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The Contemporary Relevance of Post-Keynesian Economics: Editors' Introduction

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Following the UK General Election of May 1997, the unenlightened observer might have expected to see a significant change in the approach to economic policy. This followed 18 years of a government who had reduced state intervention, privatised state industries, depressed the real income of public employees and unashamedly given priority to reducing inflation, over and above any concern for ensuring that its citizens all had realistic prospects of fruitful, meaningful and rewarding employment. A new government was elected who immediately impressed the political commentators by 'hitting the ground running' but who appeared to be running in much the same direction as their predecessors. Any lessons we might have learned from Keynes had not just been put on the back boiler while priority was given to issues for which 'Keynesian' economics had little to offer, or for which the liberal John Maynard Keynes would have had little sympathy. Rather, they appeared to have been assigned to the history of economic thought. Spending targets set by the previous Government were kept, fiscal deficits were effectively to be minimised[2] - an approach all the more easier to justify by reference to the Maastricht convergence criteria - and the Central Bank was given the greatest degree of independence since its nationalisation.

For many economists, doubtless the approach of New Labour brought few surprises. The supremacy of the market system for resource allocation appears to be part of the conventional wisdom and is consistent with a wealth of economics literature. *Prima facie* such a view appears to be supported by the demise of the communist regimes of Central and Eastern Europe.

To a significant minority, the conventional wisdom in economics is guilty of at least two serious misinterpretations of history. Firstly, what masquerades as 'Keynesian' economics has significant differences from the ideas expressed by Keynes, especially in the *General Theory* but also in much of his other work in the 1930s. Secondly, the breakdown of the Phillips curve in the late 1960s and early 1970s did not represent a discrediting of Keynes. Rather, it exposed the popular oversimplification of the *General Theory* into little more than an algorithm for increasing or decreasing aggregate demand according to whether unemployment or inflation was the problem of the day. This is not to imply that Keynes's works necessarily contained hidden answers to all of the economic problems of the modern world or even that the analysis was anywhere near complete. What was claimed - or at least hoped for - was the basis for a significantly different approach to economics which had the potential for developing some radically different policy recommendations.

The history and development of post-Keynesian economics has been dealt with elsewhere.[3] The work was begun by some of

Keynes's younger contemporaries, of whom Nicholas Kaldor, Joan Robinson and Richard Kahn were amongst the most well-known and is continued today by a group of economists spanning all generations, some of whom are represented in this volume. The research agenda was immense. It included the extension of Keynes's ideas to the long run, the development of microeconomic foundations and the development of appropriate economic policy proposals. Fundamental to this approach is the belief that we live in a monetary production economy where production takes time and uncertainty is pervasive. Markets do not clear instantly and the 'market' for labour - if such a thing exists - does not behave just like the market for potato peelers. Indeed, one of the most respected post-Keynesian scholars refers to the 'inductive proposition' that 'modern monetary economies do not possess any automatic mechanism that assures a tendency towards full employment of resources over time'.[4] In the 1970s there were a number of key papers and books setting out the post-Keynesian approach.[5] The *Journal of Post-Keynesian Economics* was launched in the late 1970s and the 1980s and 1990s witnessed the publication of a number of post-Keynesian economics textbooks.[6] The *Cambridge Journal of Economics*, *Review of Political Economy*, *Journal of Economic Issues*, *International Review of Applied Economics*, this journal and possibly a few others all at least occasionally publish papers which are reputedly post-Keynesian. So why has their been so little impact on contemporary economic policy? Why did New Labour choose to adopt patently conservative (also with a large C?) economic policies? Does post-Keynesian economics really have nothing superior to offer?

It was these questions which motivated the conference that spawned this issue. Is the economics of Keynes now to be consigned to a chapter in the history of economic thought or should it be the basis of key chapters in economic policy texts? In May 1998 we invited a number of post-Keynesian scholars to a conference at Staffordshire University. The theme was to be the 'Contemporary Relevance of Post-Keynesian Economics'. It was a source of encouragement that more papers were offered than we could accommodate and a mixture of satisfaction and regret that more papers were presented than we could possibly publish in this single issue. Nevertheless, we include a selection of papers, which we hope illustrate the richness and diversity of post-Keynesian economics. The reader can judge the contemporary relevance.

