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**AFEE Summer School & Beyond**

By Fadhel Kaboub

The Association for Evolutionary Economics (AFEE) held its 2nd annual summer school last June (23-28) at UMKC. Over 70 students and faculty from 22 different countries attended the summer school, which was co-sponsored by AFEE, UMKC’s School of Graduate Studies, and the Center for Full Employment and Price Stability (C-FEPS). The main theme of the summer school revolved around the *Institutionalist Perspectives on the “New Economy” and “Globalization.”* Among the presenters were many well-known institutionalists (and Post Keynesians) including: Glen Atkinson, Charles Clark, Gary Dymski, Greg Hayden, John Henry, Anne Mayhew, Ron Stanfield, Bill Waller, and UMKC’s faculty: Matt Forstater, Fred Lee, Jim Sturgeon, and Randy Wray.

All the participants enjoyed the lectures and the informal discussions. During the summer school, AFEE students drafted an open letter calling for a more pluralistic approach to economics education. The letter was published in the *post-autistic economics network* website* and was supported by many students and distinguished economists around the world. Among the supporters of “The Kansas City Proposal”: Mark Blaug, Steve Fleetwood, David Laibman, G. C. Harcourt, Mario Seccareccia, Tony Lawson, and Sheila Dow.

The open letter is reprinted below along with the names and affiliations of the original signatories. To sign this open letter, send an email with your name and affiliation to: pae_news@btinternet.com.

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**An International Open Letter to All Economics Departments:**

**An Invitation for Reconsideration**

*Economics needs fundamental reform – and now is the time for change.*

This document comes out a meeting of 75 students, researchers and professors from twenty-two nations who gathered for week of discussion on the state of economics and the economy at the University of Missouri – Kansas City (UMKC) this June 2001. The discussion took place at the Second Biennial Summer School of the Association for Evolutionary Economics (AFEE), jointly sponsored by UMKC, AFEE and the Center for Full Employment and Price Stability.

The undersigned participants, all committed to the reform of our discipline, have developed the following open letter. This letter follows statements from other groups who have similar concerns. Both in agreement with and in support of the Post-Autistic

* * http://www.btinternet.com/~pae_news/KC.htm
**This letter is reprinted with the permission of David Pringle and Áine Ni Léime, who wrote the open letter on behalf of the AFFE summer school students. Questions, comments and critiques may be directed to David and Áine at: pringle_djg@hotmail.com and ainenileime@hotmail.com.*
Economics Movement and the Cambridge Proposal, we believe that economic theory, inhibited by its ahistorical approach and abstract formalist methodology, has provided only a limited understanding of the challenging complexity of economic behavior. The narrow methodological approach of economics hinders its ability to generate truly pragmatic and realistic policy prescriptions or to engage in productive dialogue with other social sciences.

All economics departments should reform economics education to include reflection on the methodological assumptions that underpin our discipline. A responsible and effective economics is one that sees economic behavior in its wider contexts, and that encourages philosophical challenge and debate. Most immediately, the field of economic analysis must be expanded to encompass the following:

1. **A broader conception of human behavior.** The definition of economic man as an autonomous rational optimizer is too narrow and does not allow for the roles of other determinants such as instinct, habit formation and gender, class and other social factors in shaping the economic psychology of social agents.

2. **Recognition of culture.** Economic activities, like all social phenomena, are necessarily embedded in culture, which includes all kinds of social, political and moral value-systems and institutions. These profoundly shape and guide human behavior by imposing obligations, enabling and disabling particular choices, and creating social or communal identities, all of which may impact on economic behavior.

3. **Consideration of history.** Economic reality is dynamic rather than static – and as economists we must investigate how and why things change over time and space. Realistic economic inquiry should focus on process rather than simply on ends.

4. **A new theory of knowledge.** The positive-vs.-normative dichotomy which has traditionally been used in the social sciences is problematic. The fact-value distinction can be transcended by the recognition that the investigator’s values are inescapably involved in scientific inquiry and in making scientific statements, whether consciously or not. This acknowledgement enables a more sophisticated assessment of knowledge claims.

5. **Empirical grounding.** More effort must be made to substantiate theoretical claims with empirical evidence. The tendency to privilege theoretical tenets in the teaching of economics without reference to empirical observation cultivates doubt about the realism of such explanations.

6. **Expanded methods.** Procedures such as participant observation, case studies and discourse analysis should be recognized as legitimate means of acquiring and analyzing data alongside econometrics and formal modeling. Observation of phenomena from different vantage points using various data-gathering techniques may offer new insights into phenomena and enhance our understanding of them.
7. **Interdisciplinary dialogue.** Economists should be aware of diverse schools of thought within economics, and should be aware of developments in other disciplines, particularly the social sciences.

Although strong in developing analytic thinking skills, the professional training of economists has tended to discourage economists from even debating – let alone accepting – the validity of these wider dimensions. Unlike other social sciences and humanities, there is little space for philosophical and methodological debate in the contemporary profession. Critically-minded students of economics seem to face an unhappy choice between abandoning their speculative interests in order to make professional progress, or abandoning economics altogether for disciplines more hospitable to reflection and innovation.

Ours is a world of global economic change, of inequality between and within societies, of threats to environmental integrity, of new concepts of property and entitlement, of evolving international legal frameworks and of risks of instability in international finance. In such a world we need an economics that is open-minded, analytically effective and morally responsible. It is only by engaging in sustained critical reflection, revising and expanding our sense of what we do and what we believe as economists that such an economics can emerge.

Signed by:

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Dr. Eric R. Hake (USA) Eastern Illinois University.
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José Alfredo Pureco Ornelas (Mexico) National Autonomous University of Mexico.
Jairo J. Parada (Colombia) Penn State University.
Franziska M. Pircher (USA) University of Missouri - Kansas City.
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Dr. James F. Smith (USA) University of Vermont.
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Ermanno Celeste Tortia (Italy) University of Ferrara.
Eric Tymoigne (France) Université de Paris – Nord.
Benton Wolverton (USA) University of Missouri - Kansas City.
Seminar, Seminar, Seminar…

By Fadhel Kaboub

Since the publication of the Winter 2001 issue of Oeconomicus, many seminars and conferences have been organized by the Economics Department and its affiliated Centers. The two major events were the AFEE summer school and an all-day conference on the social security ‘crisis’ organized by the C-FEPS. Professor Lee continued his biweekly seminar on Research Methodology, in which he has invited several Ph.D. students and researchers in social sciences to present the benefits and limits of their research methods. Visiting Professor James Webb organized a monthly seminar on Pragmatism. In this seminar, Professor Webb addressed issues related to the history of pragmatism, middle pragmatism, positivism, and linguistic analysis. Among the authors discussed in this seminar were Peirce, James, and Dewey. The C-FEPS launched a new biweekly seminar on Money organized by Professors Randall Wray and Stephanie Bell. The Money seminar has addressed several issues including the origins of money, its nature, its primary functions, and its evolution.

John F. Henry, visiting Professor from California State University-Sacramento, presented two interesting lectures on Property Rights vs. Property Relations and on Property and the Limits to Democracy. He also gave a remarkable lecture before the economics club members on The Economic Origins of Racism. This lecture was voted by many students as the best lecture of the semester.

Thomas M. Hoenig*, president and chief executive officer of the Federal Reserve Bank of Kansas City, addressed a large audience of students and faculty in a meeting sponsored by the Economics Club last September. Dr. Hoenig discussed issues dealing with the Fed’s monetary policy tools, the Fed’s role as lender-of-last-resort for the banking system, as well as the relationship between monetary and fiscal policies.

The Economics Club invited Ken Bohnsack**, founder and chairman of Sovereignty, a not-for-profit organization that supports research and policy-making activities related to public infrastructure investment. He talked about the possibilities for using public infrastructure investment to jumpstart the U.S. economy. The Economics Club also invited Professor Ilene Grabel from the University of Denver’s Graduate School of International Studies. Professor Grabel presented her research on Financial Integration in Emerging Economies, and on The Asian Financial Crisis.

Professor Milton D. Lower presented his recent work on Theory and Praxis of the Emerging Global Economy, where he argues that Veblen’s work on The Theory Of Business Enterprise can be applied to analyze today’s global economic structure.

* Thomas M. Hoenig earned a bachelor's degree in economics from Benedictine College, Atchison, KS, and a master's and doctorate degree in economics from Iowa State University. Dr. Hoenig used to teach Money and Banking at UMKC’s economics department back in the 1970’s. He is currently a member of the Board of Directors for the University of Missouri-Kansas City, a member of the banking advisory boards at the University of Missouri-Kansas City, and the University of Missouri-Columbia. Dr. Hoenig joined the Kansas City Fed in 1973, and is currently a member of the Federal Open Market Committee (FOMC), the key body with authority over monetary policy.

** Ken Bohnsack has been a tireless proponent of federal government support of public infrastructure investment for a number of years. He was instrumental in promoting H.R. 1452, The State and Local Government Economic Empowerment Act of 1999-which failed to pass Congress during the budget surplus and lock-box mania of the past two years.
The Fall semester ended with a very busy and interesting week featuring two distinguished scholars. Professor Gary Dymski from the University of California – Riverside, gave two talks entitled “How the US Economy Avoided the Law of Gravity: Hegemony and Prosperity in the Neoliberal Era,” and “Chinese American Banking and Community in Los Angeles County – The Financial Sector and Community Chinatown/Ethnoburb Development.” Edward J. Nell, Malcolm B. Smith Professor at New School for Social Research, also gave two seminars entitled “Monetizing the Classical Equations: a Theory of Circulation,” and “Critical Realism and Transformational Growth.” Professor Nell was also interviewed by Oeconomicus during his visit to UMKC; the interview will appear in Oeconomicus in the forthcoming volume.
An All-Day Conference on the Social Security “Crisis” *

By Fadhel Kaboub

Over 100 people attended an all-day conference on social security organized by the Center for Full Employment and Price Stability (C-FEPS) on November 12th 2001 at the University Center, where ten presenters, including seven guest scholars, addressed the debate about the social security “crisis” and the issues related to its possible reform.

Earlier this fall, the President’s Commission on Social Security Reform approved a report stating that Social Security will face a financial shortfall in the year 2016. L. Randall Wray, professor of Economics and senior scholar at the C-FEPS, said the report “adopted a tone of urgency, and even scare tactics, in an attempt to push an agenda that favors privatization.”

“This report is based upon a set of very pessimistic assumptions about future economic performance. Social security benefits can and will be saved regardless of social security revenues so long as congressional will is maintained,” Wray said.

The proponents of privatizing social security argue that when the “baby boomers” retire in the next two decades, the ratio of retirees to workers will increase dramatically, causing a real burden on the working population. Thus, investing the current social security surplus in the stock market seems a good solution to generate enough funds to support the baby boomers in the forthcoming decades.

Wray acknowledged that a demographic problem exists, but he said that accumulating huge surpluses today will not solve the real problem of providing goods and services to the baby boomers in the future. Indeed, Dr. Stephanie Bell, assistant professor of economics, said that “there is no financial problem at all.” Bell argued that “the ability of the U.S. economy to provide for its future retirees does not depend on how much money exists in locked boxes, but rather on the ability of its future workers to provide goods and services.”

Professor Barbara R. Bergmann from the University of Maryland, author of *Is Social Security Broke? A Cartoon Guide to the Issues*, said that “social security problems are fixable and there is plenty of time to do the fixing.” Max J. Skidmore, professor of Political Science at UMKC and author of *Social Security and Its Enemies: The Case for America’s Most Efficient Insurance Program*, addressed social security’s Trustees projections as well as the use of Social Security’s surplus. “If policy makers were to base their actions for Social Security on the projections that led them to adopt tax reduction, they would have no concern for restructuring the program,” Skidmore said. “Perhaps they may reconsider their call for partial privatization and recommend benefit increases instead.”

Other presenters – namely, Ellen Frank (Emmanuel College), Michael Hudson (Institute for the Study of Long Term Economic Trends), Daniel J. B. Mitchell (UCLA), Christopher J. Niggle (University of Redlands), Tom I. Palley (AFL-CIO) and Sanford F. Schram (Bryn Mawr College, PA) – covered topics ranging from ways of preserving and improving social security to the inadequacy of today’s institutions to provide for the elderly. By the end of the day it was resolved that social security does not face a financial crisis, except the one that may come as a result of a possible privatization. Panelists echoed the need to turn to meaningful policies that will address society’s productive capabilities to care for the retiring baby boomers. Furthermore, it was repeatedly argued that social security is primarily a social program, not an investment program. So, nobody gets rich from social security, but at least those who need it can get by.

Further information about the conference and about the social security debate can be found at www.cfeps.org. A sign-up form to support “An Open Letter to the U.S. Congress” against privatizing social security is available on the site.
A Note from the Editors

On behalf the Economics Club, we would like to thank the Department of Economics and the Center for Full Employment and Price Stability (C-FEPS) for co-sponsoring many events organized by the Economics Club, and for making this past semester a real success in terms of the quality and the quantity of seminars.

We are grateful to Anne Mayhew and Steven Dunn for giving us the opportunity to interview them. We also would like to thank the contributors* to this issue for their professionalism and for their kind cooperation. Many thanks to the UMKC writing lab staff, especially David Foster for his help in editing many of the materials printed in Oeconomicus.

Finally, we hope that the readers will enjoy the papers published in this issue and that the new “Announcements” section provided at the end of this issue will be considered useful.

The Editors: Ben Young
&
Fadhel Kaboub

* All the contributors to this issue are graduate students at UMKC’s Economics Department.
Conversation with Anne Mayhew
Veblen-Commons Award Winner 2000

By Fadhel Kaboub

Professor Anne Mayhew was born in Edinburg, Texas on October 8, 1936. In 1958, she earned her B.A. in Anthropology from the University of Texas – Austin, where she was a student of Clarence Ayres and Ruth Allen. She did some graduate studies in Anthropology at the University of Chicago. In 1962, she went back to Austin where she earned her Ph.D. in Economics (1966) under the supervision of Steve McDonald. She taught at the University of Illinois (1965-68) and at the University of Tennessee in Knoxville where she held various administrative positions such as Chairperson of the Department of Economics (1986-1992), Acting Coordinator of Assessment for the University (1993), Associate Dean for Academic Programs, College of Arts and Sciences (1996-) and currently she is Vice Provost for Academic Affairs and Dean of Graduate Studies (2000-).


Professor Mayhew has been awarded the 2001 Veblen-Commons Award by AFEE in recognition of her career-long scholarly excellence in Institutional economics. She is also known for her contribution to the literature on American economic history, as well as various issues related to culture and interdisciplinarity. The reader will find a selection of Mayhew’s publications at the end of this interview. Oeconomicus interviewed Professor Anne Mayhew on June 27, 2001, in the John Hodges Library during the AFEE Summer School that took place at UMKC.

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Oeconomicus: How did you get interested in economics first and then in Institutional economics?

Mayhew: I suppose I really became interested in economics first when I was in high school. I was fortunate to have a couple of teachers (in a very small and not terribly good high school) who had recently graduated from the University of Texas – Austin who were very dedicated teachers, and they suggested various things to me to read. One of the readings was a book called The Age of Jackson by Arthur M. Schlesinger, Jr. This book dealt with the Second Bank of the United States and the banking crisis of the 1830s. It
was by far the hardest book I had ever read at that point. I really didn’t understand very much, but I found it very interesting. So, we talked a lot about economic issues and other things that I didn’t give much thought to as a 15-year-old high school girl, but I became interested.

They also told me about faculty at the University of Texas. That’s where I first heard of Clarence Ayres. Neither one of them, I believe, had ever taken a course with him, but they knew of him and some people in the economics department. When I went to the University of Texas as an undergraduate, I was fortunate to be admitted to an Honor’s program there that had the funny name of “Plan Two.” In those days they let about 100 people per year into the program, and instead of taking the normal courses, we took special courses. So, it was in many ways a wonderful program. In the second year, I took one of the most important Plan Two courses. It was called “Social Science 610,” and it was taught by Ayres.

Ayres had helped create the Plan Two program when he came to the University of Texas in the 1930s. He really patterned it, in a way, after a program that had been created many years earlier at Amherst University under the leadership of a man named Alexander Meiklejohn but also Walton Hamilton and Ayres [who was a very young scholar] were there as well. They had a program that was based upon the proposition that you should have an integration of human knowledge, an integration particularly of the social sciences. So, Ayres had patterned Plan Two after that Program and he certainly patterned Social Science 610 after it.

We read anthropology, sociology, economics, and a number of other things, but the course really revolved around Ayres’ lectures. That’s where I decided, for the first time, that I probably wanted to study economics. I also took several undergraduate courses in economics; one of them was with a woman named Ruth Allen, a really remarkable woman who was on the faculty of the University of Texas. She studied at the University of Chicago back in the 1920s or maybe early 1930s. At that time, they had a strong tradition there of doing quasi-anthropological work among people in the U.S. Ruth Allen worked among the East Texas lumber workers and people picking cotton in the Mississippi Delta. She was a very interesting woman – I took an introductory course with her.

I later quit the Plan Two Program because I went to work full time as there was a terrible drought in South Texas at that point, and my family’s fortunes were pretty poor. I couldn’t continue in the Plan Two Program because of the special nature of the seminars, I decided to major in anthropology, and this was oddly enough at the suggestion of Ayres who was very keen on anthropology among the social sciences. So I actually got my undergraduate degree in anthropology. Then I went to the University of Chicago and studied anthropology for a while, dropped out of graduate school, got married, had two kids. Eventually I was back in Austin, and I decided to go back to school. At that point I thought that if I got a masters degree, I could get a teaching position because anthropology was not in high demand. Then, I stayed on to get a Ph.D.
in economics. So, I cannot really say that economics was the thing I was most interested in, although I was really always interested in this process of economic change.

Oeconomicus: Did your undergraduate interdisciplinary background push you into doing Institutional economics?

Mayhew: Absolutely, that was what brought me into Institutional economics because that was the kind of economics that I had learned when I was a sophomore with Clarence Ayres.

Oeconomicus: What did you do your dissertation on?

Mayhew: I did my dissertation on a very dull topic, and it was a matter of practicality. At that time, several faculty members of the University of Texas had a big project funded by Resources for the Future on poverty; it was really a project on the South West economy. So, I did my dissertation on poverty in East Texas counties, and my supervisor was Steve McDonald. It was not a terribly exciting dissertation; I did it as a practical matter because I was getting paid to work on this project.

Oeconomicus: So, after your Ph.D., did you start teaching right away?

Mayhew: I did. I started teaching even before I completed the Ph.D. I went to the University of Illinois where I had a joint appointment between the economics department and the Bureau for Educational Research. This was at the time when people in colleges of education and also economists were very interested in the contribution of education in economic development. So, I was hired to work on that. It was a serious mistake because it turned out that what they wanted me to do was to provide various sorts of justifications for more spending on particular sorts of education, and I wasn’t comfortable doing that. So, it was kind of a miserable job.

Oeconomicus: What courses did you teach?

Mayhew: I taught an introductory course, an honor’s introductory economics course and American economic history.

Oeconomicus: Did you teach Institutional economics?

Mayhew: No, I have never taught a course on Institutional economics, although I teach Institutional economics [laughter].

Oeconomicus: How come most Institutionailists do not teach specific courses in Institutional economics? Is it a personal choice or is there any kind of objection from their departments?

Mayhew: No, that’s not it. I have always regarded institutional economics as an approach to the study of economics, and I use that approach in teaching, say, American
Economic History. Most of my teaching was in American economic history and some in the history of economic thought – but not very much. I have also taught international economics, business cycles, and macroeconomics… and in all of this I use the Institutionalist approach. So, I was teaching Institutional economics, but I never taught a course in Institutional economics.

_Oeconomicus:_ Don’t you think that teaching a specific course in Institutional economics will help perpetuate the Institutionalist tradition and maybe expand it?

_Mayhew:_ That’s possibly true. Actually when I say that I’ve never taught a course in Institutional economics, I guess it’s not true because I used to teach reading courses for graduate students over the summer specifically in Institutional economics. So, I taught special topics courses on Veblen for example. So, I’ve done a lot of that, and I’ve always tried in my graduate courses in particular to keep the tradition alive by using Institutional work in my courses.

_Oeconomicus:_ What about other Institutionals in other departments? Would they respond to the previous question in the same way?

_Mayhew:_ I think it varies from place to place. I have simply never ever proposed a course in Institutional economics at Tennessee, and I know that Terry Neale, who is also my husband, never proposed such a course. Both of us talked about this and agreed that we don’t want to teach such a course. But there are maybe other places where people did want to teach Institutional economics and were not allowed to. I don’t know!

_Oeconomicus:_ Could you tell us more about Ayres the teacher and the man?

_Mayhew:_ He was an excellent teacher. He has been criticized (for example, by Ronnie Dugger in a book he wrote while he was editor of the _Texas Observer_) for being a totally undemanding teacher and giving everybody A’s. It was true that he tended to give high grades, but he was a very demanding teacher in a different way, in that he was impatient with or had very little time, if you were not interested in what he was interested in. So, if you are really interested, he was absolutely a wonderful teacher. He had a commanding presence in the classroom and would bellow things. He had a huge voice and he would shout out, but he was also a very good teacher outside the classroom. He had, for example, a very keen interest in classical music, and he was a musician himself. I can remember in those days that you could go to something called the university co-op and listen to records. This was before compact discs and tapes; we had the big old records [laughter]. So, you could go under these little booths and listen to records. At that point, I was just trying to learn about classical music because I didn’t have any sort of background or training in it. I remember that Ayres came and saw me there. He came over and made all these recommendations about what I should listen to etc… and I have always remembered what he said. He would also see you on campus and make recommendations about novels etc… He was really very engaged with students and, he was a very fine professor.
Mayhew: I suppose mainly being editor of the JEI for 9 years [laughter]. That’s a big thing [laughter]. I think I have tried to clarify Institutionalist theory by writing about the importance of culture, trying to make the idea of culture clear and make it clear how that fits into Institutionalist thought. I guess my other contribution I would say is in trying to do some work on American economic history. So, I had published in other journals on American economic history.

