

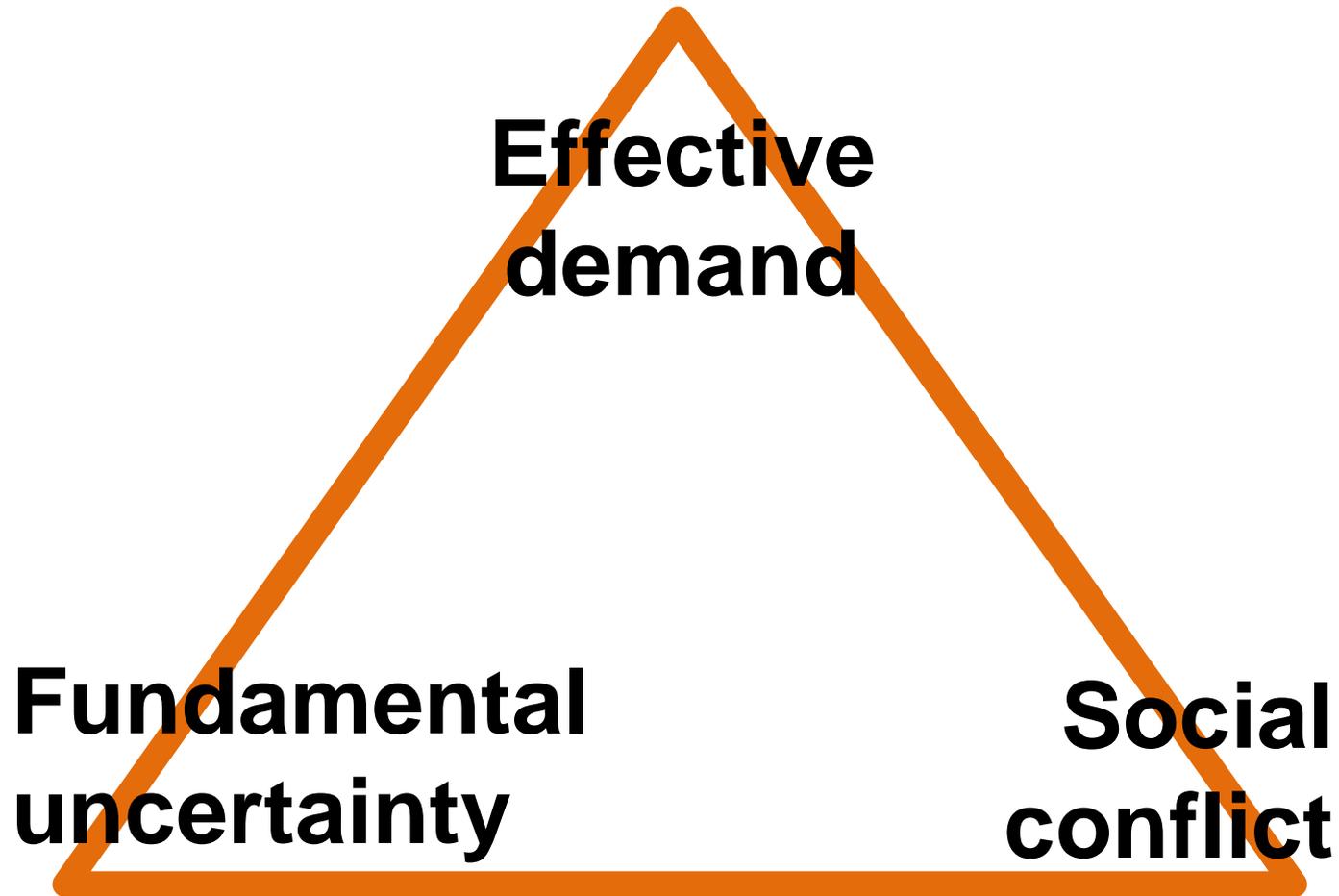
# Introduction to Post Keynesian Economics

