Interactions in Political Economy

Malvern after ten years

Edited by
Steven Pressman

Routledge Frontiers of Political Economy

ROUTLEDGE

INTERACTIONS IN POLITICAL ECONOMY

In recent years there has been a growing dissatisfaction with standard economic theorizing. This has fostered the development of alternative ways of understanding how economies actually work. Too often though these approaches have been developed in isolation, or even in opposition to each other.

Interactions in Political Economy demonstrates that the different heterodox approaches to economics have much to learn from each other. Economists working within different paradigms, including post-Keynesianism, Marxism and neo-Ricardian economics address a wide range of issues in methodology, the history of economics, theory and policy. The result is a wealth of insight into how economics ought to be done, how various theoretical approaches dovetail, and the effectiveness of various approaches to economic policy.

The volume reflects the diversity and quality of the annual Great Malvern Political Economy conferences. Contributors include some of the leading names in heterodox economics: John Cornwall, Paul Davidson, Kevin Hoover, Philip Mirowski and Ed Nell.

Steven Pressman is Professor of Economics and Finance at Monmouth University, co-editor of the *Review of Political Economy,* and Associate Editor of the *Eastern Economic Journal.* He is the co-editor of *Women in the Age of Economic Transformation* (1994) and the author of *Quesnay's Tableau Economique: A Critique and Reassessment* (1994). His research and writing is primarily in the areas of poverty, public finance, post-Keynesian macroeconomics and the history of economic thought.

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Malvern After Ten Years

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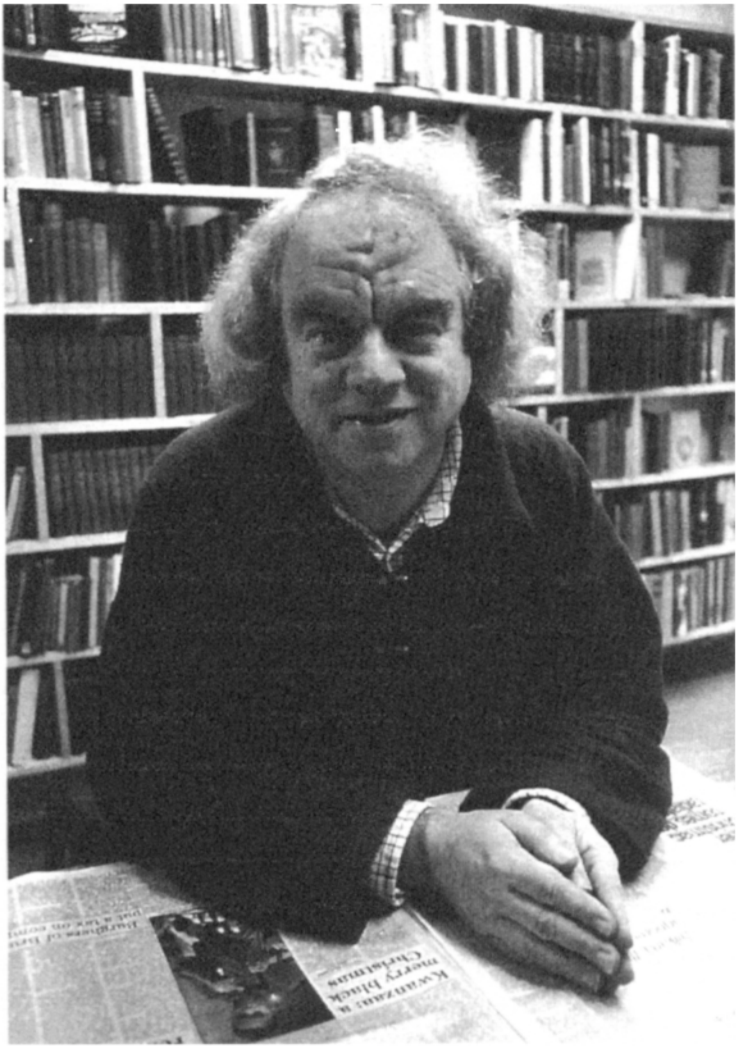
For John Pheby, who made Malvern possible



