Growth and money in Post Keynesian models

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Growth and money in Post Keynesian models

During the past few years, a significant renewal and development in Post Keynesian modeling has taken place. A perfect illustration of this can undeniably be found by opening recent issues of this journal as well as others. The growing interest for these kinds of models has been reinforced since the financial crisis began in 2007, a tragic event that has confirmed the relevance of the Post Keynesian analysis. Roughly speaking, the main strands of the current Post Keynesian literature are the Kaleckian models of growth and income distribution, the Kaldorian–Robinsonian models of path dependency, and the Minskian models of financial crises. In addition, the stock-flow consistent methodology can be a useful tool for understanding complex macroeconomic interactions with multiple buffers.

This burgeoning literature is one of the reasons why the Center of Economics of Paris North (CEPN), well known for its heterodox tradition, decided to organize a symposium, held on November 20–21, 2009, aimed at presenting and exploring further the most recent advances of Post Keynesian modeling. Many well-known contributors to this journal, such as Mark Setterfield, Louis-Philippe Rochon, Thomas I. Palley, and Amitava Krishna Dutt, have presented their most recent work at the CEPN. This issue gathers some of the most stimulating papers presented at this conference.

Despite these recent advances, however, it becomes increasingly clear that there is no all-encompassing Post Keynesian model. Indeed, there appear to be some contradictions arising from competing models. Nevertheless, there are also some well-grounded similarities. In fact, we would...
argue that all of these models share more than some basic characteristics, and are fully compatible, and even complementary to each other.

As underlined in Lang and Setterfield (2006), a first way of dealing with this matter can be based on two distinctions made by Lawson (2005), in a paper published in this journal. First, Lawson distinguishes economists who concern themselves with “equilibrium analysis” (in the deterministic, path independent sense used by the mainstream) from those who adopt a critical stance toward such kind of analysis. Moreover, Lawson also offers a distinction between the theoretic and the ontic: “the term theoretic [is used] to denote the quality of being a feature of a model and the term ontic [is used] to denote the quality of being features of the world the economist presumes to illuminate” (ibid., p. 429). For the mainstream, the “prioritization of the modeling orientation” clearly results in a “conflation of the theoretic and the ontic, with the latter reduced to the former” (ibid., p. 430). To sum up Lawson’s argument, mainstream economics reach their conclusions by dealing with “theoretic” problems, which leads them to neglect explicit discussion of the ontic. By contrast, as argued by Lang and Setterfield (2006), the desire of Post Keynesian economists to find models that better match what we perceive as the relevant features of the real world is motivated by ontic concerns: in order to be relevant, a model has to be able to explain, primarily, the main features of the reality as we perceive it.

Obviously, this way of defining Post Keynesian modeling is right but still incomplete, as it could also be applied to other heterodox schools of thought. Another common feature of all the Post Keynesian models is, of course, the leading role of effective demand. As argued by Asensio (2008), the mainstream economists—and especially the so-called New Keynesians—claim that their theory is capable of explaining market failures, since imperfect competition and incomplete markets may cause dysfunctions, but those dysfunctions stem, at least in the long run, from structural imperfections, not from insufficient demand. In the mainstream models, aggregate demand can never constrain aggregate supply once relative prices have been adjusted.

Such self-adjusting properties and the related equilibria require the fundamental assumption that individuals believe they can properly assess the present and future possible consequences of their decisions. The stabilizing effects of competition therefore only hold provided agents believe there is a “natural order,” that is, enough “structural stability” for intertemporal optimization to make sense. By contrast, Keynes (1936) built his theory by reconsidering the functioning of competitive markets in the absence of any “natural” anchor for expectations, that is,
in presence of “true uncertainty.” And while Keynes admits that people make use of all available information at their disposal, expectations still cannot be a reliable tool for decision making; past events never give enough information about what the future will be. To sum up, following Davidson (2004), *ergodicity* is the dynamic stability of a stochastic process, which characterizes mainstream models. Post Keynesian models, however, are *nonergodic*. As a consequence, individual decisions have no optimal solution, and decisions have to be made according to one’s “views concerning the future.” It was Keynes’s genuine innovation in economic theory to show why, in such a world, competitive forces do not assure the market’s efficiency, and why it is the effective demand that eventually drives the system.

