

History and Fundamentals of (Post-)Keynesian Economics

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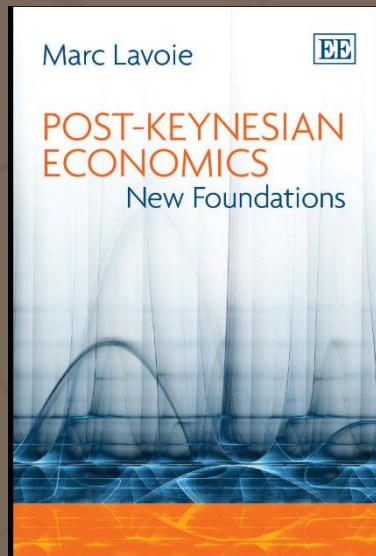
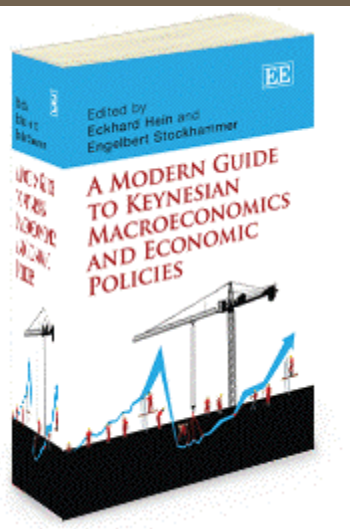
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*A Modern Guide To Keynesian
Macroeconomics And Economic
Policies*

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Outline

- 1. History of PKE
- 2. Heterodox and Keynesian schools of thought
- 3. Key features of PKE
- 4. Various streams of PKE
- 5. Economic policy and current PKE research

PART I

History of post-Keynesian economics

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Phases in the creation of PKE

1. 1930s-1950s: The Beginnings:
2. 1960s-early 1970s: The Capital controversies, the response to monetarism
3. Mid 1970s-1980s: The Romantic Age
syntheses, institutionalization
4. 1990s: The Age of Uncertainty
Methodology
5. 2000s: The Age of Policy

1.1 Around the General Theory

- Keynes's banana parable, widow's cruse 1929
- Keynes's General Theory 1936
- The Revolutionary character of the GT, underlined by the Circus and J. Robinson
- Kalecki: 1933 (cycle), 1937 (principle of increasing risk), 1939 (positive role of real wages), 1942 (A theory of profits)
- Kaldor 1934: multiple equilibria, instability, path-dependence

1.2 JR: The Accumulation of capital (1956) and Kaldor's article on income distribution (1956)

- The Accumulation of capital: Great book, that covers the dynamic long-run implications of Keynes, inspired by Harrod, Kalecki, Myrdal, the revival of classical questions, Sraffa's introduction to Ricardo's Principles, Wicksell (Kahn): growth, choice of technique, money
- A *neo-Keynesian* or *Cambridge* theory of income distribution, based on macroeconomics, instead of marginal productivity
- First awareness that the theory being discussed at Cambridge is different from that in the US (Mata, 2004).

2.1 The Capital controversies, 1960s and early 1970s

- Started with Robinson (1953-4) and Sraffa (1960).
- Capital reversing and reswitching show that the rate of return on capital cannot be a measure of its « scarcity ».
- The controversies put in jeopardy the standard production function based on substitution.
- Further work has shown that the apparent success of neoclassical production functions (Cobb-Douglas, CES, etc.) arises because they replicate national account identities (Shaikh 1974).
- More recently, it has been shown that econometric regressions on production functions estimate profit and wage shares in national income instead of elasticities of factors of production (Felipe and McCombie 2013).

2.2 The response to Monetarism

- Money is endogenous (Kaldor, Kahn, Robinson, Cramp).
- Central banks control short-term interest rates, not the supply of money.
- Causality between money and inflation is reversed.
- Causality between bank reserves and bank deposits is reversed.
- Central bank open market operations are essentially defensive, trying to stabilize interest rates.

2.3 The Americans join in...

- Sidney Weintraub (1958) starts criticizing the neoclassical synthesis.
- Efforts to gather together Keynesians and Radicals who object to the neoclassical synthesis in the late 1960s and early 1970s (Eichner, Davidson, Nell, Shaikh...).
- Basil Moore and Paul Davidson go to Cambridge on their sabbatical, and Davidson finishes his *Money and the Real World* (1972), describing the various schools of thought in macroeconomics.

