A Brief History of Economic Thought
From the Mercantilists to the Post-Keynesians
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14. The Post-Keynesian School

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KEY FEATURES

- Distinguishes post-Keynesian economics, from (new or neo) Keynesian economics.
- Argues that post-Keynesian economics is more than the economics of Keynes.
- Briefly discusses the role of Michał Kalecki.
- Discusses a number of fallacies of composition.
- Discusses 10 key characteristics of post-Keynesian economics.

1. INTRODUCTION

Previous chapters in this book have discussed the ideas of Keynes, Keynesians and new Keynesians. To many students, this may appear to be somewhat confusing at first. After all, why would economists spend so much energy insisting on distinguishing themselves between seemingly similar-sounding approaches, carrying seemingly similar names? Unfortunately, this chapter will only add to this confusion – at least initially – as we will discuss the ideas of another similar-sounding group, the “post”-Keynesians, which emerged in the mid-1950s to re-establish the ideas developed by Keynes following the efforts of the Keynesians to dilute them (as we will see, Polish economist Michał Kalecki also plays a central role).

But as the chapter goes on, it will become clear how different post-Keynesians are from new or neo Keynesians. In fact, it proposes a very different vision of economics than the neoclassical or Keynesian approaches, which are based on individual micro behaviour and exchange. In contrast, post-Keynesian economics is based on the social process of the production of goods, which involves institutions and necessarily involves conflict between various groups at the heart of this process. Above all it involves banks and therefore can best be described as a monetary theory of production.
Yet, efforts to minimize confusion are further complicated by the fact that post-Keynesian theory is not a singular, unified approach, but a co-existence of various strands and influences. Indeed, King has argued that post-Keynesians are part of a “big tent”, and a “broad church” (King, 2002, p. 5). In this chapter, owing precisely to the idea of a “broad church”, post-Keynesians will also be referred to as heterodox economists, and the two expressions will be used interchangeably.

In this chapter, I will present what I believe to be elements that are common or compatible, to a large degree, to these various post-Keynesian or heterodox strands – elements I believe form the core of heterodox economics. Undoubtedly, because we are dealing with various strands, there is a need to sacrifice the more extreme parts from all the various strands. But in the end, we are left with a positive contribution to economic theory, worthy certainly of a credible alternative to Keynesian and other orthodox approaches. As Eichner and Kregel (1975, p. 1294) wrote almost 50 years ago, “post-Keynesian theory has the potential for becoming a comprehensive, positive alternative to the prevailing neoclassical paradigm”. This, I argue, has been achieved.

Past chapters have shown in what ways all these various schools of thought have important differences, to some degree, especially with respect to how markets work – or as post-Keynesians are fond of saying – how they represent the “real” world. How economists observe the world around them and how they perceive how the world should operate impacts greatly how policies are shaped. As this chapter will show, post-Keynesians see the world in a very different way, and post-Keynesian theory is fundamentally different. We will argue in this sense that it is more representative of the real world.

As was shown in earlier chapters, early Keynesians were unable to break away from core neoclassical ideas. They had difficulty in understanding what Keynes wanted to do. As such, Keynes’s key insights were lost, and the result was a synthesis between some ideas found in Keynes’s *General Theory*, which were then embedded within an overall neoclassical theory that emphasized an eventual return to a long-run position – an approach which Joan Robinson famously labelled “bastard Keynesianism”. In particular, Keynesians believed that the economy could get stuck in the short-run, as a result of inflexible or sticky prices (imperfections), and as such it needed some help to get back to long-run equilibrium. So they kept the idea of short-run “disequilibrium” (not a word used by post-Keynesians), but defended the idea of an economy that gravitated to some long-run position independent of what was going on in the short-run. In other words, Keynesians, and new Keynesians after them, essentially kept the neoclassical theory as a general case, while adding
some imperfections to generate a special, short-run case. These similar approaches can be summarized in the following two words: “stability and convergence”.

Post-Keynesian theory therefore begins where Keynes left off by wanting to reclaim the mantle of Keynes’s proposed revolution from the Keynesians, and in doing so, post-Keynesians seek to explain the dynamics of economies in the short-run by righting the wrongs (or should we say “lefting” the wrongs?) of Keynesians and re-establishing involuntary unemployment as the general case, and extending Keynes’s analysis to the long-run – a long-run that looks very different from the neoclassical or Keynesian one. For post-Keynesians, there are no imperfections, and economies do not get stuck in the short-run because of sticky prices or wages, but because there is insufficient effective demand given an uncertain future: the economy certainly does not gravitate towards an independently-determined long-run equilibrium. This then sets up the argument for the use of fiscal policy. In two words, we can summarize the post-Keynesian approach as “instability and fragility”, which will become clear below.

The main purpose of this chapter is to introduce readers to the core ideas of the post-Keynesians. Before getting there, however, I feel that it is necessary to discuss briefly the role played by another economist whose ideas shaped post-Keynesian economics: Polish economist Michał Kalecki (see also Chapter 6). I then discuss what I believe are the core ideas of post-Keynesian or heterodox economists. The conclusion is an obvious one: economics is in need of some “Spring cleaning” (Robinson, 1985, p. 160), and post-Keynesians are best positioned to propose this alternative.

2. KEYNES AND BEYOND KEYNES

Post-Keynesian economics is a relatively new approach to economics, approximately 50 years old. As an institution, it emerged in the United States in the very early 1970s, following correspondence between Alfred Eichner and Joan Robinson (see Rochon, 2022a; Lee, 2000). The intellectual roots, however, date back a little further, to a book published by Joan Robinson called *The Accumulation of Capital*, while the very first journal article espousing the core elements of post-Keynesian economics was published in 1975, in the *Journal of Economic Literature*, by Alfred Eichner and Jan Kregel (see Eichner and Kregel, 1975).

In the early years, post-Keynesians were described – by both those within and those outside post-Keynesian circles – mainly as being against neoclassical economics, and hence in a negative way. For instance, Eichner (1985a,
p. 51) once wrote “it is less controversial to say what post-Keynesian theory is not than to say what it is. Post-Keynesian theory is not neoclassical theory”. In a similar vein, Arestis (1990, p. 222) writes “post-Keynesians tend to define their program in a negative way as a reaction to neo-classical economics”.

