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Dear Donald,

Enclosed is review of Leijonhufvud's book.

Sorry it is late: back acted up and put things on hold for a while.

Hy Minsky

HPM:plc

enclosures
Information and Coordination: Essays in Macroeconomic Theory,
(Hardcover $19.95, Paper $11.95)

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' 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; conterminously, 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 behavior, 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 as a 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' 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." Because the problem arises because relative prices are wrong, 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. 191-92). 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 neo-classical 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 insights 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." (pp. 220-21). He does not note that this
is what investing units do: Banking enables investment to be financed
independently of investor's 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 critiquing established doctrine was the task;
it is a serious flaw when the task is the building of viable theory.

(1) Oxford University Press, New York.

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