Alfred S. Eichner, A Guide to PK Economics, A Look Ahead

165 #1 Understanding gives mastery and so failure to master proves lack of understanding
But the developed market economies cannot control inflation
except at the cost of increased unemployment and reduced economic growth
for their remedy is either or both reduced public spending and curtailed credit
der lies
165 #2 The analysis offered in the preceding pages reveals where the lack of unstanding /
For the community of advanced market economies are guided by the neoclassical
paradigm, and that is both pre-Keynesian and prescientific
That paradigm involves the same conceptual framework, formulated to
demonstrate the self-correcting nature of market mechanisms, that Keynes
had to overcome in his day
a
Moreover this theory of self-correcting mechnisms initially gained its
hold on men's minds, and continuees to retain that hold today, without
having to meet the the types of tests which are necessary to establish
a paradigm in the natural sciences.

166 #1 <u>A misapprehension</u>: supposing that the neoclassical synthesis worked out by
Samuelson and his colleagues and accepted by governments of developed econ-
omies is Keynesian doctrine
It contains a Keynesian doctrine: an economy may settle down at less than
full employment; to help it recover the government may be well advised
to hasten a return to full employment through fiscal and monetary means.
But it also contains the pre-Keynesian theory, with its emphasis on supply
and demand determining price and quantity relationships under competitive
conditions. Against that system Keynes struggled, and through that opposition
he was able to affirm the possibility a stagnating economy.

166 #2 The preceding chapters have argued that the neoclassical system is less
than satisfactory in its macrodynamics, pricing, income distribution,
money, production, international trade, taxation, labor, and natural
resources. While the argument may not be clearcut in each topic, still
the overall critique is devastating; neoclassical theory is not a coherent
exp lanation of how a modern technologically advanced economy functions.

167 #1 However, ourpurpose is not a summary of what has been said, but A Look Ahead

167 #2 PK theory is still in its formative stage. Its broad outlines can already
be discerned, butmuch of the detailed argument remains to be worked out
What it offers is the prospect of uninhibited inquiry, not a promise of
quick and simple solutions to long vexing problems.
Its first important contribution will be to free economics as a discipline
from the intellectual dead weight of neoclassical orthodoxy.
This should be as invigorating to the cumulative growth of economic know-
ledge as the otherthrow of the geocentric theory was to astronomy and
the overthrow of the ether theory was to physics.

168 #1 The gradual adoption of PK perspective is likely to revitalize economics,
offering a frame-work which is more open-ended and therefore more con-
ducive to productive inquiry, bu t is not likely to bring immediate results
or pat answers. This is because the PK principles, if faithfully adhered
to, will reveal that the economic problems which currently bedevil econ-
omics, both as a discipline and as a guide to policy, are even less tract-
able than has been suspected. The advantage of the PK approach is that
it enables one to confront the probems directly and openly rather than to
conceal them under simplifying assumptions.

To elaborate on this point, it is necessary to delve more fully into
two areas -- theory and policy -- in which economics is presently stymied
as a result of the neoclassical orthodoxy. Once the full impact of the
shift to a PK perspective in each of these two areas has been described,
together with the probable limitations on what can be achieved, the ground
will have been laid for pointing out the intractability of the problems
in yet a third area. This is the area of politics itself.

168 #2 The author stresses the fact that his views are personal. PKers are not all of one mind.

168 #3 The shift from neoclassical to PK economics will change the emphasis from substitution effects to income effects.

The core of neoclassical doctrine is the Walrasian model. On that model changes occur inasmuch the demand for one good can increase only if the demand for some other good decreases; and this supposes that the price of the former decreases while the price of the latter increases.

Similarly, one type of input, such as capital, can increase, only if its relative price falls below that of another type of input, such as labor.

This approach usually eliminates by assumption the possibility that the demand for all goods and the use of all inputs could increase together.

It follows that there is little room for economic growth that results from a higher level of income and demand.