But this label is only half true, as post-Keynesians always had a very positive message, which at times got lost by their critics. Arestis also writes that “It is also true to say that post-Keynesians are united not just because of their critical attitude to neo-classical economics, but more importantly because of their attempt to provide an alternative paradigm to orthodox economics” (1990, p. 223, emphasis added). This prompted King to ask two important questions: “Can it be defined only in a negative way, in terms of its opposition to neoclassical macroeconomics? Or is there a coherent positive Post Keynesian alternative to the mainstream?” (King, 2002, p. 1). The answers to these questions are clear: no and yes.

It is perhaps easy to claim, as alluded to above, that post-Keynesian theory begins with Keynes, or that it begins where Keynes left off. That is certainly the easy answer. But the truth is more complex: Keynes is not the only or even the most prominent source for post-Keynesian economics today. In fact, as we argue below, post-Keynesian theory is the result of many influences, and while this may at times give the impression of confusion, the challenge is to build an approach that rests on the best of what each approach has to offer.

In a way, that certainly reflects one of the most fundamental ideas of post-Keynesian economics: realism (or rather realisticness; see below). This was pointed out by Eichner and Kregel (1975, p. 1309) where they argue that post-Keynesian theory seeks “to explain the real world as observed empirically”. Yet reality itself is a source of interpreting the world around us. As Rochon and Rossi (2021) argue, interpretation is subject to a number of biases, which depend in many ways on one’s ideology, and thus the lens through which we see and interpret the world around us.

But while post-Keynesian theory may begin with Keynes, it certainly does not end with Keynes, and there are good reasons to look beyond Keynes, most notably because he came from a neoclassical or Marshallian background, even describing the General Theory as a “long struggle of escape from habitual modes of thought and expression”.

The lingering question is whether Keynes succeeded in escaping from his past: did he complete his struggle? The consensus appears to be that Keynes did not fully succeed in escaping his Marshallian roots, and that other aspects of neoclassical theory remained embedded in his approach, thereby paving the way, understandably, for the rise of the “bastard” Keynesian version. In other words, the General Theory, by far Keynes’s most important
contribution, kept sufficient neoclassical elements that allowed it to be interpreted in a “bastard” way. This suggests that Keynes himself planted seeds to his aborted revolution. This echoes Kaldor’s (1983, p. 47) own sentiment that “the real author of the so-called ‘neo-classical synthesis’ was not Paul Samuelson, it was Keynes himself”.4

This exposes the weaknesses of Keynes’s approach – at least as contained in the General Theory – leading Sebastiani (1989, p. xii) to argue that because of this, “Keynes would thus have failed to perceive the complexity of modern systems, the structural problems, the proliferation of social figures, the fragmentary character of interests and the existence of conflicts which cannot be settled through macroeconomic policies”.5

This last statement may be a bit of an exaggeration as it assumes Keynes’s thought would not have evolved with time or with changing circumstances. But there is some evidence to suggest that Keynes would have perhaps changed his mind as events unrolled. After all, there is this quote attributed to him where he argues that when confronted with changing facts, “I change my mind, what do you do?” Robinson (1978, p. xxi) also describes Keynes as being able to “absorb the criticisms” quickly and “racing towards new formulations”. Skouras (1981, p. 208) reinforces this idea claiming that Keynes “was habitually quick to revise or even to completely abandon his own analytical formulations”.

And while it is difficult to see how precisely Keynes’s thought would have evolved in time, given time, perhaps he would have fully escaped his Marshallian roots to be able to better interpret the world around him. But while it is impossible to predict any of this, one thing is certain: many post-Keynesians do not always feel comfortable with Keynes even as a starting point of their analysis, seeing him as a rather “moderately conservative” figure who never really broke free from neoclassical orthodoxy (see Toporowski, 2013, p. 142). For instance, almost four decades ago, Lavoie (1985) warned us about “following Keynes too closely when it comes to money” – a statement that certainly appears odd given that the word “money” appears prominently in the title of the General Theory, and that many post-Keynesians refer to Keynes when discussing money. That said, Eichner (1979, p. 7) reaches a similar conclusion when he writes that “Yet it is not clear that Keynes was the most important of the Keynesians”.

Nevertheless, it is indisputable that Keynes played a prominent and central role within the development of post-Keynesian theory – a role that has to do certainly with the fact that he was a professor at one of the most eminent universities in the world, the University of Cambridge, and was editor of a well-respected journal, the Economic Journal. Keynes was also an advisor to the government, and an avid commentator on public affairs.
In fact, we could say that Keynes was a household name in Britain – a feat not enjoyed by any other economist to this day (with the exception of a few, like John Kenneth Galbraith or even Milton Friedman). And in the end, his book, the *General Theory*, undoubtedly and unequivocally, has been at the centre of macroeconomics since the day it was published, and for all these reasons, the approach called post-Keynesian economics bears his name. As King (1996, p. 149) argues, “Keynes’s reputation and ability to command attention had ensured that his genius was fully recognised, while Kalecki’s talents had gone largely unnoticed”. This was best said by Joan Robinson (1976, p. 7): Keynes simply “stole the limelight”.

But given the above discussion, post-Keynesian economics has to be more than Keynes. As Palley (1996, p. x) wrote, “the Post Keynesian Project represents both a recovery and an extension of the economic paradigm developed by Keynes”. Precisely: the recovery is about rediscovering Keynes and reclaiming him from the “bastard” hands of the Keynesians, and developing the more radical ideas – read non-neoclassical as there are many parts of Keynes that are truly “revolutionary”. But post-Keynesian economics is also about extending his ideas, and in many ways, going beyond Keynes.