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# Outline

- Foundations
  - Fundamental uncertainty
  - Social conflict
  - Effective demand
- Macroeconomics
  - Investment → savings
  - Involuntary unemployment
  - Credit → money
  - Financial instability
  - A few words on the supply side
- Context:
  - History of PKE;
  - Synthesis and New Keynesians
  - PKE and Marxian PE
- Economic Policy

# Post Keynesian Economics



# Fundamental uncertainty

- ‘we simply don’t know’
  - That’s a statement about the world, not about human cognitive abilities
- People can’t be ‘rational’, instead
  - They rely on conventions = look what other people are doing (social norms, anchoring, institutions)
  - Assume that the future is similar to the past (adaptive expectations)
  - Conventions can change rapidly (herd behaviour)
- Money as a means to deal with uncertainty → liquidity preference
  - Possibility of liquidity crises and panic
- Investment demand driven by animal spirits
  - Can’t make a ‘rational’ decision about long time horizon

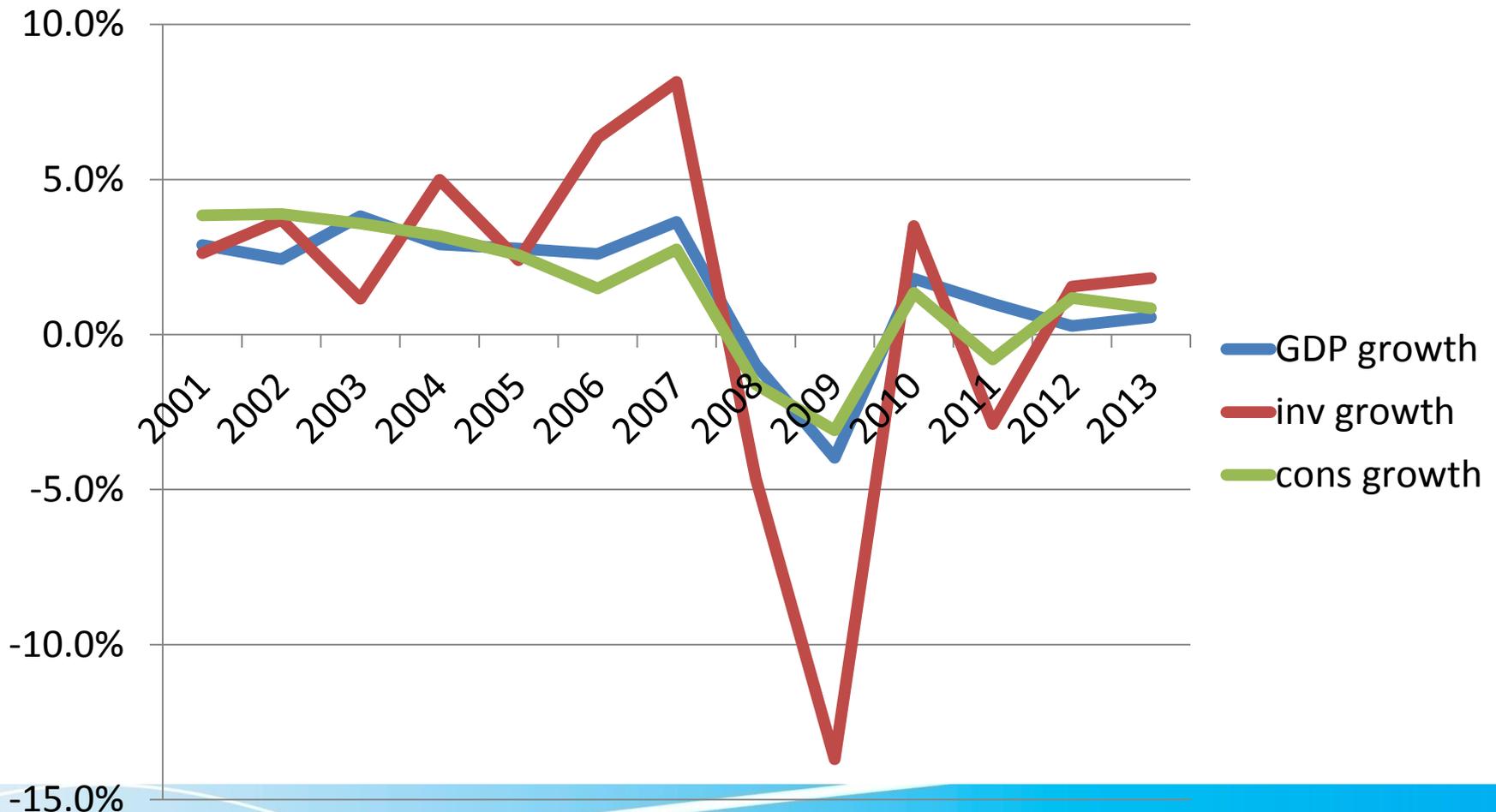
# Social conflict

- Distributional conflict
- PK models: often 3 classes: workers, capital, rentiers/financial capital
  - Capital hires labour; firing threat as disciplinary advise
  - Capitalists make investment decisions