2.4 The Eichner and Kregel article in the JEL Dec. 1975

- Eichner and Kregel claim that a new *Paradigm* has been born, called *Post-Keynesian economics*.
- They summarize the new school with the following characteristics:
 - A concern with growth and cycles;
 - A concern with history and time;
 - A neo-Keynesian/institutional theory of income distribution;
 - Incomplete information, fundamental uncertainty;
 - Imperfect markets with oligopolies, and constant marginal costs;
 - A monetized production economy;
 - Saving adjusts to discretionary expenditures (investment);
 - Purpose: to explain the real world as observed empirically.

3.1 The Romantic Age: A grand synthetic theory

- Davidson 1972, 1982
- Jan Kregel 1973
- Hyman Minsky 1975
- Eichner 1979 Guide to PKE
- Peter Reynolds 1987
- Alfred Eichner 1987
- Amittava Dutt 1990, Lance Taylor 1991
- Philip Arestis 1992
- Cardim de Carvalho 1992
- Marc Lavoie 1992
- McCombie and Thirlwall 1994
- Thomas Palley 1996

3.2 The institutionalisation of PKE

- The creation of *The Cambridge Journal of Economics*, 1977, created by young scholars at Cambridge, founded on the tradition of Marx, Keynes, Kalecki, Robinson and Kaldor.
- *The Journal of Post Keynesian Economics*, 1978, edited by Weintraub and Davidson, based on Keynes, Robinson, Kaldor, Kahn, Kalecki, Lerner, Harrod, Galbraith, Minsky, new Hicks.
- Other journals (Thames Papers, ROPE), Summer schools (Trieste, Knoxville, UMKC, Berlin, Levy), PKT network, PKSG, newsletters, blogs, conferences.
- *Then later IRAE, INTERVENTION:EJEEP, ROKE, FMM conference*

4. The Age of Uncertainty, 1990s

- The focus moves from theory to methodology:
 - Methodological disputes over the proper critique of neoclassical theory
 - History of economic thought
 - The Collected Writings of Keynes
 - The Treatise on probability and the notion of Uncertainty

5. The Age of Policy, 2000s

- Since the late 1990s, the emphasis has moved from methodology to policy.
- A large proportion of papers at PK conferences are devoted to policy issues.
- A large proportion of the papers use empirical analysis and econometrics.
- There is a return to formalization, in particular through stock-flow consistent models, and later agent-based models.

PART II

Heterodox schools and Keynesian schools

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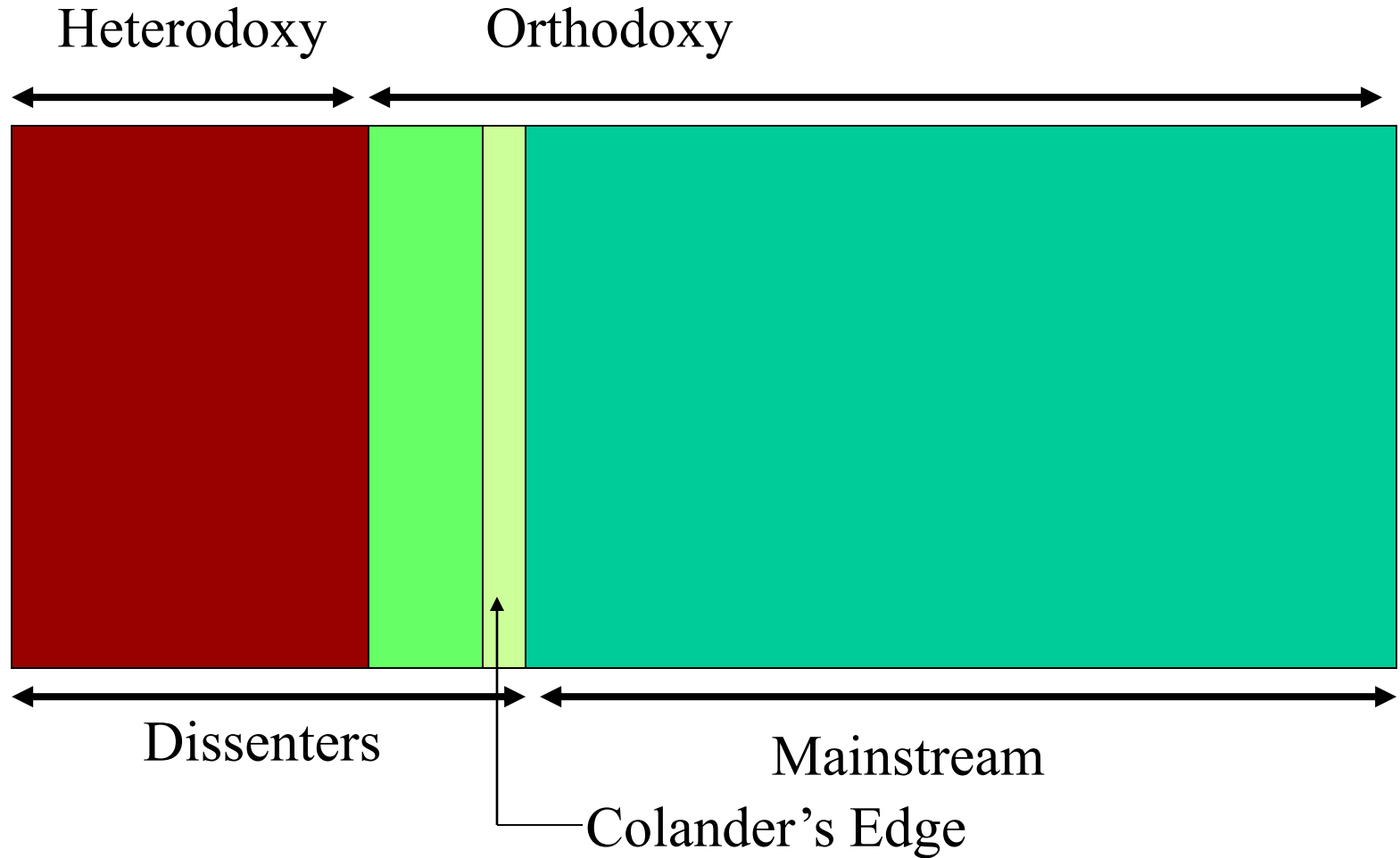