Michal Kalecki

In light of this, many post-Keynesian economists have argued that Polish economist Michał Kalecki deserves an equal if not greater recognition than Keynes, and that Kalecki, not Keynes, ought to be considered the starting point of the heterodox analysis. Indeed, Kalecki arrived at many of the core elements of Keynes’s analysis, including the theory of effective demand, yet without the neoclassical baggage. In other words, coming from a Marxist background and especially being largely self-taught in economics through readings of Marx and Rosa Luxemburg, Kalecki never had to go through a “long struggle of escape”, as did Keynes, and his approach rested on a more non-orthodox foundation like oligopolistic firms, income distribution and social classes – all elements missing or given only lip-service by Keynes. The result was “to arrive at a more sophisticated theory of output and employment and the trade cycle” (Kerr, 2005, p. 479).

Whereas Keynes’s analysis rested on perfect competition as a mode of production, “Kalecki was able to weave the analysis of imperfect competition and of effective demand together and it was this that opened up the way for what goes under the name of post-Keynesian economic theory” (Robinson, 1977 [1979], pp. 193–194). For this reason, Harcourt (1987, p. x)
claims that Kalecki’s writings were “the most profound of the twentieth century”. Kaldor (1986, p. 8) wrote that “Kalecki was superior to Keynes”.

In fact, many argue that Kalecki either anticipated Keynes’s *General Theory*, or at the very least, discovered the importance of the principle of effective demand at the same time. Robinson (1979a, p. 129) defended “Mr. Kalecki’s discovery of the General Theory independently of Keynes”, as did King (2013a, p. 487), who claims that Kalecki “discovered the principle of effective demand more or less simultaneously with Keynes”. Economist Lawrence Klein (1951, p. 447), rightly concludes that Kalecki “created a system that contains everything of importance in the Keynesian system, in addition to other contributions”.  

For these reasons, many post-Keynesians prefer beginning their analysis with Kalecki, not Keynes, thereby giving Kalecki a central role within post-Keynesian economics. Arestis (1996a, p. 11) rightly observes, “Kalecki’s role in post-Keynesian economics is both extensive and paramount”. And in recent years, Kalecki’s influence has grown considerably, such that much of what passes for post-Keynesian economics today is rooted in Kaleckian economics (see Rochon, Czachor and Bachurewicz, 2020). As Sebastiani (1989, p. xi) writes, “The widespread rediscovery of Kalecki which we are witnessing today is certainly due, at least in part, to the growing dissatisfaction with Keynes’s theory”.  

And because of the different backgrounds, Marshallian vs Marxian, followers of Keynes and Kalecki have often clashed over ideas and policies, and the rightful place of their respective master. As Eichner (1985b, pp. xi–xii) noted, “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 work of Polish economist, Michał Kalecki”. It is for this reason, for instance, that Sawyer (1985, p. 178) has claimed that “the differences between Kalecki and Keynes are substantial, such that their approaches should be separately developed and not conflated together, although there may be some places where there could be a useful cross-fertilisation of ideas”.  

Cross-fertilization of Ideas and All That: The Third Way

While Sawyer is undoubtedly correct that the differences between Keynes and Kalecki are substantial, this chapter prefers to emphasize the idea that a “cross fertilization” of ideas is possible and is what we should aspire to. After all, both authors believed in the limitations of the dominant approach in explaining recessions: Keynes and Kalecki both represented a “radical departure” from the mainstream. According to Robinson (1976, p. 7), the mainstream’s (or the “neo-neoclassics”, as she calls them) contortions in
attempting to re-establish pre-Keynesian notions after Keynes was proof of “how radical [Keynes’s] departure from orthodoxy really was”. In this sense, the intent of both Kalecki’s and Keynes’s analyses was to undermine neoclassical economics. Both, according to Robinson (1976, p. 8), “were holding a mirror up to modern capitalism”.

Moreover, both also believed that market economies failed in delivering full employment, and both placed aggregate demand at the heart of their analysis, and finally both saw investment as a leading component of aggregate demand.

Not everyone, however, agrees with the wisdom of attempting to find common ground between Kalecki and Keynes. For instance, Paul Davidson (2003–2004, p. 247), one of the founders of the Journal of Post Keynesian Economics, writes that it is an “error” to include Kaleckians in the definition of post-Keynesian economics. Davidson’s approach to post-Keynesian economics is a very narrow one, however, and rejects any influence other than Keynes’s. Otherwise, we risk ending up, according to Davidson (2003–2004, p. 247), with “Babylonian ‘babble’”.

Many have made this argument before. For instance, Harcourt has argued that post-Keynesians are a “heterogenous lot” (Harcourt, 1985a, p. 125), united perhaps best in their opposition to neoclassical theory. Hodgson (2019) argues that “heterodox economists cannot agree what heterodox economics means”. This certainly gives the impression that describing heterodox economics is an impossible task.

Yet, we believe that it is possible to propose a coherent whole, despite the various influences, sources, conflicts and all. Of course, I am not proposing a conflation of all these approaches – such a task would indeed be difficult. But it is possible to pick elements from both Keynes and Kalecki, as well as other sources, which maintain the overall intent of undermining neoclassical economics and building a more realist view of the world. In the end, we are left with maybe a potpourri of ideas, from various sources, but one that ultimately works.

This is in the spirit of Lavoie (2014, p. 42) who argues in favour of “taking the best elements from each” – while excluding many of the more extreme ideas in their respective writings. King (2021) has argued this precisely, that various post-Keynesian approaches “are essentially on the same page and, second, that while there are indeed significant differences of opinion between post-Keynesians and other schools of thought in heterodox economics, there is still considerable scope for cooperation and fruitful debate between them”. Bortis (1997, p. 235) has argued that “a consensus between the various strands of post-Keynesianism … should be possible”.

The way forward for post-Keynesians therefore may indeed be eclectic, and integrate parts of Kalecki (mark-up pricing, imperfect competition,
social conflict) with parts of Keynes (who emphasized uncertainty and fiscal multipliers), with aggregate demand, and with parts of others, like Kaldor and Robinson, who both endorsed endogenous money, and even Pierro Sraffa, another heterodox economist. This was precisely the position of Pasinetti, who argued for:

selecting and shaping the theories of Keynes and Sraffa and the developments of Kahn, Robinson and Kaldor (and Goodwin and whoever else have made contributions in the same direction at Cambridge or elsewhere) into a coherent, solid, overall framework. (Pasinetti 2007, p. 236)

There are certainly important differences in these various approaches, perhaps best left for other historians of thought to dissect. Yet, for the purposes of this chapter, I will minimize these differences, and agree with Eichner (1985b, p. xii) who argued that these differences are more a matter of emphasis than “a manifestation of two irreconcilable theories”.