  - Rentiers advance capital and receive interest + dividend payments
  - Have different consumption propensities
- Institutions regulate and mediate conflicts
- Inflation as the outcome of unresolved distributional conflicts
- Note: workers and uncertainty? job insecurity

# Effective demand

- $I(Y) = S(Y)$
- Investment  $\rightarrow$  savings via multiplier process
  - Investment not constrained by saving, but possibly by the availability of finance
  - Investment expenditures are the single most important determinant of fluctuations in GDP
  - Have strong non-rational component
- Private goods market equilibrium will in general not be at full employment equilibrium

# UK: investment, consumption, GDP



# Involuntary unemployment

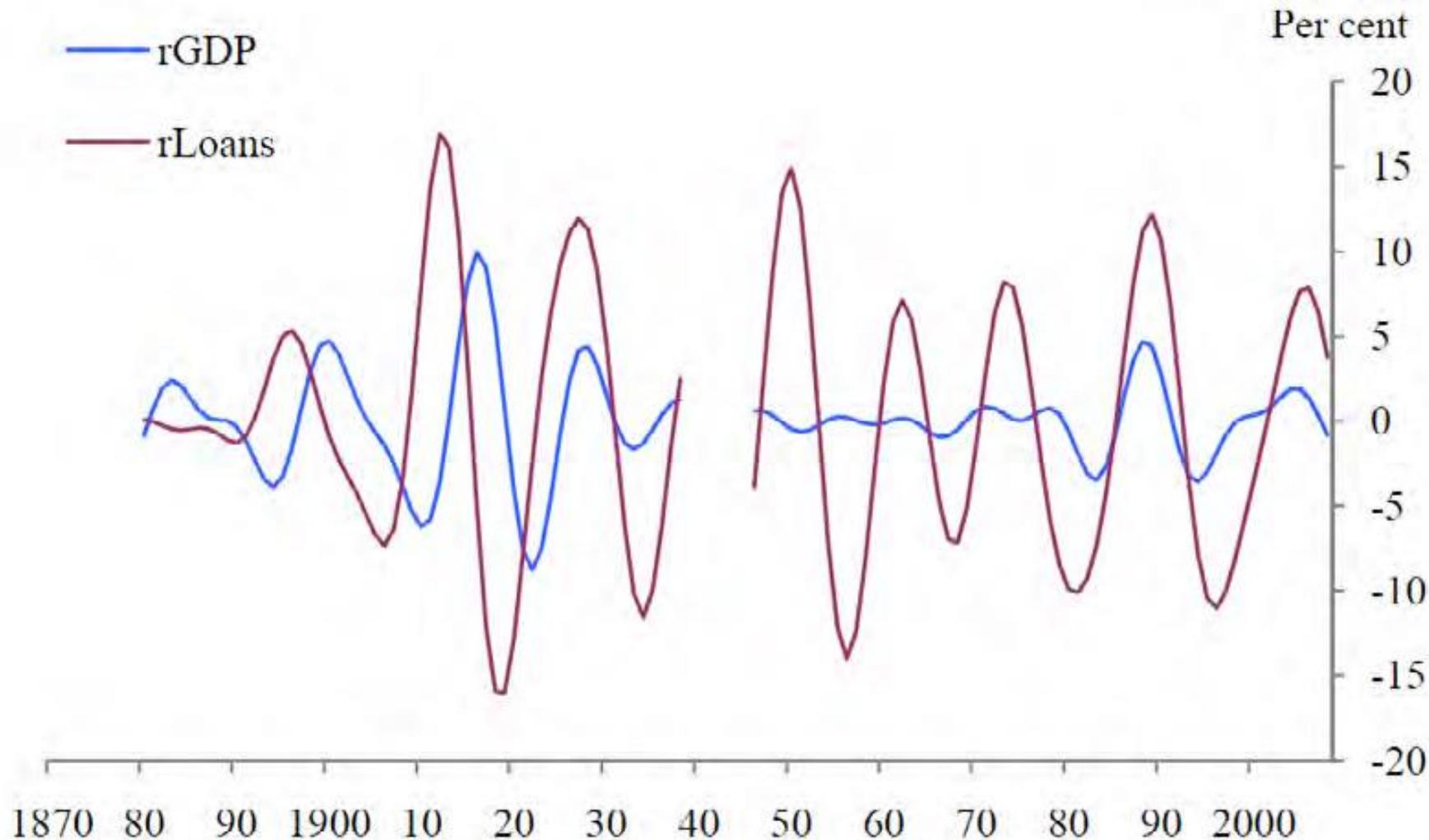
- Labour market is not self-adjusting; cannot serve as the anchor of the economy
- Wage contracts are nominal contracts
- Wage cuts → reduction in consumption demand
  - → downward pressure on prices
  - → possibility of debt-deflation spiral
- Real wage cut: workers have higher MPC than capitalists
  - → real wage cut will be contractionary unless investment is very sensitive to profit margins
- $\Sigma$  No self adjustment towards full employment
- Labour market dragged along with goods market; strong *hysteresis*