169 #1 In the more sophisticated versions of neoclassical theory, some income effects are allowed for. Still, it is the substittion effects arising from a change in relative prices which provide the impetus for the shift from one static equilibrium position to another, and thus it is only the substitution effects which make any real difference in the neoclassical models.

PKers would urge that the income effects generally swamp the substitution effects -- if they do not eliminate them altogether.

170 #1 Keynes (1936) was the first to point this out. If wages declined, this would not encourage the substitution of labor for capital. Instead it would depress business confidence and business investment, thereby increasing the number of unemployed workers

Others following in Keynes' path have found in a great variety of cases that it is the level and composition of investment, together with the income effects that derive from investment, that are the principal operative factors -- not any change in relative prices.

Econometric studies have led to the same type of conclusion, and it seems that only the dead weight of neoclassical orthodoxy has prevented the economists who works inductively from generalizing this result into an empirical principle.

170 #2 However prediction is far easier on the neoclassical model. A change in relative prices will move the economy from equilibrium position to another. But foreseeing the effects of new investment is a quite different matter. In involves shift from logical time to historical time; in the latter the past cannot be changed and the future cannot be certain.

171 #1 The systems approach.

Economics as a social science is largely the outgrowth of the 18th century mechanistic view of the universe. It may even prefer Laplace to Newton: Newton did not master problems inherent in eccentric orbits; Laplace showed that when the excentricity is small Newton's problem vanishes; so Laplace could boast that any world historical situation could be deduced from any other.

The systems, or cybernetic, approach offers social scientists the ag advante that it can incorporate into its analytical structure (a) purposeful activity, (b) cumulative processes, and (c) the interaction of subsystems both as part of a larger systems dynamic and in response to feedback from the environment.

171 #2 Under systems approach, economics is no longer the study of how scarce resources are allocated. An economic system is defined as the set of social institutions responsibile for meeting the material needs of society's members. Economic studies how such a system is able to expand its output over time by producing and distributing a social surplus.

emergent probability

It is not just that the rate of expansion is likely to be uneven. It is also that the expansion has no discernible fixed limit, and that the very process of expansion is likely to change the nature of the system in an unpredictable way.

Although the final end state cannot be deduced -- the analysis is conducted in historical time -- the process of expansion, that is, the dynamics of the system, can be intelligently analyzed.

172 #1 When the economic system is seen as just one of several major social systems, each with its own particular dynamics, the way is opened to a truly interdisciplinary attack on social problems. But even when the economy is viewed in isolation, the principles of systems theory still hold. This means that the interaction among different component parts (say, between business firms and houseolds or between financial and non-financial sectors) must be analyzed in terms of input, output, and feedback. The last is especially important if the behavior of the system as a whole is to be understood.

172 #2 From a PK perspective, it is the behavior of the system as a whole, constituted as a set of historically specific instiitutions, which economic theory must be capable of explaining. This is the first step towards a better informed public policy.

Once the system can be modeled to simulate the types of dynamic behavior actually observed in the real world -- and this means cycles as well as long-run expansion, inflation as well as rising standards of living -- the basis will be had for more effective government intervention, whether this takes the form of manipulating the system as it presently exists or restructuring some essential component.

172 #3 The importance of empirical testing.

Up to now the discipline of economics has refused to drop its habit of deducing conclusions from axioms. It has remained the Euclidian geometry of the social scences. Economists have been known to remark that they travel with a light tool kit. They mean that they do not have to burden themselves much with factual detail. They have been content to reason *a priori*, hence their preference for elegance over relevance.

But for economics as a science this has meant falling short of being a modern science. What is missing is the same standard for judging the validity of a theory which prevails in the natural sciences. This is the criterion that a theory must not just avoid logical error but that it must also account for the full range of empirically observable events -- which in the social context consist in the real world's historical events.