In the end, both Keynes and Kalecki should be equally considered the founding fathers of the school of effective demand. This is in line with Sawyer’s (1985, p. 182) conclusion that both authors “should be treated on a par rather than placing Keynes in the leading role and Kalecki in the subordinate role”.

3. FALLACIES OF COMPOSITION

Before addressing the specific characteristics of post-Keynesian theory, it is useful, I think, to briefly discuss what post-Keynesians call “fallacies of composition” in order to get a better sense of the dynamics between micro and macroeconomics.

A fallacy of composition describes an idea or an act, which at the level of the household or the firm may make good microeconomic sense but does not at the macroeconomic level. In other words, what may seem reasonable for one individual may not be reasonable if we all do it. In this sense, it produces a paradox: how can something that appears good for the individual worker or firm contribute to negative consequences at the macroeconomic level? According to Lavoie (2014, p. 17), “What seems reasonable for a single individual or nation leads to unintended consequences or even irrational collective behaviour when all individuals act in a similar way”.

It is important to be aware of such paradoxes because they reveal the internal inconsistencies and weaknesses of neoclassical economics. They also show the limitations of relying too much on microeconomic reasoning
The Post-Keynesian School

255
to explain macroeconomics. It is therefore no surprise that they can be found within the core of post-Keynesian economics.

Lavoie (2014) discusses eight such paradoxes. For instance, the paradox of tranquility argues that in periods of economic tranquility, firms may wish to adopt riskier behaviour and seek higher profits. In turn, this will contribute to destabilize the economy. This can best be summarized by invoking the aphorism attributed to Hyman Minsky (1986): stability leads to instability. In other words, instability is an endogenous feature of the economic system, and not necessarily the result of an exogenous shock. Instability can come from within.

We will not cover all eight paradoxes here but will limit our brief discussion to three more.

For instance, another classic example is the paradox of thrift, according to which acts of individual savings may benefit individual workers, but if everybody began saving, it would lead to a general decrease in consumption and thus demand, which would harm the economy as businesses would be selling fewer goods and perhaps have to let workers go as a result. So increased savings at the individual level may lead to fewer savings at the level of society as a whole.

Another example is the paradox of costs. Reducing wages may lead a firm to reduce its costs of production, and therefore (appear to) raise its profits. But if all firms acted like this, workers would collectively have less disposable income, aggregate consumption would decline thereby reducing total profits in the overall economy, and possibly lead to a rise in unemployment. This is the contrary of what neoclassical theory says: a decline in real wages may lead to an increase in unemployment. Stated differently, higher real wages lead to higher profits.

Finally, we may consider the paradox of fiscal deficits. According to this paradox, attempts by governments to reduce their deficits in an effort to obtain balanced budgets will end up more often than not in higher deficits. This is because as governments reduce spending, they reduce aggregate spending and demand, which in turn hurts economic activity, raises unemployment and reduces fiscal revenues thereby increasing deficits. This suggests that the single-minded austerity pursuit of balanced budgets does more harm than good and is self-defeating.

4. THE CORE ELEMENTS OF POST-KEYNESIAN ECONOMICS

We are now ready to discuss the specific characteristics of post-Keynesian or heterodox economics. This is not an easy task. It is confounded by some
authors who think that it is a useless task. For instance, as stated earlier, Eichner (1985a, p. 51) once claimed that “it is less controversial to say what post-Keynesian theory is not than to say what it is. Post-Keynesian theory is not neoclassical theory”. Other post-Keynesians have had the same opinion. For instance, Arestis (1990, p. 222) writes that “post-Keynesians tend to define their program in a negative way as a reaction to neo-classical economics”, whereas Sawyer (1988, p. 1) stated that “the unifying feature of post Keynesians is the dislike of neoclassical economics”.

At one time, this may have been true. In the early days when post-Keynesians were struggling to define themselves, they were overtly pre-occupied in wanting to dismantle neoclassical economics. But today, post-Keynesian and otherwise heterodox economists have made important and positive contributions to theory and policy, and define themselves according to a list of unifying principles. Here we agree with Lavoie (2015) who once stated “if by any bad luck neoclassical economics were to disappear completely from the surface of the earth, this would leave heterodox economics utterly unaffected”. Indeed, post-Keynesian economics has grown tremendously in the last five decades or so, and has become a viable alternative – coherent and fully consistent – to neoclassical economics.

Quite obviously, the ideas below need to be fully developed, which goes beyond the immediate scope of this chapter. This said, I present a sketch of the core ideas of post-Keynesian economics. Bear in mind that many of these ideas pre-date Keynes by many decades or centuries.

Also, the ideas below are greatly influenced by the theory of the monetary circuit – a view that has emerged in Europe and has greatly influenced the development of post-Keynesian economics in the last five decades (see Graziani, 1995; Rochon, 1999).

The Core Elements

1 Realisticness

The neoclassical model used in the analysis of the economy is based on a set of assumptions, which may or may not reflect the actual world in which we live. For post-Keynesians, these assumptions, more often than not, are deemed unrealistic (rationality, utility and profit maximization, perfect competition, free markets, atomistic behaviour, lack of social classes, etc). Nowhere is the lack of realisticness truer than in the explanation of the existence of money: in neoclassical economics, barter is often used to explain the origins of money, though there is scant anthropological evidence that barter existed or that it explains the existence of money. Some even question whether barter ever existed. For instance, anthropologist, Caroline Humphrey (1985, p. 48), writes: “No example of a barter
economy, pure and simple, has ever been described, let alone the emergence from it of money; all available ethnography suggests that there never has been such a thing”. Regardless, a proper understanding of money (see below) carries huge implications, one that may end up tugging at the thread of neoclassical economics and unravel it completely.

But for neoclassical economists, this is of secondary importance: assumptions or hypotheses don’t need to be realistic in the sense that they don’t need to reflect the real world. This line of reasoning was strongly advocated by Milton Friedman, who wrote that a model is “a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances” (Friedman, 1953, p. 4). Accordingly, realistic assumptions are not important, as long as the model has high predictive powers. In fact, one could argue that neoclassical theory can only arrive at its conclusions by adopting unrealistic premises.