Mayhew: Just a little bit.

Mayhew: Well, IAFFE and the whole development of Feminist economics involve a number of different people and different ideas. In the first group there are people who are really neoclassical economists who are really interested in [studying] how women are paid in the labor force etc… So, their issues are about women, but their methodological approach is really neoclassical. The other group of IAFFE are those who are trying to rethink the whole set promises in the methodology of neoclassical economics and have rethought it because they think that women have different perspectives and that the way in which women participate in the economy is culturally bound. So, when they start thinking that way, then they become very much like Institutionals. So, there is an overlap with some of them.

Mayhew: Well, as I said, I started off studying with Clarence Ayres; so, I’ve read all of his work. Very early in my college career, he suggested various things that I should read: Joseph Dorfman, Thorstein Veblen, and Wesley Mitchell’s lecture notes… I’ve read a lot of Veblen at various times over my life, and that was certainly very influential. I think that I was very much influenced by anthropology and at the time that I was doing graduate studies; I was very interested in the interconnection between anthropology and the economic development literature. At that time, there was a lot of economic development literature that I found interesting and important, but this didn’t have such a lasting influence on me as has a lot of the work in economic anthropology. Then, when I moved into teaching, I picked up my other interest, which is American Economic History, and became much more involved in that.

Mayhew: I have a number of my students who are in the field of Institutional economics. One of them is Eric R. Hake who is here at the AFEF summer school. He did his dissertation on innovations in finance at the turn of the century that helped create the
modern corporation. Janet T. Knoedler, who is on the faculty at Bucknell, did her dissertation on the steel industry and the changes in technology seen from a Veblenian perspective. William Doyle who now teaches at the University of Dallas wrote on the financial innovations in the 1870s, 1880s and 1890s in the sugar industry, although he no longer uses Veblen as his framework, which was really the framework of his dissertation analysis. Tony Maynard who teaches at Franklin and Marshall College was also a student of mine and his dissertation was in fact on Veblen and the ideas of race and culture… I’m leaving out people. These are only the ones who come to my mind right now… they are active members in AFEE and AFIT.

**Oeconomicus:** You’ve just made the transition to the next question. What’s the story behind the “split” between AFEE and AFIT? Is it a theoretical or political disagreement?

**Mayhew:** Well, when AFIT was founded [in April 1979], there was a lot of unhappiness at that time with the direction of the *JEI*. This was at the time when Warren Samuels was editor of the *JEI*. Being editor of the *JEI* is a very difficult task in many ways because as editor you want to make it a very respectable journal but also a journal that serves institutionalism. While Warren was editor, the discipline of economics was really going through an enormous change. Certainly in the 1920s, 30s, 40s and even 50s and early 60s, Institutionalists were not all that separate from the mainstream of economics. By the mid-1960s, they began to split off as mainstream Economics became more neoclassical and formalistic. At that point, one of the bad things that happened was that a lot of mainstream economists took the view that Institutionalists were simply economists who could not do proper economics, that they were not very good and that they were inferior. Unfortunately, as that split occurred, the *JEI* had been caught up in all that, and Warren Samuels was attempting, as editor of the *JEI*, to be very eclectic and to bridge this growing gap. So, he published Institutionalist work, but he was also publishing work done by other economists who were not so clearly Institutionalists. Apparently, I think what he was trying to do is to bridge the growing gap in Economics as a whole. Unfortunately, this made a lot of Institutionalists very unhappy and very angry. They thought that what Warren was saying to them was the same thing that other economists were saying, which was “you are not good enough to publish.” I think that it was the most unfortunate thing because one of the things you do, as editor, is you do have to reject articles, and you do send them back and say: “this needs to be revised,” or “no, this shouldn’t be published.” So, there was an increasing feeling that every time Warren did that to somebody who was a member of AFEE, that he was really taking this view of the mainstream that Institutionalists were no good. So, people got increasingly angry and the annual meetings of AFEE (at that time I was not on the AFEE board but I knew about them) would start at 6 p.m. and go on until midnight, and there was shouting, and a lot of unhappy people. In the middle of that, a group of people came together to form AFIT and they were going to publish a separate journal, and I believe that there was one volume of that published. I’m not quite sure how many issues were in that volume, but there is at least one issue because I have one copy of it.
AFIT was seen as a sort of substitute for AFEE. This made a certain amount of sense in various ways because AFIT was going to be part of the Western Social Science Association (WSSA). A lot of the people who were part of AFIT, and had been part of AFEE as well, lived in the West and had traditionally gone to the WSSA meetings, which before was the Rocky Mountain Social Science Association. So, it was very easy for them to get together, because they knew each other, and found association easy.

In other words, in the beginning there was not a split in institutional theory, it was a split in the view of what the JEI should be that was in large part a consequence of the change in the direction of mainstream Economics that caused Institutional Economics to be seen as something really separate. It wasn’t too long after AFIT was formed that Warren Samuels stepped down as editor of the JEI. The reason he did was because at that time, he was on the Faculty of Michigan State University, and Michigan had very serious economic problems. Michigan State had to cut back, and they cut back funding in support of Warren’s editorship. So, he stepped down as editor of the JEI. Mark Tool became editor, and he was one of the people who were involved in AFIT. At that point, the sort “big fight” in AFEE disappeared and, in a sense, the original reason for the formation of AFIT went away.

AFIT has continued to flourish for a couple of reasons. One is because it continues to be a place where people who live in the West find it easier to go to than to the AFEE meeting. The second reason is because it’s a very small group, and it’s not part of the Allied Social Science Association, and the AFEE meetings tend to be less friendly and less cohesive. AFIT has served a kind of second purpose of providing small and very friendly meetings. So, it’s been a useful organization, but it really exists for that annual meeting, which is a place where a number of Institutionalists can come together in a small group where there are no other distractions and everybody sort of hung out together and have a good time.

Oeconomicus: So, there were no theoretical issues involved in this “split”?

Mayhew: There have been theoretical issues as well. I think that the story that I just told you was mainly about the journal. But there were also theoretical issues associated with it because Institutionalists disagree about a number of things. There were some Institutionalists, particularly those who were taught in the West, and who gave great emphasis to what was often called the dichotomy between technological and ceremonial patterns of behavior. This was regarded as the tool of institutional analysis. Other Institutionalists, like myself, think that this can be a useful tool, but that it can be overemphasized. One of the things that I have said in some of my writings is that I think that it tends to become a kind of taxonomic distinction where you try to say, “ok, is this particular pattern of behavior, ceremonial or instrumental, and vice versa?” and when you get into that, I think, you get into some very difficult and non-productive arguments. So, there was strong disagreement over that among other differences as well. But I would be very hard pressed today to say that AFIT represents this line of thought, and AFEE represents a different one; that’s not the way it is.
Conversation with Anne Mayhew

Oeconomicus: When the “split” occurred, who joined AFIT and who stayed in AFEE?

Mayhew: I think that nobody left AFEE.

Professor Anne Mayhew at the 2nd annual AFEE Summer School, University of Missouri – Kansas City, June 23-28, 2001.

Oeconomicus: Yesterday in the conference, somebody referred to Douglass C. North as an Institutionalist. Do you agree with that? And what are your views on Neo-Institutionalism and New Institutionalism?

Mayhew: I don’t use the word “New Institutionalism” or “Neo-Institutionalism.” Douglass North is part of what is called New Institutionalism. You can easily call that Neoclassical Institutionalism, which is something totally apart from AFEE and AFIT. It is a line of thought that began to develop 30 or more years ago. Douglass North and Oliver E. Williamson played a major role in creating it. It is really at the application of neoclassical choice theory to institutional change. Douglass North is an economic historian. His first works were in straightforward economic history. He wrote a very interesting article in the Journal of European Economic History that everybody ought to read. He said that he had found that neoclassical theory was not particularly useful in explaining what went on in the economy, but it could be used to explain the structure of economies over time as they move toward greater efficiency. So, he helped create this New Institutional economics, which I don’t think has much to do with the kind of Institutional economics that I do or that any of the other people associated with the JEI do.

Oeconomicus: Could you tell us about some of the history of the creation of AFEE?

Mayhew: I was not involved in the creation of AFEE, but I know the people who created AFEE, and I know their stories, though I am not sure that I can remember them accurately just now. I think that it came about in the years immediately following the Second World War in the late 1940s and early 1950s. Economists such as Ayres, John Gambs, Allan Gruchy and David Hamilton had been active and reasonably “mainstream” economists. They were sort of, I guess, middle aged-practicing economists at that point. They found it increasingly difficult to be on the annual program of the AEA, which became the ASSA. That meeting was particularly important in those days because they didn’t have these other sets of regional and specialized meetings that we do today. So, it was important that they be able to go to that and be on those panels. They were having
troubles getting on the program, and they were increasingly having troubles publishing in journals like the *AER*.

If you go back before the Second World War and even in the immediate post World War period, people who are part of the Institutionalist tradition were publishing in the *AER*; and that began to end in the 40s, though the big break came later. So, a group of people decided to meet. They were called the *Wardman Group*, which was named after the Wardman Hotel where they met. It was really a small and relatively informal organization of like-minded people who wanted to meet and talk about their perspectives on Economics and how they differed from what was becoming the mainstream perspective. I don’t know how long this went on.

*Oeconomicus:* About 8 years, from 1958 to 1965.

*Mayhew:* Ok, 8 years but I think it began earlier. But by the time that AFEE was founded [in 1965], the proposition was that this group needed a journal. There were people who were not terribly enthusiastic about that, and I understand that because one of the things that any group thinks of when they come together is a journal. A journal is an expensive thing to run, it is a hard thing to run, and if it is not good, then you don’t do your own tradition any good; and you expose it to not being very strong and it takes a fairly large cadre of good scholars to produce a good journal that is published several times a year. So, there was really a worry about whether there was enough work in the Institutionalist tradition to be published, and whether or not it could be sustained. As you know the *JEI* was begun and has survived now over 30 years as a good journal; although, it has its ups and downs and difficulties. So, it was really with the creation of the *JEI* [in 1967] that AFEE became the kind of organization that it has been since then.

*Oeconomicus:* What are your views on Marxist and Socialist economists?

*Mayhew:* I would answer in two different ways. One is that I see socialism as somewhat different from Marxism or Marxian thought, as I understand it. There is a very long tradition of socialist economies and of socialist thought particularly in England where you have the Fabian socialists and others who were interested in how to organize society. Then, there is a separate tradition, which is Marxian thought, which seems to me to have ontological standing in the modern U.S., but elsewhere it is a bit different. I said yesterday in one of the conversations that we were having that I suppose that I am a socialist if I have to identify myself; that’s not something I go around identifying myself as, not because I’m afraid to, but because it’s irrelevant and does not have anything to do with what I normally do. I do support and give money to organizations that are arguing for tax reform, and I have occasionally worked in the living wage campaign. So, I do these sort of things, but I don’t say that I’m doing this because I’m a socialist or that I’m a socialist because I’m doing these things; that doesn’t have any kind of relevance. So, in a sense, I don’t even know how to deal with the word “socialist.” I think that most people who have been involved in AFEE and most Institutionals tend to be toward the left. There are relatively few, if any, conservatives either socially or economically in AFEE.
Conversation with Anne Mayhew

Then, there is a question of how institutionalism relates to Marx. I don’t consider myself a very accomplished student of Marx because I have not read all of Marx, and I think that in order to make comparisons between Marx and Veblen, for example, one needs to read all of what they wrote. One reason I have not read a lot of Marx is because I have not found his analysis particularly interesting. I understand that, in a way, it is a lot more interesting than, say, Ricardo, but my interest is not in the English economy of the middling part of the 19th century. So, I’ve not read the people who had written a lot about that; and that seems to me what Marx was about.

There is in addition to Marx himself, the whole Marxian tradition, and I have found a lot of overlap between my own views and the views of some people who could identify themselves as part of the Rethinking Marxist Group. It seems to me that they have come very close to sharing the same perspectives on economic processes that Institutionalists do. Other people working within the Marxian tradition who hold to the importance of the labor theory of value and the idea of exploitation which derives from that, strike me as not talking in the same realm of discourse that I am particularly interested in. I don’t think that it has much to do with the Institutionalist thought, and I don’t think that this is bad or wrong stuff; it’s just not very interesting to me. I don’t think that Marx and Veblen are very closely related; and I don’t even really understand why people want to make them closely related.

Oeconomicus: What is, in your opinion, the common basis that Institutionalists and Post Keynesians share? Do you see any kind of convergence or synthesis between the two schools?

Mayhew: Well, once again, I have to say that I’m not quite sure what Post Keynesianism is about; I’m more comfortable with what Institutionalism is about than what Post Keynesianism is about because there are at least two kinds of Post Keynesians [laughter].

Oeconomicus: Let’s restrict the question to the Post Keynesians appearing in the JEI.

Mayhew: Ok, one of my problems here is that Post Keynesians strike me as for the most part being what I understood to be Keynesians. At the time when I was learning economics and at the time I was teaching Macro theory and all of that; we all, I think, had a kind of understanding of what Keynes is about, the role of Keynes’ thought in the whole Western history of thought, but it’s very close to what a lot of Post Keynesians came to think. It was only when Keynes got turned into the rather silly kind of analysis that popped up in Macro texts that you then had the real development of Post Keynesianism. So, I share a lot of [ideas with] Post Keynesians in a sense that I believe the aggregate demand management is a very important tool. I don’t think that the IS-LM analysis is worth anything at all; it’s a very silly way of thinking about things. I absolutely think that the money supply is endogenously determined in most modern economies. So, I share a whole range of ideas with them. Post Keynesians seems to me to be pretty largely focused on a particular range of activity within a particular kind of economies; and I see Institutionalism as being about a broader range of issues. So, I have no problem with it.
Oeconomicus: As editor of the JEI, you had the responsibility of setting the standard for institutionalism and making sure that it was not disturbed by any sort of neoclassical ideas. What were your criteria in terms of selecting articles for publication?

Mayhew: First, my big criteria for considering work for the JEI was that it had to be good scholarship; and I try to have fairly exacting standards. The argument had to be reasonably well written, intelligible, reasonably coherent and logically organized. So, that was the first criteria; and a lot of things didn’t get published because they didn’t meet this criteria. The second thing was that it had to be something that I thought would be of interest to the people who read and supported the JEI; and that excludes a lot of work that might be done from a neoclassical, Marxian or even from a Post Keynesian perspective, if it was not really of interest. For example, there were a lot of papers that came in at various points, arguing pros and cons of endogeneity of money. Some of them I published and some of them I didn’t, and it was largely those articles about some technical point within Post Keynesian economics that were not of major interest. I have to say that in all that, I was really guided by the referees, even though sometimes I didn’t agree with them, but usually I took their advice on things. I certainly would have welcomed and did welcome things that were critical of Institutional thought, so long as it seemed to be reasonably well grounded on a good understanding of Institutional thought. I also always had the rule that articles needed to be about something. I mean, it shouldn’t just be an article that doesn’t seem to have any focus on any particular thing.

Oeconomicus: Who do you think are the new lights – age less than 40 – in Institutional economics, and what kind of contribution will they be able to provide? How different are they from the “old Institutionalist generation”?

Mayhew: Well, that’s a little hard for me to answer because I’m going to tell you about my students because those are the people that I know best. I certainly think that Tony Maynard has written an extremely important dissertation on Veblen’s role in creating 20th century thought about race and culture. So, I expect that he will do very good work. Eiman Zein-Elabdin, whom I didn’t mention, didn’t actually do her dissertation with me, but I have worked very closely with her. She is doing very important things about Africa and African economies and some of the feminist ideas in the world of institutionalism. So, I expect very good things from both of them.

John Harvey, who is at Texas Christian University, seems to me to be a person who straddles Post Keynesian and Institutional work, and I think that his understanding of international finance and his understanding of some of the bigger issues is extremely important. I am much taken with the work of Stephen Dunn who is not a student of mine. He is working on uncertainty within the Post Keynesian tradition, and I think that he has a very good understanding of a number of the issues. There are other people that I cannot remember right now, so I have to look at the JEI. There is a fellow named Bob Prasch who teaches at Middlebury College. He has done some very innovative work trying to explore some of the meanings of various neoclassical tools within Institutionalist context.
I think that Bob Prasch is a very fine scholar. Deborah M. Figart and Ellen Mutari have written on women labor-force participation rates in promising ways.

**Oeconomicus:** It seems that most Ph.D. graduates from universities who have an Institutionalist tradition do not stay in academia and teach institutional economics. They are more business oriented today. So, do you think that institutionalism will survive?

**Mayhew:** Well, I think that it is starting to be very hard because we don’t have many Ph.D. programs with people who have been trained in Institutional economics.

**Oeconomicus:** So, we should encourage more Ph.D. students to stay in academia in order to keep the institutionalist tradition alive, and maybe expand it.

**Mayhew:** Well, not necessarily because I don’t think we can place students to teach in graduate programs right now. I think that’s very difficult to achieve. I do think that in various interdisciplinary programs one can do it, but a number of our very good recruits to institutionalism have come in recent years because they were introduced to Institutional economics as undergraduates. We do have a number of people who are teaching in very good undergraduate schools. Bill Waller is teaching at Hobart and William Smith Colleges, Janet T. Knoedler is teaching at Bucknell, Tony Maynard and Eiman Zein-Elabdin are teaching at Franklin and Marshall College. So, we’ve got people teaching at very good undergraduate places where students have a good training in Institutional economics, and even though they may go on to do economics in neoclassical schools, they keep the ideas of institutionalism alive.

I don’t think that Institutional economics needs to be anything more than a body of ideas, and I see a lot of interest out there in the world in the ideas of Commons and Veblen. I’ve been very interested at this AFEE summer school in the importance that is given to Karl Polanyi as part of the American Institutionalist tradition. So, I think that these ideas will survive, but I’m not very optimistic about the survival of Institutional economics within economics departments; I don’t think that’s going to continue.

**Oeconomicus:** So, institutional thought will survive, but its teaching will disappear.

**Mayhew:** Yes, the thought will stay there, but I’m not even very optimistic about economics departments surviving. I think that economics departments will become less and less important in universities.

**Oeconomicus:** What about the neoclassical dominance of economics departments?

**Mayhew:** I think that they are digging their own grave because I think that neoclassical economics is as, ever so many other people understand, irrelevant and becomes more esoteric and irrelevant over time. I think that as that happens, the size of economics departments will shrink and the importance of having training in economics will become
less and less important. So, I think that economics departments as a whole are going to become smaller units within universities.

**Oeconomicus:** Thank you.

**Mayhew:** Thank you.

**References**


**Selected Publications by Anne Mayhew**

**Articles & Chapters**


Conversation with Anne Mayhew


Notes, Comments, Encyclopedia Entries


Conversation with Stephen P. Dunn
K. William Kapp Prize Winner 2000

By Fadhel Kaboub*


Frederic Lee, and Anne Mayhew – among others – consider Steve Dunn to be one of the leading young Post Keynesian economists for the 21st century. Approving of Steve’s research on developing a strategic theory of the firm, John K. Galbraith has written:

Occasionally, though rarely, one learns even more about oneself reading from others than from even the most diligent personal study. From this comes my gratitude for your most agreeable piece on my most compelling area of study, which is the difference made in modern economic life by the great corporation. I am pleased by the distinction you accord me but even more by the knowledge of Galbraith that you convey [J.K. Galbraith, Personal Correspondence, August 7, 2000].

In the nature of things I have rarely read a paper that told me more about myself than I thought I knew but that has now been my experience. With your wise, scholarly and, I think, deeply perceptive account of my work on the Multinational Corporation you pay me a great scholarly compliment indeed... You are certainly one of the first to read the book as I hoped might be generally the case [J.K. Galbraith, Personal Correspondence, January 29, 2001].

Steve’s research interests span methodology, the theory of the firm, Post Keynesian economics, new and old institutionalism and the economic contributions of J.K. Galbraith. Steve has lectured and presented papers at internationally recognized Universities and research institutes and published numerous academic articles in leading international economics journals including The Manchester School, the Journal of Post Keynesian Economics, the Scottish Journal of Political Economy and the Review of Political Economy. Oeconomicus corresponded with Steve Dunn between June and November 2001. The reader will find at the end of the interview a selection of Steve’s publications including those referenced in the text.

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* I would like to express my gratitude to Steve for his kind co-operation in editing this interview. Many thanks to Professor Lee for his assistance in preparing the interview questions.
** The prestigious K. William Kapp prize is awarded annually by the European Association for Evolutionary Political Economy (EAEPE), the second-largest association for economists in Europe.
Oeconomicus: How did you get interested in Post Keynesian economics?

Dunn: I began my economics instruction at the age of fourteen on the advice of my Geography teacher who recognised an idle curiosity and natural appreciation of the rigours of economic logic. Well, I’m not sure that was true but I was certainly interested in it. And so by the time I arrived at Leeds University in 1991, I was a free marketer sermonising on the world according to Milton Friedman – I was all ‘choice, freedom and a controlled money supply’. However the economists that I met on my degree programme were, generally speaking, a unreflexive and accepting lot. So, I turned to students of sociology, philosophy and politics to explore the conceptions of science and society embedded in the conventional wisdom, which I had up till this point unquestioningly accepted. And through this process I quickly became interested in the philosophy of science and radical political economy.

At the same time, I was absorbed by a course ran by Professor Peter Nolan on Industrial Economics. Professor Nolan lectured on the peculiarities of the British system of industrial relations and developed a radical view of the labour process, which also sought to challenge many of the conceptualisations that I had up to this point unquestioningly accepted. Towards the end of my first year at University, I had begun to explore Marx, Galbraith and Robinson and was guided through the conflicting pluralism of political economy by Malcolm Sawyer’s excellent textbook The Challenge of Radical Political Economy. Indeed I recall being dismayed by Professor Malcolm Sawyer’s seemingly conventional Keynesian diagnosis in his inaugural lecture on ‘Unemployment and the dismal science’. How little I knew!

