroeconomics and macroeconomic policies
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<tr>
<td>American Post-Keynesians</td>
<td>Marshallians</td>
<td>Marshallians</td>
<td>Fundamentalists</td>
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<td>Kaleckians</td>
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<td>Robinsonians</td>
<td>Kaleckians</td>
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<td>Institutionalists</td>
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Lavoie (2011: 19)
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<thead>
<tr>
<th>Strand</th>
<th>Major themes</th>
<th>Inspiration</th>
<th>Current authors</th>
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<tbody>
<tr>
<td>Fundamentalist</td>
<td>Fundamental uncertainty</td>
<td>J.M. Keynes</td>
<td>Fernando Carvalho</td>
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<tr>
<td>Keynesians</td>
<td>Monetized production economy</td>
<td>Hyman Minsky</td>
<td>Vicky Chick</td>
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<td></td>
<td>Financial instability</td>
<td>older Joan Robinson</td>
<td>Paul Davidson</td>
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<td></td>
<td>Methodology</td>
<td>G.L.S. Shackle</td>
<td>David Dequech</td>
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<td>Sidney Weintraub</td>
<td>Sheila Dow</td>
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<td>Giuseppe Fontana</td>
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<td>Jan Kregel</td>
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<td>Edwin Le Heron</td>
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<td>Basil Moore</td>
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<td>Kaleckians</td>
<td>Income and distribution models</td>
<td>Tom Asimakopulos</td>
<td>Amit Bhaduri</td>
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<td></td>
<td>the Traverse</td>
<td>Donald Harris</td>
<td>Robert Blecker</td>
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<td>Effective demand</td>
<td>Michal Kalecki</td>
<td>Amitava Dutt</td>
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<td>Class conflict</td>
<td>younger Joan Robinson</td>
<td>Eckhard Hein</td>
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<td></td>
<td>Pricing</td>
<td>Joseph Steindl</td>
<td>Steve Fazzari</td>
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<td>Peter Kriesler</td>
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<td>Malcolm Sawyer</td>
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<td>Engelbert Stockhammer,</td>
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<td>Lance Taylor</td>
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<td>Jan Toporowski</td>
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<td>Sraffians</td>
<td>Relative prices</td>
<td>Krishna Bharadwaj</td>
<td>Roberto Ciccone</td>
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<td>Technical choice</td>
<td>Pierangelo Garegnani</td>
<td>Heinz Kurz</td>
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<td>Multisectoral production systems</td>
<td>Luigi Pasinetti</td>
<td>Gary Mongiovi</td>
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<td></td>
<td>Capital theory</td>
<td>Pierro Sraffa</td>
<td>Carlo Panico</td>
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<td>Joint production</td>
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<td>Fabio Petri</td>
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<td>Long-run positions</td>
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<td>Massimo Pivetti</td>
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<td>Alessandro Roncaglia</td>
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<td>Neri Salvadori</td>
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<td>Bertram Schefold</td>
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<td>Franklin Serrano</td>
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<td></td>
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<td>Ian Steedman</td>
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Table 1.8: Post-Keynesian strands with main themes and authors (continued)

<table>
<thead>
<tr>
<th>Strand</th>
<th>Major themes</th>
<th>Inspiration</th>
<th>Current authors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutionalists</td>
<td>Pricing&lt;br&gt;Theory of the firm&lt;br&gt;Monetary institutions&lt;br&gt;Behavioural economics&lt;br&gt;Labour economics</td>
<td>Philip Andrews&lt;br&gt;Dudley Dillard&lt;br&gt;Alfred Eichner, John Kenneth Galbraith&lt;br&gt;N. Georgescu-Roegen&lt;br&gt;Abba Lerner&lt;br&gt;Gardiner Means&lt;br&gt;Thorstein Veblen</td>
<td>Stephen Dunn&lt;br&gt;Peter Earl&lt;br&gt;Scott Fullwiler&lt;br&gt;James Galbraith&lt;br&gt;John Harvey&lt;br&gt;Frederic Lee&lt;br&gt;André Orléan&lt;br&gt;Charles Whalen&lt;br&gt;Randall Wray</td>
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<tr>
<td>Kaldorians</td>
<td>Economic growth&lt;br&gt;Productivity regimes,&lt;br&gt;Open economy constraints&lt;br&gt;Real-financial nexus</td>
<td>John Cornwall&lt;br&gt;Wynne Godley&lt;br&gt;Richard Goodwin&lt;br&gt;Roy Harrod&lt;br&gt;Nicholas Kaldor</td>
<td>Robert Boyer&lt;br&gt;John McCombie&lt;br&gt;Ken Coutts&lt;br&gt;Ro Naastepad&lt;br&gt;Neville Norman&lt;br&gt;Tom Palley&lt;br&gt;Pascal Petit&lt;br&gt;Mark Setterfield&lt;br&gt;Peter Skott&lt;br&gt;Servaas Storm&lt;br&gt;Anthony Thirlwall</td>
</tr>
</tbody>
</table>

Important authors, but difficult to allocate: Arestis, Harcourt, King, Nell, Lavoie, Rochon, Seccareccia, …

Source: Lavoie (2014, Chapter 1)
Communalities of different strands of PKs?