John Pheby

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CONTRIBUTORS

John Cornwall is McCulloch Emeritus Professor of Economics at Dalhousie University in Halifax, Canada. His publications include *Growth and Stability in a Mature Economy* (Martin Robertson, 1972), *Modern Capitalism: Its Growth and Transformation* (Martin Robertson, 1977), *The Conditions for Economic Recovery* (Martin Robertson, 1983), *Economic Recovery for Canada: A Policy Framework* (James Lorimer, 1984; with Wendy Maclean), *The Theory of Economic Breakdown* (Blackwell, 1990) and *Economic Breakdown and Recovery* (M.E.Sharpe, 1994). He is a Fellow of the Royal Society of Canada.

Wendy Cornwall is Professor of Economics at Mount Saint Vincent University in Halifax, Canada. Her publications include *Economic Recovery for Canada: A Policy Framework* (James Lorimer, 1984; with John Cornwall) and *A Model of the Canadian Financial Flow Matrix* (Statistics Canada, 1989; with J.A. Brox). She has published articles on the flow of funds, applied econometrics and economic growth, both in journals and in books.

Allin Cottrell is Associate Professor of Economics at Wake Forest University. He is author of *Social Classes in Marxist Theory* (Routledge & Kegan Paul, 1984) and, with Paul Cockshott, *Towards a New Theory of Socialism* (Coronet, 1993). He has published numerous articles on economics and philosophy, socialist planning and the history of macroeconomic thought.

Paul Davidson holds the Holly Chair of Excellence in Political Economy at the University of Tennessee in Knoxville. He is also the editor of the *Journal of Post Keynesian Economics*. Davidson's many books include *Money and the Real World* (Macmillan, 1972), *International Money and the Real World* (Macmillan, 1982), *Economics for a Civilized Society* (Norton, 1988; with Greg Davidson) and *Post Keynesian Macroeconomic Theory* (Elgar, 1992).

Peter E.Earl is Professor of Economics at Lincoln University in New Zealand. His research output includes many books and articles (written from subjectivist, behavioural or post-Keynesian standpoints) on consumer behaviour and economic psychology, the economics of the firm, monetary economics and economic method. His latest major work is a text entitled *Microeconomics* *for Business and Marketing* (Elgar, 1995), which covers both mainstream and behavioural/new institutionalist theory.

Kevin D.Hoover is Professor of Economics at the University California, Davis. He is the author of *The New Classical Macroeconomics: A Skeptical Inquiry* and numerous articles in macroeconomics, monetary economics, economic methodology and the philosophy of science. He is an editor and the chairman of the board of editors of the *Journal of Economic Methodology*. He previously served on the board of editors of the *American Economic Review,* and serves currently on the boards of the *Review of Political Economy* and *the Journal of Economic Surveys.*

John E.King is Reader in Economics at La Trobe University in Melbourne, Australia. He is the author of *Labour Economics* (Macmillan, 1972) and *Labour Economics: An Australian Perspective* (Macmillan Australia, 1990). With M.C. Howard he is the author of *The Political Economy of Marx* (Longman, 197 5), and the two-volume *History of Marxian Economics* (Macmillan, 1972). His latest publications are *Conversations With Post Keynesians* (Macmillan, 1995) and *Post Keynesian Economics: An Annotated Bibliography* (Elgar, 1995).

Philip Mirowski is Carl Koch Professor of Economics and the History and Philosophy of Science at the University of Notre Dame. His most recent books are *Natural Images in Economics* (Cambridge University Press, 1994) and *Edgeworth on Chance, Economic Hazard and Statistics* (Rowman and Littlefield, 1994). He is currently working on a history of the neoclassical theory of supply and demand functions, the economics of science and the prospects for a computational institutionalist economic theory.