By the time I came to write my undergraduate dissertation in 1994, I was openly referring to myself as a Keynesian and I sought to explore the ideological associations of the concept of Equilibrium under the aegis of Dr. Michael Hudson. This led me to Joseph Schumpeter, Gunner Myrdal, Warren Samuels, Paul Davidson and the Journal of Post Keynesian Economics. Stylising somewhat, my main conclusion was that the equilibrium theorising had ideological associations not the least because of its obscuring of uncertainty and evolving historical process. I should add also that Mike was a most able historian of economic thought and, unbeknown to me at the time, stoutly defended my essay from those in the Department that thought the absence of an empirical study rendered my enquiry inferior. Nevertheless, I got the highest mark that year for that essay which nurtured my interest in the salience of uncertainty for economic analysis.

After a summer vacation, which I spent pursuing some of the leads suggested by my study on equilibrium, I embarked on a Masters programme and variously describing myself as a Post Keynesian and began my first lecture series with Malcolm Sawyer and started to more confidently espouse Keynes’ economics.

Oeconomicus: Which professors or colleagues influenced your research program?

Dunn: By the end of the first year of my Masters programme, I was thoroughly Davidsonian. He was on the reading list and Paul’s clarity of exposition greatly aided my understanding of Keynes. By the end of the year, I had begun to work on a proposal to empirically assess Keynes finance motive, which I was going to research under the supervision of Dr. Bill Gerrard. But by a simple twist of fate (a long overdue sabbatical)
meant that Professor Nolan’s two-semester course on Advanced Labour Economics did not run and so I instead choose a course offered by Malcolm Sawyer on Paradigms in Industrial Economics. And having become an ardent supporter of Post Keynesian economics, I was most surprised by the limited view of the competitive process ascribed to Post Keynesians. I was struck by the focus on big firms and pricing and the virtual neglect of Galbraith, uncertainty and the recent developments in the theory of the firm.

The most radical seemingly Post Keynesian contribution that I came across was at a research seminar given by Professor Keith Cowling from Warwick University. His paper with Roger Sugden entitled ‘Behind the market façade’ offered the prospect of advancing a radical conceptualisation of the firm that linked up well with the conceptualisation of the labour process that I had subscribed to in my undergraduate courses. However, I was struck by the absence of any recognition of the salience of uncertainty in any radical contribution to the theory of the firm. So ever the intellectual opportunist. I resolved to exploit this situation and sought to develop a Post Keynesian contribution to the theory of the firm as part of my Masters dissertation. And this also became the focus for my Ph.D.

**Oeconomicus:** What are, in your opinion, the fundamental propositions of Post Keynesian microeconomics?

**Dunn:** Well, I’m not sure I understand the question. In one sense I’m a Post Keynesian and the view of the world I subscribe to is an open system approach that is embedded in Paul Davidson’s six *a posteriori* propositions about the essence of the economic process:

1. The economy is a historical process;
2. In a world where uncertainty is undeniable, expectations have an unavoidable and significant effect on economic outcomes, and;
3. Economic and political institutions play a significant role in shaping economic events. 
4. The relevance of the distribution of income and power in the study of economic processes. 
5. Real capital is non-malleable and embodies historical decisions and is conceptually distinct from financial capital. 
6. Income effects are more dominant than substitution effects in creating and resolving economic problems.

These propositions summarise the heuristic core of Post Keynesian economics and represent a unifying agenda. And this is the vision that underlies the contribution that I am seeking to make when practicing economics: to acknowledge that there is an important link between firms, their strategic decision makers and their organic nexus to ‘uncertain’ macroeconomic processes. So, while I think that a division of labour between micro and macro theorists is helpful, especially in contributing to the extension to the comprehensiveness of Post Keynesian economics, both areas must attempt to reconcile and incorporate their respective insights. All to frequently this fundamental need is passed over.

**Oeconomicus:** What is your own contribution to Post Keynesian economics?
**Conversation with Stephen P. Dunn**

**Dunn:** As I’ve said my starting point is the distinctive Post Keynesian view of time, understood as a non-deterministic, nonergodic, open systems process. I would submit that this is a core and defining characteristic that is linked to the Post Keynesian discussion of money and the principle of effective demand. It is from this vantage point that I have sought to develop a distinctly Post Keynesian contribution to the theory of the firm, which embodies the requisite modifications pertaining to modern monetary production economies.

I began by clarifying the informational foundations of the transaction costs rationalisation of the firm [Dunn 2000b]. One can tell a story about the existence of firms that does not rely on the co-existence of opportunism, bounded rationality and asset specificity but rather invokes crucial decision-making and uncertainty. This represents a salient contribution to the theory of the firm. I then sought to embed this refinement within a strategic conceptualisation of the firm that is consistent with the Post Keynesian discussion of uncertainty and its approach to pricing. I have argued that this clarification provides a rationalisation of the firm in the long run and provides for an identification of the essence of the firm as ‘a means of co-ordinating production from one centre of strategic decision-making under conditions of fundamental uncertainty’ [Dunn 2001b]. I have then sought to elaborate upon this strategic conception of the firm by drawing upon J.K. Galbraith’s neglected theoretical contribution to the theory of the firm [Dunn 2001c] arguing that this definition and approach to the firm should facilitate a greater appreciation of the role of money and power within production [Dunn 2002]. Clearly more work needs to be done but I think the beginnings of a substantive contribution are there.

**Oeconomicus:** How does the concept of uncertainty (non-ergodicity) relate to the dichotomy between market and hierarchies?

**Dunn:** Oliver Williamson has advanced the contention that bounded rationality is the main behavioural assumption maintained by the New Institutional Economics. Bounded rationality is combined with opportunism and then used to elaborate upon the ill-defined notion of ‘behavioural’ uncertainty. The pervasiveness of the ‘behavioural’ uncertainty surrounding asset specific transaction delineates different transactions. Building on Paul Davidson’s distinction between ergodic and nonergodic processes, I would argue that the theory of the firm ignores and conflates ‘fundamental’ uncertainty with notions of bounded rationality and ‘behavioural’ uncertainty. The upshot is that the richness and distinctiveness of both concepts is obscured from theoretical view. So although while bounded rationality is an important concept that can inform a transaction cost rationalisation of the emergence of firms as distinct modes of economic organisation, it can only do so in the short run. In contrast, nonergodicity can be used to explain the existence of transaction costs and firms in the long run, conceived as a historical sequence of novel, creative events, and makes a positive contribution to the development of a Post Keynesian theory of the firm and the theory of the firm more generally [Dunn 2000b].

From this point, I have sought [Dunn 2001a] to develop Cowling and Sugden’s (1998) recent contribution and refine their novel depiction of the essence of the firm as “a
means of co-ordinating production from one centre of strategic decision-making” by extending their definition to account for the fact that strategic decision-makers engage in the co-ordination of production operate under conditions of ‘fundamental uncertainty’ (nonergodicity). This extension avoids many of the problems associated with Cowling and Sugden’s framework while simultaneously reinforcing their main conclusions and providing for a robust definition of the concept of strategy. Moreover this links well with the strategic view of the organisation and the pricing process associated with Post Keynesianism more generally and provides a unifying foundation for the elaboration of Post Keynesian contribution to the theory of the firm.

**Oeconomicus:** How compatible is your work with that of Fred Lee, Peter Earl, Neil Kay, Brian Loasby and Paul Downward?

**Dunn:** In one sense my attempt to integrate uncertainty into a Post Keynesian theory of the firm is completely compatible with the extensive contributions of Fred Lee, Peter Earl and Paul Downward. When I first read Peter Earl, Neil Kay, Brian Loasby and Richard Langlois, I questioned myself whether I had a contribution to make. Nevertheless their contributions had been generally ignored by the Post Keynesian literature. But in some senses I am now more questioning about how radical their contributions are. With the possible exception of Fred Lee, I think Downward, Earl, Kay, Langlois and Loasby can be interpreted as conflating bounded rationality with uncertainty which I, as I have mentioned, would argue are quite distinct [Dunn 2001a]. I would maintain that there is a profound distinction between bounded rationality and fundamental uncertainty, which has salient implications for microeconomics and the theory of the firm [Dunn 2000b]. That said, these authors are all open to the prospect of exploring the ramifications of uncertainty for the theory of the firm and they provide a good source of innovative perspective and debate that can contribute to a radical conceptualisation of the firm that accords with the Post Keynesian macroeconomic vision.

**Oeconomicus:** Post Keynesians pay particular attention to uncertainty, but there seems to be some confusion between fundamental uncertainty and bounded rationality. How do you distinguish between the two concepts?

**Dunn:** Well, you can read about my views on this at length in my recent article in the *Journal of Post Keynesian Economics* [Dunn 2001a] but crudely speaking it relates to the underlying view of the nature of the time. I would argue that salience of the Post Keynesian discussion of ‘fundamental’ uncertainty has often been ignored and/or conflated with bounded rationality by many economists including many micro-theorists and even some Post Keynesian economists. In my view a stress on uncertainty necessitates a creative transmutable view of the economic processes that is conceptually distinct, although not necessarily incompatible with, a stress on bounded rationality which is adaptive and ultimately relevant to closed system ergodic processes. Moreover its use in analysis is salient not least in the recognition of a long run non-neutral role for money and firms.

Controversially, I would argue that Post Keynesians who rely on bounded rationality and its associated epistemological uncertainty do not espouse the same open
systems methodology as other Post Keynesians and that this difference must be recognised. This is not to suggest that the insights gleaned from bounded rationality cannot be reformulated and made consistent with a stress on uncertainty.

I should add though that all this is complicated by the fact that there are some many different and competing definitions of bounded rationality and my stylising skates over important and subtle caveats and clarifications.

**Oeconomicus:** What have been the main influences on your own work?

**Dunn:** There are numerous influences on one’s work so I must be forgiven for the partialness of this list. The obvious influences are the classical contributions of Smith, Marshall, Schumpeter, Knight and Keynes. They have had a profound influence on the shaping of my views of the nature of the economic process. I’d like to add Veblen to that list but that is a recent interest that is still developing. One might argue that these are really not microeconomic contributions but I believe they embody perspectives on the competitive process that provides a useful starting point for inquiries on the nature of the firm. From this base, I’ve sought to build on and integrate the insights offered by Shackleton, Robinson, Davidson and Galbraith. Malcolm Sawyer has also been a constant source of insight, inspiration and scholarship, as have Geoff Hodgson and Fred Lee.
Oeconomicus: What do you consider to be the key papers/books that have had a major impact on the development of your ideas with respect to microeconomics?

Dunn: From this base I think the most influential works have been Shackle, (1955, 1967), Galbraith (1967), Davidson (1972, 1982-3, 1991, 1996), Davidson and Davidson (1984) – a widely ignored contribution to Post Keynesian microeconomics – Loasby (1976), Sawyer (1979, 1985, 1989, 1995), Hodgson (1988, 1993, 1999), Lawson (1997) and Lee (1998). Downward (1999) should also be singled out as important contribution, not in terms of the evolution of my own thinking, but the development of Post Keynesian microeconomics. It is a fine example of how to combine methodology, econometrics and case study research together and contribute on a number of fronts to the Post Keynesian research agenda. Outside of the more orthodox Post Keynesian literature Williamson (1975, 1985), Chandler (1962, 1977), Lazonick (1991) have also been influential, as have the range of contributions that I cite in Dunn (2000a).

Oeconomicus: What do you think are the main differences between Keynes and Kalecki at the micro level?

Dunn: Well in a very superficial sense Keynes elaboration of the principle of effective demand resides in a world of free and ‘uncertain’ competition while Kalecki’s is applicable to a world of risk and imperfect competition. Keynes’s microeconomics were clearly Marshallian and this is something that many Post Keynesians have sought to supersede and have looked to others beyond Keynes. In many respects this is a travesty because I believe that Keynes’s microeconomics is more complex and subtle than he has been given credit for. For example in chapter twelve of the General Theory he clearly links the historical evolution of the firm and the rise of the joint stock company to uncertainty and the macroeconomic effects of stock market speculation. This is something I would like to elaborate at length in the future as it clearly warrants further examination and exploration. Much remains to be written on the contribution to Keynes to Post Keynesian microeconomics. Indeed, recent research such as that by Cameron and Ndholu in the Review of Social Economy is instructive of this need and lacuna. Nevertheless the salience of the large corporation cannot be ignored and Kalecki (and Galbraith) bring this more clearly into view as well, as adding an important appreciation of the political context. Indeed, I suspect that the Kaleckian focus on imperfect competition and radical lineage might help explain the affection that both Joan Robinson and Ken Galbraith have reserved for Kalecki.

Oeconomicus: Is Post Keynesianism coherent? And why doesn’t it provide a positive alternative? What needs to be done?

Dunn: I would argue, and this is far from uncontroversial, that Post Keynesian economics is methodologically coherent, which is embodied in the a posteriori recognition of the importance of the principle of effective demand and its nexus to uncertainty. This principle is enshrined in a methodological approach, which rests on a transformational conception of human agency, which presupposes openness where choice
is genuine and matters. This involves an organist conception of social reality with its rejection of atomism and methodological individualism and moves beyond a closed and deterministic, e.g. ergodic, account of (maximising) economic phenomena. Indeed it is for this reason that Post Keynesians recognise that the objective of economic science is to explain the salient generalised features of capitalism and not engage in fallacious prediction.

Nevertheless, while I would argue that Post Keynesian economics is coherent at a reasonably general level, I would accept that any casual inspection of the Post Keynesian literature reveals that it is far from comprehensive in terms of its domain of relevance or applicability. It clearly needs to articulate itself across a broader range of subjects that it currently does. Moreover it is perhaps because Post Keynesians have not always been aware of their distinctive methodological foundations that they have perhaps been less inclined to broaden the scope of their contributions and restricted their focus principally to macroeconomics. Nevertheless, I sincerely believe their stress on nonergodic uncertainty and its nexus to a credit money production economy represents a useful heuristic that can be extended into areas which have until recently been ignored. That is precisely what I have been attempting to do by advancing a conceptualisation of the firm that exists in uncertain, historical time and is engaged in monetary accumulation.

So, I would encourage any young aspiring academics to get involved in extending the comprehensiveness of Post Keynesian theory. More work clearly needs to be done on elaborating Post Keynesian perspectives on the consumer, the firm, the household, race, the state and so on. What is more this need not be an arduous first principles exercise as there are lots of good contributions available elsewhere which people can (and do) draw upon. Institutionalists, Marxists, Radicals, Business School theorists and even Austrians have lots to offer. Clearly these contributions can be developed by integrating the Post Keynesian perspectives on the nature of the macro-economy to develop a historically contingent, comprehensive vision of the salient features and institutions of capitalist economies.

Oeconomicus: So you agree with the idea that Post Keynesians and Austrians share the same methodological foundations?

Dunn: I think the question that most interests me about the relationship between Austrians and Post Keynesians relates to how they conceptualise uncertainty and historical processes. Austrians talk a lot about uncertainty and in many senses adopt similar methodological precepts to Post Keynesian economics, such as their rejection of equilibrium as an organising concept. Nevertheless, their a priori insistence on the necessity of framing every problem in terms of methodological individualism and their tacit belief in the omniscience and omnipotence of a largely undefined and reified notion of the market appears to me incompatible with an a posteriori stress on the organicism and transmutability of the economic process. Maybe this is being unfair. Indeed I sincerely believe there is much to be gained from an increased level of debate with the Austrians as I find much perception in Austrian thought, especially when it is liberated from its dogmatism. For example Shackle, Loasby and Lachmann are good examples of people who have straddled the two different camps in a manner that has yielded rich insight. That said I fail to see how ultimately one can a priori defend the unfettered
virtues of the market if one recognises the salience of uncertainty. As recognised so long ago “Many of the greatest economic evils of our time are the fruits of risk, uncertainty, and ignorance. It is because particular individuals, fortunate in situation or in abilities, are able to take advantage of uncertainty and ignorance, and also because for the same reason big business is often a lottery, that great inequalities of wealth come about; and these same factors are also the cause of unemployment of labour, or the disappointment of reasonable business expectations, and of the impairment of efficiency and production” [Keynes 1926, 291]. I do not subscribe to an uncritical faith in the supreme mystical powers of some ethereal concept such as ‘the market’.

**Oeconomicus:** What is the common basis that Institutionalists and Post Keynesians share? Do you see any kind of convergence or synthesis between the two schools?

**Dunn:** Again I have a paper in the *Journal of Post Keynesian Economics* [Dunn 2000a] for which I won the K. William Kapp prize from the *European Association for Political Economy*. Part of the argument is that both Post Keynesians and Institutionalists adopt a similar vision of the nature of the economic process. Both are comfortable with a view of the economy as an evolutionary, transmutable, historical process but while Post Keynesian have traditionally focused on the macroeconomy, Institutionalists have tended to study microeconomic processes and have a more sophisticated methodological orientation. Given the pressing need to further develop a more comprehensive alternative to Neoclassical economics there are clear benefits to be had from integrating these approaches in a more systematic and constructive fashion. Indeed, that is what I perceive to be happening at UMKC. Post Keynesian-Institutionalists like Fred Lee, Randy Wray and Mat Forstater have recognised the need to initiate a more substantive discussion in the journals and have already begun this process. But clearly more exciting work remains to be done. Let’s hope UMKC and the new generation of Post Keynesian scholars can contribute to this exiting agenda.

**Oeconomicus:** Who do you think are the new lights – age less than 40 – in Post Keynesian economics, and what kind of contribution are they able to provide? How different are they from the “old Post Keynesians”?

**Dunn:** Well there are many good young economists around who are interested in Post Keynesian and Institutionalist economics. I would draw attention to Mark Setterfield, Steve Pressman, Paul Downward, John Finch, Matt Forstater, David Dequech, Stephanie Bell, Steve Pratten, Andrew Mearman, Guiseppe Fontana, David Harvie, and Eric Hake. I’m sure there are others whom I have omitted to mention but that might reflect the fact that I see them as more senior than they in fact are! What is most interesting about the younger generation is their willingness to engage with other intellectual traditions and to promote a constructive dialogue that may allow a more comprehensive alternative to mainstream economics to emerge; something that I am wholly committed.
Conversation with Stephen P. Dunn

Oeconomicus: Finally how do you manage to produce a considerable amount of high-quality papers without being in the academic arena?

Dunn: The “instinct for workmanship.” But seriously I’m not sure I agree with your assessment on the quality of my contribution hitherto offered, but I will venture a response. But there are perhaps several reasons that explain my recent productivity. Firstly, I had a clear understanding of the novelty of the contribution that I could make. Moreover this was arguably helped by the virtual absence of any serious discussion of uncertainty in the theory of the firm and of the theory of the firm in Post Keynesian economics. Such a clear opportunity provides an important impetus for research and writing. Nevertheless by the end of the first year of my Ph.D. programme I probably had a clearer understanding of the contribution that I sought to make than that of my research committee. They advised that in a field where innovative thinking is difficult I should be encouraged to adopt a more pragmatic, and more employable, empirical orientation. Having regard for my own vision, and not terribly enthused by the academic employment prospect in England, I decided that I would be wise to enter the more secure, yet murky, underworld of economic advocacy and become an intellectual dilettante. While advising Government, I would be able to pursue my own intellectual curiosity without the pressure of having to conform to the uncertain prospect of obtaining tenure. And working within Government offers a most agreeable prospect for an enthusiastic debunker.

Many Government economists trade on innovativeness, intellectual agility, transparent advocacy and a closeness to the economics of the real world. Similarly one’s contribution to the wider body of knowledge and broader professional development are warmly encouraged and thus I have been fortunate to meet with positive sponsorship in my somewhat unconventional desires to pursue my research programme alongside the more pragmatic concerns of government. I was fortunate in that my Department positively encouraged publication irrespective of my heretical orientation and I was thus presented with the agreeable opportunity to abuse the department’s library and typing pool; privileges that have long been withdrawn from the university sector.

So, after I had decided that I still had a contribution to make and that others might attempt to appropriate my ideas, I sought to pursue my inquiry. And herein lies the lesson. One of my first economics teachers, Sue Ruffell taught that writing is a skill, its something you learn and you train yourself to do. But the process of writing can be extremely painful and the flow of ideas can be extremely imperfect and an uninterrupted flow of consciousness. Too many students succumb to introspection on the rude and primitive nature of their prose and resist the process. They err against putting their thoughts down and resist disseminating their contribution for comment amongst constructive colleagues. However, knowing no shame, I’ve always sought to contact sympathetic academics to explore the salience of my ideas and gain perspective on their location within the wider literature. And this process improves composition and argument, and has compensated for my distance from the academy. Moreover many academics welcome the prospect of aiding incipient research and one should benefit from such goodwill.

Likewise it helps in developing the networks that are an essential part of academic life. If you look at the majority of my publications they have a huge acknowledgement and if there is any truth in your question it reflects the huge debt and tolerance of error of
those that have kindly given that most truly scarce resource – time. That said any errors
or omissions are purely the result of my wrong headedness.

As a postscript, I should allude to the import of technology. I am convinced that if
I had begun my studies ten years earlier, I doubt whether my contribution would have
emerged. Without remote electronic access to journals and emails, I would not have been
to complete my Ph.D. Similarly academics would have been hampered in sharing their
work in progress and I would have been unaware of emergent discourse. So overall,
while I would like to allude to Herculean endeavours, I fear that my contribution is as
much the product of circumstance and not the creativity that friends, anonymous and not-
so-anonymous referees, have attempted to bestow upon me.

_Oeconomicus:_ Thank You.

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Original Institutional Economics: A Theory for the 21st Century?

By Jairo J. Parada

I. Introduction

More than one hundred years ago, perhaps unknowingly, Thorstein Veblen initiated one of the most interesting currents of economic thought in America, the well-known “Original Institutional Economics” (OIE). In this paper I consider this strand of economic thought as it is based on the so called Veblen-Ayres’s tradition, followed by Commons and Mitchell’s approach, even though it incorporates later contributions from many American and European economists. It has to be said that in developing nations, this thought has been mostly ignored compared to Keynesian, post Keynesian and Neoclassical economic thought.