'small tent‘ vs. 'big tent‘ approach

'small tent‘:
Davidson (2002/03): only those should be considered as ‘Post Keynesians’, who, following Keynes, strictly adhere to the rejection of the classical axioms: the neutrality of money axiom, the ergodic axiom, and the gross substitution axiom

'big tent‘:
Essential characteristics of PK economics (my 'big tent' approach)

Presuppositions 1.-5. of heterodox economics plus:

6. the focus on a monetary theory of production, in which money is non-neutral in the short and the long run,
7. the dominance of the principle of effective demand in the short and long run,
8. the importance of the notion of fundamental uncertainty,
9. the insistence that economic processes take place in historical and irreversible time – and are thus largely path dependent, and
10. the importance of distributional issues and distribution conflict for economic outcomes.
PK Hierarchy of the markets

1. *Money/Financial/Asset market*
   Central bank determines base rate of interest, and commercial banks set market rate of interest. Volumes of credit and money are endogenous.

2. *Goods market*
   Investment demand as the link between asset and goods market: \( I(r, i) + \text{multiplier} \cdot (1/1-c) \) determine aggregate demand, output, and employment.

3. *Labour market*
   Labour demand depends on the goods market. Labour market sets the nominal wage rate and affects the price level.
<table>
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<tr>
<th></th>
<th><strong>NCM</strong></th>
<th><strong>PKM</strong></th>
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<tbody>
<tr>
<td><strong>Monetary policy</strong></td>
<td>Inflation targeting, which affects unemployment in the short run, but only inflation in the long run</td>
<td>Target low interest rates affecting distribution, and stabilise monetary, financial and real sectors</td>
</tr>
<tr>
<td><strong>Fiscal policy</strong></td>
<td>Support monetary policy in achieving price stability, balance the budget over the cycle</td>
<td>Real stabilisation in the short and in the long run, no deficit target, distribution of disposable income</td>
</tr>
<tr>
<td><strong>Labour market and wage/incomes policy</strong></td>
<td>Determines the NAIRU in the long run and the speed of adjustment in the short run, focus should be on flexible nominal and real wages</td>
<td>Affects price level/inflation and distribution, focus should be on rigid nominal wages and steady nominal unit labour cost growth</td>
</tr>
<tr>
<td><strong>Co-ordination</strong></td>
<td>Clear assignment in the long run, co-ordination only in the short run</td>
<td>No clear assignment, co-ordination required in the short and the long run</td>
</tr>
</tbody>
</table>
Economic policy debates within PK economics

1. Monetary/interest rate policies: activist vs. parking it (Rochon.Setterfield 2007)


3. Wage policies: to what extent can and should trade unions try to affect distribution? (Hein 2011, 2014)
4. What has been achieved?
Stages of development of PK economics

1930s/40s
- Post-Keynesian economics starts with Keynes‘s and Kalecki‘s (!) revolution in macroeconomics, involuntary unemployment, trade cycle

1950s/60s
- Distribution and growth: extending the principle of effective demand to the long period (post-Keynesian d+g models)
- Critique of neoclassical macrotheory: capital controversy

1970s (‘romantic age‘, Fontana (2009))
- Search for a grand theoretical system
- Foundation of journals (CJE (1977), JPKE (1978)),
- Theory of the firm, pricing theories, …

1980s/90s (‘age of uncertainty‘, Fontana (2009))
- Methods and methodology, ‘What Keynes really meant, really‘
- Textbooks (Arestis (1992), Lavoie (1992), Davidson (1994)
- Endogenous money (Moore), financial instability hypothesis (Minsky)
- Kaleckian distribution and growth models (Rowthorn, Dutt, Bhaduri/Marglin)

2000s
- Applied work, economic policies, financialisation
- Integrated models of money, distribution conflict, effective demand, capital accumulation + growth (analytical + sfc simulation models)
What has been achieved?

Solid body of theory and policy recommendations in the areas of:

- macroeconomics;
- employment and unemployment;
- distribution and growth;
- money, credit and finance;
- international money and finance;
- financialisation;
- financial instability and financial crisis;
- European economics and economic policies;
- development and emerging market economics …
But still several controversies

- Use of formal (equilibrium) modelling and econometrics (T. Lawson)
- Which kind of micro: Marshall or Kalecki?
- Normal rate of utilisation in the long run?
- Exact shape of money and credit supply curves (Horizontalist vs. Structuralists)
- Precise economic policy recommendations regarding monetary, fiscal and wage policies …

⇒ (necessary) controversies within the research programme without undermining coherence; but style is sometimes wanting …
What has been achieved?

