How to recognize a Good Post Keynesian

Prologue:

I wrote this while preparing my part of a chapter in Geoff Harcourt's forthcoming ***Handbook of Post Keynesian Economics*** to which Ken Coutts of Cambridge and I are contributing various parts on industrial pricing, trade and tariff policy, pass-through effects and exchange rate impacts. As we did the research and contemplated what people told us we realised that: (1) there is already a large and not very succinct literature on the properties and meaning of Post Keynesian economics; (2) it needs to be pulled together, crisply; and (3) Post-Keynesians disagree fervently among themselves, even on whether to put the hyphen between Post and Keynesian! Bravely, I have assembled these notes which are running the gauntlet among Post Keynesians and others. To say the least, comments of any kind are very welcome. I have a larger version of this in draft which subjects much allegedly Post-Keynesian price and tariff analysis to the tests I have assembled below. Provisional Finding[1]: we are all 'bastard Keynesians' if Keynesians, Post or otherwise, at all. However, there are some distinguishing features that are notable in large measure in most Post-Keynesian writings, models and hypotheses. Thus this note seems warranted. Neville N (n.norman@unimelb.edu.au) Cambridge 26.x.08. Melbourne 16.xii.08

What are the central general and distinguishing features of Post-Keynesian (PK) economics? We have a list. This is a demanding list. It reminds one of Shackle's quips about identifying a 'complete economist': it dispenses at once of the notion that there are, or ever have been, any complete ones.[2] It may help to define our boundaries. Some PKs may look or try to look like Karl Marx; alas personal characteristics are unreliable criteria for detecting allegiance. In the end, a PK economist or approach is defined by emphasis and example. We comment on these details as we progress. This list goes further and deeper than a plain enumeration of assumptions about 'the economy' commonly found in the PK literature, though that enumeration is fully incorporated and adopted here. We also begin with general PK criteria before moving to background features governing what can be described as PK pricing approaches in particular. This approach is bound to be controversial because of the considerable time spent by PKs trying to define themselves and because of the divisions within PK economists that this process exposes.

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1 Joan Robinson relentlessly reminded many of us that Keynes persistently contended that all academic conclusions were provisional ones, subject to being refined and refuted by subsequent inquiry and evidence. Keynesians frequently claim greater humility that other economists. I say the jury is out on that one! (NRN)

2 G L S Shackle (1955) p. 241. Shackle went on to give a short list of guide notes on how to recognize someone not wholly confounded by economic and financial matters. Here the answer lies in describing issues and criteria that are important to PK philosophy and which not generally shared by other schools of economics.

A. Motivation.

A PK economist is dominated by the desire to understand intimately the workings of the economic and social system and to focus attention on methods, models and matters that will actually help people, now or in the future; to look beyond immediate issues of the day; to explain as well as to predict, and not to enforce or selectively propound economics of a kind that by predilection supports preconceived viewpoints. Realism and relevance replace paranoia parading positive predictability. (My paraphrase of Lawson, 1989). But realistic idealism pales into tragedy when realism requires detail that is too great to carry in the head or to communicate, even to committed scholarly audiences. However, PKs are conscious of the linkage of social and political phenomena from and to narrower versions of economics epitomised by markets, prices, firms, growth rates, incomes and all relevant monetary values. In performing their task, PK economists take a broader view of individual and institutional motivations behind decisions than non-PK (NPK) approaches commonly do. Some who reject PK economics will claim similar motivation; some PKs betray it.

B. Methods of Analysis

PK economics need not be any less scholastic, or rigorous, than NPK approaches. Maths and econometrics can be involved, though a PK economist will be more conscious of the restrictions and limitations of condensing human psychology into manageable mathematics. Many PK economists are competent technicians; they are just more careful and guarded about it. For example, while PK economists may be well capable of using the calculus to derive something as arcane as the price-cost margin assuming exact and known demand (average revenue) functions and single-period full-information profit maximization pricing goals, they should imagine while doing this that their stomachs feel as they would after ingesting barrels of green apples. They should also explain and communicate their objections. Some PKs defend the use of econometrics vigorously. Paul Downward and his co-authors provide outstanding examples (Downward, Finch et al. 2002; Downward and Mearman 2003; Downward and Mearman 2004). We concur with them.