Gary Mongiovi is Associate Professor of Economics at St John's University, and is co-editor and book review editor of *Review of Political Economy*. His publications include: 'Sraffa's Critique of Marshall: A Reassessment', *Cambridge Journal of Economics* (1996); 'Keynes, Sraffa and the Labour Market', *Review of Political Economy* (1991); 'Notes on Say's Law, Classical Economics and the Theory of Effective Demand', *Contributions to Political Economy* (1990); 'Keynes, Hayek and Sraffa: On the Origins of Chapter 17 of *The General Theory*', *Economic Appliquée* (1990).

Edward J.Nell is Malcolm B.Smith Professor of Economics at the Graduate Faculty of the New School for Social Research. He is the author of *Transformational Growth and Effective Demand* (New York University Press, 1992), *Prosperity and Public Spending* (Unwin Hyman, 1988) and the forthcoming *The General Theory of Transformational Growth: Keynes After Sraffa*.

Steven Pressman is Professor of Economics and Finance at Monmouth University, co-editor of the *Review of Political Economy*, and associate editor of the *Eastern Economic Journal*. He is the co-editor of *Women in the Age of Economic Transformation* (Routledge, 1994) and the author of *Quesnay's Tableau Economique:*

A Critique and Reassessment (Kelley, 1994). His research and writing are primarily in the areas of poverty, public finance, post-Keynesian macroeconomics and the history of economic thought.

Ingrid H.Rima is Professor of Economics at Temple University. She has written and edited numerous books including *Development of Economic Analysis* (Irwin, 5th edn 1991), the two-volume *The Political Economy of Global Restructuring* (Elgar, 1993), *The Joan Robinson Legacy* (M.E.Sharpe, 1991) and *Measurement, Quantification and the Development of Economic Analysis* (Routledge, forthcoming). Her main research interests are labour economics and the history of economic thought, and she has published numerous articles on these subjects in professional journals.

Claudio Sardoni is Associate Professor of History of Economics at the University of Rome 'La Sapienza'. Among his more recent works are *Marx and Keynes on Economic Recession* (Wheatsheaf and New York University Press, 1987); 'Chapter 18 of *The General Theory:* Its Methodological Importance', *Journal of Post Keynesian Economics* (1990); 'Effective Demand and Income Distribution in *The General Theory*', *Journal of Income Distribution* (1993); '*The General Theory* and the Critique of Decreasing Returns', *Journal of the History of Economic Thought* (1994).

Mark Setterfield is Assistant Professor of Economics at Trinity College, Hartford. His main research interest concerns the concepts of path dependency and the introduction of historical time into economic theory. He has published articles on these topics in the *Review of Political Economy* and the *Journal of Post Keynesian Economics*.

FOREWORD

I am still tickled by the fact that I am (just) the only person under 70 on the academic board of the *Journal of Post-Keymesian Economics (JPKE)*. Nevertheless, I realized how ancient I had become when I looked through the list of contributors to the volume which commemorates ten years at Malvern. For I found there all friends, many of over thirty years' standing, and some of whom in addition are former or present colleagues, relatives and students, both undergraduate and graduate. This, of course, is one of the many joys of growing old.

I have had the privilege and pleasure of attending several Malvern conferences. I agree with the editor of the present volume that the atmosphere—in the Harcourt Room, where else?—has been friendly and constructive and that serious issues have been tackled in a profound manner and in the best of humours. That is *not* to say that the debates have not been intellectually vigorous; with such outstanding practitioners of the art as Phil Mirowski, Ed Nell and Ingrid Rima, for example, how could they be otherwise? But what is refreshing about all the chapters in the present volume is that they have one ultimate aim, to wit, to understand and then to improve the world, or rather, the lot of its citizens (not, note, agents but real people). This is so whether the contribution of their chapters is to put us right on our methods, or to bring us up to date on the phenomenon of hysteresis in uncertain environments, or to rid Keynes's theory of investment of flaws in its details.

Naturally, reflecting on ten years of Malvern conferences leaves us sad for we shall never see again in the flesh Ken Boulding, John Hicks, George Shackle or Lorie Tarshis. Their spirits, however, are very much alive in this volume, and for that alone I count it a signal honour and act of love to be able to write the foreword to this volume.

Now read on!

