

PHILIP ARESTIS AND
THANOS SKOURAS

POST KEYNESIAN ECONOMIC THEORY

A Challenge to
Neo Classical
Economics

POST KEYNESIAN ECONOMIC THEORY

A Challenge to
Neo Classical
Economics

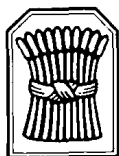
Edited by

PHILIP ARESTIS

*Head of Economics Division
Thames Polytechnic*

THANOS SKOURAS

*Head of Department of Applied Economics
North-East London Polytechnic*



WHEATSHEAF BOOKS · SUSSEX

M. E. SHARPE, INC. · ARMONK, NEW YORK

First published in Great Britain in 1985 by
WHEATSHEAF BOOKS LTD

A MEMBER OF THE HARVESTER PRESS PUBLISHING GROUP

Publisher: John Spiers

Director of Publications: Edward Elgar

16 Ship Street, Brighton, Sussex

and in the USA by

M.E. SHARPE, INC.

80 Business Park Drive, Armonk, New York, 10504

© Philip Arestis and Thanos Skouras, 1985

British Library Cataloguing in Publication Data

Post-Keynesian economic theory: a challenge to
neo-classical economics.

I. Economics — History — 20th century

I. Arestis, P. II. Skouras, Thanos

330.1 HB87

ISBN 0-7450-0027-4

Library of Congress Cataloging in Publication Data

Main entry under title:

Post-Keynesian economic theory.

Bibliography: p

Includes index.

1. Economics — History — 20th century — Addresses,
essays, lectures. 2. Keynesian economics — Addresses,
essays, lectures. 3. Neoclassical school of economics —
Addresses, essays, lectures. I. Arestis, Philip,
1941- . II. Skouras, Thanos, 1943

HB87.P62 1985 330'.09'04 84-23615

ISBN 0-87332-318-1

ISBN 0-87332-319-X (pbk)

Typeset in 11/12 point Times Roman by

Alacrity Phototypesetters, Banwell Castle, Weston-super-Mare

Printed in Great Britain by Whitstable Litho Ltd., Whitstable, Kent

All rights reserved

THE HARVESTER PRESS PUBLISHING GROUP

The Harvester Press Publishing Group comprises Harvester Press Limited (chiefly publishing literature, fiction, philosophy, psychology, and science and trade books), Harvester Press Microform Publications Limited (publishing in microform unpublished archives, scarce printed sources, and indexes to these collections) and Wheatsheaf Books Limited (a wholly independent company chiefly publishing in economics, international politics, sociology and related social sciences), whose books are distributed by The Harvester Press Limited and its agencies throughout the world.

Foreword

A. S. Eichner

One frequently sees reference in the post-Keynesian literature to an important article which has appeared as one of the *Thames Papers in Political Economy*, and yet even post-Keynesians may have trouble identifying the source. Were they to surmise that it is merely another journal, housed at some university, they would lack an important clue as to why the *Papers* have played so conspicuous a role in the development of post-Keynesian theory, for the explanation may well lie in the fact that the *Thames Papers* are not a typical journal housed at a major university — or indeed, not even a journal at all.

The *Thames Papers* are published three times a year by Thames Polytechnic, in south-east London, close to Greenwich. While most British readers will be familiar with the polytechnics, other readers may need to be told something about them. The nearest equivalent in the United States would be an institution of higher education with the local ties and technical focus of a community college, the academic standards of a state college and the degree-granting powers of a university. The faculty members in the polytechnics are expected to serve primarily as teachers, rather than as researchers, and this emphasis has had the effect of creating an environment, at least in so far as economics is concerned, which is especially conducive to the type of free inquiry in which institutions of higher education are supposed to engage (the pressure to 'publish or perish' under which academics at more prestigious institutions find themselves, whatever its effect on scholarly output in quantitative terms, does not appear to encourage the same openness to new ideas). While

there are only a few economists in the faculty at any one polytechnic, together they constitute a considerable number who, as a practice not always observed elsewhere, attend each others' seminars and conferences. It was in this environment that the *Thames Papers* were founded a decade ago as a means of enabling the larger group of polytechnic lecturers to become more familiar with the ideas of post-Keynesian economics.