# Money & finance

- Endogenous money: credit → money
- CB sets the interest (base) rate
- Private financial institution mark up according to their liquidity preference (risk premium)
- Financial markets prone to instability b/e forward looking (fundamental uncertainty)
  - Debt cycles a la Minsky: during boom investors become willing to take more risk = higher leverage = system become more fragile → endogenous cycles
- Inflation as the outcome of unresolved distributional conflicts: if capital, labour and finance can't agree on their income shares

# UK: cycles in rLoans and rGDP

Source: Haldane (2012 BIS WP)



# A few words on the supply side

- Economy demand-led even in long run
- => supply must adjust
- Unemployment hysteresis -> endogenous NAIRU; endogenous labour supply (LF participation, migration)
- Induced technical change; dynamic returns to scale (learning by doing)
- **Latin-American Structuralism**: structural differences between core and periphery countries (different sectoral specialisations, associated with different export and import elasticities)
- **Balance of Payment constraint growth models** (Thirlwall): long-term growth determined by X,M-elasticities (and thus international division of labour)

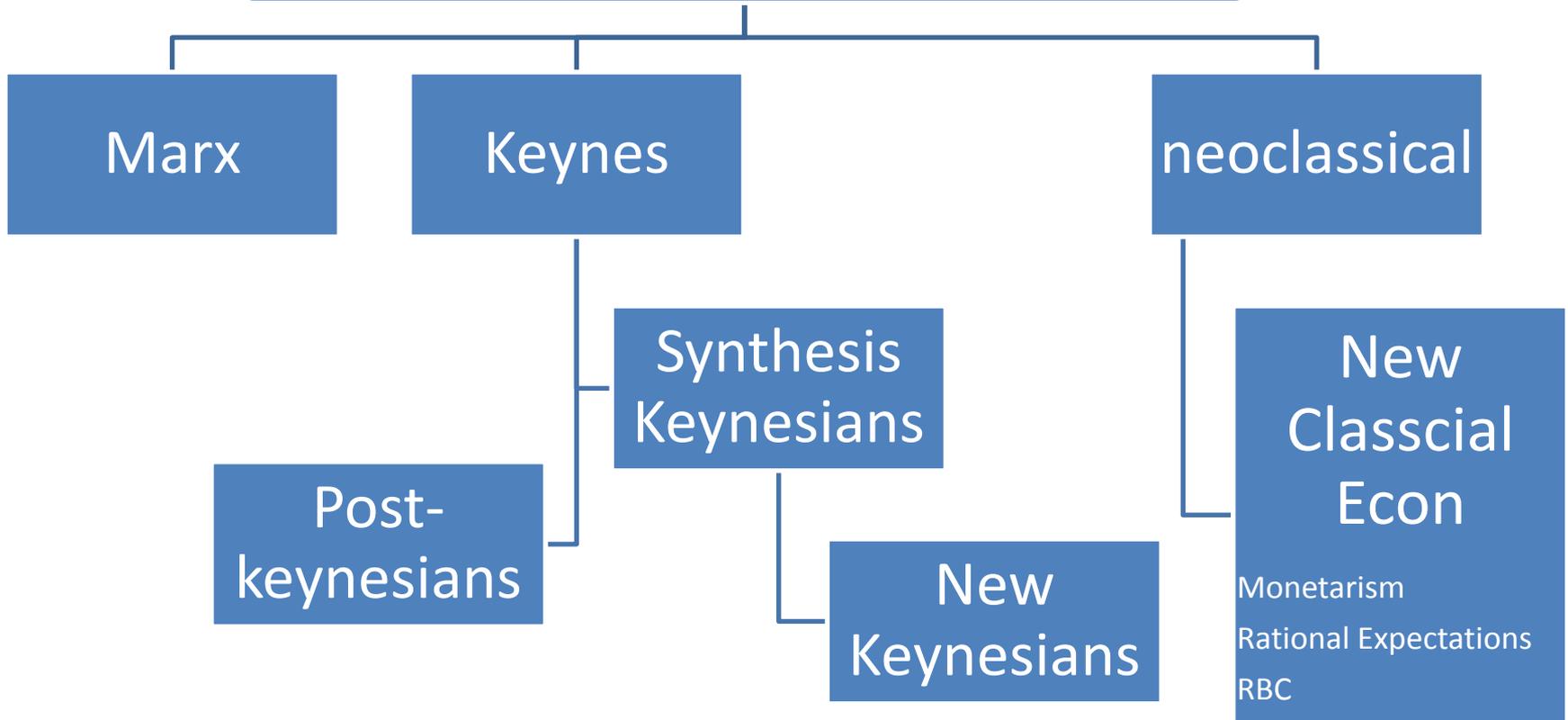
# PK: development and streams

- 1950s + 60s: Keynes in the long run – distribution and growth;
  - Capital Controversies;