G.C.Harcourt

1

POLITICAL ECONOMY AT MALVERN

Steven Pressman

In August 1987, John Pheby organized the first Malvern Political Economy conference. It was attended by over thirty economists from ten different countries, and twelve papers were presented on a wide range of topics. The individual papers and the ensuing discussion were both highly stimulating and rather contentious. Many of the papers presented were subsequently collected and published as a conference volume (Pheby 1989).

Every August since 1987 another Political Economy conference has been held at Malvern. Each conference has been different, but each has been equally stimulating. Thus far more than 200 different economists have attended the Malvern conferences, and around 100 different economists have presented papers there. Two Nobel laureates (John Hicks and James Meade) have come to Malvern, and many other luminary figures in the profession have presented papers at Malvern.

Over the past decade Malvern has become renowned for the excellent food (served by the gracious staff of the Mount Pleasant Hotel), and for the camaraderie that has developed among conference participants. As an added plus, we have had the beautiful Malvern Hills in our backyard. This provided plenty of fresh air, pleasant surroundings and enjoyable places to walk and talk when not listening to the stimulating papers. Even a die-hard New Yorker like myself managed to enjoy 'the idiocy of rural life' in our bucolic haven.

When I think back and reflect on the past Malvern conferences several themes stand out as being especially prominent. One is a dissatisfaction with standard economic theorizing. A second theme involves the search for alternative ways of understanding how economies actually work and alternative solutions to the problems faced by real economies. But perhaps the dominant theme running through Malvern has been a belief that heterodox economic paradigms have much to teach one another, and that economists with different perspectives can learn from one another if given the right environment. Malvern has provided that environment. It has been a place where all approaches to economic analysis have been welcomed and respected, and where the insights from one tradition have met up with what Latakos has called 'the hard core' beliefs from other paradigms. The results have been frequently contentious and sometimes synergistic, but they have always been illuminating.

The twelve chapters that follow were all written by people who have attended past Malvern conferences. In many instances, the individual authors have returned to Malvern again and again. The papers themselves were selected to reflect the diverse array of heterodox economics at Malvern and the cross-fertilization among these perspectives that has made Malvern a very special place over the past ten years.

METHODOLOGICAL ISSUES

Methodological questions have been one major area of concern and interest at Malvern. While these debates may appear overly abstract and abstruse to some, they do have real-world consequences. It is rather certain that mistaken views on how to do economics will lead to both bad economics and bad economic policy.

In Chapter 2 Philip Mirowski looks at the Santa Fe Institute, home of complexity theory. He examines the relationship between the hard scientists and the economists associated with Santa Fe. This study of Santa Fe is placed against the backdrop of the Cowles Commission, and yields a number of interesting similarities and differences. Both institutions were funded to engage in statistical research on stock prices, and both projects were then shifted onto another track by the major researchers and participants. But here the similarities end. The Cowles Commission was taken over by economists interested in formalizing and axiomatizing the structure of Walrasian general equilibrium theory. Their vision was to make economics a hard science like physics. The Santa Fe Institute, in contrast, has been taken over by natural scientists who are more interested in their own experimental work than in economics. Moreover, their vision is a historical one. They look to biology, more than they look to physics, as a model of science; and their view is evolutionary and organicist. In another striking contrast to the Cowles Commission, the physicists at Santa Fe have expressed disdain for the formalist programme that drives much of neoclassical economics.

From this comparative analysis Mirowski draws several methodological lessons. First, and perhaps most important, he sees in Santa Fe support for a Romantic conception of science, which is holistic and historical in outlook, which stresses indeterminacy and diversity, and which is experimental rather than formal and axiomatic. Second, Santa Fe shows the importance of cross-fertilization among disciplines and theories, of cultural images of change over time, and of the personal computer as a simulation tool. These approaches, rather than deductive proofs, lie at the forefront of contemporary science according to Mirowski; and economists would do well to emulate these approaches.

SEMINAL FIGURES IN POLITICAL ECONOMY

At Malvern, history has mattered as well as methodology. With considerable regularity conference participants have looked to the work of seminal figures for ideas about how real economies work and for insights into how to escape from an ahistorical neoclassical framework. The chapters contained in Part II reflect this appreciation for the importance of history.