The *Papers* were originally the idea of Thanos Skouras, who was then Head of Economics at Thames Polytechnic, but has since transferred to North-East London Polytechnic. Skouras had received an initial exposure to post-Keynesian theory while doing his graduate work at London University and hoped not only to introduce these ideas to the larger group of polytechnic lecturers but also to learn more himself about post-Keynesian theory. He was subsequently joined, as the co-editor of the *Thames Papers*, by Philip Arestis who succeeded him as the Head of Economics at Thames Polytechnic, and who was no less interested in some alternative to the standard economic theory.

The advantage of the *Papers* is that they avoid the formal selection process which, in the case of so many journals, defeats the very purpose of their publication. Some of the papers are the result of an invitation to a well-known post-Keynesian or other critic of conventional economics to address a meeting of the polytechnic's economists. Others are papers which Skouras and Arestis have either heard given at a conference, or have heard about from others. In this way, the editors can determine the content of the *Papers* rather than depend on a chance submission: indeed, articles are not normally submitted for publication. The editors thus retain the initiative in this as well as in other matters, and the result, as can be seen from the collection which follows, is an unusually high proportion of important contributions to the post-Keynesian literature.

This volume illustrates several important themes in the post-Keynesian literature, perhaps the most important of which is the need for economic theory to be policy-relevant. Indeed, this is one way to distinguish post-Keynesian work from that of other economists.

The primary purpose of the conventional theory is to

demonstrate that the market economy is a self-regulating mechanism and that, consequently, there is little need for government intervention. This has been the purpose of economic theory ever since Adam Smith provided the first systematic exposition. Today, this purpose is reflected in the central place of honour which is given to general equilibrium models by the majority of economists. In contrast, post-Keynesians are unwilling to assume that a market economy is self-regulating. At the very least, they believe that continuing active government intervention is essential to avoid some of the worst possibilities which are inherent in a decentralised system of production, one in which business firms as the principal actors face an unknown, and unknowable future. Prices cannot be counted on to correct any deviation from the desired growth path for, in the view of post-Keynesians, markets are as likely to be destabilising as stabilising. Hence the need, not just for an economic policy by the government but also, and even more important, for a sufficient understanding of how the economic system actually works so that effective policies for avoiding the worst of economic possibilities can be devised.

The papers included in this volume are all in this spirit. Minsky explains why a breakdown of the monetary-financial system is possible; Chick, how the introduction of new funds into the system occurs; Arestis, why the reliance on fiscal policy to stimulate the economy need not 'crowd out' non-governmental borrowers; and Bhaduri and Steindl, why a restrictive monetary policy—and hence monetarism—has become the favourite nostrum of international banking interests in the post-1971 era. Most important of all, Kitromilides explains why economists have so much trouble persuading government to follow their advice. In this set of papers—and indeed in the collection as a whole—you will find none of the arid formalism which seems to distinguish most of the work presently being done in economics. Rather, you will find a series of papers which, as well as relevant to the major policy questions of the day, are not beyond the comprehension of a non-professional audience.

Another important characteristic of post-Keynesian theory

is the tension, not fully resolved, between those who draw their inspiration from Keynes himself, and those who base their work instead on the ideas of the Polish economist, Michal Kalecki. It is this difference — between those who place a greater emphasis on monetary factors and those who see real factors as being more important — which still remains to be resolved to the full satisfaction of the leading figures within both groups. Thus, paralleling the papers by Minsky, Chick and Arestis which build on the work of Keynes, are the papers by Harcourt, Sawyer and Skouras calling attention to Kalecki's no less important role as one of the key figures in the development of a distinctly different post-Keynesian body of theory. This is only a difference in emphasis however, and not a manifestation of two irreconcilable theories, as is the case with the micro and macro halves of the 'neoclassical synthesis'.