Some economists may point out that in recent decades there has been a growing insistence on empirical proof for any theoretical arguments that

173 #1 may be offered. Indeed the work of PKers is often rejected on these very grounds.

But this riposte ignores two points. The first is that the received orthodox theory is usually exempted from any empirical proof of its validity especially if some formal or mathematical proof can be adduced. The second is that most of the empirical testing carried out so far has presumed the correctness of the orthodox theory; and while a large body of anomalous evidence has emerged from these studies, as well as from econometric investigations, the orthodox neoclassical theory has yet to be subjected to any rigorous empirical testing -- in which its explanatory power could be directly compared with alternative formulations as PK.

173 #2 In the social sciences controlled experiments are out of the question. Historical data easily lack the precision needed for scientific verification: it is difficult for a historian to have in mind a theory he never heard of and so be led to seek the information a social scientist would need. But our point is not to discourage scientists from seeking ever better models. Rather it is that a theory in the social sciences can be held as valid only after being incorporated in public policy and thereby bringing about the predicted results.

Such was the verification of the Keynsian prescription to prevent large scale unemployment. Simlarly, the neoclassical prescription for attaining full employment without inflation is revealed to be a failure. Again, the test for the policies of A Guide to Post-Keynesian Economics will be the development of a set of policies for bringing inflation and trade deficits under control without sacrificing economic growth and employment.

174 #1 Incomes policy

An incomes policy represents, not the starting point for a change in public policy, but rather the final move in an anti-inflationary effort requiring other antecedent changes in public policy. PK theory can point to the series of steps by which inflation and other current economic problems might eventually be brought under control, but it offers no "quick-fix" solutions.

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175 #1

While an incomes policy is the necessary capstone to an effective anti-inflationary program, still it does not mean what the term is thought to mean by trade union critics and by some advocates.

An incomes policy is not a device for limiting the wage gains of organized workers. Rather, it represents a means of determining the annual noninflatinary rise in all the different types of income that accrue to households-- dividends and rents as well as wages and salaries.

Also it reflects the PK view of inflation as being the process by which prices rise to deflate nominal incomes, thereby bringing real incomes into line with the availability of real resources.

Note further an incomes policy limits personal income: it is not a limit on retained profits with the aim of financing further capital development.

175 #2 In a democratic society an incomes policy cannot simply be imposed. IT MUST GAIN ACCEPTANCE AMONG THE DIFFERENT economic interest groups as the fairest and most equitable basis for distributing the fruits of technological progress in the form of higher output per worker. This means that a consensus must be reached, through the appropriate representative bodies, about the principles which will govern the apportionment of any social surplus.

It also means facing up frankly and honestly to the distributional issues involved. Indeed, the reason why the neoclassical synthesis as been so little help in fashioning an effective anti-inflationary policy is that, by focusing on the "marginal productivity" of unmeasurable quantities like "capital," it misconstrues the distributional issues.

So an incomes policy needs to be preceded, at the poliical level, by some minimal societal agreement as to how the gains from economic growth are to be distributed.

The fact that the market alone is incapable of rendering this judgment is what makes an incomes policy essential.

176 #1 Investment and growth

Distributional issues are inextricably linked to investment and growth issues. For the core of political economy lies in investment and growth.. Once the rate and composition of investment have been determined, the economy's long-run growth path has been largely set. The long-run rate of expansion (and with it the growth of output per worker) depends on the rate at which supply capacity -- both business plant and equipment and social infrastructure -- is being increased.

The short-period fluctuations around that trend line depend on how steadily the growth of investment and other forms of discretionary spending are being maintained.

Moreover it is a matter of quality as well as of quantity. Just any type of spending will not do -- only the projects that will yield the highest marginal gains to supply capacity relative to the outlay, so that the secular rate of expansion is maximized.

What must be recognized is that (contrary to the conventional neoclassical argument) the market cannot be fully relied on to assure the best results in this regard.