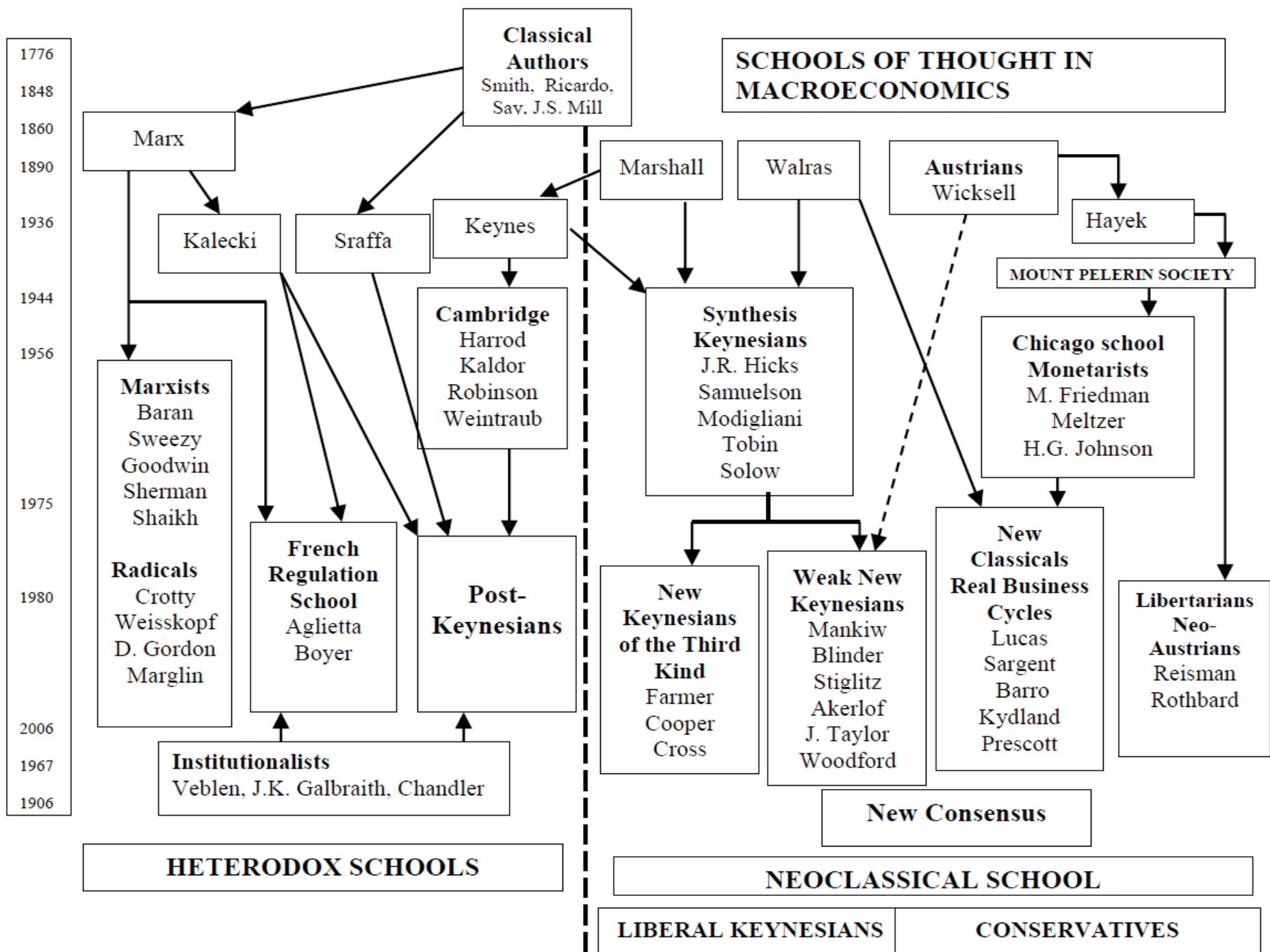
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Heterodox vs Orthodox economics