There is a further point of tension within post-Keynesian theory though, and one which, even if not reflected in this volume, still deserves to be mentioned. This is the difference between those who, following Harrod and Sraffa, are primarily interested in the long period and those who, drawing upon Keynes and Kalecki for their inspiration, are more concerned with the short period. Again, it is principally a matter of emphasis, or rather, of what types of question are being asked. In this volume, the focus is on the short period and the types of policy questions which arise within that time scale. This means that it is largely the followers of Keynes and Kalecki among the post-Keynesians, and not the Sraffians, who are represented. However, within these parameters and, more importantly, within the limits of what can be included in a single volume, one can see the contribution of the *Thames Papers* to the growing body of post-Keynesian literature.

Contents

<i>Foreword</i>	<i>A. S. Eichner, Rutgers University</i>	ix
<i>Introduction</i>		1
1	The Formation of Economic Policy: A Question for Economists? <i>Y. Kitromilides, Thames Polytechnic</i>	7
2	The Financial Instability Hypothesis: A Restatement <i>H. P. Minsky, Washington University</i>	24
3	The Rise of Monetarism as a Social Doctrine <i>A. Bhaduri, Jawaharlal Nehru University and J. Steindl, Austria Institute of Economic Research</i>	56
4	Keynesians, Monetarists and Keynes: The End of the Debate — or a Beginning? <i>V. Chick, University College, London</i>	79
5	Is there any Crowding-out of Private Expenditure by Fiscal Actions? <i>P. Arestis, Thames Polytechnic</i>	99
6	Post-Keynesianism: Quite Wrong and/or Nothing New? <i>G. C. Harcourt, Cambridge University</i>	125
7	Towards a Post-Kaleckian Macroeconomics <i>M. Sawyer, York University</i>	146

8	The Political Economy of Rapid Industrialisation <i>T. Skouras, North-East London Polytechnic</i>	180
	<i>Bibliography</i>	213
	<i>Index</i>	230

Introduction

P. Arestis and Thanos Skouras

This book is a selection from *Thames Papers in Political Economy*, a series which has appeared three times a year for over a decade and has enjoyed a small but increasing circulation amongst interested readers, mainly in British universities and polytechnics. The character of the series was firmly set by Joan Robinson in the very first paper, 'History versus Equilibrium' (Robinson, 1974). Subsequently, *Thames Papers in Political Economy* have investigated theoretical and policy questions in political economy always from a non-neoclassical perspective. Indeed, since its instigation, the series has aimed to broaden the discussion of economic problems beyond the confines of neoclassical analysis and to contribute to the construction and development of an alternative to the dominant paradigm of neoclassical theory.

The alternative, to the development of which this series has mainly contributed, is that of post-Keynesianism. It is true that post-Keynesianism is not a homogeneous body of thought; nevertheless, there are two important characteristics which distinguish it from others. First, there is the critical and theoretical, in contrast to merely empirical,¹ opposition that it has presented to neoclassical economics; second, the continuing search for a consistent theoretical construction that will complete the largely aborted Keynesian revolution (Eichner and Kregel, 1975). The various theoretical contributions that are brought together in this construction derive from a large and often disparate variety of authors.² Amongst them the most pre-eminent are those post-Keynesian economists to whose memory this book is dedicated: the Polish Michal

Kalecki, the English Joan Robinson, the Italian Piero Sraffa and the American Sidney Weintraub.

It has not been easy to compile this selection. The strict constraint on length, dictated by publishing considerations, made it impossible to include all the papers of merit that we would have liked. Having drastically cut the number of papers in repeated drafts, the final selection could only be made by further excisions on the grounds of accessibility and length, as well as on the requirements of continuity with respect to the book. However, we hope we have offered the reader a balanced selection, that reflects the advances that have been made in the development of post-Keynesian economics and is indicative of the calibre of the *Thames Papers in Political Economy* series.

The first chapter, by Yiannis Kitromilides, raises the crucial question of policy-making in the real world and asserts the need for a relevant theory of political economy. Kitromilides challenges the traditional justification for strictly separating the economist's formulation and assessment of economic policy from the political process of policy-formation and implementation. He argues that the common distinction between the 'politics' and 'economics' of economic policy is logically and practically inadequate and he finds a need for an integrated 'political economy' approach to policy-making.