Peter Earl explores the views of George Shackle concerning entrepreneurship and the firm. Shackle is best known for his view that the world is kaleidoscopic, and that uncertainty plagues any investment decisions that a firm or entrepreneur makes. This radical uncertainty, for Shackle, reduces investment and effective demand, thereby creating macroeconomic problems. Yet, in his work on entrepreneurship and the economics of the firm (especially his 1970 textbook on the theory of the firm), Shackle failed to make use of key ideas from Coase and Schumpeter on entrepreneurship that would have complemented his better-known lines of thought. Instead, Shackle focused on the views of Cantillon, who saw the entrepreneur as an arbitrageur rather than someone proceeding into unfamiliar territory and beset with uncertainty. And he failed to see how, by internalizing the market, firms could reduce transaction costs and thus the uncertainty that they face.

Earl concludes with a discussion of why Shackle missed the opportunity to make these connections. Here Earl identifies several possibilities. First, Shackle was an armchair theorist whereas Coase followed the Marshallian strategy of letting empirical matters direct theoretical inquiry. Second, Shackle saw in Cantillon the idea that entrepreneurs face uncertainty about their future revenue streams. Conversely, in the Coasian tradition, transaction costs reduce uncertainty and make the economic system more resilient.

John King, a well-known and prolific historian of Marxian economics, tackles the economic thought of post-Keynesian economist Hyman Minsky in his chapter. King notes a tension in the early work of Minsky, which reflects some acceptance of post-Keynesian doctrines and some acceptance of neoclassical theory. On the one hand, Minsky recognized the dangers of financial instability, and the need for government economic policy and a lender of the last resort. He also accepted the multiplier-accelerator model as the basis for doing macroeconomic analysis. On the other hand, Minsky took a loanable funds approach to the determination of interest rates, and held that savings constrained investment.

King argues that when Minsky discovered Kalecki's theory of profits it helped to liberate him from the anti-Keynesian loanable funds view of savings and investment. It also made Minsky a true post-Keynesian monetary theorist. Kalecki's theory allowed Minsky to analyse cash flows into firms, and to show how these cash flows could be used to help to finance investment. Thus Minsky was able to escape from the neoclassical view that it was savings that determined and constrained business investment.

Allin Cornell's chapter examines *Monopoly Capital* by Baran and Sweezy, thirty years after its publication. That work argued that the degree of monopoly had been rising in developed capitalist economies; and that with greater monopolistic elements capitalist economies would tend to stagnate, as the growth of labour productivity increased profit rates and reduced effective demand. Baran and Sweezy also expressed scepticism that government economic policies would be put into effect that increased social spending, and thus offset the trend towards reduced private spending.

Cottrell, however, notes a number of 'awkward facts' that cast doubt on this explanation for stagnation and high unemployment. First, the degree of monopoly in the US economy appears to have fallen rather than grown since the publication of *Monopoly Capital*. Second, Cottrell notes that other data seem to contradict the argument of Baran and Sweezy. Over the past thirty years productivity growth has stagnated, as have corporate profits; at the same time, consumption has exhibited a tendency to rise as a fraction of income, rather than fall.

Cottrell concludes his critique by turning the Baran and Sweezy argument upside-down, thereby returning to Marx and classical economics. Rather than high profit rates reducing spending and contributing to stagnation, Cottrell suggests that it may be falling rates of profit that have reduced investment and contributed to our current economic problems.

COMPARATIVE APPROACHES TO POLITICAL ECONOMY

As noted earlier, one of the defining traits at Malvern has been a cross-fertilization among different economic paradigms and an attempt to integrate ideas from various contemporary schools of thought. The chapters in Part III all attempt to bring the insights from one heterodox paradigm to bear on another heterodox paradigm.

Claudio Sardoni's paper examines the investment demand function contained in Chapter 11 of *The General Theory*. Keynes assumed, according to Sardoni, that as businesses invested more and more, the cost of capital goods would increase and the expected returns to investment would fall as capital became less scarce.