Geoff Harcourt has been a source of inspiration and encouragement to many and it is a privilege to be able to count him as a friend. When he offered to present a paper at the conference we were delighted. His paper essentially provides the link between the intellectual origins of post-Keynesian economics and recent work, such as that contained in this issue. The paper forcibly illustrates his role in setting the methodological parameters within which particular post-Keynesian research projects have developed. In his introduction, Harcourt contrasts the approach of Kalecki with that of Friedman and compares himself to the former. In many respects this is a caricature of the difference between post-Keynesian and neoclassical economics. The latter is essentially deductive and reductionist. This helps to make it precise and easy to define. This contrasts with the approach explicitly favoured by Harcourt's first PhD supervisor, Nicholas Kaldor (1985, p.8), who proposes, 'one should subordinate deduction to induction, and discover the empirical regularities first'. As one begins to understand how an economy works, policy recommendations may be derived. Such an approach is aptly referred to as 'Horses for Courses'. Although Harcourt is probably best known for the light he shed - especially for the uninitiated - on the capital controversies of the 1960s, his contributions to policy and his political involvement to attempt to secure policy change, especially in his native Australia, continue right up to the present day. In his later work especially, a common theme is that economies are typically not characterised by well- functioning markets, taking us smoothly towards full employment but by cumulative causation processes. The policy recommendations are not a further move towards flexible labour markets - an unfortunate focus of New Labour's policy, as discussed by Arestis and Sawyer - nor a further freeing up of financial markets. But neither is there a suggestion of moving to the other extreme. The policy proposals relate to a middle way.

Despite Harcourt's efforts, one of the accusations sometimes levelled against post-Keynesian economics - even by some of its sympathisers - is that it lacks coherence.[7] There have been substantial methodological discussions in post-Keynesian economics devoted to this issue. Most of this discussion, echoing Harcourt's intentions, suggests that the coherence of post-Keynesian economics lies in a commitment to Critical Realist Philosophy (Dow, 1990; Arestis, 1992; Lavoie, 1992; Downward and Reynolds, 1996). The paper by Flavio Comim takes this discussion further by elaborating on the methodological basis of a Horses-for-Courses Approach and suggesting a complementarity with Critical Realism. Comim discusses the Horses-for-Courses Approach in conjunction with Wittgenstein's concept of 'Forms of Life' and further develops the argument that the coherence of post-Keynesian economics is in its diversity.

The next paper relates explicitly to New Labour's economic policy. Arestis and Sawyer focus attention on the new arrangements for monetary policy and on the approach towards the labour market, with the apparent acceptance of the notion of a NAIRU and the virtual abandonment of active fiscal policy - at least from any macroeconomic perspective. The influence of the NAIRU and the role of fiscal policy are again taken up by Skott and by Mair and Laramie.

The defining feature of New Labour's approach to monetary policy - aptly referred to by Arestis and Sawyer as 'new monetarism', was to give operational independence to the Bank of England. Under new monetarism it is the interest rate rather than the money supply *per se* which is the instrument of economic policy but inflation is still the policy target. This appears to reflect a continuing belief in the classical dichotomy. Tight monetary policy reduces inflation with output and employment costs that are either negligible or of secondary importance. Few post-Keynesian economists would argue that output and employment costs are negligible and even fewer would relegate them to secondary importance. Arestis and Sawyer home in on the transmission mechanism(s) from money to prices. Although a number of routes are examined, output costs are always present.

In new monetarism the natural rate of unemployment is superseded by the NAIRU. Although it is recognised that this can be affected by education and training, policy pronouncements encourage a 'flexible labour market'. Arestis and Sawyer acknowledge that there are constraints to achieving full employment without high inflation but focus on the effect of the productive capacity constraint on the inflation barrier. In contradistinction from models which assert that aggregate demand tends towards the NAIRU, Arestis and Sawyer acknowledge the necessity for maintaining an adequate level of effective demand. Sufficient aggregate demand and adequate productive capacity are 'two essential requirements for full employment'. Aspects of the capacity problem are addressed by Ciaran Driver *et. al* and the existence of the NAIRU is further questioned by Peter Skott, who also identifies a role for demand management but in a different policy package.