And while the rate and especially the composition of investment are not easily regulated at the aggregate level, still, the representatives of key interest groups -- trade unions, corporations, farmers, consumers, etc. -- have some say in these questions, they will be unable to serve the best interests of their constituents in what matters to them most.

The rate of inflation and the relative distribution of income among households, as determined by an incomes policy, are certainly important, but the growth of real income over time, as determined by the rate and composition of investment, is even more important.

177 #1 Pricing

Distribution and investment are only two of the three legs of the Post-Keynesian triangle. The third involves the pricing mechanism. Orthodox theorists have led public policy badly astray by insisting that the only relevant issue is whether resources are optimally allocated. But the pricing mechanism also plays a central role in providing investment funds for business and in determining relative income shares.

The interrelationship among these three critical sets of factors is made more complex by the fact that in the U. S. there are two quite different types of markets, whose pricing and investment behavior vary from each other.

There are the competitive markets, largely involving primary products, which the focal point of orthodox theory, and the oligopolistic markets -- dominated by large corporations and found primarily in the technologically more progressive sectors of the economy, about which orthodox theory is mostly silent. In the former, prices are governed by supply and demand factors, and investment is unplanned. In the latter. prices are cost-determined and planning, based on the long-term capital expansion programs of the individual corporate giants, is the rule.

Thus there is no model, or set of policies based upon a model, that applies across the board to both the competitive and the oligopolistic markets. Indeed, in the competitive sector, the government must make up for the lack of inter-firm coordination and planning, while in the oligopolistic sector, it must make sure that the private power to plan does not subvert and larger public interest.

178 #1 Once the interrelationship among distribution, investment, and pricing is properly understood, it becomes clear that fashioning an effective anti-inflationary policy is no easy task and that simply adopting an incomes policy will not suffice. The task is made even more difficult by the fact that each national economy is part of a larger world economic system -- one that is little understood by economists of any stripe, post-Keynesian or otherwise.. The instability of exchange rates, and the reverberating effects on domestic price and investment levels, point to this dimension of the world's current economic ills. Still the task of fashioning an anti-inflationary policy is not a hopeless one, and if PK THEORY offers no easy quick solution, it does at least point out the direction in which policy must move.

178 #2 The criticism it offers of the orthodox neoclassical system should, as a first step, seal off some of the blind alleys which public economic policy has entered.. But even more important than that, PK theory suggests the order in which the set of essential, interrelated factors needs to be dealt with. Determining the rate and composition of investment is the first order of business. Only after those questions have been settled, thereby fixing the economy's growth path, can precise figures be attached to any pricing and incomes policies. Indeed, if the policies are based on a correct understanding of the role played by prices and relative income shares, the derivatione of the numbers should become a routine, an almost technical matter. For if the PK arguments are correct. it will be found that there is only one average profit margin and only one rate of growth of household income which, for the secular growth rate that has been chosen, will be noninflationary.

179 #1 Public and private investment

It will, of course, be objected that determining the rate and composition of investment is beyond the power of government -- at least without a radical transformation of the economic institutions found in developed countries like the U. S. But this argument ignores the current reality. The fact is that at least a third of the total national income in developed countries like the U. S. already passes through the public sector. Is it a Post Keynesian blunder?

The real question is what use is to be made of those resources. Are they , as investment in the infrastructure, to expand economic output? Are they to be used instead to attain noneconomic ends? Or are they simply to be frittered away in boondoggles of one sort or another? Once the rate and composition of public investment have been determined in answer to these questions, then the rate and composition of private investment will largely fall into place. For left to itself, private investment can be expected to adjust to the changing composition of final demand over which through its own pattern of expenditures, exerts the predominant influence.