Keynes needed a downward sloping investment demand curve, Sardoni points out, to explain why business investment did not expand until full employment was reached. If investment demand did not slope downward, the only limit to investment would be the lack of resources to produce more plants and equipment, and we would be back in the full employment world of classical economics.

Yet, Sardoni argues, the downward sloping investment demand function has some logical problems. First, Keynes assumed pure or perfect competition, where no firm can affect the overall market. Thus, greater investment by one firm should not affect supply prices adversely. Keynes's views about expected profits can be similarly criticized. Since one producer cannot affect aggregate outcomes, there is no reason that expected returns to investment should fall wherever investment increases. Moreover, as investment rises, entrepreneurs may expect greater profits due to the economic expansion and rising prices.

Finally, Sardoni maintains that Sraffa helps to point the way out for Keynes's investment demand function. What is needed is the assumption that imperfectly competitive market forms are the norm. The problem facing a firm wanting to expand thus becomes how to sell the additional output produced by the new investment. As such, investment is limited because the demand for goods is limited; and an unemployment equilibrium becomes possible because of this limit.

In Chapter 7 Gary Mongiovi poses four problems for post-Keynesian macroeconomic theory from a Sraffian perspective. These difficulties, according to Mongiovi, all stem from the failure of the post-Keynesians to pay due attention to questions of value and distribution.

First, Mongiovi argues that the IS-LM model is wrong, but not for the reasons advanced by post-Keynesians. The problem is not that the IS-LM model does not accurately represent the views of Keynes. Rather, the problem is that the model ignores issues of distribution. More important, according to Mongiovi, is the way in which IS-LM ignores distribution. As noted in the Sardoni chapter, Keynes advanced a downward sloping investment demand curve. Mongiovi argues that this curve is grounded in the marginal productivity theory of distribution, a theory discredited in the Cambridge controversy; and that furthermore, this curve forms the basis of the IS curve.

Second, post-Keynesians are wrong about Say's Law, and the importance of overthrowing Say's Law. Say's Law is a red herring, according to Mongiovi, and does not imply a tendency to full employment. Conventional beliefs among economists that there is a tendency to full employment stem from the marginalist theory of distribution. Third, Mongiovi contends that post-Keynesians are wrong that non-neutral money accounts for unemployment; non-monetary economies will not necessarily move towards full employment equilibrium. Finally, Mongiovi argues that post-Keynesians tend to reject equilibrium analysis. This, however, makes it difficult to do any economic analysis, since it becomes impossible to pinpoint the consequences of any changes that affect the economic system.

In the next chapter, Paul Davidson defends Keynes and post-Keynesian economics from the criticisms leveled by Mongiovi. Davidson argues that Keynes does not require a downward sloping investment demand curve. Moreover, he contends that Keynes's investment demand curve is not a traditional, Marshallian demand curve; rather it is a curve showing statistical frequency distributions. Thus it does not ignore the lessons of the Cambridge critique regarding returns to capital.

Davidson agrees with Mongiovi that Say's Law does not entail full employment, but he notes that Say's Law is also *not* a theory of output and employment. This theory is what Keynes provided, and what makes up the Keynesian revolution. In response to Mongiovi's point about non-neutral money, Davidson argues that uncertainty and the two essential characteristics of money identified by Keynes are necessary to explain unemployment in real-world economies. Finally, Davidson contends that the persistent centers of gravity demanded by Mongiovi and the neo-Ricardians cannot exist in the real economic world where uncertainty is so pervasive.

Mark Setterfield's chapter addresses the consistency of the notions of hysteresis and uncertainty. The former notion, a favourite of the new Keynesian school, involves the idea that the present state of our economy depends upon its past. In contrast, the uncertainty highlighted by Keynes and Frank Knight involves the impossibility of knowing the probabilities of different potential economic states. The past thus tends to be irrelevant if radical uncertainty prevails. Setterfield should therefore be seen as addressing the issue of whether new Keynesian and post-Keynesian economics are consistent in at least one respect.