In the following chapter, Hyman Minsky provides a succinct critique of the neoclassical synthesis and develops a novel theory of the operation of capitalist economies. In his view, the financial structures and interrelations which are essential to the capitalist system result inevitably in pronounced volatility and even fragility of the system. The financial aspects of advanced capitalism, which are closely linked to expectations about future profitability with the latter crucially affecting investment decisions, far from reinforcing equilibrating market mechanisms, necessarily cause the system to be unstable. Minsky's 'financial instability hypothesis', in essence, is that certain financial aspects of a capitalist economy, which are indissociable from its capitalist nature, make such an economy inherently unstable.

The importance of the financial aspects of capitalism, and of the banking system in particular, is also emphasised in Chapter

3 by Amit Bhaduri and Josef Steindl, who are concerned with the question of the rise of monetarism and the interests that are favoured by the pursuit of restrictive monetary and fiscal policies. They argue that it is the banking and *rentier* interests which are primarily served by such policies, and that it is the shift of economic power from industry to banking and the increase in the banks' international operations and influence in the last quarter century which have made the monetarist episode possible. They conclude that monetarist policies are short-sighted, that the advantage they afford to the banking interests is fraught with danger, and that monetarism is not a sustainable policy doctrine.

Monetarist theory and its fundamental similarity with the 'Keynesian' position, in contrast to Keynes' method, is the topic of Victoria Chick's chapter. Chick focuses on the *mode* of introducing new money into the system and analyses this question, not in terms of neoclassical comparative statics, but by means of a much more interesting and policy-relevant process analysis. She concludes that the apparent differences between neo(classical)-Keynesians and monetarists, as to the relative efficacy of fiscal and monetary policy, are due to their shared neglect of the way in which monetary change originates, demonstrating well their common distance from Keynes' style of analysis.

The efficacy and monetary implications of fiscal policy is also the theme of Philip Arestis's chapter. Fiscal policy has been questioned as an effective policy instrument not only by monetarists but also by other neoclassical economists — notably the advocates of 'rational expectations theory' — on the grounds that government spending is competitive to, and crowds out, private expenditure. Arestis reviews both the theoretical foundations of the crowding-out argument and the empirical evidence for it. His conclusion is that although it is important to distinguish between the different ways governments finance budget deficits, it is, nevertheless, the case that complete crowding-out is extremely implausible and that, for all practical purposes, fiscal policy is of great importance in terms of its impact on the level and pace of economic activity.

Whilst the relative efficacy of monetary and fiscal policy has

been at the heart of the debate between monetarists and neo(classical)-Keynesians, a similar concern has not been the sole or even the main preoccupation of post-Keynesian economists. Geoff Harcourt provides a 'guided tour', at an admirably brisk pace, of most of the body of thought of post-Keynesianism. After presenting the main contributors and indicating their considerable differences, he begins to untangle the various analytical strands which come under the umbrella of post-Keynesianism. In presenting the main characteristics of post-Keynesianism, Harcourt recognises the importance of Kalecki's original contributions, and makes clear that Kalecki, as much as Keynes, provides the inspiration for many of the strands of post-Keynesianism.

A further consideration of Kalecki's contribution is provided by Malcolm Sawyer, in a chapter which might seem provocative to many post-Keynesians, especially in the US. Sawyer maintains that Kalecki's work provides a superior starting-point to that of Keynes for the development of macro-economics. He shows that Kalecki differs from Keynes in four important respects: on the nature of competition in a developed capitalist economy; on the nature of the financial system; on the usefulness of equilibrium analysis; and on the relative importance of political factors, institutions and ideas. Sawyer concludes that Kalecki's position on all these is more realistic, and goes on to outline the key features of a post-Kaleckian macroeconomic theory.

Kalecki also provides the starting-point for the final chapter in this volume, by Thanos Skouras. Skouras outlines a Kaleckian approach to development and, in particular, to the problem of rapid industrialisation. His analysis distinguishes between different types of political regimes which are combined with different types of property relations in the backward agricultural sector in order to explore the role and importance of political conditions in the development process. He concludes that political factors cannot be abstracted from the analysis of development and that rapid industrialisation is rare, under any kind of political regime, mainly because of the sociopolitical stresses that it inevitably gives rise to.