  - critique of neoclassical-Keynesian Synthesis (ISLM etc)
  - Where? Cambridge
- 70s + after: formation of PK school (journals); spreading out
  - Conflict inflation; endogenous money
  - Shift towards short/medium run analysis (Kaleckian models): distribution and demand, wage-led growth
  - Financial instability (Minsky)
  - More on economic policy, more empirical
  - Where? Lost Cambridge -> spreading out (USA, continental Eu..)
- Streams
  - Sraffians: long run, distribution, technology and prices
  - Monetary Keynesians (incl. Minsky): uncertainty, money, short term
  - Kaleckians: social conflict, distribution, demand; short/medium term
  - Various other (often narrower streams): BoPC growth, SFC, MMT ...

# Neoclassical vs Keynesian theory

	Neoclassical theory	Keynesian theory
Key concepts	Rational behaviour, equilibrium	Effective demand, 'animal spirits'
Behaviour	Rational behaviour by selfish individuals	'animal spirits' (non-rational behaviour) and conventional
Markets	Market clearing ← prices adjustment	Some markets don't clear
Money	Classical dichotomy (money is neutral)	'money matters' (has real effects)
unemployment	Voluntary or due to rigidities	Involuntary, due to lack of demand on goods markets
policy	Laissez faire: markets are self-regulating and gov't should not intervene	market economies are unstable and result in unemployment → gov't should intervene