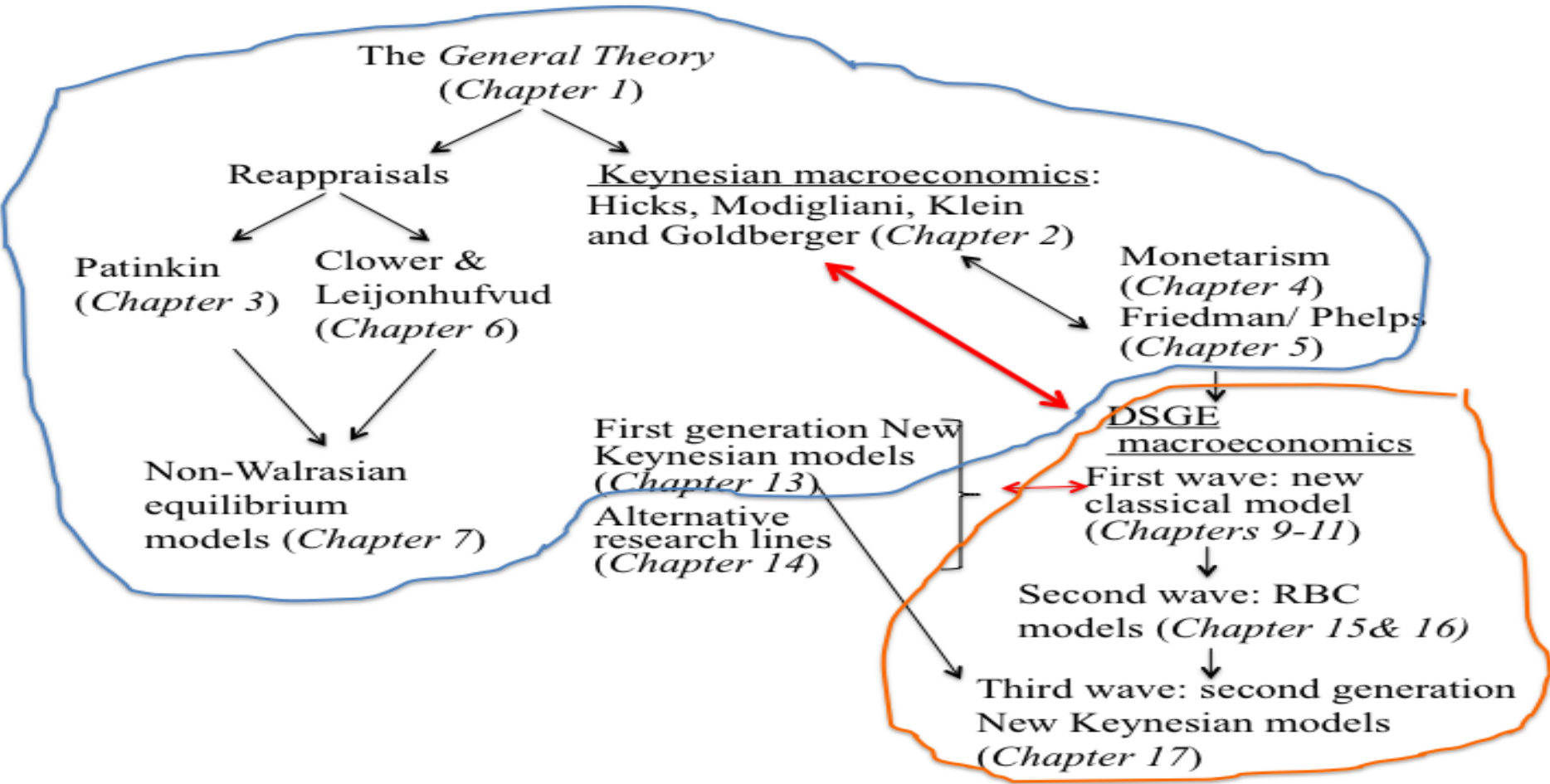
- HETERODOX PARADIGM
- NON-ORTHODOX PARADIGM
- POST-CLASSICAL PARADIGM
- REVIVAL OF POLITICAL ECONOMY
- REAL-WORLD ECONOMICS
- ORTHODOX PARADIGM
- DOMINANT PARADIGM
- THE MAINSTREAM
- NEOCLASSICAL ECONOMICS
- MARGINALISM