The main purpose of this paper is to reassess the basic contributions to economic theory of these authors (Thorstein Veblen, C. E. Ayres, and John Commons) who represent the ‘core’ of institutional economics. The paper tries to assess if their contributions give, to a current student of economics, powerful insights about the basic problems of economic theory, problems that still need resolution despite the enormous advances made by the discipline. Although most of the mainstream Neoclassical economists might see this exercise as one of limited use, I suggest that the basic ideas posited by institutional economists during the last century are still too important to be ignored. Furthermore, the recent and powerful revival of New Institutional Economics (NIE), and its increasing movement somewhat away from mainstream economics, suggests that OIE still remains vital as an evolving paradigm, one that anticipates an alternative economic theory.

First, I will review the origins of Institutional economics, revisiting its methodological issues in order to grasp the main ideas of Veblen, Ayres, and Commons. Second, I will review the methodological origins of institutional economics. Third, I will discuss the basic elements of the theory proposed by the founders of OIE. Fourth, I will refer to an analysis of the economic role of government. Finally, I discuss the basic characteristics of institutional economics as a paradigm, and I conclude with an elaboration of a set of suggestions for further research.

Surprisingly to many young economists today, OIE was very influential during the first half of the 20th century. Its scope and methodology were very powerful in some economics departments between World War I and II, but OIE’s influence began to decline during the 1950s overwhelmed by the enthusiasm for the Keynesians’ ideas. Today, OIE has a small influence and, as W. Samuels (2000) indicated, “… has gone from being a more or less recognized part of the discipline and practice of economics to a

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marginalized heterodox status, and from being part of the mindset and work of many, if not most, economists, to being the specialized schools for some economists and latent in the work of some specialists in some specialized fields... but … it is alive and reasonably well, if not prosperous.”

II. The Origins and Methodological basis of OIE

The methodological roots of institutional economics can be traced back to the German Historical School (GHS) of the 19th century, when it gained some recognition among scholars. As a reaction against British classical economics, the GHS claimed that each society must establish its own rules, asserting that only detailed attention to historical developments would result in real progress in economic analysis. The GHS, alleging the superiority of the inductive method, believed that the deductive method used by classical economists was too abstract. The GHS criticized the basic assumption of mainstream economics about the rational behavior of humans and questioned the pretension of finding generally applicable laws. According to the GHS, economists should pay attention only to patterns of development common to different economies; they also rejected free trade policies preached by Great Britain for the rest of Europe.

Among the GHS scholars, Wilhelm Roscher tried to find the relationships among ethical, political, and economic phenomena, emphasizing the role of non-economic factors in economic life. Bruno Hildebrand developed statistical methods that could be applied to social sciences. One of the main scholars of the GHS was Gustav Schmoller, who underlined the role of state intervention in Germany and wrote a series of articles about social laws that provided insurance policies against illness, accidents, and old age. His discussions with Carl Menger are well known, and his influence on W. Sombart is clearly recognized [Schizinger 1987].

The GHS challenged the basic assumptions of the Marginalist school, proposing an inductive methodology instead of the marginalists’ deductive one. The GHS emphasized first the specificities of particular research instead of the easy generalizations of mainstream economics. Also, they looked for motives for economic activities other than the strict economic ones. The legacy of the GHS was not forgotten by the founders of OIE: Veblen himself addressed the importance of Schmoller's work, and later on Ayres was greatly influenced by the ideas of this school. Veblen (1901) considered that Schmoller modernized the GHS and that he started a more theoretical branch compared with the old empiricist one. He also pointed out that Schmoller’s ‘historical’ approach was more Darwinian than Hegelian. Schmoller, according to Veblen, saw the evolution of institutions aiming “… at a Darwinist account of the origin, growth, persistence, and variation of institutions in so far as these institutions have to do with the economic aspects of life either as a cause or as effect” [Veblen 1901, 81]. Schmoller argued that behind the production process, we have not only the factors of production (land, capital and labor), but also population, the material environment, and technological conditions. This vision would be developed later by former institutionalist economists.

The methodological underpinnings of OIE are based mostly on John Dewey's seminal work on “inquiry.” As Dewey notes, “inquiry is the controlled or direct transformation of an indeterminate situation into one that is so determinate in its constituent distinctions and relations as to convert the elements of the original situation
into a unified whole” [Dewey 1991, 108]. In Dewey’s view, the process of assessing a research problem involves seven steps: 1) the indeterminate situation; 2) institution of a problem or finding out what the problems and problems are; 3) the determination of a problem-solution; 4) the process of reasoning; 5) reasoning; 6) the operational characters of facts-meanings; 7) the evaluation of common sense and scientific inquiry [Dewey 1991, 113]. Dewey insisted that every special inquiry “…was a process of progressive and cumulative re-organization of antecedent conditions.” He believed that there is no such thing as an instantaneous inquiry; and that “there is, in consequence, no such thing as a judgment (the conclusion of inquiry) which is isolated from what goes before and comes after” [Dewey 1991, 245].

Dewey indicated the relevance of the inductive method. He asserted that: “…any theory which fails to take as basic in its conception of induction experimental operations of transformation of given objects of perception and institution of new orders of data, is radically defective” [Dewey 1991, 422].

Based on John Dewey’s pragmatic or instrumentalist philosophy, Gruchy (1987) demanded an economic theory that reflected the real world and proposed a ‘culturalist’ method instead of the formalist one of mainstream economics. Gruchy’s methodology is based on the following assumptions:

1. It is not necessary to impose excessive rational assumptions on economic agents.
2. One should focus more on the concept of process rather than the obsession for equilibrium.
3. The economic system is a historic-cultural outcome instead of a hypothetical, idealized, and highly competitive one [Gruchy 1987, 43].

Gruchy claims that the problem of economic theory is not that of prediction, but of “…the use of organized community or national intelligence to provide some kind of social control over economic activities with the aim of enhancing the life process…” [Gruchy 1987, 45]. However, in my opinion, this is one of the pitfalls of OIE that has undermined its influence among economists. It is true that a good theory should give us powerful tools to generate policy proposals in our society in order to enhance human life. Nevertheless, a good theory also must have good explanatory and predictive power. OIE must show, as Commons and Mitchell did several decades ago, strength in explaining and predicting outcomes of the main facts of our economic life. Such strength will prove the superiority of a methodology that claims to be objective and inductive over the idealistic deductive one of Neoclassical economics.

More recently, Stanfield (1999) has emphasized that OIE uses a critical historical method, looks at facts to be explained, examines alternative explanations, selects one alternative explanation close to these facts, and draws implications for thought and action. In his view, OIE relies “…less heavily upon econometric techniques…and more on the comparative methods developed by anthropologists to collect information and pursue generalizations about the economic activities of human groups…” [Stanfield 1999, 236].

While Stanfield’s statement has merit, we must interpret it with care. We must recognize that an historical method truly relies less on econometric techniques. However, the role of econometrics and the advanced techniques that have been generated in the last
decades are well known. OIE economists should be aware of these factors and try to use all these techniques in their research in order to test their hypothesis. A progressive paradigm has to use all the techniques that econometrics now offers, rather than be speculative or unable to account for mathematical and econometric models.

To summarize, OIE’s methodology is based on a value-driven, dynamic process that is instrumental, not equilibrium focused, and evolutionary. This method is competitive, activist, holistic, and non-dogmatic. It focuses on situations in which technology plays a crucial role, and that are not exclusively oriented towards a rational choice approach. Many of these concepts would be developed by the founders of OIE.

III. The Founding and Theoretical Development of OIE

Veblen’s Dichotomy

As G. Hodgson (1998) has asserted, Veblen’s contributions to economic theory are vast, ranging from the consumer-behavior approach, to the currently popular notion of transaction costs, to the modern emphasis on the role of knowledge and human capital in economic growth. Veblen also produced powerful insights about the modern notion of “bounded rationality” developed later by H. Simon (1957).

I now turn to the core of Veblen’s dichotomy, a powerful concept that has driven the analysis in institutional economics and is the core of this school. In his famous work *The Theory of Leisure Class* (1899), Veblen distinguished “industrial” activities from “pecuniary” ones. For Veblen, the notion of “industry” implies an effort to combine some inputs in order to create an output. Veblen goes back through history, and compares these activities to the predatory ones. Veblen also opposes the instinct of ’salesmanship’ to ’workmanship’, and distinguishes between invidious or ‘ceremonial’ behavior and ‘instrumental’ (technological) behavior. For Veblen, the emergence of a leisure class coincides with the beginning of ownership, and gives birth to conspicuous leisure and conspicuous consumption. Veblen then analyzes the pecuniary standard of living, and distinguishes between the “elementary” wants and the “higher” wants, which are influenced by the conspicuous consumption. The latter is defined by Veblen as “specialized consumption of goods as an evidence of pecuniary strength” [Veblen 1899, 60].

Veblen believed that “institutions are, in substance, prevalent habits of thought with respect to particular relations and particular functions of the individual and of the community” [Veblen 1899, 132]. Using this concept, he introduced the evolutionary vision of institutions, which claimed that in society, through the struggle for existence, man developed a process of selective adaptation to choose the most suitable institutions. However, this process is a dialectical one. Veblen (1899) asserts that “…[institutions] are at the same time special methods of life and of human relations, and are therefore in their turn efficient factors of selection. So that the changing institutions in their turn make for a further selection of individuals endowed with the fittest temperament, and a further adaptation of individual temperament and habits to the changing environment through the formation of new institutions” [Veblen 1889, 131].

According to Veblen, institutions are never in full accord with the requirements of the present society; they incorporate elements of social and psychological inertia. Hence,
changes in these institutions are going to require changes in the habits of thought of individuals [Veblen 1889, 132-133]. What are the forces behind changes in institutions? Veblen suggests that there is a clear answer: “The forces which make for a readjustment of institutions, especially in the case of a modern industrial community, are, in the last analysis, almost entirely of an economic nature…” [Veblen 1889, 134].

Evolution in society is going to arise from the contradiction between “ceremonial” or “pecuniary” behavior, which is enforced basically for the leisure class, and the social forces interested in “industrial” activities. Veblen defines “industrial activities” to mean “all efforts directed to enhance human life by taking advantage of the non-human environment…” [Veblen 1889, 26].

In another brilliant work Veblen (1898, org.1898) criticizes mainstream economics for its failure to be an evolutionary science, rather than a static one. According to Veblen, for a science to be evolutionary, it needs to be a theory of process, with an endless sequence subjected to cumulative causation [Veblen 1898, 403-404]. Veblen launches his critique of the hedonistic man that is at the core of modern micro and macro theory, calling him “a lightning calculator of pleasures and pains, who oscillates like a homogeneous globule of desire and happiness under the impulse and stimuli that shift him about the area, but leave him intact” [Veblen 1898, 411]. As any graduate student in economics knows today, this is the sacre coeur of mainstream economics and the reason why all models keep maximizing utility for consumers and profits for firms, no matter how stochastic are the environments of the models, using Markov processes or i.i.d. variables. In the end, the model is good if you discover a 'steady' state that is consistent with the assumption of the hedonistic man.

Veblen proposes a very different concept of the individual. For him, “…the economic life history of the individual is a cumulative process of adaptation of means to ends that cumulatively change as the process goes on, both the agent and his environment being at any point the outcome of the past process” [Veblen 1898, 411]. The role of institutions in economic growth and economic development is out of the question today. The demise of socialism in 1989 and the tough lessons that western economists have received in dealing with the pervasive Russian economic crisis and the recent East Asian financial markets is just another proof that Veblen's legacy is still important in today’s political economy.

Clarence E. Ayres: Technology and institutions

C. E. Ayres’s (1862-1945) theoretical work appeared by the end of World War II and strongly influenced institutional economics, to the extent that some scholars claim there is an Ayres’ strand in this school. However, if one reads his work carefully, one finds it very faithful to Veblen's initial approach. Ayres introduced to Institutional Economics deep philosophical topics that are known today as the theory of “instrumental value.

For Ayres, there are two main forces shaping the evolutionary process of mankind:

“…one, progressive, dynamic, productive of cumulative change; the other counter-progressive, static, inhibitory of change” [Ayres 1962, vi]. Ayres sees in technology the progressive force. He explains that technology should not be reduced to the use of tools or human skills, but is the inseparable
combination of both elements, anticipating the modern idea of human capital [Ayres 1962, vii]. There is resistance to technological change in ceremonial institutions that are embedded in social stratification, conventions, or mores, and are carefully protected and enforced by ideology. All these behaviors are codified in rites and ceremonies [Ayres 1962, viii].

In his *Theory of Economic Progress*, Ayres (1944) claims that economics should be “a way of thinking,” not just a field of inquiry. After examining the price system and the concept of capital, he develops his famous “theory of value.” Ayres is strongly dissatisfied with mainstream economics that explains basically value through the price system. After criticizing economists’ obsession – still prevalent today – with the notion of equilibrium, Ayres asserts that relative prices are not able to explain the notion of value. Nor is the notion of “utility” a natural phenomenon that is determined practically by nature. Ayres claims that the “social medium” in which each man lives is which determines what his/her utility is [Ayres 1962, 75].

Ayres uses the notion of *culture*, which he defines as “the organized corpus of behavior of which economic activity is but a part. It is, he said, a phenomenon *sui generis*…it is the stuff of social behavior” [Ayres 1962, 95]. According to Ayres, “…the distinction of the technological and the ceremonial aspects of organized behavior is a dichotomy but not a dualism… it undertakes to distinguish two aspects of what is still a single, continuous activity both aspects of which are present at all times” [Ayres 1964, 101].

After dealing with the concepts of technology and progress and examining industrial evolution, Ayres emphasizes the role of technology in establishing the institutions of capitalism, and the underlying role of the organization of a society that allows inventions to be fostered. He explains human history as “…a perpetual opposition of these forces, the dynamic force of technology continuing making for change, and the static force of ceremony – status, mores and legendary belief – opposing change…” [Ayres 1962, 176]. Ayres claims that the presence of mores destroys the theory of economists where value is explained by the relative price system. He believes that mankind is a tool-using species, and that through an organized activity, men “make a living.” Whatever enables man “to carry on this activity is economically valuable… ‘means’ and ‘ends’ are no more distinct orders of phenomena than causes and effects” [Ayres 1964, 224]. In Ayres’ view, technological process is the locus of value where progress is defined as “the continuous development of the technological arts and crafts and the accompanying recession of superstition and ceremonially invested status” [Ayres 1964, 231].

Ayres’ vision of the relationship between technology and institutions paved the way for the theory of instrumental value in Original Institutional Economics. In “Toward a Reasonable Society” (1961) he examines the value-system of industrial society by looking for a relationship between scientific (objective) knowledge, on the one hand, and the socially accepted values, on the other. He differentiates between those values generated by technological knowledge and those embedded in traditions, beliefs, and mores.

According to Ayres, the continuing human process of doing and knowing implies that science and technology are not value-free. Ayres argues that “this life process is the matrix from which all genuine values – as distinguished from sentimental fancies –
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Values cannot be seen in an agnostic way, as limited to social practices.

Based on accumulated knowledge, Ayres believes it is very important to be able to distinguish between values that are true, and progressive, and those that are irrational and false [Ayres 1961, 86]. Ayres also looks closely to fundamental values in our western industrial society: freedom, equality, security, abundance, and excellence. He criticizes mainstream economics for its notion of value, which reduces economic theory to a “resource allocation theory.”

Institutional economists today view economic science as value-driven, and they reject the value-aseptic distinction between positive and normative economics. For these social scientists, economics is not only a theory of allocation of resources, but also of deployment of resources. And this deployment of resources is value-driven. Marc R. Tool (1993) has developed the theory of instrumental value inspired by Ayres’ work. Tool argues that “to define an economic problem is to distinguish between ‘what is’ and ‘what ought to be’” [Tool 1993, 119]. This basic approach leads Tool to formulate the instrumental value principle: “do or choose that which provides for the continuity of human life and the non-invidious recreation of community through the instrumental use of knowledge” [Tool 1993, 121]. According to Tool, one can find four primary conceptual components of this principle: 1) the continuity of human life; 2) the recreation of community; 3) the pursuit of non-invidious change; and 4) the instrumental use of knowledge.

Tool claims that the instrumental social value principle is “…derived from reflections on the continuum of human experience, the social process itself in all its complexity, the evolutionary development of cultures and peoples…” He also rejects any teleological idea behind this principle or any support based on “natural laws.” This principle is not hedonistic, does not tend to any equilibrium, and does not recommend any institutional structure. Basically, it provides criteria for choosing among alternative structures [Tool 1993, 124-126]. Based on the Deweyan notion of “inquiry,” Tool’s principle provides practical, pragmatic, and relevant judgmental criteria for problem analysis.

Tool contends that the theory of instrumental value has been extended and refined using mathematical instruments by Paul Bush (1986). Bush constructed eight theorems and ten axioms that refer to the logical implications of the institutional dichotomy and allow us to distinguish between “regressive” and “progressive” social changes [Bush 1986, 131-140]. Bush has developed Ayres's notion of “progress,” giving economists a powerful tool against many misconceptions regarding values and enhancing our ability to distinguish the progressive ones from the regressive ones.

At times Ayres’ approach gives the impression that ceremonial institutions are always regressive in comparison to technological ones. Preventing economists from falling into that common mistake, Klein (1998) states that

… we institutionalists have, after all, been at pains for some time to underscore that institutions cannot only thwart progress as Ayres emphasized, but they are also essential to house and support progress. If institutions can be past binding …it is also true that without institutions there can be no progress, no technological continuum, no human life. There can be no future [Klein 1998, 839].
The institutional economics of J. R. Commons

J. R. Commons (1862-1945) dedicated his life to the study of the development of institutions through capitalism. Witnessing a period of economic and social disarray in the U.S. Midwest, Commons combined academic and intellectual activities with personal participation in the search for economic and social solutions for the problems faced by American society [Chamberlain 1963]. The relevance of Commons’ work lies in his interest in law and organizations as well as in their evolution. At the beginning of his academic career, Commons was influenced by R. T. Ely, who emphasized the problem of property rights, and the advantages and privileges derived from institutionalized monopoly power.

Commons’ notion of ‘institutions’ is a unique one. He claims that institutions have been identified with a framework of law or natural rights, or the behavior of individuals. He defines institutions as “collective action in control, liberation and expansion of individual action” [Commons 1931, 648].

At the same time, the notion of collective action is important to Commons’ approach. This notion is based on what Commons calls “collective will,” the overall outcome of the individual and collective, governmental and judicial, decision-making processes [Rutherford 1990]. This idea of collective will does not mean that there is not a role for individual decisions. Commons’ standpoint does not represent extreme individualism or extreme holism. As Chamberlain (1963) states:

When Commons speaks of collective action…he is not referring simply to the activities of organizations such as business firms and labor unions, trade associations and governmental agencies. These are of course included…but in addition (he) includes unorganized custom, the laws of the state and the common law of the courts, the total bundle of patterns of conduct by which a society sanctions or compels of its members [Chamberlain 1963, 72].

In this way, Commons enriches the notion of institutions established earlier by Veblen and Ayres. Commons believes that institutions emerge and change only through the actions of decision-makers, through political efforts, or pressures from political parties to change legislation. Following institutionalist tradition, Commons’ view rules out any teleological vision of the role of autonomous social forces [Rutherford 1990].

The basic unit of analysis in Commons’ theoretical approach is the transaction as a relationship between individuals. These transactions transfer the rights to property of different kinds and generate negotiations, persuasion, coercion, and diverse conflicts. But this transferring process “…must be negotiated between the parties concerned, according to the working rules of society, before labor can produce, or consumers can consume, or commodities be physically delivered to other persons” [Commons 1931, 58]. These “working rules” (that mainstream economics assumes just as “given”) are a crucial concept in Commons’ analysis.

From this perspective, Commons derives his well-known characterizations of different kinds of transactions. A bargaining transaction is one between equals that proceeds according to the ruling authority that decides disputes [Commons 1931, 59]. In managerial and rationing transactions, there is a relationship between a legal “superior” and a legal “inferior.” The “superior” is an individual (or a hierarchy of individuals) that
give orders to the inferiors. In rationing transactions, the superior is a “collective superior or its official spokesman” [Commons 1931, 59], like a court, an arbitration tribunal or a board of directors. Managerial and rationing transactions imply the use of legal authority that is constrained by a particular set of previous rules (constitutions, customs, and managerial procedures). Based on this, wealth is created through managerial transactions and apportioned through rationing ones. But there is always a clear relationship between superior and inferior levels.

Conversely, bargaining transactions are based on legal equality that does not exclude differences in the ability to exercise economic power among any of the involved parties. Commons defines economic power as the number of alternative opportunities available to those involved in the bargaining process and their ability to withhold this capability of bargaining. These abilities are restricted by the “limits of coercion” that define the set of possible outcomes between the parties. [Commons 1931, 58]. These transactions take place within the context of the “working rules” that define for each party when it can or cannot, must or must not, or may do [Rutherford 1989, xxx]. They define the limits of the collective actions through the transaction processes.

According to Commons, transactions are not just generated by selfish economic agents; they come from the organized activities of individuals. Furthermore, he rejects the Darwinian vision of the evolution of institutions that contaminated Veblen’s theory, and instead posits that man, subjected to his own limitations, can use his capabilities to control the natural forces around him.

Like Ayres, Commons tried to build a theory of value, and he was a pioneer in developing the concept of futurity developed later by Knight. Commons also developed a theory of property rights and their role in economic transactions. To summarize, Commons followed the institutionalist approach by seeing the economic activity of individuals as not only connected by price transactions but as parts of organizations and institutions [Chamberlain 1963, 88].

Commons was not very enthusiastic about the capability of capitalism to manage financial and economic crises, but, despite his distrust of the centralized power of governments, he believed that some sort of improvement of the administrative abilities of the government could smooth the problem [Gruchy 1952]. Despite his failure to provide a broad analysis of capitalism, Commons’ legacy offers many tools that economists today use widely. As Rutherford (1989) has stated, the recent interest in Commons’ approach is based on a growing interest in property rights, the behavior of courts and common law, and the behavior of organizations. It is impossible for economists today to take these issues as “given” (or as exogenous variables) any longer.