In conclusion, we would like to take the opportunity to

thank all the contributors to the series over the years as well as our colleagues S. Daniel, G. Hadjimatheou, J. Harrison, K. Heidensohn, Y. Kitromilides, G. Koolman, P. Nore and P. Oxlade, who have served for various periods on the editorial board. To C. Driver for initially suggesting the possibility of such a book and for making useful and helpful comments; and to the other members of the Division of Economics (Thames Polytechnic) for their help and encouragement. We also wish to acknowledge with gratitude the financial and other support that the *Thames Papers in Political Economy* have been given by Thames Polytechnic from the beginning, and by North-East Polytechnic since 1978. Finally, but by no means least, special thanks are due to Edward Elgar of Wheatsheaf for encouragement and constructive suggestions at the various stages this volume has gone through.

NOTES

- 1 This does not mean, of course, that post-Keynesians have not attempted empirical investigation. For a recent attempt to verify empirically some aspects of post-Keynesianism, the reader is referred to the work of A.S. Eichner and his associates at Rutgers University (Forman and Eichner, 1981, is a very good example).
- 2 Eichner (1983) offers a detailed view of what constitutes the theoretical core of post-Keynesianism (see also Robinson, 1979a). Indeed, the paper by Harcourt in this volume (Chapter 6) throws considerable light on the differences and common ground among post-Keynesian economists.

1. The Formation of Economic Policy: A Question for Economists?

Y. Kitromilides

INTRODUCTION*

Economics is often described as a 'policy science'. What is normally meant by such a statement is that the implications of economic theory or the information generated by economic research can be applied and utilised in tackling problems of public policy. Although economists consider their subject to have relevance for policy, the process of policy-formation itself has not been of immediate interest to economists. The conventional justification for neglecting the study of the process of policy-formation in economics is based on the principle of intellectual division of labour: the economic policy of any government is part of the general policy-making process. In order to understand how the policy-making machine operates and why certain policy options are adopted or rejected, it is necessary to examine a wide set of factors — political, administrative, cultural (in addition to economic theory) — which affect the formation of policy. The study of these wider influences on policy falls outside the scope of the discipline of economics. According to this conventional view, the type of questions raised in the discussion of how economic policy is actually being formulated are best analysed by specialists in other fields, such as political science, public administration, sociology, etc. This leaves economists free to

concentrate on what is their major task, that of understanding how the economic system works. Naturally, on the basis of this understanding, economists may recommend policies on how society can achieve predetermined objectives, but it is not their job to study either the way the objectives themselves are established, or the actual design and implementation of policy.

In economics, therefore, policy questions are approached within a framework of a 'given' policy-making system, in the sense that the workings of the system itself is not the object of study. Discussions of economic policy in economic textbooks usually begin with a description of the various 'objectives of economic policy', followed by an examination of the various 'instruments of policy'. The formation of economic policy is seen as essentially political in that policy-makers determine the objectives of policy. The application of economic theory, however, is not seen as political but rather as a purely technical exercise of providing information on the best instruments to achieve given ends. An important distinction is, therefore, drawn between those aspects of policy which require values and are 'political', and those that do not and are purely technical.¹ Ultimately, all policies are inevitably based on values, but it is claimed that these are not the values of the technical expert, but of the political decision-makers. The economist's claim for participation in policy-making is based on his/her ability to provide 'dispassionate', 'neutral' and 'objective' scientific advice, which although by itself insufficient to determine policy, nevertheless helps policy-makers to assess the consequences of pursuing alternative objectives or select the best instruments to achieve predetermined ends. This view of policy-making and the relationship between scientific knowledge and public policy is usually referred to as the technocratic model.

THE TECHNOCRATIC MODEL: DESCRIPTIVE OR PRESCRIPTIVE?

The main features of the technocratic approach are (i) the insistence upon the separation of 'facts' from 'values', and (ii)