His conclusion is that the notions of hysteresis and uncertainty are compatible and tend to complement one another. First, he points out that both notions are properties or characteristics of the real economic environment, rather than qualities of the individuals who inhabit that world. Second, Setterfield notes that both concepts are attempts to deal with real-world historical time. For Keynes, and for the post-Keynesians, historical time creates uncertainty. Similarly, hysteresis is an evolutionary process that takes place through historical time and takes place in an uncertain environment. Finally, Setterfield finds pragmatic compatibilities between models of hysteresis and the post-Keynesian research programme. Post-Keynesians seek to develop useful models that improve our understanding of real-world economies, and to set forth economic policies that might help economies to perform better. Since hysteretic models show how increases in aggregate demand can have permanent and positive effects on unemployment, post-Keynesians should accept these models for pragmatic reasons as well as for theoretical reasons.

POLICY ISSUES

Malvern has not been just about methodology and high theory. These aspects of economics are important only to the extent that they lead to improved economic performance. This, after all, is the reason for studying economic principles—or at least the reason that economic principles *should* be studied.

The chapter by Edward Nell addresses the issue of why developed economies have stagnated since the early 1970s. He notes several important factors contributing to poor economic performance over the past twenty-five years—consumption spending, investment and net exports have grown slowly and become more volatile. While the appropriate government policy should have been to counteract these changes, the USA has failed to employ the appropriate economic policies.

Nell goes on to explain why all the components of aggregate expenditure have grown more slowly and become more volatile since the 1970s. The key factor is that changing technology has changed the way that markets have worked. Higher costs for new technology have made investment more expensive and more risky, thus explaining the changes in investment. Through the multiplier-accelerator process, the whole economy has become less stable and less likely to grow; thus consumer spending slows down. Technology has also increased foreign trade, but it has also allowed capital to pick up and move to wherever labour is cheapest. This has made countries more susceptible to balance of payments problems.

Looking at US economic history since the Second World War, Nell argues that expansionary government policies have led to successful economic performance. And he argues that such expansionary policies must be used again, if the current economic stagnation is to be ended.

John and Wendy Cornwall analyse the dynamics of macroeconomic change over time. They reject as unhelpful neoclassical growth models that assume full employment, that ignore demand and that ignore path dependence. Only an evolutionary perspective that incorporates the role of institutions, the Cornwalls argue, can help to understand macroeconomic dynamics. A two-way street runs between institutions and economic performance. Economic performance induces institutional change; but institutional change also impacts the economy. The Cornwalls then use this schema to explain the economic performance of the major OECD countries after the Second World War.

The experiences of the Second World War in ending the Depression led to a commitment to full employment on the part of national governments, and a willingness to expand demand and guarantee full employment. It also led to cooperative industrial relations, so that low unemployment rates would not spill over into higher inflation. In essence, labour and management agreed to split the gains of productivity growth. And generous social welfare benefits were provided just in case something went wrong.

The good times, though, led to a breakdown of these institutions and to a resurgence of inflation. High employment increased labour power at the same time that labour became more willing to use that power in order to obtain higher wages. An inflationary bias was imparted to the world economy. Fearing inflation, governments began to use contractionary policies, and unemployment rose in virtually every OECD country.

Given this analysis, the appropriate policy solution follows directly. Institutional changes that bring back a social bargain between labour and capital are absolutely imperative. Only within an institutional framework that limits wage growth to productivity growth can expansionary policies again be employed to control unemployment without leading to unacceptable levels of inflation.

NEW DIRECTIONS IN POLITICAL ECONOMY

It is especially fitting to end this volume with the notion of new directions; the very first Malvern conference resulted in a volume entitled *New Directions in Post-Keynesian Economics* (Pheby 1989). And this theme has continued to be important at Malvern over the ensuing years. In fact, more than anything else, Malvern has been associated with an attempt to move economics forward by developing new approaches and modes of analysis. Both chapters in Part V make concerted attempts to push economics along such new lines.

