Master

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THE ESSENTIAL CHARACTERISTICS OF POST - KEYNESIAN ECONOMICS

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for previous I put forth

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I never did ...

Keynesian: I prefer "Wall Street" paradigm. ... wider of power and ...

Note at bottom continued

...nes is to develop an economic

...ial theorem. Frank Hahn has

...ers the best available starting

... This is summerized in what

...re about the real variables -

...GT Keynes accepts that the

...ion.): Note, the ... ultimately* The Keynes axiom that we live out our lives in the transition.

...d by by Lucas as:

→ Assets: yield (q, c, ... , l_2 ...)

l_2 ↑ ... l_2 ↓ → P_a yield

assets ↑ : → stock market boom → investment boom.

My ... Post-Keynesian economics says M

...a collection of hypothetical ... history and prospects of cash flows.

...l market structure, determine ... of these balance sheets and cash flows

...re is the explicit subject of

...Yrjo Jahnsson Lectures, Basil

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1. On an abstract plane the problem set by Keynes is to develop an economic theory which has the non neutrality of money as an essential theorem. Frank Hahn has often stated that the Arrow Debreau model, which he considers the best available starting place for serious economic analysis, find no place for money. This is summerized in what Hahn calls the axiom of the reals, that ultimately agents care about the real variables - the flows of consumption through time. (Note that in the GT Keynes accepts that the underlying end of economic behavior is a stream of consumption.)

This fundamental neo classical position has been stated by by Lucas as:

"Any economic model is going to have at its center a collection of hypothetical consumers whose decisions, together with the technology and market structure, determine the operating characteristics of the system, and whose welfare is the explicit subject of normative analysis." (R. Lucas Models of Business Cycles, Yrjo Jahnsson Lectures, Basil Blackwell 1987 p. 20)

Lucas then specifies this to

$\sum_{t=0}^{\infty} E\,U(c)$ {sigma from t=0 to ∞ ~

the objective of economic behavior is to maximize the present value of consumption sequences. (E signifies expectations and U(c) is a utility function with consumption as the operative variable.)

Within any model based upon the Lucas or a similar specification money can only affect behavior as it affects how expectations are formed. However as preferences and production technologies determine the stream of output and its distribution - distribution is but another facet of pricing - the impact of monetary changes is at most transitory. This is so because if units really knew the structure of the economy and knew what was happening to money and why, they would adjust their behavior so that the monetary impact was nil. In this view fiscal policy, in the sense of deficits or surpluses, can affect the economy only as it changes the quantity of money: all demand management policies operate by affecting the money supply. Monetary changes can only affect the the money price level: the quantity theory of money is validated and policy ineffectiveness is a theorem.

Within the Lucas specification of the problem of economics, the money neutrality result can be overridden by making expectaions something other than the outcome of a learning process in which agents find out how they truly fit into the preference system - production function structure which determines the equilibrium of the economy. Thus the new Keynesians make much of the structure of information and the posession of private information (assymetric information) which makes the system deviate from the result mandated by preferences and technology; and which makes policy conditionally effective. Non-neutrality is achieved not as a fundamental property of the system but as result of special assumptions.

The result of this Lucas - new Keynesian methodology is the game "My rabbi is holier than yours," i.e. my special assumption on expectation formation is better than yours. Questions of evidence and the meaning of better now enter, which we ignore.

New Keynesians are serious and the best are concerned with the adequacy of the fundamental "standard" agents, preference system maximizing model.

My conjecture is that the Hahn (dolor de gueres) turn from neo-classical formalism is due to the feedback from the young Turks to the old Bearings.

Look to the World: there is a beast out there whose behavior we have to understand: The beast can misbehave (1929-33) but it can be controlled and harnessed.

