EMPIRICAL ANALYSIS AND POST KEYNESIAN ECONOMICS

In a previous work (Holt & Pressman, 2001), we argued that Post Keynesians needed to pay more attention to the empirical testing of their economic theories. This was not a new case when we made it. It was a point stressed by Alfred Eichner (1983, 1985) around twenty years ago. And it is a general argument about economics that has been made many times, probably most persuasively by Wassily Leontief (1971) in his AEA Presidential address.

Our concern, however, is only with Post Keynesian economics, mainly because we are both Post Keynesian economists, and as Post Keynesians are concerned with developing this approach to understanding how real economies work. Towards this end, the empirical testing of Post Keynesian theories is extremely important. Similarly, for Eichner, empirical work was needed to complete the scientific Post Keynesian paradigm.

Eichner (1985) identified two stages in the development of Post Keynesian economics. A first stage, stretching from the late 19th century to the 1960s involved a theoretical critique of neoclassical economics. This critique begins with Marx and Veblen, both of whom Eichner classifies as Post Keynesians of sorts.

Veblen, of course, with great wit, demolished the neoclassical idea of rational and autonomous economic agents.
Rather, for Veblen [1899], consumption behavior was social in nature. Spending was determined by the desire to keep up with one's neighbors and even surpass their levels of consumption. Cars were not bought because they provide the individual with the greatest possible utility (given the constraints of the income budget), but because they were more lavish and more expensive than the cars driven by one's friends and neighbors. The same thing was true of homes, of clothing, and of most consumer items.

Marx, like Veblen, saw behavior as determined in large part by social factors—in particular by one's economic class (for more on Veblen and Marx, see Pressman, 1999).

In addition to Veblen and Marx, there were the incisive critiques of Sraffa and Robinson. Sraffa's 1926 article on increasing returns showed that supply and demand analysis could not apply in a world of increasing returns. Then Production of Commodities by Means of Commodities (Sraffa, 1960) made the more general criticism that the neoclassical theory of value and distribution was circular in its reasoning. Robinson (1953-54) raised the question of how it possible to measure capital and thus its return. But since there was no way to measure aggregate capital (outside of having the rate of return and using this to measure capital), neoclassical theory could not explain either value or distribution. This led to the famous
Cambridge Controversy, which Harcourt (1972) documented so ably and with great wit.

A second stage in Post Keynesian economics, according the Eichner, stretches from the 1930s (but mainly the 1960s) to the present (or at least to 1985, when Eichner was writing). During this stage, Post Keynesians have been primarily concerned with developing a theoretical alternative to neoclassical economics. Some of the key actors in this stage are John Maynard Keynes, who developed a monetary theory of production, Michel Kalecki, who developed a markup theory of pricing, and Nicholas Kaldor, who set forth a non-marginalist, Post Keynesian theory of distribution.

Keynes [1936] explained how a money-using economy could easily fall into prolonged bouts of high unemployment. He also explained the economic policies needed to remedy that problem. Kalecki (19xx) explained the importance of markup pricing and what determined the markup. He also explained how the markup affected income distribution, investment and the business cycle.

And Kaldor (19xx) explained how aggregate spending propensities lead to a division of output between capital and labor. This explanation for distribution did not depend on the marginal returns to aggregate capital and labor, and so did not depend on the suspect notion of aggregate capital. Joan Robinson (19xx) was also important here stressing the importance
of historical time in economic analysis rather than equilibrium analysis.

More recently, the work of Pasinetti (1962) built on the work of Kaldor to develop the mathematical structure of theory distribution that was not neoclassical in nature; Walsh and Gram (1980) highlighted the differences between the classical and neoclassical theories of general equilibrium.

Eichner (1985:177) noted that this theoretical perspective stands in sharp contrast to neoclassical theory. It focuses on "production rather than just distribution, income effects rather than just substitution effects, [and] a monetarized rather than just a barter economy." Post Keynesian models were also more concerned with how economies move through time and recognized that this process may change the ultimate economic outcome. In these models, investment or capital accumulation determines prices (because the markup is determined, in part by the need for internal funds for investment), income distribution, and the rate of economic growth.

In addition, the consequences of this approach to economics are fundamentally different from the consequences of neoclassical economics on a number of important issues (income distribution, the role of the state, the importance of different institutional arrangement, tax incidence, the causes of inflation and unemployment and economic growth). There is no
presumption that market outcomes are optimal (in some sense) and no presumption that economic policy is at best ineffective and at worst harmful (see Hold & Pressman 2001).

There is a good deal of scholarly literature that summarizes the key Post Keynesian theoretical contributions in greater detail and contrasts them with neoclassical theory (Lavoie 1992; Davidson 1972, 1994; Eichner & Kregel 1975). There is also some literature of this sort that is geared more towards students (Eichner 1978; Holt & Pressman 2001).

Eichner argues, however, that all these developments and advances do not go far enough. A third stage is needed in Post Keynesian economics. At this stage, the theoretical alternative which has been developed must be tested and validated. Until this stage is reached, Post Keynesian theory is inadequate, according to Eichner. It is this stage that will make economics in general, and Post Keynesian economics in specific, scientific (1983:10). This empirical stage of Post Keynesian thought must focus on several things.

First, Post Keynesians need to compare the conclusions of the theory with reality and see if there is a correspondence between the two. In addition Post Keynesian theory needs to be tested against other theories to determine which one is closer to accurately describing the real world. Similarly, other (i.e., neoclassical theories) must be tested against Post
Keynesian theory rather than a null hypothesis. Theories have consequences and at some point, those consequences have to be examined.