Ingrid Rima argues that traditional economics goes wrong by starting at the microeconomic level and assuming that macroeconomic outcomes will be Pareto optimal. Since microeconomic behaviour can lead to undesirable macroeconomic outcomes, such as Great Depressions, Rima suggests that we need to reverse the direction of our analysis. We need to begin with those macroeconomic outcomes desired by a nation's citizens, and then determine the best means, or the least costly policies, that will let us reach these goals. Rima terms this approach 'instrumentalism', and traces its roots to Adam Smith, John Maynard Keynes, Jan Tinbergen and especially Adolph Lowe.

More important than the historical origins of instrumentalism are its policy implications. First, the transitional economies of central and eastern Europe should not blindly pursue privatization and marketization in the belief that this will lead to the best possible outcome. Rather, a social consensus for reform must be developed that will set out the desired outcomes and the feasible means to achieve these ends. Second, developed capitalist economies must figure out how to move to a more optimal growth path. This will likely involve, among other things, establishing international organizations like a European Central Bank and a European currency in order to keep individual countries from adopting anti-growth policies like 'beggar-thy-neighbour' import restrictions. What it will not involve, however, are the *laissez-faire* economic policies typically championed by neoclassical economists.

Finally, Kevin Hoover's chapter 'Some Suggestions for Complicating the Theory of Money' is advertised as a prolegomenon to future monetary theory. Hoover begins by discussing the uneasy relationship between the theory of money and Walrasian general equilibrium models. Quite simply, in general equilibrium models it is hard to find any role for money. Since barter determines relative prices among goods, money is not needed for this purpose. Furthermore, in a Walrasian economy the auctioneer can set relative prices to eliminate any imbalances in particular markets. This traditional function of money is thus rendered obsolete. Finally, in a Walrasian model it is hard to explain why people hold money, which pays no interest, rather than interest-bearing assets.

Rather than just blaming general equilibrium theorists for these limitations, Hoover also finds fault with monetary theorists who insist on seeing money as a means of exchange or store of value. Hoover then argues that a more appropriate monetary theory must look to the unit of account function of money. Money is important, according to this line, not because it simplifies exchange or provides utility to its holder, but because it is the way that we keep score of who owes how much to whom.

A more appropriate monetary theory, according to Hoover, must begin with the accounting and settlement functions of money, neither of which have a role in general equilibrium models. In addition, Hoover suggests that rather than assuming that money is needed to purchase goods, monetary theory should begin by assuming that goods are purchased with credit, and that money is needed from time to time in order to settle balances. The puzzle of why people hold money is thus solved—people do *not* want to hold money, rather they want to get rid of it (and buy assets) as soon as possible.

CONCLUDING REMARKS

It should be apparent that the fivefold division that I have imposed upon the chapters in this volume is rather arbitrary. Examining methodological issues yields important insights into the directions that economics should follow if it is to be more relevant, as well as insights into the thinking of seminal figures. A study of seminal figures leads to new insights regarding economic methodology, how various theoretical approaches dovetail, and the efficacy of different policy proposals. The chapters that bring together strands from different heterodox paradigms have distinct policy implications, as well as insights into methodological questions such as the nature and importance of uncertainty. The policy-oriented chapters emphasize the limitations of the neoclassical approach, and attempt to build theories that borrow from different heterodox approaches and that also add something new. Finally, the chapters most explicitly addressing new directions build upon the insights from various schools of thought, show sensitivity to methodological issues and consciously seek better policy proposals.

This lack of a neat and orderly division among the chapters here should not really surprise anyone. Nor should it be seen as a criticism of either the chapters or the division that I have imposed upon them. Rather, it should be seen as a reflection of the breadth of each chapter and the breath of fresh air that Malvern has provided to the grand tradition of political economy over the past decade.[1]

NOTE

1 The editor gratefully acknowledges financial support from Monmouth University through a mini-sabbatical to help bring this volume to completion. Many thanks are also due to Diana Prout for typing numerous chapters, and parts of chapters, in this volume. Finally, each author whose paper appears in this volume deserves special thanks for putting up with such a difficult and demanding editor.

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