Commons’s contributions to institutional economics have paved the way for further analysis regarding the problem of economic power, the government, and the legal system. Other subsequent institutional economists paid attention to different problems, such as business cycles in the case of Wesley Clair Mitchell, that even today mainstream economists consider an important theoretical and empirical contribution to understanding the complex relationships between growth theories and business cycles. Here, I am going to direct my attention to further contributions of institutionalist economists regarding the important problem of the economic role of government.
IV. The Economic Role of Government

As any student of economics knows, the economic role of government still is a very important issue in the current economic debate that is taking place throughout the world. Since the economic reforms that were fostered during the 1980s in developed nations and LDC countries, the issue of the role of the State still remains, due to the poor results of the transitional orthodox policies in the former socialist economies. In addition, all the problems that Latin American and African countries face, even though they have gone through most of the economic reforms preached by the Washington consensus, the IMF, and the World Bank, serve as proof of the salience of this topic. In addition, the recent protest events in Seattle and Washington are just the tip of iceberg of the future discussion regarding the problem of the economic role of government. We must recognize, with Warren Samuels (1989) that:

the fundamentals of the economic role of government are not simple and obvious. The reason for that arises from the fact that… economy and policy are not self-subsistent but can be seen as either mutually defining or arising in the legal-economic nexus [that] is a continuing, explorative and emergent process through which are worked out ongoing solutions to problems such as whose economic interests are to count and which economic and other performance results are to be pursued [Samuels 1989, 245].

The government’s economic role depends also on the social belief system and the concept of power, as well as the simultaneous interactions between economic and political power.

According to Warren Samuels (1989), the economic role of government “… is not determined exogenous to society or to the individual, and it is not self-subsistent or self-determining” [Samuels 1989, 246]. In short, this role does not come from the sky, but it is a result of the complex relationship between the polity and the economy. Government can be seen as: 1) an exogenous black box; 2) a neutral extension or aggregation of private choice; 3) a non-neutral decision-making or preference-aggregating process; 4) an instrument of the powerful; 5) an instrument with which to check the power of the powerful; 6) a source of problems, if not evil, in society; 7) a source of progress; and 8) part of the necessary framework of the market (1989).

Conventional economics views the economic role of the government as that of helping to reduce those market failures that push the economy away from the Pareto Optimum. The latter is an ideal state where all resources are used in the best way possible, and no economic agent can be better off without harming others' welfare. Mainstream economics recognizes the role of the government in issues regarding law and order, property rights, enforcement of competitive markets, adequate monetary structure, and national security. Issues such as equity and public good are seen as “normative” problems to be solved by applied economists.

Institutionalist economists believe that the economic role of government, without excluding the issues mentioned above, involves a wider notion of “efficiency” that goes far beyond Pareto Optimality. Applying the instrumental value theory, institutional economists raise this question: “Given the resources and the technology of any given
system, are its resources being deployed in such a way to move the system maximally (hence optimally) towards the total objectives which its participants, ideally informed, would wish?” [Klein 1994, 196].

This question leads us to consider the problem of economic power, defined as “one's ability to influence the way the economy operates to carry out the tasks assigned to it” [Klein 1994a, 149]. The source of this economic power is technological, in Ayres’ sense. The belief system of the society and the definition of the objectives of the society are influenced by these asymmetries in power we find in society. Based on this view, institutionalist economists use the concept “higher efficiency,” attained when all participants in society have real, full information and when values such as security, equity, freedom, and compassion are equally shared [Klein 1994, 196].

Based on this view, the economic role of government is defined according to several functions:

1. Monitoring the resource allocation of the market economy and deploying resources to reach the “general efficiency” defined above through a value system.
2. Recognizing the monopolistic and imperfect competition that exists in the market economy and supervising the allocation of resources in critical areas to the public interest in accordance with the evolving values of the community [Klein 1994, 198].
3. Providing public goods such as national defense and security but also fostering science and technology, improving labor markets, and guaranteeing a minimum welfare for society.
4. Transmitting of values in society, values that are a result of achievements such as human rights, compassion, equity, and so on. As Klein asserts “institutionalists would not necessarily disagree with Friedman's characterization of the government as rule maker and umpire, but they would add the government is also sometimes player, manager and coach” [Klein 1994, 200].

In sum, institutionalists are neither interventionists, nor anti-interventionists. They are mostly concerned with the role of the government in “enhancing the life process,” guided by the ongoing and continuing construction of values in society, where government does not care only about the market allocation of resources but about the deployment of these resources with a view toward higher efficiency. This higher efficiency will be characterized by the “collective ought,” which is defined by the evolutionary process that mankind follows and which cannot be determined in relative or arbitrary terms by each society but has to take into account Ayres’ concept of “progress.”

V. OIE as a Paradigm

Using Kuhn’s (1962) concept of paradigm, it is valid to ask if institutional economics is a different school of economic thought or just a dissent from mainstream economics. If we understand the concept of paradigm not only as a set of shared beliefs and practices, but also as the concrete answers and solutions to some puzzles that can be set forth in models, then these models must be tested against alternative explanations based on analytical tools and empirical evidence.
Institutional economists argue that their discipline is an alternative paradigm that still is under construction. From the discussion presented above, it is possible to summarize OIE’s main characteristics:

- The vision of the economy as a dynamic process, based on Dewey’s means-end continuum that implies an evolutionary view of the economic process.
- Allocation of goods and services in the economy is not defined only by the “invisible hand” (even with imperfections) in a harmonious way but also by cultural conditions combined with changes in technology. Conflicts are frequent.
- Economic resources are allocated not only through the market system but also through an interactive value system where power and values play an important role.
- The motivation of economic agents cannot be explained as maximizing utility or profits, where self-interest is exogenous. Economic agents behave according to their “perceived self-interest,” where these behaviors come from an endogenous process defined by historical institutions [Thelen and Steinmo 1992].
- Distribution of the decision-making process is not assumed to be based on one dollar equals one vote but on concentrated wealth and power.
- The objective of the economy is not reduced to clearing market equilibriums but is an end-in-view process in which community values play a significant role.
- Decision-making in the economy cannot be based on a pure competition model but according to the views of the participants in the economic process.
- Technological change is limited by concentrated economy power. Consumer sovereignty is limited.
- Markets are not able by themselves to define the maximum welfare of society due to the imperfect knowledge that comes from the distortions that power blocs impose upon society.
- Institutional Economics is not teleological. There is not a definable absolute end such as a “pure competitive economy” or “communism.” Society defines these ends and means through political and economic decisions.11

Institutional Economics, as one can see has been able to develop a critique of mainstream economics and to build a body of knowledge and tools that can be applied to numerous economic problems. In fact, since the 1950s mainstream economics has been incorporating many issues from institutionalist economists in its research agenda. However, its influence today is very small compared with the golden age between the wars and during the 1940s.12 This topic will be explored in the last part of this paper.

VI. OIE and its Perspectives

During the 1990s, the New Institutional Economics (NIE) has become more popular among economists, as compared to the OIE.13 One reason for this could be that the NIE does not declare itself at variance with mainstream economics and has found some support from institutions such as The World Bank. It must be recognized that this stream of institutionalist economists has developed important tools of economic analysis that are being applied in many fields.
This is not the case with the OIE, which has been reduced to a “marginalized heterodox status” [Samuels 2000]. Several factors could explain this situation:

- The political atmosphere in the world changed since the 1980s toward a more conservative political and economical thought, even though it seems today that the balance is moving more toward the center. The last two decades have not been favorable for any heterodox school of thought in the social sciences in general.
- Economic science today has been dominated by a wave of excessive mathematical formalization, seemingly more concerned with converting discourses into equations than with understanding and interpreting the real world [Hodgson 1999, 2]. The OIE is behind the curve at the level of modeling and formalization.
- Current OIE research should focus more on developing theoretical and empirical tools instead of emphasizing reinterpretations of concepts built by the founders of institutional economics. Some groups of OIE scholars have become isolated and dogmatic. This could lead to their becoming a sect rather than a school of economic thought.
- OIE definitely must build bridges with NIE economists, as Stanfield (1999) suggested, despite the deep ideological differences.

If OIE develops a renewal of its theoretical tools and methods, if it advances in modeling and formalization, and if it is able to show more applied research, its future could brighten and it will again become attractive to younger economists. It is a road worth following in order to preserve and develop its rich legacy from the past century.

Notes

1. It was known until the 1990s as Institutional Economics, but with the increasing influence of new institutional thinking coming, basically, although not exclusively, from mainstream economics (New Institutional Economics), sometimes it has been renamed “Old Institutional Economics.” In this paper, I follow the more respectful term “Original,” not the pejorative “Old.”
2. A weak attempt was made by Macario during the 1960s in Latin America, who wrote several articles in “El Trimestre Economico” from Mexico, to link the American institutional approach with that of the Economic Commission for Latin America (ECLA), which was very popular during those times in that region.
3. It is beyond the scope of this work to attempt a complete review of the extremely vast literature written on Institutional Economics.
4. The Membership Directory of the Association for Evolutionary Economics (AFEE 2000) registers more that 480 members in more than 40 countries. See AFEE, Membership Directory (January 2000).
5. A good attempt to work in models was made by Klein when he analyzed the demand theory and the impact of changing tastes [Klein 1994].
6. The role of values in OIE will be discussed later in this paper.
7. As is going to be shown later, the terms ‘ceremonial’ and ‘technological’ used with respect to this dichotomy come from C. E. Ayres.
8. This notion of economics as being also about deployment of resources is taken from Klein, as found in his lectures at Penn State (Spring-1999). See his article “Economics: allocation or valuation?” [Klein 1994, 3-25].

9. A well organized presentation of Commons’ theoretical framework compared with modern institutionalists can be found in Chen (1999).

10. A good review of Mitchell’s contributions to business cycles theory can be seen in Klein (1983). A more recent reference to Mitchell’s research in this area can be found in Cooley (1995).

11. This list has been developed based on lectures and handouts given by Klein in his Spring 1999 course at Penn State.

12. The situation of Institutionalist economics between the first and second World Wars has been addressed by Rutherford (2000).

13. Annual meetings of the ISNIE have been crowded with thousands of participants in Paris (1998) and Washington (1999).

References


Social Security Myths

By Franziska Maria Pircher*

This paper will begin with a brief history of Social Security. First, the neoclassical argument is explained, showing its’ opposition to a program of social insurance. Then, an explanation of the new theories that came to be at the turn of the twentieth century, that can take the credit for the Social Security program. Starting with the implementation of the Social Security Act of 1935, this paper follows most of the major revisions to the Act. It briefly lists Social Security’s encounters with some key opposition that can be blamed for the delay of Medicare.

Next, I will explain the modern money system because one must grasp this concept to understand the fictions that surround Social Security. The theory of the modern money system will shed new light upon government spending and its’ actual restraints. The modern money system argument leads into the current debates over lockboxes for the Social Security surplus and the “trust funds.” Both the financing matters for Social Security are discussed, along with the unnecessary “trust funds.”

Then, I will go into the problems that the yearly financial projections made by the Social Security Trustees have caused, regarding the recent myths of Social Security troubles. Most of the reformers use these projections to further their arguments. I will explain the reasons for the projections made every year by the Social Security Trustees and give some of the problems with the projections and assumptions.

Lastly, I will give a short explanation of the current proposals to alter the Social Security system. There is a huge push for investment of the “trust fund” in the stock market, but I will take a look at privatizing, cutting benefits, and means testing. I will not go into great detail, but I will briefly describe a few modest changes that could be made to the system that would be beneficial.

Social Security is by far the most popular and successful program the United States government has ever implemented. Social Security provides a guaranteed income to one out of every six Americans [Social Security: Options for Reform, 2000]. Social Security has never missed a payment in sixty-one years since the first check of January 31, 1940 [Skidmore 1999]. Social Security will never miss a payment. Social Security is contested terrain within political and economic debates. There are many myths and fictions surrounding Social Security and this paper hopes to expose some of them for what they really are. The current system is sound and any reform or changes hastily done within its’ structure would prove to be unnecessary so we must maintain the structure of Social Security, as it is, so future generations can rely upon Social Security. Just what is Social Security?

Social Security is a social insurance program provided for the American people by the government. It is not just a retirement program. Social Security contains Old Age
and Survivors Insurance (OASI), hospital insurance (HI) (which is a portion of Medicare), Supplemental Medical Insurance (SMI), and Disability Insurance (DI) [Papadimitriou & Wray 1999]. Only two-thirds of benefits go to retirees, the remaining one-third goes to disabled workers (and families) and survivors of deceased workers [Social Security: Options for Reform]. When reforming Social Security is on the table, it must not be forgotten that it has many functions within society (not just as, more commonly known, an elderly program). Social Security provides benefits to spouses of workers as they retire, even if they have never worked. The disability insurance covers the entire working population and the survivor insurance is essentially a life insurance policy for the worker’s family in the event of worker death [Baker 1996]. It provides benefits in a progressive manner; those at the bottom of the income scale get back a greater percentage of their earnings than those at the top [Skidmore 1999]. The program is extremely efficient; administrative costs are at less than 0.1 percent of annual benefits [Baker 1996]. Social Security is a very encompassing program.

**History**

At the beginning of the twentieth century, a new era of economics began. Many things were changing in America within the institutional structures and within the prevailing technology. Neoclassical thought and the famous doctrine of laissez-faire became insufficient. The American people were realizing that policies based upon the neo-classical ideology were not working. In the twenties and thirties, the Great Depression had a tremendous effect upon the American people’s confidence about the absence of government in the economy. Keynesian and Institutional economic theories came about to fill the void laissez-faire had created. Americans wanted some assurance of economic security. There was a need for change and Keynesian and Institutional theory sought to explain and give real world answers for the needed change.

The classical beliefs of laissez-faire doctrines dominated political agendas at the end of the 19th century. *Laissez-faire* is a French expression meaning “hands off” or “to leave alone.” This belief is that economic systems function best with little or no interference by the government. Bentham stated that interference by the government was “generally needless” and “generally pernicious” [Keynes 1963]. In this thought, individual welfare is important and promotes public welfare. Individuals are rational and hedonistic (pain minimizing and pleasure maximizing). The economy is believed to have natural forces (i.e. competition) that are constantly at work to keep the economy running at an optimal point of maximum well-being for every individual. The economy is self-regulating and supply creates its own demand (Say’s Law). Invisible forces are always pushing the economy towards equilibrium or full-employment. Government intervention with rules, regulations and restrictions would just throw off the invisible and natural forces’ effectiveness. Competition would work in the economy to get rid of unfair businesses and it would keep prices down. Classical thought did value limited government intervention in public works, regulation of foreign commerce and building of infrastructure to facilitate trade. But any more intervention and the government would then be keeping individuals from pursuing their own choices. A program like Social Security would be a huge intervention by government upon individual maximizing and freedom. This theory did not understand the interdependence of people within a society.
and so a program of relief was not highly valued. This *laissez-faire* doctrine was accepted for many decades until something stopped it in its tracks: The Great Depression. The Great Depression in the late 1920’s and early 1930’s caused people to question the belief that markets should be left alone and they would run optimally by themselves. Output and prices fell and unemployment skyrocketed and it appeared the natural forces that had been regulating the economy had disappeared. As *laissez-faire* fell into disrepute, new theories of Institutionalism and Keynesianism (Bastard Keynesianism coined by Joan Robinson) took over economic thought [Shaikh 2000]. Both theories gave way to an enormous reform in policy-making decisions.

Keynes cleared up many of the principles of *laissez-faire*. He stated that individuals are not necessarily rational and individual self-interest does not operate for public interest [Keynes 1963]. He also threw out the idea of the invisible hand, stating, “The world is *not* so governed from above that private and social interest coincide.” [Keynes 1963, (Italics in original)].

Institutional economists like John R. Commons and Thorstein Veblen sought to give new explanations for the neo-classical beliefs, as well. Institutionalism examined every assumption and foundation laid by neo-classical theory and helped to replace many of them with new more encompassing theories. Institutionalism incorporates many academic divisions like sociology, anthropology, and psychology into their theories regarding economics. Most of the progressive era ideas came about from Keynesian and Institutional ideas. The most popular and successful policies that came to pass from progressive economics, given to the American people, was the implementation of the Social Security Act of 1935.

The history of the passing of Social Security is a tangled one. Following the Great Depression, poverty among the elderly grew substantially. Because of the stigma of welfare and the status connotations that followed it many elderly simply would not get the help they desperately needed. With President Roosevelt coming to office in 1932, a social insurance alternative became the idea [Pre-Social Security Period, 2001]. Roosevelt had decided there must be a permanent change in policy to aid the elderly. Taxes paid in while employed, would create a benefit payment when retired. This made Social Security a work related, contributory program that helped to keep the stigma of welfare far from it [Pre-Social Security Period, 2001]. At first it seemed quite radical, a change towards a larger government, but many knew the challenges brought about from the Great Depression could not be ignored. When President Roosevelt spoke to Congress about the soon-to-be Social Security program on June 8, 1934, he stated:

Security was attained in the earlier days through the interdependence of members of families upon each other and of the families within a small community upon each other. The complexities of great communities and of organized industry make less real these simple means of security. Therefore, we are compelled to employ the active interest of the Nation as a whole through government in order to encourage a greater security for each individual who composes it...This seeking for a greater measure of welfare and happiness does not indicate a change in values. It is rather a return to values lost in the course of our economic development and expansion...[Social Security History, 2001].

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Roosevelt created a committee to analyze the security problem and in a little over six months the job was completed [Social Security History, 2001]. President Roosevelt signed the Social Security Act of 1935 into law on August 14 [Social Security History, 2001]. Even though Social Security passed into law in 1935, the first check wasn’t issued until January 31, 1940 [Skidmore 1999]. Social Security began as just individual retirement income, unemployment insurance, and aid to dependent children [Social Security History, 2001]. The 1939 Amendments added family emphasis through benefits for wives and children and it also added an advantage for low-income and short-term workers [Skidmore 1999]. As the years went on, new amendments increased the employments covered, gave options for early retirement, increased benefits and also increased the wage base and tax rates for Social Security [Skidmore 1999]. In 1956, disability insurance, for those over fifty years old, was added [Skidmore 1999]. Finally, in 1965, Medicare was added [Skidmore 1999]. An automatic cost of living adjustment, which was tied to the Consumer Price Index, was added in 1972 [Skidmore 1999]. The program was initially a pay as you go system, where the current workers taxes covered the current retirees benefits [Skidmore 1999]. In 1983, this was discarded and a “trust fund” was set up [Skidmore 1999].

President Roosevelt was an amazing speaker for the Social Security Act and always kept it in the public eye as a positive program for America. He had to, because he was one of the first but not nearly the last to fight the strong opposition against Social Security. The American Medical Association (AMA) was strongly opposed to Medicare since the first thought of adding it to federal policy and failed many of the proposals towards medical coverage help [Skidmore 1999]. The AMA used propaganda, advertising, literature, posters and strategic attack plans to fight Medicare, which kept it from being added into the Social Security program for 30 years [Skidmore 1999]. The AMA had control of the National Physicians Committee, insurance agents-companies, dentists, and pharmacists [Skidmore 1999]. Even, someday-to-be President, Ronald Reagan joined the fight against Medicare becoming involved in a large underground scandal (Operation Coffeecup) [Skidmore 1999]. Social Security fought an enormous uphill battle. The history is very long and rich, so this just touches upon the major events. Now, I will move on to the purpose of the paper, the fictions surrounding Social Security.

Modern Money

Before I begin to explain some of the myths and fictions surrounding Social Security, I must make something perfectly clear. One must understand the workings of our current modern money system, as this gives way to understanding the Social Security fictions. In the orthodox view, money is used to facilitate exchange and as a store of value. However for Keynes (1964), money must first become a unit of account before it can become either of the above. First a few presumptions must be accepted 1) It must be understood that the ‘taxes-drive-money’ view informs this explanation of the money supply components. This is that a government’s ability to tax is the acceptance of twintopt2, or in our case, money. The government has the monopoly on high-powered money and the population needs it to pay the tax, which has been imposed upon them. The government can set the conditions for the population to obtain it, and it is within this
The government must normally spend more money than it takes in (taxation) because the public will want to hold some extra money (in case they may lose some in the wash). So deficits should be accepted as the norm [Wray 1998].

2) The government (Treasury) conducts the fiscal policy. 3) The Federal Reserve (central bank) conducts the monetary policy. Now let us move on to the components of the money supply.

The money supply has vertical and the horizontal components. Understand that for the context of this paper, this explanation will be kept simple. Fiscal policy, government’s taxing, spending and ‘borrowing’ procedures, is based in this vertical component. The vertical component begins at the top, with the government supplying fiat money (reserves, coin, and Federal Reserve notes) to the private sector in exchange for goods and services that have been produced (spending procedure). This high-powered money (twintopt) is then, through wages, etc., placed in the hands of the households and others who must pay taxes. So taxes are paid and the money is back at the top of the process (taxation procedure). The government for all intensive purposes burns this money. If all the fiat money in the hands of the private sector is not paid to the government in taxes (this is deficit spending) or there are excess reserves in the banking system, then money hoards are created. The government can offer interest-earning bonds in exchange for the hoards (which is what conventional theory calls ‘borrowing’ but later I will explain why it is not ‘borrowing’ but just an alternative to non-interest-bearing money)[Wray 1998].