Most PKs argue that there needs to be some connection back to the writings of J. M. Keynes[3] (which writings?)(or Marx, or Kalecki, or Joan Robinson), and this is best illustrated by deeper consideration of the assumptions about the workings of the economy as detailed in section E below.

Predictive ability is not a sufficient test to certify good economics, according to most PKs; there must be explanation and understanding of the entire economic (and probably social and institutional) process in a PK approach. An attempt to understand the causes of an economic event is important. This is not to dismiss prediction tests, because approaches that cannot reliably predict are plainly not addressed to the circumstances they purport to explain. PKs are just saying prediction is not enough, and it can be an

[3]Arestis's (1992) p.ix emphasizes this aspect of PK delineation from the start.

unreliable guide. The priority given to explanation and understanding means that there is scope for plural research methods to be used in understanding events: economics should be defined by subject matter not analytical method (Runde 1998; Lawson 2003; Dow 2004; Downward and Mearman 2006).

There needs also to be explicit rejection of central features of the grand neo-classical synthesis, if an approach is to be genuinely counted as PK. This is a theme on which Philip Arestis's (1992) treatment of Post-Keynesianism is based.[4] John King (King 2003) concurs.

C. Momentum: The Treatment of Time.

PKs profess to work in chronological time rather than logical time, and frequently they do. Strangely, economic hypotheses based on chronological time dovetail far better with the data and methods of modern time-series econometrics, which some PKs reject, than static classical approaches. There is a genuine difficulty here in that much work that professes to be PK economics is erected on a timeless or one-period framework, akin to most neo-classical theories. To count such work as PK we may be to excuse its failure to meet this test, providing it scores well enough on the other criteria. We need thus to say much more about this test and to discipline ourselves to what adherence to its strictures means for our work. Dates and delays do matter, and PKs need to emphasise that more firmly; but the same could well be claimed for much NPK work, such as models expressed in difference and differential equations and in the dynamic optimisation literature.

The economic system is always evolving in PK treatments. It might be useful to say something like the following: We can take snapshots of the economic system, but the evolutionary process is always uppermost in the mind of the PK economists, even if conventional-looking diagrams are used to communicate relationships, feasible zones and stopping points.

D. Information presumed by decision makers in the economy

Uncertainty is the dominant description of the state of information available to decision makers depicted in PK economics.[5] PK economics rejects rational expectations.[6]Equally, full information models such as imperfect competition cannot strictly qualify for anything like PK economics, even though they may be used to derive some findings and policy implications that PJ economists might be tempted to share. Decision makers in the world embraced by PK economics normally proceed with consciously imperfect information. The underlying decision-making environment of substantial uncertainty is quite central to

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[4] Arestis, chapter 2 especially. Also King (2003), p. xiv

[5] Arestis (1992) pp 90-1

[6] Arestis (1992) Chapter 1

nearly all heterodox approaches in economics; orthodoxy claims to incorporate it, by certainty-equivalence and paranoia over precision and exact solutions, betray the apparent commitment to incomplete information in orthodox economics. In pricing analysis, any approach that uses seriously and relies upon an exact demand/average revenue function presumed to be known in all its manifestations in all relevant time periods contradicts this important pre-requisite for PK economics.

Uncertainty and historical time in Post Keynesian economics have particular implications for role of money in the economy. Money is the mechanism through which transactions in the real economy are managed over time and this means that the real economy can not be considered separately from its financial institutions. This is expressed by Post Keynesians in arguments about the non-neutrality of money (Davidson 1987; Davidson 1988; Minsky 1993).

E. Assumptions about How the Economy Operates

This sub-set of requirements for PK economics is derived from the study of many PK theories or approaches and from specific reflective writings of economists seeking to describe and delineate PK economics.

E.1: Inherent instability of the economic system:

While the economic system can be observed at places of rest, there are always disturbing undercurrents that make equilibrium and steady-state growth paths inoperable, unobtainable or undefinable. Cycles around any statistically-defined trend are not regular or predictable; indeed their causes are never fully known; and known causes are accumulated in the course of an economy's development. Stages or epochs associated with different economic and social orders can be observed, each one generating forces to question and change them. This feature is borrowed from Karl Marx. PK economists should be seizing the opportunity to advance the role and insights of PK economics in the light of the global financial crisis from late 2007.