Dissenters and “the edge”





Mainstream macroeconomics according to Michel De Vroey (2016)



Heterodox schools in economics

- Post-Keynesians
- Sraffians (Neo-Ricardians)
- Old Institutionalists
- Marxists, Radicals
- Structuralists (Development, Latin-American school, Furtado, L. Taylor)
- French Regulation School, Social Structure of Accumulation (SSA)
- Neo-Schumpeterians
- Circuitists (Monetary theory of production)
- Free Berlin University school
- Social economics and Humanistic economics
- Economists of « conventions »
- Feminist economics
- Green economics (Ecological Economics)
- Old behavioural economics
- And no doubt many others (Ghandi economics, Henry George, Gesell, Neo-Austrians (?), etc.)

What do all these heterodox schools have in common?

- Differences between schools of thought and their relative ranking have a lot to do with the sociology of the profession.
- Some of the discrepancies are due to specialization in certain fields (cf. T. Lawson).
- Still, in my opinion there are broad features that characterize heterodox and orthodox schools.
- These are called the presuppositions of research programmes by philosophers of science: they are things that cannot be questioned

Five Presuppositions of the heterodox programme vs those of the mainstream

	Paradigm	
Presupposition	Heterodox schools	Orthodox schools
Epistemology	Realism	Instrumentalism
Method	Holism, organicism	Individualism, atomicism
Rationality	Reasonable rationality	Hyper rationality Optimizing agent
Economic core	Production, growth, income effects	Exchange, scarcity, substitution effect
Political core	Regulated, tamed, markets	Unfettered market optimism

Three further candidate presuppositions: 1. Ideology

- Variant of fifth: Ideology (Guerrien 2009, Marglin 1984, Samuelson 2007).
- ‘Economists produce the sorts of knowledge that its patrons desire’ (Mirowski, 2011, p. 508).
- Paul Krugman (2013): ‘the austerity agenda looks a lot like a simple expression of upper-class preferences, wrapped in a facade of academic rigor. What the top 1 percent wants becomes what economic science says we must do’.

2. 1A further candidate: abuse of mathematical methods (Lawson CJE 2013)

- ‘The insistence that mathematical methods should be everywhere used is not only mainstream doctrine; it is the cause of the discipline’s continuing ills’ (Lawson, 2009b, p. 109).
- Sheila Dow (2000, p. 164): ‘the guiding principle of orthodox economics is mathematical formalism’....‘heterodox paradigms share a rejection of mathematical formalism’.
- Lawson (2009e, p. 190) himself denies that he is ‘opposed to mathematical formalism per se’. What he is opposed to is ‘the abuse of mathematical formalism’ and to modeling based on isolated or atomistic optimizing individuals, the requirement to put arguments in a mathematical-deductivist form. (Lawson, 2013). Against micro-foundations of macroeconomics?
-

2.2 Mathematics and PKE?

- Several post-Keynesians endorse ‘the cautious use of formal methods in economics’ (Fontana, 2009, p. 39) or argue that ‘formalism is fine, but it must know its place’ (Chick, 1998, p. 1868).
- It is a source of tension between the various strands of PKE, and sometimes between PKE and other heterodox schools of thought.