The private money supply process is horizontal, in that there is leveraging of the hoarded fiat money taking place. This leveraging happens in many ways, most being credit activity through banks. Banking is complicated and I do not make this explanation in great detail. Banks are required to keep a reserve ratio on their deposits, and reserves are the means of payment among banks (clearing of checks) and to the central bank [Wray 1998]. If the banks do not have the reserves to meet a payment, then the central bank must be able to step in and make sure that reserves are lent to that bank’s account so it may resume its activity. If the central bank cannot or will not step in when needed then banks might have checks bounce and then the population would no longer trust that bank or maybe any bank with their deposits. This would end up causing a nation wide bank panic, so the central bank must be able to add reserves and reduce reserves as necessary. This means that control of the money supply could not be through yearly injections; it must be a daily process. Reserves do not earn interest so through the buying of government bonds by the banks gives an interest-earning alternative. This helps to keep the bank overnight lending rate on target. Too many reserves in the system and the rate would fall to zero. However, currently we have a lagged reserve accounting system and banks have time to check their required amount and borrow or lend the necessary reserves through the overnight lending window. So the credit activity of banks accommodates as the demand for loans changes. A new supply of money is created with bank loans and is endogenously (within the system) determined by the demand for bank loans [Wray 1998]. The banks do not make loans on the basis of their extra reserves (deposit multiplier view³), if they need extra reserves to meet the requirements, they can borrow at the overnight rate. Banks are profit-seeking intermediaries and lend out of the willingness to borrow by the private sector, the ‘loans create deposits’ view [Minsky
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1993]. Now I will explain how this endogenous view is linked to monetary and fiscal policy and breakdown some of the components of the conventional view.

While the conventional view believes that tax revenues are needed by the government to finance its’ spending, this is a misunderstanding of the process. There must first be high-powered money in the system for the government to be able to collect high-powered money in taxes. It is understood that the budget is spent before tax revenues are even known, let alone collected. The government conducts fiscal policy to drain or add the needed reserves in the banking system. They do not need to finance their spending, except by issuing high-powered money. The conventional view also argues that the Federal Reserve or the central bank through monetary policy has control over the supply of money in the system (money multiplier view⁴) [Wray 1998]. The central bank cannot refuse to add the needed reserves for banks that cannot meet the reserve requirements or as we explained, if checks were to bounce a bank panic could happen. If a bank does not meet the required reserve ratio for a time period, then the central bank automatically steps in and makes a loan of reserves to that bank [Wray 1998]. The selling of government bonds is used as a reserve drain if needed and this publicly held debt is just an interest rate maintenance account, to keep the Feral Funds rate on target [Wray 1998]. Also government borrowing does not crowd out the private sector as the conventional view argues because the private sector can increase the lending as the demand increases. The central bank uses monetary policy keep their target, the federal funds rate, on target; it does not try to control the money supply, which would be impossible. So the central bank coordinates policy with the government policy and the two could never act independently [Wray 1998]. Monetary and fiscal policy are inevitably linked.

Through the explanation of the horizontal and vertical components of the modern money supply, a better understanding of Social Security policy (payments and taxes) can be explained. The government does not need financing to spend because it is the only issuer of the twintopt and ultimately, for clarification, that is the extremely important point to realize [Wray 1998]. The modern money system explanation should help one to recognize the “trust funds” as unnecessary for Social Security.

Trust Funds

In 1983, revisions were made to the set up of Social Security; it initially began as pay-as-you-go, and was changed to advanced funding [Papadimitriou & Wray 1999]. A “trust fund” was to be set up at the Treasury, as the account where the unused, excess revenues of Social Security taxes are kept. The “trust fund” money is invested into government bonds, to accumulate interest. This “trust fund” will be there with revenue for benefit payments when, as the projections assume, there is a shortfall in Social Security income from taxes. This separate account keeps the money safe from other uses the government might have [Bell & Wray 2000]. Now, using what has just been explained about the modern money system, the “trust fund” becomes a useless accounting gimmick.

The whole notion of a trust fund for safe keeping of future Social Security payments makes no sense. The government does not have to accumulate reserves of cash to pay benefits. The idea of a separate account has no economic justification. The
separation helps to keep the myth of Social Security as a private pension fund intact. The “trust fund” balance is the extra taxes the government collects. The government believes raising tax rates to keep increasing this balance will prepare for the shortfall projected in 2032. The ability of the government to make benefit payments has nothing to do with the “trust fund” balance [Bell & Wray 2000]. It does not need to tax anything at all for Social Security, if it wishes. The government doesn’t have to collect money now to save it for later. First, the government is the printing press operator; it is the only issuer of that which is necessary to pay taxes. Through taxation, government destroys money. When the government makes a Social Security payment, it simply issues a check from the US Treasury. It does not check its bank vault to make sure it has enough money to give. When an individual pays taxes, that money is burned, essentially destroyed. What should taxation be used for? Taxation is used by the government to remove income from working people so they do not buy up all the output in the economy. The Social Security check is not what the retirees need to survive; it’s the goods and services they can buy with that money. The government creates a need for its’ currency through taxation, and then it uses taxation to remove enough income from the rest of the population as to leave some goods out there for the retirees. Through this the government provides for the retirees. The surplus of the “trust funds” is not a target to set the tax rate around. The government should look to the private sector and the availability of goods and services to decide the rate of taxation. The buying of government bonds with “trust fund” money is not borrowing by the government. The government bonds are just an interest-bearing alternative to the non-interest-earning “trust funds.” There is a huge debate over the investing of the “trust funds” into bonds and whether there is a better return in other investment possibilities. However, since the government can issue money when it needs it, the idea of keeping a “trust fund” is nonsense, along with arguing over whether the bonds are the best alternative for the “trust fund” money. The government will always make Social Security payments because of its ability to operate the printing press. Then by leaving enough goods and services for the retirees to live on, the government will meet the real needs of the retired [Bell & Wray 2000]. If the government could just understand the need of taxation, then much of the debate would end. Now let’s discuss the reason the “trust funds” were initiated.

**Projections**

Most of the current policy directions and suggestions deal with the myth in society today that Social Security is in financial trouble. Most of the common knowledge in the public and what is thought to be hard facts are hardly close to the truth. A lot is based upon the projections that the Social Security Trustees are required to produce by law every year over the Trust Fund and its balance. The Trustees are required by law to make the projections to determine whether future demographic changes could be problematic for the program. This helps, if done correctly (not overly pessimistic nor optimistic), to foresee future financing problems. This whole situation of future problems could be easily resolved if the Trustees understood that the government is not spending restrained. Since the modern money system theory is not widely known, let’s just start to look at the problems within the future projections and the assumptions underlying them.
First, let’s begin with a look at the “looming crisis” within Social Security we are facing today, through these projections. At the Treasury, there are special “trust funds” that have been established to keep the excess OASDI taxes [Papadimitriou & Wray 1999]. The Social Security Act requires the Board of Trustees to make annual reports upon the operations and status of the OASDI Trust Funds [Papadimitriou & Wray 1999]. The trustees must estimate the status of the funds for the next five years and also provide the “actuarial status” [Papadimitriou & Wray 1999]. The trustees also, make projections for the next ten years and for the next seventy-five years of the financial status of the funds [Papadimitriou & Wray 1999]. This long-range 75-year projection is the start of the trouble. The trustees say they know the problems associated with such long range projections, so they use three different sets of costs for the projections, high cost (pessimistic), “intermediate cost,” and low cost (optimistic) [Papadimitriou & Wray 1999]. Social Security Act doesn’t require the trustees to make an actuarial status balance for the long term so they have established their own rules for assessing the funds [Papadimitriou & Wray 1999]. As Papadimitriou & Wray state,

"The rules are rather complex, but essentially the rules for solvency require that the funds’ projected income (expressed as a percent of taxable payroll) does not fall below 95 percent of their projected expenditures (also expressed as a percent of taxable payroll over the 75-year period. The program is said to be in “close actuarial balance” if estimated income over the 75-year period is within 5 percent of estimated cost [Papadimitriou & Wray 1999]."

So, the method of assessing is one problem. It is like, as if, as an individual you considered yourself bankrupt if you didn’t have at least 95 percent of next years estimated cost of living in your bank account. The trustees say that they are using some tolerance because they understand the difficulty in making such long-term projections. They also claim to meet projecting standards, but they use private sector analysis. A public sector program does not need such pessimistic assumptions. It seems to me that they forgot to use common sense, though. Does anyone think that in 1925, anyone could have come close to projecting the economy we have today? I doubt it. Such requirements seem like a pretty ridiculous measure of financial soundness and this is what many reformers rely upon for their changes to the system.

The assumptions that the trustees rely upon to make the three sets of cost projections are considered pessimistic even for their so-called “low-cost (optimistic)” projections. The problem lies in the assumptions used for the projections for the future cash flows of Social Security that are made every year by the trustees’ board. These projections, as I stated earlier, are made for a seventy-five year period. An increase in tax schedules was mandated into law in 1983, bringing Social Security into a surplus [Skidmore 1999]. The surplus has been kept in a Social Security trust fund. The projections that year anticipated a 0.2 percent surplus over the next seventy-five years. Recently, projections have been anticipating a trust fund exhaustion beginning around 2032. How can we possibly rely on projections seventy-five or even thirty years in the future? Also the tests for these projections on Social Security are very unreliable no matter how far into the future they are predicting because the economic conditions that are used in the calculations are extremely pessimistic. The baby-boomers are pointed out as the major problem for the “financing” of Social Security [Papadimitriou & Wray
The problem, critics say, resides in the future population shifts and the increase in life expectancies. The argument goes:

As baby boomers retire, the number of people receiving retirement benefits escalates, while the number of workers paying into the system in relation to the number of retirees shrinks. Thus, progressively fewer workers will be supporting the system, which must make payments to progressively more beneficiaries [Skidmore 1999].

First, the baby boomers will pass through the system. The shortfall is expected to rise throughout the 75-year projection and the baby boomers will certainly not be around the whole seventy-five years [Papadimitriou & Wray 1999]. Even though the number of retirees may be increasing, the number of children under 18 is decreasing, and both are included to figure the number of beneficiaries. The relevant number is actually the number of beneficiaries compared to the number of people in the workforce, which today is 46 percent [Skidmore 1999]. The number in 2030 is projected to only decrease slightly to 44 percent, which is much greater than in 1964, for example, when the number was only 37 percent [Skidmore 1999]. The increase in life expectancies is mainly because the infant mortality rate is decreasing, so the population lives longer because fewer infants die [Skidmore 1999]. In 1990, at age sixty-five, the life expectancy for a male is 15.3 years and for a female 19.6 years [Skidmore 1999]. In 1940, the numbers were 12.7 and 14.7, respectively, reflecting not much of a change in fifty years [Skidmore 1999]. Also many individuals are working longer along with their increased lifespan because Social Security just doesn’t seem to be enough for the lifestyle they would like to lead. This can mean that these people will pay into the system longer.

The trustees have many other assumptions for the demographic projections that they depend upon. For the long-term projections, they have decided to rely upon a low fertility rate (1.9 under the intermediate assumptions) [Papadimitriou & Wray 1999]. Even though, historically, fertility rates have fluctuated widely and this 1.9 would actually depopulate the country in the absence of death rate reductions and net immigration flows. The trustees still use that low number to base their projections on [Papadimitriou & Wray 1999]. The trustees have also assumed a slow growth of the labor force, which is linked to the assumption of low fertility and another assumption of low net immigration [Papadimitriou & Wray 1999]. They state that the labor force participation rates for men will decline slightly but they say the rate for women will increase only slightly. It is understandable and historically correct that the male participation rate have remain quite unchanged at around 75 percent but the women’s has increased enormously in recent years, at 60 percent in 1997 and the projections only expect it to increase to 60.6 percent in 2075 (intermediate cost) [Papadimitriou & Wray 1999]. The trustees are assuming a reduction from current net immigration [Papadimitriou & Wray 1999]. Greater immigration increases the programs revenues, by more workers under the system paying in. Many immigrants retire back to their homeland so increasing immigration flows would be beneficial for the program.

The next assumption that this leads to for the trustees is one of low growth of real wages, which is growth of nominal wages relative to inflation [Papadimitriou & Wray 1999]. This is linked to assumptions of low productivity gains, as well [Papadimitriou & Wray 1999]. Historically slow growth of labor force and low growth of productivity has
Franziska Maria Pircher

not been correlated in the same direction, so why would the trustees use both negative assumptions? The trustees must begin to realize that unduly pessimistic assumptions are not required for public program analysis. These assumptions also affect the assumption for the low growth of real output. Papadimitriou and Wray state that,

> Over the past 75 years our economy has had an average real rate of growth of GDP equal to nearly 3.5 percent per year. (Note that this period included the slow growth during the Great Depression and following the “oil price shock” of the early 1970’s). The trustees project that over the next 75 years; real growth will slow to only 1.3 percent for the intermediate projections [Papadimitriou & Wray 1999].

Again the assumptions seem unwarranted.

Another assumption, which is accepted by the trustees for the yearly projections, is a falling portion of taxable wages [Papadimitriou & Wray 1999]. This problem is easily corrected. Even with our ‘new economy’, the U.S. has seen the greatest income difference between the population in the top quintile and the bottom quintile [Tilly & Albeda 1996]. Since the OASDI tax is capped at $76,200, then that means there will be a growing portion of income not susceptible to the tax. This smaller tax base is estimated to only be 35 percent of GDP in 2075 (falling from 41 percent in 1999) [Papadimitriou & Wray 1999]. The growing income distribution must be included in reform proposals.

This “looming crisis” is built upon the yearly projection reports made by the Social Security Trustees. As one can tell, the projections are very pessimistic. The publicized demographic problem is not really a problem at all, just the reformers’ way of scaring the public with numbers. The reformers, with their seemingly reasonable usage of the projections, are making a big holler out of nothing. A “cry wolf,” if you will, out of a problem, I have shown, will never arise.

Reforms

The questions regarding Social Security have caused an enormous response from reformers wanting to “save” the system. Throughout the last Presidential Election, the debates over Social Security were intense. There are many different proposals out: increasing retirement age, cutting benefits, privatizing, means testing and many combinations of them. Let’s take a look and see what these reforms have to offer.

Some reformers begin with cutting benefits but the answer to that is an easy one. Cutting benefits is a ridiculous reform proposal because we know that the benefits are hardly enough as is. Any reform involving cutting benefits is a proposal out to destroy the popularity of the program. This would lead to its eventual elimination. Increasing the retirement age is also another form of cutting benefits. If we increased the retirement age to 70, that would amount to 23 percent less in benefits than what is currently received at that age [Eisner 1998]. Cutting the benefits would just push many more of the elderly into poverty. I believe the idea of this program was to get them out of poverty (which it has done an amazing job, if only we could implement a program to help our children in poverty?). There is also a plan to change the cost-of-living adjustment by tying it to a new, corrected version of the Consumer Price Index [Eisner 1998]. This would lead to another way to cut the benefits, which we know is no way to reform the system.
Making Social Security means-tested is another proposal pushed by Peter Peterson [Eisner 1998]. His approach is meant to eventually lead to the demise of the program entirely. He uses the public supported concept that if an individual has wealth and does not need Social Security, they should not get it. Peterson uses this to help with the “financing” problems in the future. The disguise is that a move in this direction would lose public support for the program, which has kept it strong for over 65 years. Now the elderly would essentially have to prove that they needed the benefits. This stigmatizes the program with the “stench of welfare,” which Peterson knows does not have a strong public support [Eisner 1998]. So means testing is not a way to save the system but to destroy it.

The next reform idea is the push for privatization of Social Security. Some of the proposals biased towards privatization include The Ball Plan, The Gramlich Plan, and The Schieber-Weaver Plan [Baker 1996]. These three plans include cutting benefits, increasing tax rates, and are for partial or full privatization. With privatization, many problems arise. With the current system, every retiree gets inflation-proof income when they retire and are provided the equivalent of a $200,000 life and disability insurance policy for most of their working life [Baker 1996]. Remember Social Security is not just a retirement program; privatization of Social Security would do away with the other benefits tied to it. With privatization, we would also lose the disability and survivors insurance that many forget is included with Social Security. We would lose the current progressive benefit structure and ability to tie benefits to need (lower income get a greater return). Social Security is guaranteed and privatizing could not guarantee anything. Privatizing would increase the risk of the actual returns because in the stock market there are few winners and many losers. Most people do not have the time to study the stock market and invest wisely so much of their retirement income would be lost to big dogs in the market. Firms and regular investors will prey upon the inexperienced. Many people just do not have the ability to keep track of a portfolio along with their everyday duties. Privatizing would increase the cost of administration of the program immensely. Currently, Social Security operates at a cost of administration of less than 0.1 percent a year [Eisner 1998]. The anticipated administration costs for an individual privatized program would be 20 times greater [Social Security: Option for Reform, 2001]. The stock market is not guaranteed to increase the “trust funds,” as the last year has shown with the stock market falls. It is now understood that higher rates of return on the “trust funds” do not really matter, for the government can always make the benefit payments. It is too obvious that privatizing is a sure loser. As stated above, we do not have a Social Security problem that calls for this type of reform. Most proposals for reform are just vested interests’ of different groups out to try to destroy the Social Security system.

There are some ways to help the system along that do not require radical changes. One sensible reform is to return to a pay-as-you-go system and cut the current tax rates [Papadimitriou & Wray 1999]. Since taxing is required to remove income from the public, it should only be done when needed. The “trust funds” cause and unnecessary worry for the public. Raising the cap on taxes from $76,200 would help the “financial” problems and bring in more revenue. We know there will be an increasing amount of income not subject to Social Security tax; so eliminating the cap would reduce this problem. Currently benefits given by employers are not subject to tax. If we are still really stuck on the “financing” problem, one could begin taxing in that realm of wages.
One reform that Eisner suggests is tying the yearly adjustment of benefits to wages rather than prices (1998). This would let retirees share gains and occasional losses but would ultimately end up raising the benefits [Eisner 1998]. There are many choices for reform but none need to be made immediately. We must not forget that Social Security is more than just retirement income and reforms must not change it to take away the other relief within it. There is plenty of time for the public to review the options and eventually decide on the best choice for the safety of the program.

Social Security is not facing bankruptcy nor will the government ever miss a payment. Social Security is sound and as long as we preserve the system, it will be there. We do not need the trust funds, means testing, or decreases in the benefits. We do not need radical changes because of the unreliable, pessimistic projections. The projections are just that, projections, not certainty, and numbers are not what we need to worry about. As I have shown, the projections are unduly pessimistic anyhow. How could a policy maker rely upon any statement regarding 75 years into the future? As long as the government is the only issuer of twinto and taxation removes the necessary amount of income from the workers, then the government will have the ability to offer Social Security for generations to come. Social Security is a social insurance program for all. Its popularity remains because benefits are seen as a right and not relief. There are many programs included in Social Security and they are equally important and beneficial to the American people. Social Security takes away the burden of children caring for their elderly parents. Most people do not realize the worth of this benefit. Social Security has a cost of living adjustment to ease the burden of inflation and options for early or later retirement. It provides medical and hospital insurance for the elderly. Social Security provides disability and survivors insurance to virtually the entire working population. It is the most efficient program to be found anywhere [Eisner 1998]. The fictions that surround Social Security must be brought to the attention of the public to help the program survive. Exploring the myths and fictions helps to keep the political agendas out of Social Security reform.

Notes

1. To get these presumptions explained in more detail, I suggest reading Wray’s book, Understanding Modern Money, 1998.
2. A neologism meaning, “that which is necessary to pay taxes.”
3. They believe that a deposit creates a check, which creates another deposit and so on, and the extra reserves accumulated from these deposits in each institution determine the amount of loanable funds.
4. Conventional theory has a money multiplier that equals the money supply divided by the base (currency and reserves).

References


Entitlement to Food and Employment

By Zdravka K. Todorova

Stockholm, 15 October 2001 – the Food and Agriculture Organization (FAO) of the United Nation announced: “In the 1990s the number of hungry people declined by 6 million a year on average.” At this rate it would take 60 years to reduce the number of hungry people in the world to 400 million [FAO, 2001]. Should we consider this, an “improvement,” or is there unexplored potential for fighting food insecurity? The objectives and the criteria for success are defined by one’s view of the causes of malnutrition and hunger.

Amartya Sen [1988] has identified two types of approaches toward issues of hunger. First, the availability approach focuses on the problem from its production side. Advocates of this approach are concerned about scarcity of food and limitation of potential for production. Second, the entitlement approach analyses the disfunction of the links in the channels for distribution that become responsible for the inadequacy of means to purchase food. “The end of starvation reflects a shift in the entitlement system, both in the form of social security and – more importantly – through systems of guaranteed employment at wages that provide exchange entitlement adequate to avoid starvation” [Sen 1981, 7].

There is a concern that population is beginning to outrun food production. However, as Amartya Sen [1994] points out, the rise in food output has been significantly and consistently outpacing the expansion of world population. Thus, the total food supply in the world as a whole is not the only issue. Sen raises the question of the regional distribution of food. He notes that concerns about scarcity of food due to overpopulation may be valid if the rising ratio of food to population was mainly caused by increased production in richer countries (for example, if it appeared that US wheat output was feeding the third world, in which much of the population expansion is taking place). However, as Sen points out, the largest increases in the production of food — not just in the aggregate but also per person—are taking place in the third world, particularly in the region that is having the largest absolute increases in the world population, like India and China. For example, between the three-year averages of 1979-1981 and 1991-1993, food production per head in the world moved up by 3 %, while it went up by only 2 % in Europe and went down by nearly 5 % in North America. In contrast, per capita food production jumped up by 22 % in Asia generally, including 23 % in India and 39 % in China [Sen 1994].

Sen [1994] opposes the argument that maintaining growth in food production may require proportionately increasing investments of capital, drawing them away from other kinds of production. The supporters of this view believe that this would tend to make food progressively more expensive if there are “diminishing returns” in shifting resources from other fields into food production. And, ultimately, further expansion of food production may become so expensive that it would be hard to maintain the trend of increasing food production without reducing other outputs drastically. However, Sen questions the belief that food production is getting increasingly expensive. “There is, in fact, no evidence for that conclusion… Food generally has become cheaper during recent
decades… there have been increasing complaints among food exporters, especially in the third world, that food prices have fallen in relation to other commodities.” For example, in 1992 a United Nations report recorded a 38 % fall in the relative prices of “basic foods” over the last decade. This is entirely in line with the trend, during the last three decades, toward declining relative prices of certain food items in relation to the prices of manufactured goods. The World Bank's adjusted estimates of the prices of particular food crops, between 1953-1955 and 1983-1985, show similarly steep declines for such staples as rice (42 %), wheat (57 %), sorghum (39 %), and maize (37 %).