E.2 Capacity Slackness and demand determination of actual output:

Effective demand determines output volumes up to a capacity limit which is seldom ever reached; productive capacity is in any event expanded as soon as it is perceived to be limiting. This is the part of PK economics that most owes its allegiance to J M Keynes. Investment is not supply or savings constrained; it is limited by decisions, imagination, regulations and opportunities perceived by business firms. At the micro level, if cost functions are admissible in PK economics they should not reflect in their shape, slope or adjacent defining conditions any boundaries or constraints that arise from aggregate saving or more specific industry or firm-based capacity limitations. At the micro level, the PK capacity assumption and output determination mechanics can be expressed in more orthodox language by saying that income effects will tend to dominate substitution effects[7]. Again, PK economics solidly supports the use of stimulus packages while purchasing power has collapsed. Hardly any nation failed to adopt such packages in 2008: hardly an NPK dared publicly to oppose them. (Did PKs do enough to show the role and relevance of PK economics at this time?)

E.3 Power-based industry structure:

Significant market power being used in price setting and adjustment, product selection, the technique of production and its location is the general working of the producing sector. Oligopoly is the main market form in PK economics. This does not mean that orthodox 'imperfect competition' can possibly qualify as meeting this test, because there are other criteria that must be read in conjunction with the important general indicia, especially the stricture that imperfect information pervades consciously in the minds of all relevant decision-makers.

E. 4 Distorted or Administered Prices and Wages:

There is no simple market-clearing determination of prices and wages. Wages and prices exhibit limits and administered aspects[8]; in general there is a dominant cost determination of prices, with demand conditions playing little or no role in their formation and adjustment. The origins of this part of the PK approach stem back the Oxford research group of the 1930s and before that to Marx. These PK pricing premises, are strongly affirmed in nearly all survey and econometrics tests, even in the face of international competition, as reported in Coutts and Norman (2007).

E.5 Distribution Relevance as Goal and Determinant:

Income and wealth distribution are both important outcomes of the economic processes and are significant determinants of prices, output, industry structure, demand patterns, emotions, social actions, agitation, political activity, each considered with the set of economic phenomena by PK economists. Specifically, income and wealth distributions are not exogenously determined, or expressible or derivable from marginal productivity relationships or market-clearing processes. They arise from the interaction of social struggles, inheritance and endowments, regulations and differential opportunities available to different sectors of society.

[7] As they do even in many orthodox approaches in economics, such as the impact of tax rates on work effort, causing orthodox economists to resort to such pejorative and predilective descriptions as the backward-bending supply curve.

[8] Arestis (1992) pp 92-4

F. A Comparison with Criteria for PK Economics as developed by Other PK Economists

We can relate our own list of how to detect a complete or good PK economist to some well-known criteria in the PK literature that has been devised by others to define PK economics. There is a conservable overlap, but also considerable differences in emphasis. It can also be see, by applying any of these sets of tests, that many renowned PK approaches do ***not*** meet a large number of these demanding requirements for genuine or good PK economics.

1. **Paul Davidson's 1982 six-part list** involves the commitment to historical time (C above); uncertainty as the relevant background assumption for decision makers (D above); institutional determination of prices and wages (E3-4); the central relevance of distribution of income and wealth (E5); the requirement that real capital is malleable and reflects time-based experience (C, E2); and that income effects dominate substitution effects (E2).

2. **Alfred Eichner's (1987) list** also involves six conditions, expressed differently: there is an unstable economy which exhibits persistent cycles (E.1); there is an institutional determination of income and wealth distribution not expressible through marginal productivity relationships (E.4-5); uncertainty stands as the dominant information basis for making business, regulatory and other economic policy decisions (D); absorption or income-based closure conditions complete macro models rather than market clearing conditions (E.4); imperfect markets with power forces dominate price and quantity determinations in markets (E.3); and (PK) theory must explain and not merely predict economic behaviour (condition B).

