Introduction to Post Keynesian Economics

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Outline

• foundations
  • Fundamental uncertainty
  • Social conflict
  • Effective demand
• Macroeconomics
  • Investment → savings
  • Involuntary unemployment
  • Credit → money
  • Financial instability
• Context: Synthesis and New Keynesians
• Economic Policy
Fundamental uncertainty

• ‘we simply don’t know’
  • That’s a statement about the world, not about human cognitive abilities
• People can’t be ‘rational’, instead
  • They rely on conventions = look what other people are doing (social norms, anchoring, institutions)
  • Assume that the future is similar to the past (adaptive expectations)
  • Conventions can change rapidly (herd behaviour)
• Money as a means to deal with uncertainty → liquidity preference
  • Possibility of liquidity crises and panic
• Investment demand driven by animal spirits
  • Can’t make a ‘rational’ decision about long time horizon
Social conflict

• Distributional conflict
• PK models: often 3 classes: workers, capital, rentiers
  • Capital hires labour; firing threat as disciplinary advise
  • Capitalists make investment decisions
  • Rentiers advance capital and receive interest + dividend payments
  • Have different income propensities
• Institutions regulate and mediate conflicts
• Inflation as the outcome of unresolved distributional conflicts
• Note: workers and uncertainty? job insecurity

Effective demand

• I(Y) = S(Y)
• Investment → savings via multiplier process
• Inv not constrained by saving, but possibly by the availability of finance
• Investment expenditures are the single most important determinant of fluctuations in GDP
• Have strong non-rational component
• Private goods market equilibrium will in general not be at full employment equilibrium
Involuntary unemployment

- Labour market is not self-adjusting; cannot serve as the anchor of the economy
- Wage contract are nominal contracts
- Wage cuts → reduction in consumption demand
  - → downward pressure on prices
  - → possibility of debt-deflation spiral
- Real wage cut: workers have higher MPC than capitalist
  - → real wage cut will be contractionary unless investment is very sensitive to the profit margin
- No self adjustment towards full employment
- Labour market dragged along with goods market; strong hysteresis

Money & finance

- Endogenous money: credit → money
- CB sets the interest (base) rate
- Private financial institution mark up according to their liquidity preference (risk premium)
- Financial market prone to instability b/e forward looking (fundamental uncertainty)
  - Debt cycles a la Minsky
- Inflation as the outcome of unresolved distributional confictions: if capital, labour and finance can’t agree on their income shares
PK: development and streams

• 1950s + 60s: Keynes in the long run – distribution and growth; Capital Controversies; critique of Synthesis; Cambridge
• 70s + after: formation of PK school (journals); spreading out
  • Conflict inflation; endogenous money
  • Financial instability (Minsky)
  • Shift towards short/medium run analysis (Kaleckian models): distribution and demand, wage-led growth
• More on economic policy, more empirical

PK streams + further readings

• Sraffians
• Monetary Keynesians
  • Minsky
• Kaleckians

• Lavoie: Introduction to Post Keynesian Economics
• Hein & Stockhammer: New Guide to Keynesian Macroeconomics and Economic Policies
• King: History of Post Keynesian Economics
• Keynes, Kalecki
Neoclassical vs Keynesian theory

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

- Marx
- Keynes
- Synthesis Keynesians
- New Keynesians
- Post-keynesians
- Neoclassical
- New Classical Econ
  - Monetarism
  - Rational Expectations
  - RBC
New Keynesians

- in 1980s (Mankiw, Blanchard, Stiglitz, Fisher)
- reaction to New Classicals - accept microfoundations and often rational expectations
- but assumes (or derives) imperfect markets –
  - menu costs,
  - NAIRU, insider outsider models
  - credit rationing / asymmetric information
- 2008-? Crisis

PK and mainstream economic policy

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<thead>
<tr>
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<th>Mainstream Policy Mix</th>
<th>Post Keynesian Policy Mix</th>
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<tbody>
<tr>
<td>Overall aim</td>
<td>Efficiency (minimal interference in markets)</td>
<td>Full employment</td>
</tr>
<tr>
<td>fiscal policy</td>
<td>Balanced budgets (‘sound fiscal policy’)</td>
<td>Countercyclical fiscal policy to ensure full employment</td>
</tr>
<tr>
<td>Monetary policy</td>
<td>Inflation targeting</td>
<td>Has to support growth; In recession with debt hangover; higher inflation allows rebalancing</td>
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<td>Labour market</td>
<td>Encourage ‘labour market flexibility’</td>
<td>Institution building</td>
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<td></td>
<td>Wage as a cost factor</td>
<td>Wages as source of demand</td>
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<tr>
<td>Financial market</td>
<td>financial liberalisation, trusts efficiency of financial markets</td>
<td>Regulate finance</td>
</tr>
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Reading suggestions

- Keynes: General Theory of Employment, Interest and Money
- Kalecki: Theory of Economic Dynamics
- Robinson: Accumulation of Capital
- Minsky: Stabilizing an Unstable Economy

- Lavoie: Introduction to Post Keynesian Economics
- King: History of Post Keynesian Economics

Appendix
PK goods market: basic multipliers

- Standard Keynesian multiplier
  \[ C = c_1 \cdot Y + c_0 \]
- \[ I = I_0 \]
- In equilibrium
  \[ Y = C + I_0 \]
  \[ Y^* = \frac{1}{1-c_1}.(C_0+I_0) \]

Different consumption propensities for profit income and wage income

- \[ C = c_W \cdot W + c_R \cdot R \]
  \[ \pi = \frac{R}{Y} \] (profit share)
- \[ C = c_W \cdot (1-\pi) \cdot Y + c_R \cdot \pi \cdot Y \]
- \[ Y = c_W \cdot (1-\pi) \cdot Y + c_R \cdot \pi \cdot Y + c_0 + I_0 \]
- \[ Y^* = \frac{1}{1 - c_W + \pi[c_W - c_R]}.(c_0 + I_0) \]

- If workers don’t save: \( c_W = 0 \)
  \[ Y^* = \frac{1}{\pi}(1-c_R).(c_0 + I_0) \]
- \[ \frac{dY^*}{dI_0} = \frac{1}{\pi}(1-c_R) \]
- \[ \frac{dY^*}{d\pi} = -\frac{1}{\pi^2}(1-c_R) < 0 \]
Wage-led versus profit-led demand

- \( Y = C + I + NX \)
- Increase in profit share
  - Negative effect on consumption
  - Positive effect on investment
  - Positive effect on net export (for an individual country)
- \( Y = C(Y, \pi) + I(Y, i, \pi) + NX(Y, \pi; Y^W, ex) \)
  - \( Y \) income, \( i \) interest rate, \( \pi \) profit share, \( D \) debt, \( Y^W \) world GDP, \( ex \) exchange rate, \( P \) price level, \( p \) inflation
- \( \frac{dY^*}{d\pi} = \frac{h_1}{1-h_2} \)
- \( h_2 = \frac{dC}{dY} + \frac{dI}{dY} + \frac{dNX}{dY} \)
- \( h_1 = \frac{dC}{d\pi} + \frac{dI}{d\pi} + \frac{dNX}{d\pi} \)
- \( \text{neg + pos + pos = ??} \)
  - If \( h_1 > 0 \) profit-led demand
  - If \( h_1 < 0 \) wage-led demand

Net Effects: \( \Delta Y/\Delta WS \)

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