# Schools of thought in macroeconomics



# New Keynesians

- in 1980s (Mankiw, Blanchard, Stiglitz, Fisher)
- reaction to New Classicals - **accept microfoundations** and often rational expectations
- but assumes (or derives) **imperfect markets** –
  - menu costs,
  - NAIRU, insider outsider models
  - credit rationing / asymmetric information
- 1990s: “New Consensus Model” (New Keynesian-Neoclassical Synthesis):
  - again short run/long run dichotomy, but with strict microfoundations
  - Pseudo IS curve: downwards sloping because of intertemporal consumption

	<b>PKE</b>	<b>Marxian econ</b>
<i>scope</i>	Economic theory	Part of richer, interdisciplinary project (Historical Materialism)
<i>Demand</i>	Effective demand	Often assumes Say's law; demand ('realisation crisis') only in short run
<i>Production</i>	Little to say to production	Production as labour process
<i>Class analysis</i>	classes have different consumption propensities; only capitalists make investment decisions	Class struggle at site of production Class struggle -> theory of state
<i>Money &amp; finance</i>	Money is created by banks as side effect of lending Money to deal with uncertainty	Commodity theory of money: money is produced commodity
<i>unemployment</i>	Lack of effective demand; no tendency to full employment	Industrial reserve army necessary to discipline workers
<i>policy</i>	Normative: full employment policy; can also benefit capital	Reform futile within the capitalist system

# PK and mainstream economic policy

	Mainstream Policy Mix	Post Keynesian Policy Mix
Overall aim	Efficiency (minimal interference in markets)	Full employment
fiscal policy	Balanced budgets ('sound fiscal policy')	Countercyclical fiscal policy to ensure <i>full employment</i>
Monetary policy	Inflation targeting	Has to support growth; In recession with debt hangover: higher inflation allows rebalancing
Labour market	Encourage 'labour market flexibility' Wage as a cost factor	Institution building  Wages as source of demand
Financial market	financial liberalisation, trusts efficiency of financial markets	Regulate finance

# Illustrating different paradigms

	Austrians	Mainstream	PK	Marxist
Financial crisis	'too low interest rates'	Random shock; Wrong incentives to bank managers → excessive risk taking	Unregulated financial (animal spirits + endogenous credit) → boom-bust cycles	Reflects more fundamental contradictions of capitalism (exploitation)
Recession / unemployment	Economic crisis as cleansing process	Swift return to equilibrium	No built-in mechanism to return to full employment	Unemployment a normal feature; necessary to maintain discipline
Government interventions	avoid	May be useful in short run	Necessary for socially desirable outcomes	Futile in capitalism

