Introduction to Post Keynesian Economics

Engelbert Stockhammer
Kingston University
Outline

- Foundations
  - Fundamental uncertainty
  - Social conflict
  - Effective demand
- Macroeconomics
  - Investment $\rightarrow$ savings
  - Involuntary unemployment
  - Credit $\rightarrow$ 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

Effective demand

Fundamental uncertainty

Social conflict
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 contract are nominal contracts
• Wage cuts $\rightarrow$ reduction in consumption demand
  • $\rightarrow$ downward pressure on prices
  • $\rightarrow$ possibility of debt-deflation spiral
• Real wage cut: workers have higher MPC than capitalists
  • $\rightarrow$ 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
- \( \Rightarrow \) supply must adjust
- Unemployment hysteresis \( \Rightarrow \) 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

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

- Marx
- Keynes
- Synthesis Keynesians
- Post-Keynesians
- New Keynesians
- New Classical Econ
  - Monetarism
  - Rational Expectations
  - RBC
- Neoclassical
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 intertertemporal consumption
<table>
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<tr>
<th><strong>PKE</strong></th>
<th><strong>Marxian econ</strong></th>
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<tbody>
<tr>
<td><strong>scope</strong></td>
<td>Economic theory</td>
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<tr>
<td><strong>Demand</strong></td>
<td>Effective demand</td>
</tr>
<tr>
<td><strong>Production</strong></td>
<td>Little to say to production</td>
</tr>
</tbody>
</table>
| **Class analysis** | classes have different consumption propensities; only capitalists make investment decisions | Class struggle at site of production  
Class struggle -> theory of state |
| **Money & finance** | Money is created by banks as side effect of lending                            | Commodity theory of money: money is produced commodity |
|               | Money to deal with uncertainty                                                   |                                                                 |
| **unemployment** | Lack of effective demand; no tendency to full employment                      | Industrial reserve army necessary to discipline workers |
| **policy**   | Normative: full employment policy; can also benefit capital                      | Reform futile within the capitalist system |
# PK and mainstream economic policy

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<tr>
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<th>Mainstream Policy Mix</th>
<th>Post Keynesian Policy Mix</th>
</tr>
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<tbody>
<tr>
<td>Overall aim</td>
<td>Efficiency (minimal interference in markets)</td>
<td>Full employment</td>
</tr>
<tr>
<td>Fiscal policy</td>
<td>Balanced budgets (‘sound fiscal policy’)</td>
<td>Countercyclical fiscal policy to ensure <em>full employment</em></td>
</tr>
<tr>
<td>Monetary policy</td>
<td>Inflation targeting</td>
<td>Has to support growth; In recession with debt hangover: higher inflation allows rebalancing</td>
</tr>
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</table>
| 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

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

- 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
- \( C = c_1.Y + c_0 \)
- \( I = I_0 \)
- In equilibrium
- \( Y = C + I_0 \)
- \( Y^* = 1/(1-c_1).(C_0+I_0) \)
Different consumption propensities for profit income and wage income

- \( C = c_W W + C_R R \)  \( \pi = R/Y \) (profit share)
- \( C = c_W (1 - \pi) Y + c_R \pi Y \)
- \( Y = c_W (1 - \pi) Y + c_R \pi Y + c_0 + I_0 \)
- \( Y^* = 1/(1 - c_W + \pi [c_W - c_R]).(c_0 + I_0) \)

- If workers don’t save: \( c_W = 0 \)
- \( Y^* = 1/\pi (1 - c_R). (c_0 + I_0) \)
- \( dY^*/d I_0 = 1/\pi (1 - c_R) \)
- \( dY^*/d\pi = -1/\pi^2 (1 - c_R) < 0 \)
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
- \( \frac{dY^*}{d\pi} = h_1/(1-h_2) \)
- \( h_2 = \frac{dC/dY + dl/dY + dNX/dY}{dC/d\pi + dl/d\pi + dNX/d\pi} \)
- \( h_1 = \frac{dC/d\pi + dl/d\pi + dNX/d\pi}{dC/d\pi + dl/d\pi + dNX/d\pi} \)
  - 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**

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