3. Last candidate: open/closed systems

- Another defining dichotomy between orthodox and heterodox economics has been put forth by Lawson (1997) and Dow (2000). Heterodoxy would entail a belief in open systems, while orthodox economics would deal with closed systems.
- Dubious distinction, in my opinion, and that of John Smithin (2004, pp. 67-70) and Mearman (2006).

What about neo-Austrians and analytical marxism?

- They do not fit most of the criteria defining the heterodox paradigm.
- This is also Davidson's (1989, p. 469) assessment, who says that 'the Austrians have neither logically differentiated themselves from the neoclassical approach, nor raised major problems in it'.
- The same could be said about analytical Marxism (Mary Wrenn 2007, p. 102).

PART III

The presuppositions of post- Keynesian economics

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PKE adopt the five general heterodox presuppositions

- Realism, holism, reasonable rationality, production, the need to tame markets.
- Holism: See next slides on macroeconomic paradoxes
- Taming markets is required because post-Keynesians often underline *disequilibria and instability*.
- There are endogenous destabilising forces at work and price mechanisms cannot in general counteract upon these (example: labour market).
- The best examples currently are unemployment (Keynes) and financial instability (Minsky).

Distrust in unfettered markets

- « On the one side are those who believe that the existing economic system is, in the long run, a self-adjusting system, though with creaks and groans and jerks and interrupted by time lags, outside interference and mistakes On the other side of the gulf are those that reject the idea that the existing economic system is, in any significant sense, self-adjusting »
- Keynes, CW, xiii, p. 487 (1934)

Some general macroeconomic paradoxes that every policy maker should be aware of

Paradox of thrift (Keynes 1936, Robinson 1956)	Higher saving rates lead to reduced output or reduced growth
Paradox of public deficits (Kalecki 1971)	Government deficits raise private profits
Paradox of costs (Kalecki 1969, Rowthorn 1981)	Higher real wages lead to higher profit rates (activity, wage-led growth)
Paradox of profit-led demand (Blecker 1989)	Lower wages may lead to slower growth despite all countries being profit-led
The flexibility paradox I (Krugman 2012)	The more flexible wages and prices are, the more dramatic the perverse Fisher debt effect will be
The flexibility paradox II (Seppecher 2012, Dosi et al. 2016)	The more easily employers can hire and fire employees, the less employment there is

Some crisis-related macroeconomic paradoxes that every policy maker should be aware of

Paradox of tranquillity (Minsky 1975)	Stability is destabilizing
Paradox of debt (I. Fisher 1933, Steindl 1952)	Efforts to de-leverage might lead to higher leverage ratios
Paradox of liquidity I (Minsky 1986, Nesvetailova 2007)	Financial innovations seem to increase liquidity when in fact they are reducing it
Paradox of liquidity II (Dow 1987)	Efforts to become more liquid transform liquid assets into illiquid ones – the Minsky moment
Paradox of risk (Wojnilower 1980)	The possibility of individual risk cover (MBS, CDS) leads to more risk overall
Paradox of degrading standards (McCauley 2009)	Default rates are low because of the degradation of underwriting standards

Specific post-Keynesian presuppositions (Lavoie, Hein)

- Principle of effective demand
- Investment causes saving
- Monetized economy
- Historical and irreversible time
- Fundamental uncertainty
- Income distribution
- Institutions make a difference

Other PK candidates....

- Non-ergodicity
- Specific microeconomics
- Power relations
- Open systems
- Pluralism

What about econometrics and PKE I ?

- Lawson argues that the nature of the phenomena to be studied in economics is rarely appropriate for the use of standard econometric methods.
- Keynes (1973, xiv, p. 320) himself was rather pessimistic about the use of econometrics in macroeconomics, going so far as talking of 'statistical alchemy'.
- However, from the very beginning, there have always been post-Keynesians who 'defend the use of econometrics vigorously' (Norman 2008, p. 2), the best and earliest example, perhaps, being Kalecki.
- .

What about econometrics and PKE II ?