The papers contained in this issue can be considered as illustrations of these common features of Post Keynesian models. The first paper, by Asensio, Lang, and Charles, presents the current “state of the art” of Post Keynesian modeling, as well as the most important issues raised by this modeling. They propose a new formal statement of Keynes’s “static model of a dynamic process” and analyze the most important classes of Post Keynesian dynamic contemporary models. They argue that none of the recent models encompass all the rich and realistic properties of Keynes’s vision and that as a result, a synthetic dynamic Post Keynesian model still has to be developed.

In the second paper, Cross, McNamara, and Pokrovskii provide evidence that economic fluctuations do change potential output paths in the case of recessions. So, while the mainstream macroeconomic models assume that the effects of recessions are not permanent, the authors provide evidence to the contrary. Using a model based on an analogy with water flows in porous media, they prove that potential output displays hysteresis with regard to aggregate demand shocks and thus retains a memory of the shocks associated with recessions.

The next three papers are based on the popular Kaleckian model of growth and income distribution. Dutt provides a systematic analysis of how growth affects income distribution through a number of alternative channels. His paper draws on Kalecki’s discussion of the determinants of changes in the degree of monopoly: the influences of capacity utilization, industry characteristics, the importance of overhead costs, and the power of trade unions. Palley explores the implications of wealth and wealth distribution for the Kaleckian model. He introduces a rich description of capital accumulation that includes a profit rate effect, a Tobin *q* stock market valuation effect on investment, and a consumption wealth effect on saving. Palley also shows that introducing managerial
pay dramatically changes the model’s properties and undoes Pasinetti’s (1962) theorem regarding the irrelevance of worker saving behavior for income distribution and growth. Finally, Hein focuses on the long-run effects of “financialization” and increasing shareholder power in a Kaleckian endogenous growth model. He shows that the conditions under which increasing shareholder power has positive effects on potential growth of the economy are very particular, and that these conditions are questionable empirically. As a consequence, an overall long-run “contractive” regime seems to be the most likely outcome of “financialization” and the pronounced shareholder value orientation that is characteristic of the finance-led growth regime.

The next two papers, well entrenched in the Kaleckian tradition, deal with the right approach to monetary policy within a Post Keynesian perspective. Rochon and Setterfield try to find an answer to the “Smithin question”: What is the appropriate benchmark rate of interest in a Post Keynesian economy in which there is no natural rate of interest? They evaluate the impact on macroeconomic performance of three variants of the “parking-it” approach to monetary policy, and show that each of these rules is consistent with an explicit distributional objective vis-à-vis the role of the rentier class in a capitalist society. In the next paper, Docherty develops a framework for evaluation of the long-term implications of monetary policy, focused on interest rate rules that ensure balanced long-run growth leading to a situation close to full employment. He provides support in favor of a Smithin rule, combined with an activist approach to monetary policy.

Finally, the paper by Kam and Smithin is a short note on another version of an interest rate rule and the relationship between banks and the central bank—a timely issue these days.

On the whole, we hope that the papers published here will contribute stimulating future Post Keynesian research. As a matter of fact, even if the path that has been covered through the recent years is spectacular and stimulating, it seems that, at the present stage, there is still room for further research in the field. According to us, the next important stage for Post Keynesian modeling should really be the framing of a Post Keynesian synthesis. The baseline of such a synthesis could be a Kaldorian model of growth and income distribution, with a path dependent rate of capacity utilization, and an endogenous supply of credit that changes as the behavior of financial institutions varies in the different phases of the cycle. Class struggle, subcontracting, and domination should also be taken into account explicitly. Arguably, to enrich these models and their understanding of reality, Post Keynesians should really develop further
the discussion with the other heterodox schools, rather than engaging with the mainstream. The latter has become so blind to the events taking place in the real world that whatever happens, its representatives won’t ever pay attention to what the other economists have to say.

As usual, we would very much like to thank all the contributors for their time and their papers as well as Paul Davidson for his full support and encouragement in this issue and in the past.

REFERENCES