Keynes had difficulty with such an approach, which for him, can have “disastrous” consequences. As he writes in the opening paragraph of the General Theory, “the characteristics of the special case assumed by [neo] classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience” (1936 [1964], p. 3). This is why he recommended “a vigilant observation of the actual working of our system”.

Indeed, how can we expect our models or theories to have anything meaningful to say about the world, or propose relevant policies, if they describe some fictitious, highly stylized world? For instance, the neoclassical model is mostly about long-run stability and convergence to an equilibrium, or about how it gravitates back to equilibrium following a shock. How then can we expect it to have any relevant information about financial crises, for instance, or a health crisis-cum-economic depression? In these neoclassical models, crises cannot happen, which explains why the vast majority of economists did not see the 2007 crisis coming. As such, it could not provide any meaningful policies either, having to fall back only on austerity.

Yet, to be relevant, economic theory must bear some familiarity with the world in which we live. Hence, there must be a sense of what post-Keynesians call “realisticness”; assumptions must be realistic, and the overall theory must do its best to describe the real world. And while theories are a simplification of the real world, there must be realisticness within these simplifications. What are we leaving out of these models? Is it justifiable to exclude social classes, or income distribution, or mega-corporations? One of the core elements of post-Keynesian theory is to build models that incorporate proper pricing mechanisms by firms,
proper market structures, a realistic banking system, the inclusion of a central bank that controls the rate of interest, the role of unions, the role of the State and other institutions, and more.

Robinson (1956, p. 24) knew all too well the importance of realism, as she tells us that “One of the purposes of economic theory is to look through the veil of money to the realities behind it”. Hence many of the elements that follow are a way of incorporating realism into the post-Keynesian approach.

2 A monetary economy of production and endogenous money
While we must indeed look behind the veil of money, we must also recognize that we live in what Keynes called a monetary economy of production. This is in contrast to the world depicted by neoclassical economics, where money is not necessary to explain the real world. Indeed, we use textbooks to teach students the causes of employment and unemployment, wages, consumption, investment, prices and growth, without once referring to the monetary system. In most textbooks, money appears much later in the book, towards the end, well after the discussion of real variables: money is an afterthought. One could conclude that money does not exist in the pure neoclassical model. This is at the heart of the lack of realism in neoclassical theory, as described above.

Yet, in a monetary world, money, debt, consumption, investment and production are linked: we cannot speak of production, labour, investment or even growth without first having a grasp of the meaning of money. In such a world, Say’s Law is reversed, and entrepreneurs finance their production and the purchase of capital goods through borrowing from banks, not through savings. In this sense, there is a close link between the existence of money and debt. Money is a creature of production.

Central banks play a role in setting the rate of interest. It is considered a true exogenous price. In fact, central banks can have any rate of interest it wants – though there may be consequences to that decision.

This rate will play a role in influencing other rates along the spectrum of assets, including the rate on loans, the supply of which depends on how banks perceive borrowers, and their degree of creditworthiness – or the “reputation” of borrowers (Robinson, 1956, p. 50). When banks agree to grant a loan (credit on the asset side of the banks’ balance sheet), money appears on the liability side of banks’ balance sheets, at which point, money is created. But banks do not lend to everyone who asks for credit. As Keynes tells us, there will always be a “fringe of unsatisfied borrowers” (1930, p. 212).

It is in this sense that post-Keynesians speak of the endogenous nature of money:
A wage economy requires money. An employer who is starting in business has to pay his workers before he has anything to sell so that he must have a stock of purchasing power (finance) in some form of other before he begins. (Robinson, 1956, p. 20)

Banks are therefore “special” in the post-Keynesian story, and much has to do with the “subjective attitude of the bankers” (Robinson, 1956, p. 244). Rochon (2006) has expanded on this (see also Lavoie, 2014, chapter 4). Banks are never constrained by a lack of funds, but only by a lack of good borrowers.

The implications of endogenous money are vast, and cut through the theoretical vacuum of neoclassical theory. In the end, as Robinson (1943, p. 25) reminds us: “But in general, in a slump, it is not lack of finance but poor prospects of profit which is the seat of the trouble. The most that the banks can do by easy lending is to take the horse to the water – it needs an assured future market to make him drink.”

3 Social classes and power
A starting point of post-Keynesian economics is the inherent conflict among groups within capitalism – workers, productive capital (capitalists), and financial capital (rentiers), although for realism, we should add the State, banks, the central bank and the “rest of the world”. Analyzing the economy from this perspective only emphasizes the difficult dynamics and interrelationships between groups, and how power is exercised. This approach is a nod to the Classical School, as described in chapter 1, and is more closely linked to the Kaleckian branch of post-Keynesianism. For Arestis (1992, p. 101), economics “is based on the premise that capitalism is a class-divided society”.

This view stands once again in contrast to neoclassical theory, which is founded on atomistic behaviour of individual agents, with maximizing functions. Indeed, in neoclassical theory, the centre of analysis is the rational economic man or homo economicus. In doing so, it eliminates the need to discuss macroeconomics as a distinct field: if everyone behaves rationally, then studying the single individual is the same as analyzing the economy as a whole. This is the essence of the notion of microfoundations to macroeconomics. Yet in doing so, it also eliminates the need to discuss how specific groups act and react with and against one another, and as such, how power can contribute to specific economic outcomes.

For post-Keynesians, however, the economy is not micro-founded, but rather is based on macro-groups or social classes, such as workers who supply the labour, capitalists who own the means of production, and rentiers, a class whose income derives from owning financial assets. This
hierarchy emphasises the struggle of one group against the others, and the conflict over the proper distribution of income (see below). Moreover, firms tend to be oligopolistic, bestowing them with heightened power in setting prices and increasing their share of the national income.

This way of seeing the economy carries important consequences, such as placing income distribution at the heart of economic analysis, as well as inevitable conflict over this distribution. Indeed, the most powerful relationship must be between workers and firms, over wages and price setting. In fact, post-Keynesians see inflation itself as the result of conflict over the distribution of income (see Rochon and Setterfield, 2008).