World changes: + the proximate specification of a [illegible] tuned model will change

It is obvious that more structure is needed if the consumption stream only postulate of Lucas is to be abandoned and if money is to be non-neutral for causes more fundamental than the assymetry of information. Chapter 1 of The General Theory reads:

"I have called this book the General Theory of Employment, Interest and Money, placing the emphasis upon the prefix *general.* The object of such a title is to contrast the character of my arguments and conclusions with those of the *classical* theory of the subject, upon which I was brought up and which dominates the economic thought, both practical and theoretical, of the governing and academic classes of this generation, as it has for a hundred years past. I shall argue that the postulates of the general theory are applicable to a special case only and not to the general case, the situation of which it assumes being a limiting point of the possible positions of equilibrium. Moreover, the characteristics of the special case assumed by the classical theory happen not to be those of the economic society in which we actually live, with the result that its teaching is misleading and disasterous if we attempt to aplly it to the facts of experience." (G. T. p3)

The characteristics of the ~~actual~~ economic society in which we live includes bankers and clients of bankers. Bankers and clients of bankers live in an M > C > M' world, where cash flows are the proximate determinants of behavior. The structure of the model for such an economy must include bankers and units that finance activity from bankers at the begining, not as an afterthought. Thus units have to broken down into consuming units, investing units and banking units as a minimum.

Non-neutrality in a deep sense requires that the monetary variables enter in an essentially different way in different parts of the system. Keynes solution to this problem was to separate aggregate demand into investment and consumption demand and by having two sets of prices (the prices of current output, including investment output

Banker's saying: "I've never seen a pro-forma I did not like"

Banker's skepticism. Its regular breakdown after a period of economic success

(the CPI), and the prices of capital and financial assets (the Dow Jones)) whose proximate determinants are quite different.

Whereas money or finance or credit enters in an essential way in Keynes's investment theory, money, credit and finance do not enter in an essential way in his theory of consumption.

2. We are all familiar with one non-neutral money model. It is the fixed money wage IS-LM model of Hicks. The IS-LM model without a labour market

and

without the Patinkin effect that has delta w shifting the C fn. in an appropriate way.

A bit of the history of thought. Pigou had a labour market determination of output prior to Keynes. One objective of the General Theory was to create a model of the economy in which the standard labour market equilibrium was not the determinant of an economy's normal state or centre of gravity. Most well trained economists were unwilling to give the monetary-financial sphere the full partnership in determining aggregate demand that Keynes's work pointed towards. (The Modiglaini-Miller theorem asserted that liability structures do not matter: the financial system cannot affect decxisions.)

Recent work by Caskey and Fazzari, Delong and Summers, Solow and Hahn tend to validate the Keynesian Theorem that if appropriate circumstances rule then an initial condition of unemployment is likely to be made worse, not better by price level flexibility. In this work, if $dp/dt < 0$ then either or both of the burden of private debts increases or the real (price level adjusted) interest rate increases.

Keynesians and macro-economists in general need to distinguish between relative price flexibility and price level flexibility. Relative price flexibility serves a useful

purpose in resource allocation whereas the usefulness of price level flexibility in response to excess supply is questionable.

3 The burden of debt is a useful concept for macroeconomic research. We distinguish classes of units in debt: business, households, government and international. During each accounting period a portion of the revenues of each economic agent has been prior committed by debt, equity and lease contracts: these prior commitments are on account of both principle and interest. In the stripped General Theory - Kalecki derived model we have for business firms

Pi = I, Profits equals investment.

In the more complete statement we have

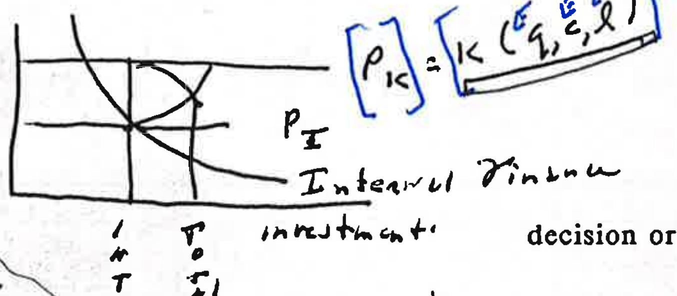
Pi = I + Gov. Def - Bal Tr Def + C(Pi) - S(w).

Internal finance is:

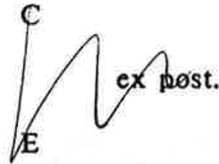
Int Fin = Pi - Tx(Pi) - (Int + Prin) Bnds - (Int + Prin) loans

~~Lns Cust Div.~~ — customary dividends

The Minsky Diagram.



decision or



INVESTMENT

Aggregate internal funds is a rectangular hyperbola in the price investment plane. For a fixed aggregate Profits (Pi) the greater the tax rate on profits, the level of indebtedness, the interest rate and the traditional dividend the smaller the aggregate internal funds.