New Labour's approach to fiscal policy is addressed by Mair and Laramie. Mair and Laramie argue that the orthodox approach to public finance, which appears to underpin New Labour's 'Code for Fiscal Stability' (HM Treasury, 1998), suffers from major weaknesses arising from a lack of congruence between its micro and macroeconomic elements. They offer an alternative framework. Building on the work of Kalecki, the authors outline a dynamic approach to taxation where both micro and macroeconomic considerations are integrated. Mair and Laramie acknowledge that their approach has little to offer concerning the allocation aspects of fiscal policy and are prepared to recommend orthodoxy as the horse for this particular course. The Kaleckian approach is predicated on changes in the structure of taxation and focuses on the distribution and stabilisation aspects of fiscal policy. The impact of balanced changes in taxation and government spending on investment and on the distribution of income is considered. The macroeconomic impact is affected by both an income-distribution effect, operating via changes in the wage share and a tax-shifting effect, operating through changes in firms' mark ups. The authors demonstrate that balanced-budget changes in taxation have different macroeconomic effects, according to whether or not firms are able to adjust their mark ups to the tax changes.

Peter Skott examines a unionised economy, where workers care about inflation, and demonstrates that even with rational agents and rational expectations a well-defined NAIRU may not exist. Under one version of the model, where wage aspirations are endogenous, the employment rate demonstrates hysteresis, though in contrast both to orthodox duration and membership theories and to the Arestis and Sawyer capacity constraint, hysteresis in Skott's paper is caused by sluggish changes in workers' real-wage aspirations. Again, the policy conclusion is that expanding demand may have a role to play in reducing unemployment but in this case the inflation barrier is overcome by the adoption of a temporary incomes policy.

Ciaran Driver, Elias Karakitsos and Mark Bunyan offer a theoretical framework for explaining the decline in fixed investment experienced by most major industrialised countries in recent years. This takes up the issue of the importance of plant capacity, raised by Arestis and Sawyer and highlights the possible divergence between the private and social returns to investment. This divergence, the volatility of investment and the importance of investment generally both in short-period output determination and in long-period growth analysis has meant that investment has been the focus of much post-Keynesian work, both at the theoretical and empirical level. Driver *et. al.* focus on the effects of the policy response to any initial shortfall in plant capacity. In their simulation model, the initial output gap is met by deflationary policy, which increases uncertainty and thereby encourages firms to adopt an even tighter capacity stance, further exacerbating the capacity shortage and leading to a cumulative depressive effect.

It has long been appreciated by post-Keynesian economists that as economies evolve, so do their institutions, including their monetary institutions.[8] Hence, post-Keynesian monetary theory is largely concerned with credit-money economies in which banks operate liability management, the Central Bank acts as lender of last resort and the money supply is essentially endogenous. Keynes and Kalecki both recognised the role of the banking system in providing credit for investment and as post-Keynesian monetary theory has developed this was generally broadened to encompass corporate demand for loans in general. Economies continue to evolve and Peter Howells documents and analyses two recent developments, particularly in the UK. Household demand now exceeds corporate demand and total transactions have grown much more rapidly than GDP, particularly in the 1980s. Recognising that credit may be required for all types of transactions, Howells discusses some of the implications of these developments.

So does post-Keynesian economics have contemporary relevance? In the United Kingdom, as in other countries throughout the world, there are involuntarily unemployed people. This is taken as an inductive proposition. Recognising that freely functioning markets, with minimum government interference and balanced budgets may not be the answer to everything, post-Keynesian economists have sought to develop an approach to economics which addresses the problems of the untidy world in which we live. This may require different approaches at different times and in different places. In Britain today, productive capacity and effective demand are just two of the constraints on employment. There is a role for expanding demand but the inflation constraint must be addressed - which means dealing with the capacity problem and /or facing up to the wage aspirations of workers. There is a role for fiscal policy but this should be analyzed in a framework where the effects of tax changes on investment and on income distribution are considered. The institutional framework is a critical aspect of post-Keynesian analysis and this is probably most apparent in the area of monetary economics. The papers in this issue offer a taste from the post-Keynesian menu.

Endnotes

1. Staffordshire University

2. More precisely, the Government adopted a 'Code for Fiscal Stability', discussed by Mair and Laramie.

3. See, for example, Dow (1991), Reynolds (1987).

4. Davidson (1980, p.164) but see especially Davidson (1972/1978).

5. These include Davidson (1972/8), Kregel (1973), Eichner and Kregel (1975) and Eichner (1979).

6. Arestis (1992), Lavoie (1992), Paley (1996), Reynolds (1987).

7. See Hamouda and Harcourt (1988).

8. See Chick (1992).

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