4 Instability and fragility
As stated above, neoclassical theory is foremost about convergence and stability to a long-run equilibrium position, independent of short-run dynamics. The economic system has mechanisms (market forces and price flexibility) that guarantee its convergence to this long-run equilibrium following an exogenous shock. But this convergence is largely based on some well-behaved demand and supply curves: downward-sloping demand curves and upward-sloping supply curves.

Yet, these curves are theoretical only, and have no empirical support. In fact, we can easily imagine, for instance, downward-sloping labour supply curves: as wages fall, workers must work longer hours or find another job just to make ends meet. Moreover, as wages increase, this may lead firms to hire more labour given the higher levels of effective demand. This is the paradox of costs discussed above.

The above description is what is often called “free market” or laissez-faire economics. According to this view, the inevitable role for governments is to ensure that anything that stands in the way of free markets must be removed, otherwise it will prevent the system from converging quickly to equilibrium. So governments must reject unions, minimum wage laws, price ceilings and floors, and any imperfections that prevent the economy from gravitating toward its long-run equilibrium.

For post-Keynesians, however, free markets are not conducive to economic or financial stability: rather free markets are prone to periods of great instability. In fact, economist Hyman Minsky argued that periods of stability lead to periods of instability. In other words, the so-called market forces operate very differently in the real world: in periods of stability, firms will be earning good profits, and will seek higher profits by adopting ever-increasing risky ventures, making the system unstable.

This instability suggests moreover that there is no path to a pre-determined, unique, long-run equilibrium; there is no centre of gravitation towards which the system converges. In fact, for post-Keynesians, the
long-run is not independent of what takes place in the short-run. Kalecki argued that “the long run trend is but a slowly changing component of a chain of short-period situations. It has no independent entity” (Kalecki, 1971, p. 165). You can therefore argue that the long-run may not exist, and the economy simply moves from one short period to another, without any tendencies to any long-run values.

This analysis leads to a very different role for governments – or rather roles. First, if the economy is unstable and prone to periods of instability, governments must adopt the necessary regulations to prevent the economy from collapsing into a depression state. Second, fiscal policy can play a very important role in growing the economy.

5 The principle of effective demand
Effective demand is the basis – or “backbone” (Arestis, 1996b, p. 112) – upon which post-Keynesian economics is built. In essence, it suggests that economic growth is almost always and everywhere a demand-led phenomenon. This does not mean that supply does not or cannot play an important role, but its influence is certainly of second-order: “Stripped down to the bare essentials, Post-Keynesian economics rests on the principle of effective demand” (King, 2013b, pp. xiv, 121).

Abstracting for simplicity issues dealing with open economies, consumption, investment and government expenditures all play an important role in determining output and growth. This has definite implications.

For instance, with respect to consumption, when workers increase their income or salary, this will tend to increase consumption overall and increase aggregate demand. In this case, we can say that the economy is wage-led. This is an important source of economic growth as wages are an important component of overall aggregate demand (Lavoie and Stockhammer, 2013). Policies that are aimed at increasing wages (minimum wage laws, living wage laws) have positive effects on output and thus economic growth. Again, this stands in contrast with the neoclassical view of flexible wages as a source of stability and convergence to equilibrium.

One immediate conclusion is that savings (non-consumption) are a drain on economic activity. The paradox of savings applies here: savings may be a good thing for individual households/workers, but not for the economy as a whole.

As for what determines investment, this is a complex and very dynamic problem, and many questions must be addressed. First, an investment is a permanent addition to the stock of capital: firms do not build new factories or purchase new machines in order to leave them idle. An investment implies a permanent increase in the capacity to produce. If a firm commits
to increasing its productive capacity over the life of the capital good, it must therefore be convinced that this extra output will be demanded or consumed (firms do not build new factories to use them for only one year). Firms must therefore be convinced that effective demand will not just increase in the short-run, but must increase permanently (or at least over the life of the investment) in order to absorb the increased production in all future periods of production. In other words, decisions to invest depend on the firms’ expectations of permanent increases in aggregate demand. If these expectations are weakened, investment can collapse. Again, we turn to Robinson (1943, p. 25) for this idea: “Firms producing consumption goods would make greater profits, and, if they had sufficient confidence that the higher demand would continue in the future, they would enlarge their capacity by building more plant.”

Of course, these investments also need to be financed, and this will depend on firms’ access to bank loans consistent with the theory of endogenous money, keeping in mind that banks also face their own expectations about future levels of aggregate demand, thereby setting up a specific dynamic between banks’ and firms’ expectations of aggregate demand. If banks are more or less optimistic than firms, then the supply of credit will adjust accordingly. Again, for Robinson: “in a slump, it is not lack of finance but poor prospects of profit which is the seat of the trouble. The most that the banks can do by easy lending is to take the horse to the water – it needs an assured future market to make him drink” (Robinson, 1943, p. 25).

This view is very different than the naïve neoclassical theory that says that investment is negatively related to the rate of interest, and financed by saving. Empirically, we know this to be false: rates fell after the 2008 financial crisis (and during the COVID crisis) and remained low for close to a decade, and were close to zero for some years. Yet investment did not increase: this was because despite historically low rates, there was too much uncertainty regarding the future of effective demand that it made no sense for firms to invest.

If anything, low interest rates may in fact lead to a decrease in investment, as low rates may contribute to asset price inflation. In turn, in a hyper financialized world, firms may find it more rewarding to invest in financial markets or to buy back their own shares, rather than invest in physical capital.

This analysis leads to a rich discussion over the role of fiscal policy, whose role is to raise effective demand sufficiently as to influence the expectations of both banks and firms, and in turn influence investment decisions and bank lending. It is in this sense that fiscal policy will have multiplier effects (discussed below).
6 Income distribution
The topic of income distribution could have been easily discussed within a few of the topics above. But the issue is too important and deserves to be aired on its own. For post-Keynesians, it is one of the most essential core elements, as it can affect aggregate demand and growth, although its precise impact is complicated as it pertains to the relative importance of workers and capitalists.