3. **John King's *Elgar Companion to Post Keynesian Economics* provides** a further delineation of PK economics from orthodoxy. The essential PK features are stated as "the dominance of effective demand rather than supply in determining the main economic (variates)" (E.2 in our list). King also makes it mandatory that genuine PK economics involves and emphasizes the rejection of the grand neo-classical synthesis (King (2003) p.xiv). (The final part of condition B. above). We argue that much more than this needs to be enumerated to nail down the genuine PK approach. In detail but indirectly King provides some of it, but it is not given there in a crystallized form. Thus our more schematic and structured account of PK conditions above.

4. John King likes and kindly drew my attention to **Tony Thirlwall's description** of what John describes as a **"reasonable minimum platform for PK economists"[9]**

[9] Cited as Thirlwall (1993) in King (2002)

> *output and employment are determined in the product market, not the labour market; involuntary unemployment exists; an increase in savings does not generate an equivalent increase in investment; a money economy is fundamentally different from a barter economy; the Quantity Theory holds only under full employment, with a constant velocity of circulation, while cost-push forces cause inflation well before this point is reached; and capitalist economies are driven by the animal spirits of entrepreneurs, which determine the decision to invest (Thirlwall 1993, pp. 335-7).*

We can take Tony Thirlwall's list as a re-expression of E2, E3 and E4 without explicit reference to our other criteria addressing the decision-making (micro) environment, but with the valuable addition of some monetary and macro background features.

5. **Marc Lavoie's approach.** Marc Lavoie (1992) sets up the ambitious objective of providing a "coherent set of (PK) theories that can provide an alternative to the dominant neoclassical paradigm… (arguing that) microeconomic foundations can be associated with post-Keynesian economics, and that these are consistent with its macroeconomics." (Lavoie 1992, p1)

   Lavoie admits that PK "is rather vague and has been used to define different sorts of economics and economists. As a first approximation, I shall define post-Keynesians as those economists who are extending and generalizing the seminal ideas of the unorthodox economists of the 1950s, most notably...Joan Robinson, Richard Kahn and Nicholas Kaldor." (p.1) Lavoie argues that it is necessary to jettison Keynes's own price theory (and probably the aggregative supply function) as they are "too closely associated with the neoclassical views to be kept within the synthesis" (p.3)

It seems a defining feature of the good Post-Keynesian economist to **ignore the open economy**, frequently doing so both consciously and apologetically. For instance, Marc Lavoie (1992, in the Preface at p. vii) honestly describes his conscious omission of "the consequences of an open economy" as "the main drawback of this book." Indeed, throughout the life of the *Journal of Post Keynesian Economics* only a handful of contributions have adopted an explicitly open economy. Perhaps really good Post Keynesians will in time repair this imbalance and significant omission. My own attempt to start this process is at Norman (1996); in good PK tradition that approach does not pass all the tests that are set out above for good PK economics.

The case for being conscious of what really constitutes PK economics is made out by observing how easily we can stray from it. It is useful to use our list of PK requirements to assess some work that is commonly presented as PK economics, especially in the areas of micro or pricing analysis all too frequently, some of this work seems to struggle or to lose the plot. For example in Nina Shapiro and Tracy Mott's contribution as Chapter 3 in Paul Wells's useful collection of PK essays, the authors rightly identify as PK pricing hypotheses those that present prices as being made by firms with discretion and power and which are based on costs. The treatment of the mark-up then descends into neo-classical territory or simply rank confusion: "When the product is priced in the market, its price depends on the particularities of its sale rather than those of production..." (Wells 1995 p. 36). Things go really off the rails when the authors suggest that Kalecki-type firms charge the "profit-maximizing price" (Wells 1995, p. 40). It is strange that there is no attempt in Wells (1995) to set out the general features of PK economics and very little detail of the PK pricing models that Shapiro and Mott seem to want to embrace.

G. Concluding Remarks.

The upshot of this assembly and survey seems to be this: There are no pure Post Keynesians. There is a significant band of economists with a significant attachment to the central Post-Keynesian ideas at a time when alternative economic doctrines are destined to be noticed and perhaps even heeded. We can all make an effort to be better Post Keynesians. Nobody's perfect! But is it not the hallmark of a Good Post Keynesian to present and promulgate imperfections?

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