Not only is food getting less expensive, but we also have to bear in mind that the current increase in food production (substantial and well ahead of population growth, as it is) is itself being kept in check by the difficulties in selling food profitably, as the relative prices of food have fallen… Indeed, average income and food production per head can go on increasing even as the wretchedly deprived living conditions of particular sections of the population get worse, as they have in many parts of the third world. The living conditions of backward regions and deprived classes can decline even when a country’s economic growth is very rapid on the average [Sen 1994].

For example, in 1990 more than three-quarters of Bolivia’s population lived below the poverty line, including 95 % of people in rural areas, who earned less than a dollar per day on average [IFRD 1993, 4]. This was happening after a decade of boosting agricultural export growth in Bolivia with a dollar-value increase of more than 600 % in five years [Lappe et al. 1998, 110]. Realizing returns of exports does not secure equity in distribution, and thus poverty still can be persistent.

The mainstream view is that “a rising tide can lift all boats.” This perspective is applied in the recommendations for development at global, regional and local levels. Stimulating demand on macro level is not able to secure a match between change in required job skills resulting from technological changes, because of persistent discrimination in the allocation of opportunities for access to “validated activities” such as education and employment. People’s ability to avoid malnutrition and to lead healthy lives is connected to their access to jobs, adequate incomes and work conditions, as well as to ownership of wealth and access to credit. Thus, inadequacy in food distribution should be addressed not only via fighting food wastage in efforts to feed the hungry, but also with employment policies on macro and micro level. According to the International Labor Organization in Geneva, nearly a billion people (about 30 % of the world’s labor force) either cannot work, or have such jobs that they cannot support themselves or their families. Chronic problems of unemployment, involuntary part-time employment, and low wages are among the factors that contribute to food insecurity.

Increases in unemployment are often deliberate government policies intended to prevent inflation. However, the issue of inflation can be addressed through a job opportunity program that “hires off the bottom,” providing minimum-wage jobs for all those who are ready, willing, and able to work. The program would create a buffer stock of labor from which employers could hire during upturns instead of bidding up the wages of the already employed and thus would offer both full employment and price stability [Wray 2000].
In a situation of continuously increasing food production, the issue of food insecurity is apparently an issue of distribution. Although redistribution of food itself can contribute to the alleviation of hunger and malnutrition, a more fruitful approach is redistribution of entitlement to food. The entitlement to goods and services in economies with capitalist property relations is determined by the ownership of assets and by access to adequate employment. For the majority of us, labor is the main asset that we can sell. If nations have the political will to work toward full employment by implementing their own development policies within their own means, they will be advancing toward the elimination of food insecurity and human resources wastage.

**Notes**


4. For a critique of the view that the “New Economy” in US can raise the living standards of the labor force in at the bottom, see Wray, L.R., Mark-André Pigeon, “Can a Rising Tide Lift All Boats? Evidence from the Clinton-Era Expansion,” Journal of Economic Issues, 34 (December 2000): 811-845.


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The modern theory of endogenous money is very poorly understood by economists. They attribute to it defects that are not founded and, the implications induced by its adoption are generally ignored. Through a presentation of the recent debates between various Post Keynesian authors, this article shows that, contrary to what is often maintained, the endogenous money theory takes into account the fact that agents have a demand for money. At the macroeconomic level, this demand is, however, not independent of the demand for loans because money is credit money.

The analysis of the effects of the evolution of money supply on the economic system is a major concern of the economists. This analysis started with what economists call “the quantity theory of money.” developed by Cantillon and Bodin. Authors like Walras or Pigou argue then in favor of a perfect dichotomy between the real sphere and monetary sphere in the more or less long-term. Any rise in money supply results in a proportional rise in the general level of the prices, leaving unchanged the relative prices and the demands for various goods. Patinkin calls into question this dichotomy of the spheres in better clarifying the transmission mechanisms going from money towards the general price level. Thus, following a rise in the money supply economic agents will try to restore the quantity of money, they wish to hold in portfolio. For that, they will buy goods and/or titles. This supplement of demand will lead to a rise in prices of goods and financial assets, which will allow the stock of real balances to return to a desired level. Money is thus not neutral in the short run because of the transmission mechanisms related to the existence of a real balance effect.

From the beginning of the seventies, some Post Keynesian authors, like Kaldor, called into question this type of explanation. Indeed, such explanation analyzes the consequences of exogenous variations in the money supply. It does not question why nor how money plays a role in the economic system. Yet, today, the introduction of money into the economic system mainly results from loans granted by banks and its scarcity only rests on the will of banks to respect criteria of volume and risk. All supply of credit money is demanded, we are no longer in economies where there are exogenous rises of money supply following the discovery of new gold mines or other metals that are used for striking coins or granting new loans. Based on this reality, Basil Moore concludes:

* This article is the translation of “La demande de monnaie dans le modèle de Moore: enjeux et état du débat.” We thank Franck Vandevelde for his abundant and invaluable remarks. We thank also Jérome de Boyer des Roches and Edwin Le Héron for their comments. The author remains responsible for possible mistakes in interpretations and ideas expressed in the article.
Thus, both the portfolio balance explanation of interest rate determination, and the conventional “transmission process” of monetary change are flawed [Moore 1988, 289].

However, to arrive at this conclusion, he claims that, at the macroeconomic level, there is no autonomous demand for real balances: demand for money is a function of demand for loans. Moreover, in this work, he rejects the liquidity preference theory. One finds here the position taken by Kaldor in 1982, when he affirms that liquidity preference loses its importance when money supply is endogenous. His explanations caused multiple reactions among Post Keynesians who divided into two sides. On one side, Horizontalists defended the position expressed by Moore—a position that is a deepening of the writings of Kaldor and Trevithick. Other authors, like Goodhart, Arestis and Howells, were not be satisfied by the explanations advanced by the preceding authors and defended the traditional idea that there is an autonomous demand for real balances. Today, Post Keynesians have succeeded in reconciling these points of view. One of the objections to the endogenous money theory is not justified anymore: it does not ignore the fact that agents have a demand for real balances. This theory simply shows that, at the macroeconomic level, this demand is not independent of the banking demand for loans and thus of the supply of credit money.

I will thus present, in the first part, Moore’s point of view; the concept of “convenience lending” will then be developed. Then, in the second part, I will examine some criticisms of him. We will see that Post Keynesians do not accept the standard liquidity preference theory. Lastly, in the third part, I will show that today the two approaches have succeeded in agreeing and defining a relatively coherent framework of analysis in which they can be reconciled. The only major point of divergence remains the way in which the central bank and the private banks fix their rates.

I. Endogenous Money, Convenience Lending, Administrated Interest Rates and Reflux Law

For Moore, because of the specificity of the banking system, and as long as the money is accepted as a means of exchange, there are not necessarily evolutions in the interest rates to adjust supply and demand for money.

A. Administrated interest rates and perfectly elastic loan supply: the specificities of the banking system

Moore starts with the idea, accepted by all Post Keynesians, that supply and demand for credit money are interdependent: one cannot distinguish the amount supplied and demanded for loans. After having defined their objectives in terms of volume of emission and degree of risk,\(^1\) banks provide all the credit money demanded of them at a discretionarily determined lending rate \((i_L)\). We have then:

\[
i_L = i_L(i_R)
\]
The lending rate \( (i_L) \) is given in a discretionary way by fixing a mark-up on the day-to-day lending rate between banks \( (i_R) \). The importance of the mark-up depends on the structure more or less oligopolistic of the banking system. Graphically we have:

**Graph 1: The Bank Loan Market**

\[
L_d = L^d (PQ, i)
\]

As we see, this graph shows us that \( L_s = L^d = L^* \). This identity is causal. It says to us that the agreement of new loans is made at the instigation of the demand of economic actors. Banks answer this demand and, subsequently, seek the funds necessary to increase their required reserves and, possibly, their secondary reserves.

This demand for credits implies a demand for credit money on behalf of the borrowers: \( L^d \equiv C^d \). Therefore, the loan supply by banks results in an supply of their money: \( L^s \equiv C^s \). Following the operation of credit, there is thus an identity between supply of credit money and demand for credit money \( C^s \equiv C^d \). Stated alternatively, as supply and demand for loans are interdependent, it is implies that supply and demand for credit money are interdependent.

In this case, a net rise in the demand for credit \( (L^d) \) creates an equivalent additional net supply of deposits \( (C^s) \) and, the new quantity of deposits could be reduced only when the new contracted loans are (partly or entirely) repaid, or part of the credit money is transformed into high power money. Stated alternatively, at each moment of time, or over one period, loans granted previously are repaid and new loans are granted; the amount of outstanding debts increases if the new creations of loans override their destruction. In an economy without external money, a bank deposit always comes from the initial indebtedness of a non-financial economic agent at a bank so, at the macroeconomic level, \( C \equiv D \). It follows that (physical or moral) persons who contracted loans will be able to repay them, only when they capture an equivalent amount of money. Simultaneously, other people will see their deposits, or their stock of high power money resulting from their deposits, falling. At the macroeconomic level, the repayment of bank loans thus involves an equivalent reduction of deposits. Therefore, we have the following identity \( L \equiv D \): the amount of the loans is identically equal to the amount of credit money. This identity is causal and goes from the loans to the deposits: \textit{loans make deposits.}

All that has just been presented is accepted by Post Keynesians. However, Moore goes further and says that the “total quantity of nominal deposits demanded from the banking system is thus not independent of but identical to the total quantity of nominal deposits supplied. [...] The increase in the “demand” for transactions deposits associated with an increase in the quantity of loans granted and deposits supplied may be viewed as an increase in “convenience lending” of fiat money by depositors to the banking system” [Moore 1989a, 480]. In a more formalized way, this means that \( C^s \equiv D^d \) or, as \( C^s \equiv C^d \),
that $C^d \equiv D^d$. The quantity of money required as a medium of exchange (the amount of deposits initially demanded) is identical to the new quantity of bank deposits desired in portfolio. We can also express this idea through the identity: $L^d \equiv D^d$ (with the causality $L^d \rightarrow D^d$) because we know that $L^d \equiv C^d$. Thus, no adjustment is necessary so that the money created by the banking system is desired: there is never an excess of money supply and so inflation does not directly have a monetary origin. The flow of supply of deposits and the flow of demand for deposits are identical ($C^d \equiv D^d$) or, “the demand curve for deposits [...] is dependent on the quantity of deposits supplied” [Moore 1989b, 24].

B. “Convenience lending” and the reflux law: an improvement of Kaldor and Trevithick’s writings

Based on an analysis of the production of credit, Moore concludes that money is never desired for itself and that supply and demand for money adjust through quantities and not prices. For that, he develops the principle of convenience lending and combines it with the reflux law.

- **Money is never desired for itself**

As Aglietta points out, as long as money has sufficient purchasing power, it is recognized as a representative of the general equivalent and is unanimously accepted in exchange:

The specificity of credit money is as follows: it is an act of credit whose origin is a private relation; but the sign that it expresses acquires a social character later on, contrary to all other private assets, while circulating as a representative of the general equivalent before returning to the bank and being destroyed [Aglietta 1997, 358-359].

When a bank credit is made, borrowers exchange their own IOU against the IOU of banks (the credit money). Everybody accepts this because of the confidence the public has in the money created by banks: it is *fiduciary* money. Credit institutions are indeed recognized for the quality of the management of their activity. Moreover, there are several standards, rules and institutions within the banking system intending aimed to maintaining this point of view among non-banking economic agents. The banks’ IOU thus is more easily accepted in exchange. Banks facilitate the exchange by “depersonalizing” IOUs. They transform a personal debt into a debt socialized in exchange.

In this case, for Moore, *the credit money, an IOU without intrinsic value, “is not desired for its own sake, but for the goods it can command in exchange”* [Moore 1988, 294]. Indeed, when a person applies for a loan, he or she knows that credit money will be accepted in the exchange process. In this case, when a person sells a good and receives credit money, he or she makes a “convenience lending” to the banking system by agreeing to hold its IOU:

An act of borrowing from a bank, the sale of a financial asset (primarily security or IOU) in return for money (secondary security or deposit), thus simultaneously involves an act of lending as well as borrowing. [...] Whenever the banking system acquires financial assets, its liabilities
(deposits) and so the money stock increase. [...] An act of borrowing from the banking system thus involves a simultaneously act of lending to banking system [Moore 1988, 300-301].

... [a]ny seller of goods who accepts money in return is temporarily extending credit to the bank (if deposits), or to the government (if fiat money), for so long as his money balances increase. With credit money all the goods are sold on credit... [Moore 1988, 301, note 18].

A person agrees to lend reserves to the banking system while keeping in deposit the funds he or she obtained. However, the retention of this money does not result from intertemporal choices (present or future consumption) or arbitrages between liquidities and titles (liquidity preference). When the person makes this loan, he or she invests his (or her) funds on a saving or current deposit) because he or she knows that credit money is generally accepted in exchange. The detention of this money thus does not represent any sacrifice; so, for Moore, it does not have to be remunerated (or the remuneration should be very small).

At the individual level, convenience lending, and the surplus of money that goes with it, are generally only short-term. It is a time of the temporary accumulation of money following an exchange i.e., the time that each individual chooses what he or she will do with theses funds. Indeed, agents, taken one by one, are not constantly arbitrating by looking at the assets’ yields to know if they should or should not withdraw their funds from their current or saving deposits. At the macroeconomic level, convenience lending is generally a long-term loan, in which the term is equal to the time of circulation of the money created by the initial bank loans. Its term is thus generally higher than the initial loans that initiated it: it is the time when the initial net increase in the money supply is destroyed. In an economy in growth, this term is indefinite.

With this type of approach, we thus conclude that money is always “desired” because it is accepted as a means of exchange: the borrowers do not have to worry because the credit money is always accepted in the exchange. However, this demand for money is not desired in the traditional sense (the proportion of money individuals rationally determine according to their preferences), so interest rate plays little role in its retention. Going further, as Moore does, we can even conclude that hoarding is good for the economic system because it shows that money is accepted by everybody.5

- Why is the orthodox approach incorrect?

For Moore, as we have just seen, following an (endogenous) rise in the money supply, the adjustment does not pass through prices but quantities. Contrary to the “orthodox” approach, during the process, money supply does not remain necessarily on the level it has reached. Indeed, there are always non-banking agents that have outstanding banking debts. Thus, if they obtain a supplement of money, they can use it to repay their loans. This repayment will cause a drop in money supply and will make it possible to find a desired level for $M/P$ without any evolution in prices. Moore uses here the reflux law expressed by Kaldor and Trevithick in 1981. In addition, as the retention of money does not represent any sacrifice for economic actors, it is not necessary to remunerate it, so interest rates do not play an important role.
However, Moore does not deny that there are movements in the prices of assets and, thus, in their yields. It is necessary to distinguish between asset’s yields, given at any moment by the market, and interest rates, which are fixed in a discretionary way. It is also necessary to distinguish the short-term and the long-term.

Moore reasons in the very short-term: he considers the market period. He defines it as being the period between two meetings of the Federal Reserve [Moore 1998, 175]. In this case, the central bank fixes in a discretionary way its discount rate and controls indirectly the day-to-day rate between banks. In the same way, the remuneration of money is fixed in a discretionary way by banks or law. It is thus insensitive to variations of supply or demand. The interest rate on new long-term securities is fixed by the borrowers with reference to the market yield of these titles. However, for Moore, this yield, if it is true that it evolves with supply and demand, is largely influenced by the anticipations of short-term interest rates. However, these rates are largely controlled by the central bank. If the latter is credible, it will influence the market.

It follows that one cannot apply the following reasoning: the excess of money supply (whose formation is never clarified) involves a rise in the demand for titles, i.e. a fall in interest rates. In fact, the yields will drop: the prices of the assets will increase. Interest rates are established exogenously. The central bank establishes its refinancing rate and indirectly controls the short rates. The loan rate and the deposit rate are given according to the interest rate of the central bank. The long-term rates of the market are partially determined by the central bank rate:

The portfolio balance view implicitly proceeds as if all financial asset markets are perfectly competitive and all financial actors are quantity setters and price takers. This is true in fact only for marketable financial assets and, households wealthowners. [...] The present argument maintains that the most financial goods and services, like most non-financial goods and services, are determined in fix-price markets. [...] Yields on long-term wholesale financial assets are based on market participants’ expectations of future central bank behavior governing short-term rates in the future. [...] The short-term interest rate is the center of gravity around which the rates on all other assets, financial and nonfinancial, evolve [Moore 1988, 288-289] (Bold type added).

Thus, to explain the interest rate structure, Moore replaces the liquidity preference theory by a theory based on anticipations of the monetary policy. In this case, the wealth owners can allocate as they wish the funds they lay out, and hold their desired level of real balance:

One must distinguish the demand to hold money balances over time (what Dennis Roberston colorfully called “money sitting”) from the demand for money in transactions (or what Roberston called “money on the wing”) [Moore 1989a, 482].

However, as Patinkin showed, a supply of goods is simultaneously a demand for money. As money is credit money, the expenditures of economic agents result in extending convenience lending to the banking system. As this loan does not require any sacrifice, it is remunerated at the lowest possible rate and in a discretionary way, by the banking system. Thus, the reallocation of the funds by wealth holders does nothing but
redistributes funds. *In no case is the total quantity of deposits reduced.* Only the reflux can achieve this goal. The only effects will be a variation in the velocity of money according to the demand for money (i.e. the supply of goods and not of “the” interest rate) and a rise in the asset prices on the secondary market. Therefore, there will be a decrease in the old asset’s yields:

If insufficient newly created financial assets are available, increased demand to accumulate financial assets will be directed toward increased demand for existing financial assets. This will serve both to reduce aggregate demand for current output and *to raise the market price of financial assets* [Moore 1988, 297] (Bold type added).

It is only when one approaches full employment that the prices of the new goods and interest rates will be touched by a rise in the money supply: there is a demand-pull inflation related to a too fast expansion of credits.7

II. Goodhart, Howells, Arestis: desired stock of money and adjustments by the relative interest rates

The approach developed by Moore will involve multiple reactions. Authors are not satisfied by its explanations and criticize him, although he takes account of it, for forgetting the fact that agents wish to hold a stock of money. The reintroduction of this concept implies that interest rates have a role to play in “reconciling” the supply and demand for money.

A. Goodhart: Moore forgets the demand for money

In 1989, Charles Goodhart wrote an article entitled “*Has Moore become too horizontal?*” In this article, the author criticizes several ideas developed in “*A simple model of bank intermediation*” written by Moore following the publication of his book. His most significant criticism is summarized in the following sentence:

> In its model, in section 6, Moore fails to distinguish between the general acceptance of money in exchange and the underlying demand for money [Goodhart 1989, 32].

For Goodhart, Moore does not make a distinction between the fact that money is always accepted in the exchange, and the fact that there is a desired quantity of money: it is not because we accept money during an exchange that we wish to hoard it in a portfolio. One can then want to buy, with this supplement of money, goods and/or financial assets (which, obviously, Moore does not deny as we have seen). For Goodhart, each person has a proportion of his or her wealth he or she wishes to hold in money. When a person holds a surplus of money, he or she does not hoard but uses it to make purchases or as a buffer stock.

Thus, Goodhart thinks that it is necessary that there are adjustments in terms of expenditure so that \( L^d = D^d \): supply and demand deposits are independent. This affects prices, interest rates, and economic activity (inflation has a monetary origin, *but* this is
Demand for money, in the sense of an optimal amount that I would want to hold in equilibrium in a given context, is not the same thing as or determined by—the credit-counterpart supply of money. The credit market is distinct and different from the money market. [...] I agree that at any moment the actual supply of money is determined, under present circumstances, primarily in the credit market—as the credit-counterparts approach indicates—and that it is willingly accepted. But I deny that this actual stock is necessarily also demanded in the equilibrium sense outlined above. Instead, the discrepancy between the stock of money created by credit expansion and the stock that would be demanded in equilibrium sets up subsequent portfolio readjustments involving purchases/sales of a wide number of goods, services and assets, until full equilibrium is restored [Goodhart 1989, 33].

Here, we find the traditional position. The problem is to know how we arrive at $d^d = d^a$ i.e. how the new net quantity of credit money and the desired additional net demand are adjusted.

B. Arestis and Howells: criticism of the reflux law and importance of adjustment through interest rates

- Automatic repayment is not ensured

Kaldor and Trevithick suppose that all the receipts perceived by borrowers are automatically used to repay their bank loans in order to pull ahead of the schedule of repayment and thus to limit the cost of loans. Moreover, they suppose that we are in a credit economy in which everybody is involved in debt:

Unlike commodity money, credit money comes into existence as a result of borrowing from the banks...and is extinguished as a result of the repayment of bank debt (which happens automatically under a system where an excess of receipts over outlays is directly apply to the reduction of outstanding overdrafts) [Kaldor and Trevithick 1981, 7] (Bold type added).

This is the way the two authors justify the impossibility of an excess supply of money. As all the economic actors are involved in debt, “excess” of money is immediately used to refund loans contracted before. However, this position is easily questionable because it postulates that all the economic actors are involved in debt. If this is not the case, the money received in supplement by an individual is used to make additional expenditures and/or is kept to deal with opportunities or unforeseen needs and/or, especially, to buy into titles.

Moore accepts the fact that not everyone is involved in debt to the banking system. So that the mechanism of refunding applies (all “excess” of money is used automatically to repay loans), it is enough, for him, that the Enterprise pole is regarded as involved in debt to private banks. “This is certainly less restrictive and more realistic but it does not follow that it is true” [Howells 1997, 431, note 1]. Moreover, for Howells, it is not because this condition is met that the problem disappears. Indeed, let us suppose that
an actor is involved in debt to finance a purchase, but that finally the amount he pays is lower than the amount of the credit that he contracted. Generally, the actor will not use his surplus of money to start repayment. He will make additional purchases and will start to reimburse according to the schedule of repayment. Then, some firms face an increasing demand, which they did not anticipate. *Vis-à-vis* this surplus of demand, firms will increase their prices. So, *ceteris paribus*, they will have a supplement of profit. This will not be used inevitably to repay their debt. If they anticipate that the increase in demand is likely to be durable, they initially will buy raw materials to produce and constitute stocks of goods, or they straightforwardly will invest in new equipment. In any event, whatever their choices, the extra spending has already occurred (through households). Lastly, if the supplement of money is used to buy financial titles, prices will go up and yields will fall. If firms emit new titles, the funds obtained can be used to refund bank loans, but this is not necessarily the case. In addition, the capital gains, obtained by some people following the rise in prices, may form, *at their level*, a surplus of money, which can be used for various objectives.