We can discuss inner-class and inter-class distributions of income, and their impact on aggregate demand. As Perraton (2019, p. 95) reminds us, “Post-Keynesian models provide grounds for predicting systematic differences in propensities to consume between rich and poor, wage earners and capitalists and between debtors and net creditors”.

Inner-class refers precisely to the distribution of income among workers, that is from high-wage earners to low-wage earners. Because the marginal propensity to consume of lower-income wage earners is higher, redistribution toward low-income wage earners will have a positive effect on aggregate demand.

This said, it is the inter-class distribution of income that has attracted considerable attention within post-Keynesian economics. In this sense, income distribution is about the shares of income of respective social classes, such as the wage share for workers, that is the ratio of total wages to total income, and the profit share for capitalists (the ratio of profits to total income). The dynamics between income distribution and economic growth centers on what happens, say, when the wage share falls or rises. Stated differently, what is the impact of changes in the profit share or rentier share on growth? This leads to a fundamental question in post-Keynesian economics: are economies wage-led or profit-led? If an economy is profit-led, then increases in the wage share may have a limited impact on output and growth. It is a complicated dynamic. According to Fields (2021; see also Lavoie and Stockhammer, 2013):

If the propensity to consume out of wages is higher than that to consume out of profits, redistributing income away from wage earners would depress total consumption. However, it could also stimulate investment expenditures because of a higher profit share, which would in essence counteract the depressing effect of lower consumption expenditures on effective demand. Depending on which of these effects dominates, there are two possibilities that can emerge: i) greater consumption expenditure owing to higher real wages and lower profit share (wage-led growth), or ii) greater investment expenditure owing to higher profit share and lower real wages (profit-led growth).

It is important to note, however, that this does not change the overall demand-led nature of capitalism. The only question concerns the relative
importance of wage and profit shares, and the overall structure of the economies.

7 Involuntary unemployment
Neoclassical economics assumes that all unemployment is voluntary, in the sense that it is generally the result of real wages being too high thereby discouraging firms from hiring additional labour. As real wages come down, provided there is nothing impeding this adjustment, excess labour is absorbed and the economy converges to a full employment equilibrium. One immediate conclusion is that unemployment is the result of disruptions in the labour market, and the solution to the excess supply is found within the labour market itself. If there are any imperfections, like artificial minimum wages and the likes, then once they are removed, the market resolves itself. Hence, unemployment is only a short-run phenomenon.

For post-Keynesians, however, unemployment is the result of a lack of aggregate demand. In other words, the causes of unemployment are not found in the labour market, but are the result of disruptions in the goods market. As a result, if workers cannot find work, it is not because the real wage is too high, but rather because there is an insufficient demand for goods and services. As such, workers are unemployed “through no fault of their own” – in other words, they are involuntarily unemployed: workers are willing to work, but firms will not hire them because of a lack of effective demand. In this sense, unemployment and more specifically involuntary unemployment is the “general” state of affairs in our economic system, and hence the title of Keynes’s book. The solution is to increase aggregate demand.

8 Uncertainty and historical time
Uncertainty is a core and fundamental element of post-Keynesian economics, and permeates all relationships. It is often referred to as “radical uncertainty” to distinguish it from the treatment of uncertainty in mainstream theory, which is nothing more than situations of risk with known outcomes and probability distributions.

Radical or fundamental uncertainty, as Keynes tells us, is a situation in which “we simply do not know” future outcomes of any variable, let alone the economy in the future. We don’t know the outcome, we don’t know the possibilities or probabilities to these outcomes. To be clear, “we simply do not know”. Moreover, it is impossible to gain knowledge about the future and reduce uncertainty, because the future is by definition unknown and unknowable. Each group is affected by it, and in turn, it affects the decisions made by various groups, be it consumers or workers, firms, banks, as well as the State and the central bank. In Eichner and Kregel’s celebrated
article, the authors argue that “only the past is known, the future is uncertain” (1975, p. 1309).

This does not, however, mean that agents are paralyzed in their decision making, but they must rely on other means, perhaps by adopting rules of conduct. And the consequences of recognizing uncertainty is devastating for neoclassical theory. For starters, you can no longer have stable positions of equilibrium or centres of gravitation. The concepts depend on knowing where in the future the economy is going. But if the future in uncertain and unknown, then what?

For Robinson (1979b, pp. xi, xvii), “It is from this point that post-Keynesian theory takes off. The recognition of uncertainty undermines the traditional concept of equilibrium. … When all the rubble of disintegrating equilibrium theories has been cleared away, post-Keynesian analysis can come into its own.”

And the implications are important. As discussed above, firms plan their investment decisions in an uncertain world by relying on expectations, as do banks. But uncertainty also affects workers and consumers who may, faced with uncertainty, decide to reduce consumption. The State is also subject to uncertainty in deciding how much to spend, and the central bank must decide, in an uncertain world, where to set interest rates – decisions that are based on expectations of aggregate demand and growth.

Adding to this, historical time implies that economists must deal with the passage of real time. In neoclassical theory, there is no time in the sense that decisions can be made and undone, curves move back and forth. But in the real world, the past is given and cannot be changed, and the future is unknown. This suggests that many decisions are irreversible: if a firm, based on expectations, decides to build a new plant, it cannot simply decide to unbuild it at a later time: decisions made today remain with us. In other words, history matters:

In an historical model, causal relations have to be specified. Today is a break in time between an unknown future and an irrevocable past. What happens next will result from the interactions of the behaviour of human beings within the economy. Movement can only be forward. (Robinson, 1962, p. 26)

9 Institutions matter
If we want realistic assumptions to represent the society in which we live, we must reject neoclassical theory’s emphasis on atomistic individuals, and recognize that all individuals are part of a social class, and as such are social beings. This has often been referred to as an ‘organicist’ approach
A brief history of economic thought

(Lavoie, 2014; Arestis, 1990): “In this sense, post-Keynesians take a more complex view of human nature and of individual behavior in so far as they see individuals as social rather than atomistic beings.”