Lenders and borrowers risk enter into the determination of investment. The Pk depends upon expectations of future Pi, upon the model of the economy that the agents of the economy whose expectations are relevant to investment have.

4. Outline of the Post Keynesian View.

1. The subject is capitalism

A. Characterization of Capitalism

To each agent: ∃ an associated balance sheet + income [E cash flows] statement [sources + uses funds]

This has taken on increased importance with the dissolution of the Stalinist model of socialism.

B. Varieties of Capitalism

2. Capitalist economy -> capital assets, bonds, firms as well as current output have prices: -> two sets of prices.

A] $P(K) = K(q,c,l)$; P(M) ≡ 1

q = E cash flows
c = payment commitments
l = ability to acquire cash by "selling" or "hypothecating" Kapital

[liquidity has 2 aspects: ability to transform assets into cash ("selling"); flow of incomes in cash terms]

Note that successful ...

1. money enters pricing of assets through l and c

1.1 P(M) = 1

2. financial institutions integral to determining P(K).

Keynes as a theory of asset prices

Neoclassical as a theory of output prices: (neo-classical assumes $\frac{P(K)}{P(O)}$ = constant)

B. P(O) = C(W, r, Mkt Pw)

1. W as a cost and P as a way of recapturing costs and a carrier of profits. Treating P. as a way of recovering costs and a carrier of profits immediately focuses on business and banker decisions as being vital. Whereas households may be viewed as being solely concerned with the future flow of consumption, business and bankers in particular are concerned with the future flows of money.

2. Wage setting institutions ~~as~~ anchor~~ing~~ P(O) and the link between aggregate demand and output price level changes is conditional upon the institutional structure. Weak or strong trade unions: Do the firms sell commodities or products?

commodities: homogeneous (price takers)

products: differentiation → innovation? quality

3. M -> K -> M', K => Pi (profits). Pi validates the contracts that exchange M for M'. This cash flow perspective is an adaptation of points made by Marx.

4. Investment is the result of decisions made by business men that are financed. The standard Minsky diagram as taken up above. "Banking Structures" enter into both P_K, and the availability of external finance

(Banking Structure determined & through sales money.

5. The structure of payment commitments (liabilities), Hedge Speculative and Ponzi Finance as determining the vulnerability of the system to financial shocks.

6. Special Minsky Hypothesis w/r/t/ the structure of liabilities through time

A. Hedge => Speculative => Ponzi.

B. Profit seeking financial institutions as merchants of debt. →

1. Profits equation for banks $\frac{\Pi}{Equity} = \frac{\Pi}{Assets} \times \frac{Assets}{Equity}$

2. The evolution of banking

3. Bankers as merchants of debt. Innovation: Securitization

C. Making position by selling out position -> P_K collapses

1. Central Bank Prevents P_K from collapsing

2.Gov. Def. Sustains Profits -> P_K is sustained

7. Profits (Pi). Determination and prior commitment of through the liability structure. The complete Kalecki structure. (taken up above)

8. Yesterday, today, and tomorrow, Tomorrow introduces a subjective element in decision making Tomorrow can exist today only in the minds of decision makers. How are the relevant ideas about tomorrow formed today. The agents in the model have a model of the model. The two model hypothesis of Ben Friedman.

Model 1. nice normal distribution
Model 2. rare event (Poisson Distribution) -> collapse in asset values:

9. Hysteresis, chaos, deep structures; natural outgrowth of complex non linear dynamics.

A. Built in Stabilizers, Floors and ceilings.

B. Discretionary stabilizers

C. Thwarting incoherence

10. Intervention: the floors and ceilings arguments

A. Intervention can do nothing but mischieve is the neo-classical position

B. intervention can be constructive in the Keynes position

1. Lender of last resort
2. Monetary Policy
3. Fiscal Policy
4. Industrial Regulation (Morgan's appreciation of Monopoly in Market power)

11. Requirements for a serious depression.

12. Post war stabilization policy.

The "banking" perspective of a Keynes Kalecki viewpoint is using stabilization policy is effective as cash flows of business i.e. Π

13. Varients of Financial Structure.

A. Commercial Capitalism

B. Financial Capitalism

C. Managerial Capitalism

D. Money Manager Capitalism

Etc.