- ‘While Post Keynesians should be skeptical about prediction, this does not mean that they should abandon all empirical work’ (Holt, 2007, p. 101).
- Bill Mitchell (2007) says that policy makers require hard numbers for policy making, and these can be provided either by back-of-the envelope calculations or by econometrics.
- Econometrics is a powerful weapon in the battle of ideas. Economics is all about rhetoric (Deirdre McCloskey 1983).
- Katarina Juselius (2011) argues that general-to-specific cointegrated vector autoregression (CVAR) reflects post-Keynesian concerns about the non-stationarity of data and the importance of short-run dynamics

PART IV

The various strands of post- Keynesian economics

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The Hamouda and Harcourt (1988) 3-way typology

- They identify three strands:
- **The Fundamentalist** (American or Marshallian) Post Keynesians: Weintraub, Davidson, Minsky, Shackle
- **The Kaleckians**: Kalecki, Steindl, Asimakopulos, Eichner
- **The Sraffians**: Sraffa, Eatwell, Garegnani
- They admit that they don't know where to put Robinson, Kaldor, Goodwin, Godley, Pasinetti

The Lavoie (2010, 2014) 5-way current typology

- **Fundamentalist Keynesians:**
 - Money, liquidity preference, uncertainty, methodology
 - Davidson, Kregel, Chick, Dow, Rotheim, Tily, Hayes, Fontana
- **Kaleckians:**
 - Pricing, growth, cycles, employment, profits,
 - Sawyer, Bhaduri, Dutt, Blecker, Fazzari, Hein, Stockhammer,
- **Sraffians:**
 - Relative prices, capacity, normal profit rate,
 - Salvadori, Kurz, Roncaglia, Schefold, Serrano, Cesaratto, Stirati
- **Institutionalists:**
 - Institutions (firms, banks)
 - Fred Lee, Peter Earl, Arestis, Wray, Fullwiler, (MMT), Galbraith
- **Kaldorians:**
 - Growth, money, international, productivity
 - Godley, Thirlwall, McCombie, Palley, Skott, Setterfield, Storm, Naastepad
 - **Ecclectic authors go across all or at least two of the categories, for instance Nell, younger PKs**

PART V

Economic policy and current post-Keynesian research

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Theoretical constructs rejected by PK economists

- NAIRU or the natural rate of unemployment
- The loanable funds theory and the natural rate of interest
- Crowding-out effects (except for possible psychological effects)
- Say's law
- Inflation is a monetary phenomenon
- Aggregate employment determined in the labour market
- Higher saving leads to higher investment
- The government debt constraint is similar to that of households
- The efficient market hypothesis, in its various incarnations
- That unemployment is only due to sticky prices
- Bank reserves cause bank loans and deposits
- Unit cost curves have a U-shape

What defines Keynesians? Is it a belief

- In the existence of involuntary unemployment
- In the principle of effective demand and the paradox of thrift
- In the existence of an independent investment function

- That capitalism is the best system but that it needs to be tamed
- That markets, especially financial markets, are inherently unstable
- The need for fiscal counter-cyclical policies
- The need for capital movement impediments, managed exchange rates

- In animal spirits and fundamental uncertainty
- In path dependence, multiple equilibria, and hysteresis
- In the non-neutrality of money, the significance of liquidity
- The dangers of wage and price deflation

- In the existence of imperfections that thwart price adjustments

Current research (real side)

- Consumption determinants
- The balance-of-payment constraints on growth
- The demand-led determinants of the natural rate of growth (or NAIRU)
- Wage-led vs profit-led economies, debt-led vs export-led economies
- The impact of real wage increases on productivity
- The role of changes in income and wealth distribution on the financial crisis
- The relevance of fiscal policy (or monetary policy)
- Ecological economics
- Agent-based models ?
- Meta-regression analysis ?

Current research (monetary side)

- The integration of real flows with stocks of tangible and financial assets, along with flows of funds (SFC approach)
- Financial instability, household debt
- Financialization, shadow banking, finance capitalism vs managerial capitalism (micro and macro elements)
- The role of credit easing, quantitative easing, alternatives to inflation targeting
- The links between monetary policy, fiscal policy and the clearing and settlement system (chartalism, modern monetary theory)
- Public deficit and debt sustainability
- International trade and exchange rate arrangements
- The fundamental identity (financial domestic saving, public budget surplus, current account balance)

Conclusion: the future of PK economics

- Should PKE engage more with other social sciences?
- Should PKE engage more with other heterodox schools?
- Should PKE engage more with orthodox economists, in particular orthodox dissenters? How?
- **This is the topic of the panel discussion on Friday!**

