

12-1-1982

## Review of "Information and Coordination" by Axel Leijonhufvud

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### Recommended Citation

Minsky, Hyman P. Ph.D., "Review of "Information and Coordination" by Axel Leijonhufvud" (1982). *Hyman P. Minsky Archive*. Paper 379.

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away from industries which price low. In his system, however, there is no *equation* which allows for substitution between commodities in consumption as a result of short-term relative price variation and in the absence of production functions unequal profit rates do not lead to inappropriate capital intensities.

One example will nevertheless illustrate the mayhem which could result if his natural price system were ever adopted without considerable further refinement of the concepts. Suppose it is discovered that a country (Britain) has the opportunity to produce a commodity (oil) in a new way (from under the seas). Then oil must be so priced that the entire costs of extraction and investment for future extraction are obtained from current sales revenues. This would have resulted in zero oil extraction in the early 1970s, or in such a high price for oil that demand for it would have been minimal. With new products and processes the need for capital commonly precedes the derivation of sufficient revenues to cover development costs, so it is unlikely that any actual economy would find that it could safely dispense with inter-sectoral capital markets.

Pasinetti's new book is therefore still very much a contribution to economic theory and not to practicalities. As such it will strongly influence and stimulate all those who believe that Marx and/or Sraffa have pointed their successors towards fundamental concepts which underlie superior ways of organising production and distribution.

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*Information and Coordination*. By AXEL LEIJONHUFVUD. (Oxford: Oxford University Press, 1981. Pp. x + 388. £14.95 hardback, £6.95 paperback.)

Leijonhufvud's 1968 *On Keynesian Economics and the Economics of Keynes* made a splash with the thesis that American Keynesianism (the neoclassical synthesis of Samuelson *et al.*) was not true to Keynes's *General Theory*. In 1968 American Keynesianism was riding high. Leijonhufvud's work was an important contribution to the development of an American 'Keynes based' critique of orthodox Keynesianism and monetarism.

The twelve essays in *Information and Coordination* fall into four parts: (1) four essays (from the late sixties) interpret and explain the 1968 book, (2) three essays carry the argument about the substance of monetary theory to new grounds for Leijonhufvud, (3) two essays examine inflation, and (4) three essays deal with miscellaneous topics.

The four essays which explicate the 1968 book reinforce the view that Leijonhufvud was more powerful as a critic of the American orthodoxy than as the creator of a new macroeconomics. Since Leijonhufvud's book and early essays appeared, American Keynesianism as a guide to policy and research faltered; contemporaneously, the economy misbehaved and policy floundered. This is evidence that a new macroeconomic synthesis is needed. Such a synthesis may well be based on Keynes, but its supporting case will depend on the need to understand system behaviour, not literature.

In three essays – 'Effective Demand Failures', 'The Wicksell Connection:

Variations on a Theme', and 'Monetary Theory in Hicksian Perspective' – Leijonhufvud carries his critique of neoclassical theory forward by presenting 'Leijonhufvudian' macroeconomics in which the coordination of intertemporal choice by the interest rate mechanism (a theme due to Wicksell) is the central question of monetary theory. If the interest rate mechanism doesn't work properly then effective demand failures take place. The interest rate mechanism is formulated in terms of supply and demand for loanable funds, where 'demand' relates to the 'natural' rate and supply to the 'market' rate. Full employment growth equilibrium rules when the loanable funds market is in equilibrium.

In Leijonhufvud's view Keynes's contribution made it clear that effective demand failures will affect output and employment if they occur when liquidity has been 'squeezed out' of the system. Effective demand failures occur when 'intertemporal prices are wrong' because, 'the market rate (of interest)... differs from the natural rate'. As a result 'the ratio of durable goods demand prices to consumer goods prices will also be wrong'. The problem arises because relative prices are wrong, and deflation '... would only *add* the problem of a large error in the money wage level to an already confused system state'; real balance effects will be perverse (pp. 191–2). As in Keynes, price flexibility in a depression makes things worse, not better.

Leijonhufvud's theory has separate price levels for output and capital assets. With two price levels quantity theories, both Wicksellian and Fisherian, break down. Money supply and demand cannot determine both price levels. The need to determine capital asset prices leads to liquidity preference. Liquidity preference is both a model determining the price level of capital assets and a theory of the determination and significance of liability structures. Investment is determined by the relation between the two price levels and acceptable liability structures. With this construction any concept of the natural rate of interest as a productivity rate evaporates. The loanable funds theory, that is central to Leijonhufvud's position, is not tenable.

Leijonhufvud's attempt to construct a macroeconomic theory that goes beyond the neoclassical synthesis is valuable. His point that coordination failures that lead to serious depressions can occur only after liquidity has been squeezed out of the system is important. However, he offers no insight on how this takes place. He notes with Hicks that the social accounting problem '... is to ensure that no one gets away with systematically appropriating resources of a greater value than he contributes.' He does not note that this is what investing units do: banking enables investment to be financed independently of investors' savings by financing placements out of liquidity. With 'banking' income, prices and profits adjust so that saving conforms to financed investment.

Leijonhufvud works to the literature, not to institutions and their evolution. This was valuable when criticising established doctrine was the task; it is a serious flaw when the task is the building of viable theory.

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