Survival as a contested and embattled minority in a hostile and unfriendly environment. Managed to develop an academic infrastructure – as part of heterodox economics in general – which, of course, has been required for this survival so far:

1. Textbooks
2. Journals
3. Networks/associations/conferences/summer schools
4. Graduate programmes
1. Textbooks, handbooks etc.:

2. Journals

- Cambridge Journal of Economics
- Journal of Post Keynesian Economics
- Metroeconomica
- Review of Political Economy
- Journal of Economic Issues
- International Review of Applied Economics
- Review of Keynesian Economics
- Review of Radical Political Economics
- International Journal of Political Economy
- PSL Quarterly Review
- Bulletin of Political Economy
- Brazilian Journal of Political Economy
- Contributions to Political Economy
- Panoeconomicus
- …
3. Networks/ associations/conferences/ summer schools

- **North America**: Levy Economics Institute, annual Hyman P. Minsky conferences in New York, international Post Keynesian conferences in Kansas City, and Minsky summer seminars in Annandale-on-Hudson, NY
- **South America**: Brazilian Keynes Association, annual conferences
- **Australia**: PKs as main organisers of and contributors to the Australian Society of Heterodox Economics (ASHE) conferences.
- **Asia**: Japanese Society for Post Keynesian Economics, seminars, conferences, Keynes Society Japan, annual conferences
- **Denmark**: Nordic post-Keynesian network (conferences)
- **France**: PK conferences at the University of Dijon, partly co-organised by the French Association pour le Developpement des Etudes Keynesiennes (ADEK), French PKs heavily involved in the newly founded Association Francaise d’Economie Politique (AFEP), conferences and other activities
- **Spain**: University of the Basque Country in cooperation with the Cambridge Centre for Economic and Public Policy, annual conferences
- **Germany**: German Keynes Society, small annual conferences for German speaking participant, Research Network Macroeconomics and Macroeconomic Policies (FMM), annual international conferences, biennial summer schools
Graduate programmes

- **Brazil**: several universities (Campinas, Rio de Janeiro, …)
- **US**: University of Massachusetts Amherst, the New School for Social Research, New York, the University of Missouri, Kansas City, and at the University of Utah, Salt Lake City.
- **UK**: Leeds University Business School, Kingston University, London, and SOAS London
- **France**: University of Paris 13
- **Spain**: University of the Basque Country, Bilbao.
- **Germany**: Berlin School of Economics and Law and the HTW University of Applied Sciences Berlin, without PhD
- **Erasmus Mundus Master Programme on Economic Policies in the Age of Globalisation** (EPOG): University Paris 13, the University Torino, the Berlin School of Economics and Law, Kingston University London, and the University of Witwatersrand as major partners, Seoul National University, the Federal University of Rio de Janeiro and the University of Massachusetts Amherst associated.
5. Perspectives and tasks for the future
Colander (2009), Fontana/Gerrard (2006): PKs should observe the developments within orthodox/mainstream economics more closely, avoid attacking a textbook ‘strawman’, use modelling methods which are acceptable to mainstream economists, engage in dialogues and cooperate with mainstream economists, in order to convince them of the relevance of post-Keynesian economics.

Davidson (2009): PKs should actively fight orthodox economics, with the aim of convincing mainstream economists that their approach is wrong.

Both are misguided: over-estimation of the potentials for constructive dialogues or controversies, given the contradicting presuppositions of orthodox and heterodox economics, and of the willingness of mainstream economists to enter into such dialogues or controversies.
• Don‘t target orthodox economics in the first place, but do not avoid controversies

• Focus on ‘useful explanations of ongoing socio-economic transformations’, as Stockhammer/Ramskogler (2009, 228)

• Contribute to a change in attitudes and power relations in the economy and the society as a whole – this is also a pre-condition for changing academic economics
1. Improve PK research programme
   • Examine potential links between modern micro (experimental, behavioural) and PK macro
   • Integrate ecological constraints
   • Political economy of economic policies (Kalecki, Steindl, …)
   • Link with other heterodox schools (Institutional economics, Marxian economics, Regulation school, SSA, …) in order to develop an integrated but open political economy research programme

2. Improve institutionalisation of PK and heterodos economics
   • University positions, research funding, graduate programmes, journals and appropriate journal rankings, associations and networks, conferences and summer schools
   • Join forces with other progressive social scientists, business economists, engineers, scientists, and so on

3. Improve impact on economic policies
   • cooperation with trade unions, social movements and political parties, as well as with research institutes and think tanks outside the university sector