# Reading suggestions

## **classics**

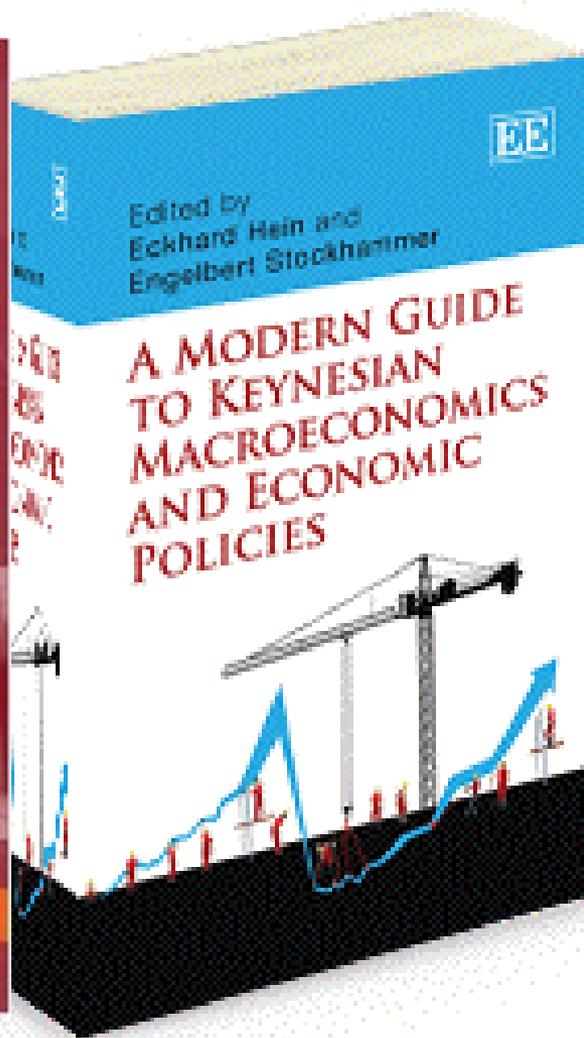
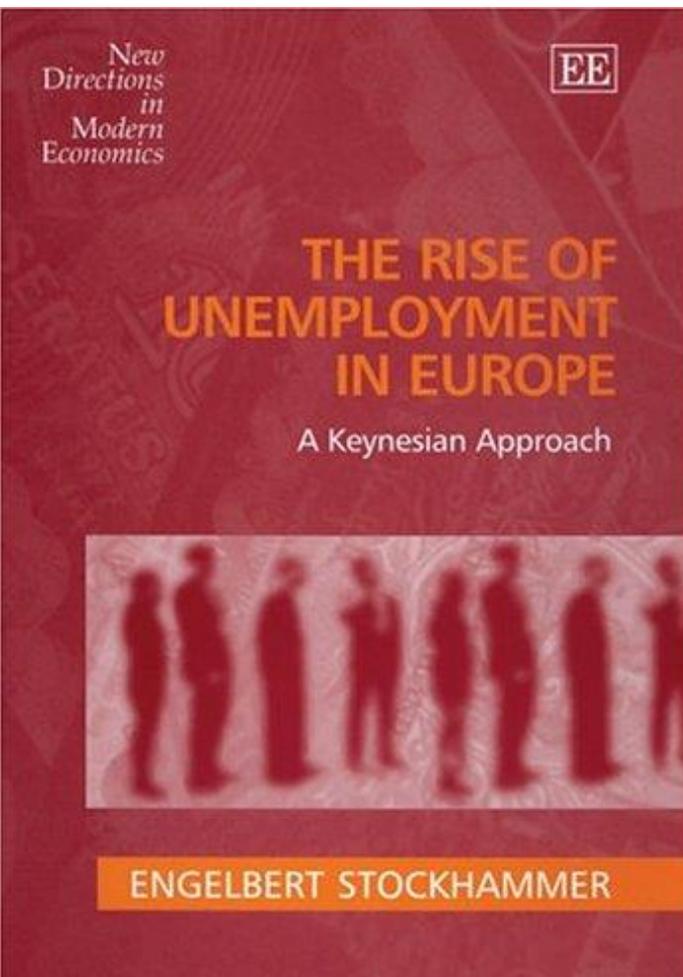
- Keynes: General Theory of Employment, Interest and Money
- Kalecki: Theory of Economic Dynamics
- Robinson: Accumulation of Capital
- Minsky: Stabilizing an Unstable Economy

## **Introductions, surveys, history**

- Lavoie: Introduction to Post Keynesian Economics
- Hein & Stockhammer: A New Guide to Keynesian Macroeconomics and Economic Policies
- King: History of Post Keynesian Economics

# Conclusion: PKE

- foundations
  - Fundamental uncertainty
  - Social conflict
  - Effective demand
- Macroeconomics
  - Investment → savings
  - Involuntary unemployment
  - Credit → money
  - Financial instability



**ADVANCES IN LABOUR STUDIES**

Edited by  
Marc Lavoie and Engelbert Stockhammer

**WAGE-LED GROWTH**

An Equitable Strategy  
for Economic Recovery



# Appendix



*PKSG & PERG*

# An Introduction to Post Keynesian Economics and Political Economy

14-16 July 2016,  
Kingston University  
*E Stockhammer, M Sawyer, V  
Chick, S Mohun, O Onaran, S  
Keen, G Dymski*

[http://fass.kingston.ac.uk/research/perg/  
events/](http://fass.kingston.ac.uk/research/perg/events/)