179 #2 No, the more valid answer is that the government lacks the capacity to make better decisions about the rate and composition of public investment -- not to mention the capacity to coordinate these expenditures with capital spending in the private sector as part of an overall integrated plan. Thus it is not the government lacking the means to impose its lueprint on the economy. Rather it acks the means of devising a workable blueprint -- at least in the U. S. In part, this is because false clues have been provided by orthodox theory, and these clues have led government to focus on the wrong issues. But it is also because the government has not properly structured itself to devise an overall blueprint. And this is pity, since many of the requisite elements for a system of indicative planning to be carried out under government auspices, are already in place.

180 #1 There is, first of all, the system of private planning based on the capital expansion programs of the nation's largest corporations. There is even an effort to coordinate these private plans through the forecasting and other services provided by groups such as the Conference board, Data Resources, Inc., Chase Econometric Associates, and the Wharton Economic Forecasting Unit. Within government itself, there is an effort to bring coherence and foresight to spending within various areas -- for example, transportation and energy, perhaps the two critical areas in so far as the economic infrastructure is concerned. What is missing is some organ of government capable of fusing the results pf these diverse efforts into a comprehensive plan, one that, because of its greater scope and coherence, would take precedence over other plans in guising economic policy. Neither the Council of Economic Advisers and the Office of Management and Budget within the executive branch, nor the congressional Budget Office, with the narrow political constituency they serve and the meager staff resources they command, can develop such a plan. It requires, instead, a new body -- a planning secretariat functioning as the technical arm of a social economic council on which would be represented, along with key public officials, all the private interest groups whose support is essential to the success of any incomes policy.

181 #1 A new social contract

In this way -- but only in this way -- the basis would be had for a "social contract" that would finally permit governmentto pursue a maximum growth or "full employment" policy without having to fear the inflationary consequences. In return for not exercising the market power which enables them to obtain higher than called-for increases in nominal income, thereby contributing to the wage-price inflationary spiral, the important interest g-oups -- the nations largest corporations and trade unions among them -- would be given a more direct voice in determining the growth of real income. This would be the result of the influence which those interest groups were able to exert, through the social and economic council and its planning secretariat, on the rate and composition public spending. Once that set of decisions had been reached, the rest -- the rate and composition of private investment, the level of prices and the growth of real household income -- would fall into place.

181 #2 This is not to suggest that the working out of such a plan would be without its difficulties. Nor would the creation of an effective planning mechanism at the national level solve all the world's current economic ills. But only along the lines suggested by PK theory can an effective anti-inflationary policy be developed as the first step toward olving other types of problems. The PK approach, by highlighting the role played by monetary institutions and uncertainty in the working of a market economy, as well as the role played by prices inredistributing income, also offers important insights into the nature of certain international economic problems. Still, from what has already been said, it should be clear that fashioning an effective anti-inflationary policy or dealing with other types of economic ills is not just a matter of theory or policy. It is also a matter of politics.

182 #1 The politics of inflation

At one level, it would appear that putting the government in a position to cope more effectively with inflation requires only a slight enlargement of the considerable role which the government already plays in the economy -- assuming of course that the dead weight of the orthodox, neoclassical theory were to be removed. To add an incomes policy to the existing arsenal of intervention devices, all that seems necessary is to superimpose a social and economic council, together with a planning secretariat, on the existing economic policy-making structure. This would involve only another incremental step in the long chain by which the existing structure has come into being -- difficult as that ext step might be to take in practice. But this assessment ignores the most fundamental point of the PK explanation for inflation. And this is that inflationoccurs because of conflicts over the relative distribution of income which are otherwise irreconcilable. (On closer examination, many of the international economic problems will, no doubt,be seen to involve the same types of conflicts.)

A social and economic council is merely a devise for bringing those conflicts into the open, providing a forum where, it is to be hoped, the genius of politicians can provide a temporary resolution so that other business of the day can proceed. The result of the planning secretariat's analytical work should be to show that, for many of the issues posed, he nature of economic processes offers no real choice. Still, not all potential conflicts can be resolved solely on the basis of objective analysis. The rate of growth of output per man governs only the average growth of real household income, not the relative distribution among households