Rather than beginning the analysis with the representative agent, post-Keynesians recognize the role of banks, of large oligopolistic firms capable of setting prices, and workers often organized around unions. And by focusing on institutions rather than individuals, this allows us to bring the concept of power and power relationships into the discussion and analysis. And the inevitable result of this is to take economics and embed that into the notion of society.

For instance, in contemplating the distribution of income, we can link the decline of unionization in many developed economies to the steady decline of the wage share in the last four decades.

10 Fiscal policy dominance

The role of fiscal policy in post-Keynesian theory has been alluded to above. It is an integral part in efforts to stabilize an unstable economy through its impact on effective demand.

The post-Keynesian position, however, stands in stark contrast, yet again, to more mainstream policies that place monetary policy, that is fine-tuning, at the heart of stabilizing economic activity. Yet, monetary policy can often be clumsy, and much of it can be rather ineffective (see Rochon, 2022b). Nevertheless, during the last four decades or so, the burden of regulating economic activity was placed entirely, in many countries, on monetary policy, not fiscal policy, leading to the expression “monetary policy dominance”. As for fiscal policy, it was relegated to measures of austerity – or what was also called “fiscal consolidation” – on the belief that fiscal policy can be inflationary and lead to all sorts of crowding-out effects. Balanced budgets were the primary goal of prudent governments: this was called “sound finance”.

Yet, for post-Keynesians, fiscal policy can in fact have all sorts of crowding-in or multiplier effects: increased government spending can encourage more investment, for instance. Given what was said above about the determinants of investment, fiscal spending will play two roles. On the one side, it will increase effective demand, thereby making firms and banks more optimistic about the future, and perhaps, indeed, more willing to invest and to lend. On the other side, firms who are on the receiving end of fiscal spending will see its revenues increased and as such will be seen as more creditworthy by banks, who in turn will be more inclined to lend to them.

If this view is correct, then low levels of fiscal stimulus may be insufficient to convince firms and banks; similarly, incremental fiscal interventions may have similar limited effects. Therefore, depending on the severity of
the economic downturn, only high levels of fiscal expenditures will have a sufficient effect. Rochon (2008) has also argued that the value of the fiscal multiplier is not only dependent on the economic cycle, but also on fiscal policy, and is thus policy-dependent: the larger the fiscal intervention, the larger the value of the fiscal multiplier.

Lastly, there is, from a post-Keynesian perspective, more to fiscal policy than what was described above. Indeed, government must not only assume control of the business cycle, but it must also become the guarantor of our collective road to “economic bliss”. As Keynes tells us in his wonderful pamphlet, *Economic Possibilities for our Grandchildren*:

> The pace at which we can reach our destination of economic bliss will be governed by four things – our power to control population, our determination to avoid wars and civil dissensions, our willingness to entrust to science the direction of those matters which are properly the concern of science, and the rate of accumulation as fixed by the margin between our production and our consumption; of which the last will easily look after itself, given the first three. (Keynes, 1930, p. 69)

There is a definite role for the State in trying to reach this destination, what exactly that is, is up for some further debate. But it certainly begins with what Keynes calls the “socialization of investment”: “I conclude that the duty of ordering the current volume of investment cannot safely be left in private hands” (1936, p. 320).

5. CONCLUSION

At age 50, post-Keynesian economics has come a very long way. It has developed into a full-fledged positive theory capable of addressing the most relevant economic problems and crises.

Many of the ideas in this chapter deserve their own airing and indeed perhaps their own entire book. But its purpose was to serve simply as an introduction to some of the most basic post-Keynesian economics, and to see not only how it contrasts with new-or-otherwise Keynesian schools, but how it is based on a realistic interpretation of the world in which we live.

Interestingly, since the financial and COVID-19 crises, many post-Keynesian ideas have crept into the mainstream vernacular. Reliance on fiscal policy as a means of stabilizing this instability no longer seems to attract the kind of derision it once did. The notion that central banks control the money supply is now relegated to outdated textbooks. Sadly, though, post-Keynesians are never if ever quoted, giving the impression that these are “new ideas”.
Post-Keynesians are being proven right in their assessment of business cycles. We have been consistent in our analysis, unlike more mainstream colleagues who once had proclaimed the end of business cycles, just before the financial crisis under the guises of the Great Moderation.

NOTES

1. I would like to thank, without implications, Wesley Marshall for comments made on earlier drafts.
2. The astute reader will soon realize that there are two spellings of post-Keynesians in this chapter: post-Keynesians and post Keynesians. We will not discuss here the significance of the hyphen. Suffices to say that for the purposes of this chapter, both spellings refer to the same body of thought. While I prefer the hyphen, the non-hyphenated term is used here only when appearing in original quotes.
3. Robinson writes that at the time, in Cambridge, Alfred Marshall “was economics” (1973, p. ix; emphasis in original). It is no surprise that Keynes was educated in the deepest of Marshallian tradition.
5. Bortz (2017, p. 571) refers to a letter from Keynes to Kalecki where the former approved of Kalecki’s paper on the “Political aspect of full employment”.
6. The debate of who got there first is secondary to the notion that both were discussing similar ideas at roughly the same time. Simultaneous discovery “is not important, except for the historians of economic thought. The clear thing is that both Kalecki and Keynes were pioneers of a new economics” (Kaldor, 1986, p. 6) – a sentiment echoed by Joan Robinson: “The important question is not about priority, but about the content of the theories. In several respects, Kalecki’s version is more robust than Keynes” (Robinson, 1977 [1979], p. 187).
7. Despite the fact that Kalecki anticipated Keynes’s General Theory, we still call ourselves post-Keynesians rather than post-Kaleckians. In light of this discussion, perhaps “heterodox” is a preferred epithet. In an unscientific Twitter poll of 400 heterodox scholars (22 March 2021), 60% were in favour of calling ourselves “post-Kaleckian” rather that post-Keynesian.
8. For those wishing to look at the differences between Keynes and Kalecki, see Sawyer (1985) and Toporowski (2013, 2018).
9. The inclusion of Sraffa is a difficult one, but not impossible.
10. In a letter to Lord Beveridge, Keynes (1973, XIV, p. 57) wrote that the General Theory was essentially about effective demand and the multiplier: “half the book is really about it” the multiplier.

REFERENCES