- PKSG Annual Workshop, June
- FMM conference, Oct
- FMM summer school, Aug, every other year
- PKSG email list  
<http://www.postkeynesian.net/>

# PK goods market: basic multipliers

- Standard Keynesian multiplier
- $C = c_1 \cdot Y + c_0$
- $I = I_0$
- In equilibrium
- $Y = C + I_0$
- $Y^* = 1/(1-c_1) \cdot (C_0 + I_0)$

# Different consumption propensities for profit income and wage income

- $C = c_W \cdot W + C_R \cdot R$        $\pi = R/Y$  (profit share)
- $C = c_W \cdot (1-\pi) \cdot Y + C_R \cdot \pi \cdot Y$
- $Y = c_W \cdot (1-\pi) \cdot Y + C_R \cdot \pi \cdot Y + C_0 + I_0$
- $Y^* = 1/(1 - c_W + \pi[c_W - C_R]) \cdot (C_0 + I_0)$
  
- If workers don't save:  $c_W = 0$
- $Y^* = 1/\pi(1 - C_R) \cdot (C_0 + I_0)$
- $dY^*/dI_0 = 1/\pi(1 - C_R)$
- $dY^*/d\pi = -1/\pi^2(1 - C_R) < 0$

# Wage-led versus profit-led demand

- $Y = C + I + NX$
- Increase in profit share
  - Negative effect on consumption
  - Positive effect on investment
  - Positive effect on net export (for an individual country)
- $Y = C(Y, \pi) + I(Y, i, \pi) + NX(Y, \pi; Y^W, ex)$ 
  - $Y$  income,  $i$ .. Interest rate,  $\pi$ ..profit share,  $D$ ..debt,  $Y^W$ ..world GDP,  $ex$ ..exchange rate,  $P$ .. price level,  $p$ ..inflation
- $dY^*/d\pi = h_1/(1-h_2)$
- $h_2 = dC/dY + dI/dY + dNX/dY$
- $h_1 = dC/d\pi + dI/d\pi + dNX/d\pi$
- $neg + pos + pos = ??$ 
  - If  $h_1 > 0$  profit-led demand
  - If  $h_1 < 0$  wage-led demand

# Net Effects: $\Delta Y/\Delta WS$

*Effects on private excess demand*

	<i>EU 12 (openness 15%)</i>	<i>Austria (openness 50%)</i>
Consumption	0.37	0.36
Investment	-0.07	-0.15
<i>Domestic sector</i>	<i>0.30</i>	<i>0.21</i>
Net exports	-0.09	-0.39
Total effect	0.21	-0.18

# Comments about the state of 'Economics'

- Theoretical and methodological monoculture ('neoclassical economics')
  - Microfoundations (rational behaviour)
- a scholastic science: self-referential
  - Journal ratings
  - RAE/REF
- Has proven utterly dysfunctional as regards the crisis
  - CB models don't have a role for the financial sector or bankruptcies
  - DSGE models regard the crisis as a 'random shock'
  - EMH has encouraged financial deregulation

# Teaching Economics: pluralism!

- Different theories: neoclassical, New Keynesian, neo-Austrian, Post Keynesian, Marxist, Behavioural Econ
- Problem-oriented (as opposed to theory guided):
  - Topics like unemployment, financial crises ...
- Economic history!
- Should encourage methodological pluralism: quantitative as well as qualitative methods

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# PKE and Ecological Economics

- For long time little interaction (hetecon is highly segmented)
- Recently attempt from both side
- Similarities: market economies don't generate optimal outcomes; non-rational behaviour, uncertainty, hysteresis, explosive dynamics, concern for equality
- Tension: EE often de-growth, PKE often pro-growth
  - PKE: analytical: demand (animal spirits, finance etc) *does determine* growth; normative: capitalist growth normally not sufficient for *full employment*
  - EE: normative: ecological constraints = supply-side constraints *should* determine growth in order to stay within ecological boundaries (*sustainability*)
- Synthesis?
  - Need a framework that has social as well as environmental externalities
  - Need a modes of production approach to theorise non-capitalist employment relations