Thus, once we accept that not everyone is involved in debt to banks, the only means, at the individual level, to reduce the deposits in surplus is to buy goods and titles. Therefore, even if it is true that at the macroeconomic level the amounts do not change, there is a reallocation between people because of the expenditures. This act of expenditure does not leave prices unchanged.

Thus, it is not because we obtained a supplement of money that we wish to hoard it. Unless there are evolutions in other variables (interest rate, uncertainty...), the persons who receive money in surplus will try to decrease it to a desired proportion. The demand for money does not intervene during exchange; it intervenes when we reallocate the funds obtained.

**- Flow of money, stocks of money and liquidity preference**

The endogenous money theory states that banks answer any demand that is addressed to them after having fixed their debit rate. It is thus a *flow approach*; one that analyzes the monetary creation process. Goodhart’s point of view is based on the will of economic agents to hold a *stock* of money. It is then necessary to wonder about mechanisms permitting that a flow of bank loans required by agents in deficit, to be “transformed” into a desired *stock* of money by the people who manage their portfolio. The conciliation of the interests of these two groups requires mechanisms of adjustment.

Therefore, one cannot make an analogy between the supply of loans (which is a flow curve that can be represented horizontally) and the supply of money (which is a very inelastic stock curve relative to interest rate). If we suppose that the supply of loans is horizontal, we can draw Graph 2 to represent two equilibriums at various moments of time.

The displacement of the curve of supply is roughly a function of the net flow of bank loans. The displacement of the demand for money is a function, notably, of the increase in the money-income. However, the intersecting line is not necessarily horizontal; it will depend on the behavior of the banking system (represented by the curve of supply $M^s$) and of the will (represented by the curve of demand $M^d$) of the agents to hold the supplement of money put in circulation (represented by the curve $L^s$). Then, we have to define what are the exact mechanisms that permit evolutions in equilibrium. This
question raises the problem of the nature of the interest rate in the vertical axis and raises questions about the accuracy of this graph.

**Graph 2: Supply of Loans and Stock of Money**

Indeed, let us suppose that one accepts the idea that the curve $L^s$ is horizontal. In this case, the interest rate is a function of the day-to-day rate between banks and a mark-up. However, the graph also takes into account the demand for money, which is represented by the interest rate of long-term securities. Unless one assumes a constant interest rate structure, one cannot reconcile the two curves ($L^s$ and $M^d$) on the same graph. This assumption, however, is not justified. In this case, the preceding graph is problematic. As Howells and Arestis say, this problem is reinforced by the fact that displacements of $M^d$ represent the ex post evolution of the money supply whereas $L^s$ represents the ex ante evolution of the money supply. A mechanism should then be found to reconcile the will of the borrowers and the will of other people to hold an amount of money.

- Adjustment through the variations of interest rate: the correct expression of the liquidity preference theory

Classically, the liquidity preference theory is expressed, as in Keynes, by referring only to the interest rate of long-term securities. For Howells and Arestis, it is not a correct way to present the liquidity preference theory: the arbitrage between placements and hoarding is based on “relative” interest rates. Thus, it is the variations of interest rate differentials that express an evolution of liquidity preference. Stated alternatively, the liquidity preference influences the risk premium between different assets (long-term/short-term, specific characteristics of assets...).

Let $i_O$ be the yield offered on the titles emitted by the non-financial agents, $i_L$ the cost of bank loans and, $i_D$ the interest rate offered on bank deposits. The arbitrage to know where to borrow (direct or indirect financing?) is a function of the differential $i_O - i_L$. For financial investment decisions, the differential $i_O - i_D$ is what investors look for. For Howells, with these two differentials, one can reconcile the desired supply (i.e. the demand for new loans) and the desired demand for new money. Let us suppose that $d^d > d^l$: the amount of new deposits created is higher than the net additional amount desired. There is an “excess” of money supply at the macroeconomic level. Therefore, there will be a process of acquisitions of new financial assets and thus, simultaneously, a rise in asset prices and a fall in the yield on the new financial titles ($i_O$). This sequence has two effects. The first effect comes from the fall of the differential $i_O - i_D$. This fall involves a
rise in the demand for deposits: the net demand of money desired increases (\(d^d\) rises). The second effect originates in the fall of differential \(i_O - i_L\). As it becomes relatively less expensive to choose a direct financing, there is a decrease in the net demand for new bank loans (lower \(l^d\)) and that a lower net supply of new money (lower \(c^s\): the growth of money supply decreases). This adjustment process works until \(l^d = d^d\). It is supposed that the differentials can vary continuously (because \(i_O\) varies continuously) and that actors are very sensitive to these evolutions.

One can add a third differential, which would be \(i_L - i_D\), the difference between the loan rate and the deposit rate. Indeed, when agents want to finance expenditure beyond their income, they can choose to resell securities instead of borrowing. The combination of these three adjustments makes the reconciliation of borrowers’ preferences and those who receive this money possible:

Suppose [...] that the ‘surplus’ of deposits are swept into non-bank liabilities. There must surely be some price and interest rate effects. Prices must rise and yields fall, the latter relative to rate on both deposits and on bank lending [Arestis and Howells 1996, 549]. The change in the “bonds” yield is also a change in the rate at which agents can borrow from nonbanks. Nonmoney interest rates fall relative to the rate on money, but also relative to the rate on bank lending [Howells 1995, 102].

The yield \(i_O\) evolves according to the market yield, and the two other interest rates are more or less managed by the banking system.

- Moore and the adjustment through interest rates

As we saw above, Moore states that asset prices would fall if there was an “excess” of money. If we compare this point of view with the above assertions of Arestis and Howells, we are amazed by the fact that they arrive partly at somewhat similar conclusions: the yields of the titles will drop. Moore is, however, not in agreement with the two preceding authors. The adjustment that we have just seen does not make it possible to find an “equilibrium” because economic actors are not so sensitive to evolution of interest rates and these rates (and thus differentials of rate) are not very flexible. That is particularly the case for short-term rates. Long-term interest rates are strongly influenced by the anticipations of short-term rates if the central bank is credible. In this case, and adding the argument based on convenience lending (agents are not always looking at interest rates), the adjustment through interest rates, if it exists, can only be secondary. The principal adjustment works through the reflux of money to banks and thus, the extinction of part of the debts.

Beyond the fact that there is no agreement on the way in which adjustments are made in the case of an “excess” of money (reflux law or relative interest rates), the fact that they arrive at results that are similar, allow us to forecast the possibility of reconciliation. As we will see, Lavoie shows that these two approaches can be reconciled.
III. Taking into Account the two Mechanisms of Adjustment: Demand for Money and Reflux Law

Marc Lavoie will enter in the debate by showing that the two approaches are not irreconcilable. First of all, he shows, through the Circuit theory, that the flows of supply and demand for money are necessarily equal. However, that does not go against the solution proposed by Howells and Arestis: reflux law and adjustment through relative interest rates explain the same thing from two different views.

- The identity of stocks of outstanding loans and demand for bank deposits

We saw that Howells criticized the reflux law as Kaldor and Trevithick had presented it. He reproaches them for making two strong assumptions: automatic mechanism and the fact that everyone is involved in debt. The answer brought by Moore, which does not satisfy Howells, is that it is enough to suppose that only firms are involved in debt so that the mechanism works. This answer does not satisfy Lavoie either:

But assuming that households hold no lines of credit is already granting too much to the opponents of the Kaldor-Trevitick mechanism [Lavoie 1999, 106].

In this case, it is possible to show that the identity of the supply and demand for money occurs apart from any reference to the preferences of agents. To prove that, Lavoie reasons through a Circuit with three poles (Banks, Enterprises, and Households). After establishing of a plan of production, firms begin to implement their process of production. They ask the banks for initial financing to pay for wages, raw materials and other elements necessary to launch the production process. Firms go to banks that advance the funds necessary to them. We have the following balance sheet at the Bank pole [Lavoie 1992]:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>New loans to firms</td>
<td>R</td>
</tr>
<tr>
<td>New deposits of firms</td>
<td>R</td>
</tr>
</tbody>
</table>

The payment of wages involves an increase in the deposits of households: there is a transfer from firms to households:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>New loans to firms</td>
<td>R</td>
</tr>
<tr>
<td>New deposits of households</td>
<td>R</td>
</tr>
</tbody>
</table>

Households thus receive this supplement of money and they make, at the same time, a “convenience lending” to the banking system [Lavoie 1999, 106]. At the individual level, this loan lasts for the time that each household keeps part of its deposits. At the macroeconomic level, this loan lasts for the time that firms recover the amount (R) necessary to repay the banks and thus to extinguish the debt that the banks have towards
non-financial actors. Households gradually destroy their income by consuming it. That makes it possible for firms to collect part of the distributed income:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>New loans to firms</td>
<td>R</td>
</tr>
<tr>
<td>New deposits of households</td>
<td>S</td>
</tr>
<tr>
<td>New deposits of firms</td>
<td>R − S</td>
</tr>
</tbody>
</table>

Firms use these receipts to fund their new debts:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans to firms</td>
<td>S</td>
</tr>
<tr>
<td>Deposits of households</td>
<td>S</td>
</tr>
</tbody>
</table>

Households also will make portfolio choices and will invest part of their savings: they get rid of their surplus of money by buying new titles for an amount $S_p$:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans consolidated with the firms</td>
<td>$S_i$</td>
</tr>
<tr>
<td>Deposits of the households</td>
<td>$S_i = S − S_p$</td>
</tr>
</tbody>
</table>

In fine, the net variation of money supply is thus equal to the initial loans that have not been repaid yet because of the liquidity preference of households. This positive variation increases the money supply. It is the remnant of a remnant, and it has no causal importance. There is thus an identity between the net demand for loans and the net demand for money: $l^d = d^d$. No adjustment of preferences is necessary to equalize them.

Thus, the additional demand for deposits is largely a consequence of the new loans granted initially to firms: the assertion that “loans make deposits” must be taken in the broad sense. The price-effect relating to portfolio choices has little importance here. One can regard “the interest rate and its structure as an exogenous variable” [Lavoie 1999, 156].

Reconciliation: introduction of preferences in the Circuit during the final financing

According to what we have just seen, economists who adhere to the Circuit theory think that the funding done by firms will automatically eliminate all “excess” of money. Repayment will be done as soon as possible to limit the cost of interests and, why not, gain on the schedule of repayment. Howells and Arestis do not reject the reflux law, but they think that it is exaggerated to regard it as automatic and as a single means of adjusting the net flow of supply and the net flow of demand for credit money (and thus stocks if they were balanced before). Thus, these two points of view seem not easily reconcilable. However, Lavoie thinks that it is possible.

Let us take again the last two balance sheets we have just established. In the first, the firms have an amount of new banking debts equal to $S$. To decrease it, they will try to collect the savings of households by emitting titles (shares, bonds): this is the second source of the final financing (the sale of goods being the first one). Households wish to invest part of their savings $S$. In the last balance sheet, we see that they allocate their savings between new hoarding, for an amount $S_h$, and new investments, for an amount $S_p$. At the macroeconomic level, households can increase their stock of titles only if new
titles are emitted. Seeing that households wish to hold new titles, firms begin to issue them.

Arestis and Howells think that the adjustment works through relative interest rates. In this case, the rise in demand for titles from households will increase the price of old bonds and so lower their yields. Firms will be able to issue new bonds by choosing a rate $i_O$ equivalent to the yield offered on the market. Ceteris paribus, $i_O$ will fall, and so the differential $i_O - i_L$ will too. This will encourage firms to be financed indirectly and to reduce the net flows of banking loans.16

We have just presented in two complementary ways the effects induced by the same phenomenon: the transfer of funds from creditors towards debtors.

- Adjustment by the interest rates: a secondary mechanism?

“No one denies that interest rate differentials and the behavior of economic agents based on these differentials has some relevance” [Lavoie 1999, 108]. By writing that, Marc Lavoie seems to show that Post Keynesian authors have become “reasonable” in the sense that they take into account effects and mechanisms advanced by the orthodoxy: economic agents wish to accumulate a stock of money in proportion to their real wealth. We think however that this last idea never really left an author like Moore:

> While the total quantity of transactions deposits that are demanded to hold over time for transactions and asset purposes will be a function of the price level, real income, wealth, and the structure of interest rates on other assets—as the conventional view has it... [Moore 1989a, 480].

However,

> [...] the total quantity transactions deposits demanded from banks in the aggregate—always identical to the total of the quantity of transactions deposits the banks create. The total quantity of nominal deposits demanded from the banking system is thus not independent but identical to the total quantity of nominal deposits supplied [Moore 1989a, 480].

Moreover, he adds:

> An offer to supply goods is simultaneously an offer to demand money. Price-setting and quantity-taking behavior on the part of the sellers implies that their demand for transactions deposits cannot be expressed as unique function of the income, wealth, interest rates and tastes [...] but it is also dependent on the demand for the goods and services which they are offering for sale and over which they have no direct control [Moore 1989a, 482] (Bold type added).

Moore does not reject the idea that there is demand for money at the microeconomic level. The fact that ‘any increase in the supply of money always creates its own demand in the form of an increase in convenience lending of fiat money to the banking system’ [Moore 1989a, 485] (what is expressed by the boldfaced sentence) does not imply that the curves of supply and demand for money are confused. This implies that, at the macroeconomic level, they are interdependent (as we saw with Lavoie). This
is an element, which, in our opinion, was badly interpreted in previous years. Thus, the mechanisms that prevail in case of “excess” of money supply are the reflux law (which is expressed by the reimbursement of the loans and/or the sale by banks to the private individuals of part of the assets they have in their portfolio)\textsuperscript{17} and the principle of convenience lending. Adjustment through interest rates can only be secondary because money is credit money (so demand generates supply):

The role is secondary both in theory and in historical time; for production is made possible by the flows of credit-money provided by the banking sector in the first place. Portfolio decisions about new flows of savings come at later stage. [...] I believe that the most of the adjustment between the creation of deposits and the demand for deposits is done through the reflux mechanism [Lavoie 1999, 108]. Needless to say, this does not imply that portfolio and interest rate effects are irrelevant, they are simply subsidiary” [Lavoie 1999, 110]. Their effects are not, in general, essential compared to the initial creation of credit money [Lavoie 1992, 156].

Moore agrees with all of the above. The income effect prevails on the substitution effect: the adjustment works mainly through the supply (net destruction of money ($I_d < 0$) or deceleration of monetary creation) rather than the demand for money (substitution with unchanged supply).

Arestis and Howells agree with the analysis of Lavoie: reflux law and adjustment through interest rates are complementary:

If indeed the financial flows associated with the reflux mechanism are to be recognized as involving changes in the relative interest rates, we can hardly disagree. The point that we were making it that they are not so recognized in Kaldor and Trevithick and, are explicitly rule out in Moore [Arestis and Howells 1999, 116].

However, these authors exaggerate their point of view on Moore: following criticisms of the belief in the automatic aspect of the reflux law, Moore questions the possibility of joining equilibrium through continuous variations of (absolute or relative) interest rates. As Keynes pointed out to Hicks, a rise in investment will not “inevitably” make interest rates increase.

Lastly, for Arestis and Howells, to judge the importance of each element, it would be necessary to go to the empirical level. They point out that the Circuit analysis, to which Lavoie refers, is heavily based on the importance of firms;\textsuperscript{18} the decisions of households are also significant for the evolution of credit. Thus, the variations of bank credits are not necessarily a function of the production decisions of firms. In England, it is even the inverse: loans to households are more significant than bank credits granted to firms.

**Conclusion**

Critics often reproach the endogenous money theory for ignoring the demand for money as a stock desired by economic agents. We have shown that this criticism is not justified. If it is true that Moore rejects the portfolio choice theory and the equilibrium mechanisms of the real balance effect, he does not say that agents have no demand for a
stock of money. In addition, recently Moore has ended up by conceding that adjustments through interest rate differentials, i.e. liquidity preference, could play a role even if these adjustments are, for him, of secondary importance. Indeed, interest rates are not very flexible and are only one element, and not the most significant, which influences the economic agents’ decisions. Moreover, classically, the adjustment through interest rates typically concerns the demand side aspects. However, as today money is credit money, adjustment by quantities takes importance: following an “excess” of supply, the money ebbs. Thus, the traditional explanations are not relevant any more (or, at least, far less relevant).

On the other side, Howells and Arestis accept the idea that the reflux law exists, and so adjustment through interest rates is not the only means for adjusting preferences. They insist, however, on the fact that reallocation of monetary balances, even if it does not modify the amounts at the macroeconomic level, will involve a modification of the prices of goods and the yields of financial assets.

The demand for money is thus taken into account by the endogenous money theory. This demand is, however, not independent of the supply of loans and is identically equal to the money supply in a closed economy of pure credit. Recently, Godley and Lavoie (2000) showed this in a model where no condition is posed for the equalization of the supply and demand for money, and where the “excess” of money supply does not affect the prices of the goods or financial assets.

However, there still exist some points on which various authors of the Post Keynesian monetary theory are not in agreement. This is particularly the case for the way interest rates are determined by the central bank and private banks. For authors like Robert Pollin, one cannot consider that the supply of reserves and the supply of credit money are horizontal. The central bank fixes its main rates while reacting constantly to the financial market [Palley 1996]. Banks have criteria for risks, which cause them to limit their loans, to prefer to maintain liquidity or to buy more secure assets as, for example, government bonds. There is a liquidity preference in the banking system [Le Héron 1986, and Wray 1992]. As we foresaw, Lavoie (1996a) (and also Wolfson 1996) recently showed that the horizontalist approach did not result in rejecting this fact. Their propositions are, however, different from those Le Héron and Wray in the sense that the former includes rationing in the supply curve, whereas the second one includes it in the demand curve. The horizontalist approach thus seems to have gained in importance in Post Keynesian thought at the price of an integration of the liquidity preference theory, even if this integration still required further development.

Notes

1. Both are important, the maximum amount of money that a bank is ready to create is a function of the risk, which it is ready to take. However, the risk plays another role: it influences the selection of the customers considered as being a good risk.
2. \(i_g\) is an “average cost of the funds (including the costs of providing transactions services on deposits)” [Moore 1988, 57]. When banks need liquidities, they can be financed through several ways: central bank (rediscount, open-market policy), other banks (federal fund market...), by reselling liquid assets (Treasury bills...), by emitting their own debts (certificates of deposits, time deposits...), or going on the euro-devises market. Contrary to the loans market, banks are price-takers and quantity-setters in these markets. Moore qualifies all those as “wholesale markets.” They exist in all countries where there are developed
secondary markets [Moore 1988, 58]. “The central bank, in its role as ultimate provider of liquidity, plays the crucial role of controlling the quantity and price of the net inflow of funds into the wholesale markets [...] it is in a position to determine, within wide limits, short-term wholesale interest rates” [Moore 1988, 59]. This works through open-market operations. We can see that the cost $i_R$ can take several forms. Generally, authors use the federal fund rate.

3. See note 17.

4. The only point of disagreement concerns the infinitely elastic supply of credit money relative to the interest rate.

5. As we will see with Lavoie this point of view is valid only within some limits.

6. This supposes that the concurrence between banks is not too exacerbated. If this is not the case, banks compete to obtain new customers on both sides of their balance sheet [Grabel 1995].

7. In Post Keynesian theory, demand-pull inflation is, however, a particular case: cost-push inflation prevails [Le Héron 1991, and Lavoie 1996b].

8. See [Kaldor 1982 (1985), 61, 114] for a new formulation of this idea.

9. When it is used at the macroeconomic level, this term is ambiguous in Post Keynesian theory because supply and demand for credit money are inevitably equal: see [Godley and Lavoie 2000] for a definition of this idea. This definition is subjacent in Howells’ paper: it is the difference between supply of money and anticipated demand for money.

10. Banks and the central bank can have an upward sloping supply curve that evolves with their liquidity preference and the convention in the banking system: the more risk and volumes are high, the more the debit interest rate increase (at least from a threshold). However, the horizontalist approach does not result in rejecting this idea. It is necessary to take into account the evolution of the standards of the banking system and thus of the perceived risk [Le Héron 1986, Wray 1992, and Lavoie 1996a] and to distinguish the short-term from the long-term: “One could then envisage some longer-term “money supply function” upward sloping with respect to the interest rates. But that would merely reflect the fact that the central bank would exogenously raise or lower the administered level of nominal interest rates in an attempt to control the rate of growth of the money stock, given its particular policy target [...] Even with such a policy regime in force, the short-run money supply function of would always be horizontal. The long-term money supply function is, in general, strictly undefined, since it is not independent of the credit and money demand forces” [Moore 1988, 265, note 9] (Bold type added).

11. From [Arestis and Howells 1996, 542].

12. At the macroeconomic level, only the payment of employees appears (the payments between firms are balanced in the consolidation).

13. This is true for the debate that interests us. On the other hand, it is true that the hoarding of households involves problems of refunding for the firms. Therefore, contrary to what Moore says, hoarding can be bad.

14. Le Héron (1986) concludes similarly, showing that evolutions in $S_{1}/S_{1}$ (flow view) involve an adjustment in quantities, whereas arbitrages on the accumulated wealth (stock view) make financial asset prices evolve.

15. We are in a closed pure credit economy.

16. Therefore, the fall of the differential will not necessarily cause a fall in demand for credit at the macroeconomic level: this phenomenon may just slow down the growth of the demand for credit ($t'$ remains positive but becomes lower).

17. The repayment of the loans is not thus a sufficient condition to reduce deposits at the macroeconomic level.

18. This is normal because the circuit theory aims to study capitalism, which is a monetary economy of production.

19. However, today practically everybody agrees that reserve supply is horizontal.
Eric Tymoigne

References