Surely it is true, as numerous people have pointed out (Hanson 1958), that observations are "theory-laden". What you see is, to some extent, determined by how you see the world. Nonetheless, it is not necessarily the case that different theoretical perspectives are irreconcilable as Kuhn (1962) maintained was true of different paradigms (Martins 1972, Tomass 2001). Even Hanson, using an optical illusion originally presented by Wittgenstein, acknowledges that it is possible to see things from two different perspectives when these contrasting views are clearly pointed out.

The ability to compare and contrast things from two different theoretical perspectives is made easier in a discipline like economics, where many key, theoretical terms are quite well defined. Thus, Post Keynesians and neoclassicals can pretty much agree on the definitions of saving and investment. They also agree that in a simple economy with no government and no foreign trade, savings must equal investment. This is, in fact, a simple national income accounting identity. Where these two schools differ is not here, but in how they see the causal nexus between the two. For neoclassicals, savings causes investment; it provides the funds needed to build new capital
equipment. In contrast, Post Keynesians hold that investment determines savings. Investment can be financed by borrowing from banks, which does not require savings because banks create money by lending. Investment, in turn, generates jobs and incomes. Some of this income will get spent and the rest will be saved.

Given perspectives that are similar in some respects, but different in a number of crucial areas, it should be possible to test for the causal nexus. There are Granger causality tests. It should also be possible to look at historical episodes where either savings incentives were increased or investment incentives were increased. On the Post Keynesian view, savings incentives, by lowering spending, should lower investment demand. Investment incentives, however, should expand the economy and increase savings. On the neoclassical perspective just the reverse is true. What we have here is a testable proposition. It is a testable proposition that needs to be tested.

Second, empirical work helps to delineate the scope of a theory. For example, Keynes (refs) was, at times, in favor of the gold standard and at other times opposed to it. His arguments were primarily about the effects of fixed exchange rates on aggregate spending. If fixed exchange rates sometime increase spending and sometimes reduce it, we need to know the
conditions under which fixed exchange rates might increase spending and employment and the conditions under which flexible rates are better for expanding effective demand.

Third, empirical work is needed to delineate elasticities. If theory holds that tax cuts stimulate spending (rather than savings to pay for future taxes needed to repay the large deficit as Barro, 1974 argues) we still need to know how much spending takes place and how much spending gets crowded out. Similarly, it is important to know the value of both regional and national multipliers. Only empirical work can answer these questions for us.

The preceding remarks do not deny that Post Keynesians have done empirical research. Nor does it deny that Post Keynesian hypotheses have been tested. A good deal of empirical research has been done in the Post Keynesian tradition, and has been published in professional journals such as the Journal of Post Keynesian Economics, the Cambridge Journal of Economics, International Review of Applied Economics, and the Review of Political Economy.

Some of this work has focused on inequality. Galbraith (1998), for example, has done extensive work showing the importance of low rates of unemployment for greater income equality, and Pressman (2001, 2002) has shown how government spending and tax policies affect national poverty rates and
income equality. Another strand of Post Keynesian empirical work, stemming from Kaldor and Thirlwall's laws has focused on export-led growth (refs!).

But these works have tended to be the exception rather than the rule. To be more optimistic, one might argue that previous empirical work has indicated the beginning of the third stage of Post Keynesian thought that Eichner called for. This book attempts to build up the early empirical work and help develop this third stage.

Eichner (1985:181) argues that many of the key ideas at the core of neoclassical theory have failed to meet the test of experience. This includes the notions of indifference curves, isoquants, positively sloped supply curves in the industrial sector of the economy, the marginal physical product of capital and the Phillips Curve. While some of these concepts have been modified, there do remain serious problems. It has been impossible to derive any indifference curve from empirical data (Mishan 1961). And the literature on preference reversal (refs) seems to falsify the notion of an indifference curve. And the work of Eichner (1976) put to test the notion positively sloped supply curves, finding that most industrial firms operate under conditions of increasing returns rather than diminishing returns.
But there are other reasons that a greater focus on empirical work is needed. As Kuhn (1962) noted, in any mature science, most of the theoretical issues have been addressed. Sure there are some anomalies and puzzles that need to be explained, and some people will work on these theoretical issues. But most practitioners will need to do empirical work. This work aims to articulate and confirm the paradigm by laying out its scope and precision (Kuhn, 1962, p. 36). It is this empirical work that provides for the doctoral dissertations and the refereed publications needed to advance professional careers and to sustain a mature paradigm.

Second, theoretical arguments are not likely to be noticed by and are not likely to have any impact on neoclassical economics. In part, this stems from the methodological precepts of Friedman (1953), who argued that the only thing that matters for economics is the validity of its predictions. Although Friedman's methodology has been subjected to much critical examination, its instrumentalism is generally accepted and Friedman's essay becomes a ready response to alternative theoretical viewpoints and to theoretical arguments raised against neoclassical theory. Consequently, the only way to engage neoclassical theory is to present empirical evidence against its predictions and supporting the Post Keynesian perspective.
A third function of empirical work is that allows important debates to go beyond two warring factions. In effect, empirical work attempts to convince more objective outsiders of the correctness of a particular viewpoint. Solid empirical work, in essence, lets Post Keynesians go over the heads of neoclassical economists and appeal to other social scientists and to the general public.

To take one important and recent real world case, the work of Card and Krueger (1994, 1995) has demonstrated that contrary to neoclassical expectations, a higher minimum wage would not increase unemployment. Because the basic ideas behind their work, as well as the empirical tests and results, could be explained in simple terms, the case for increasing the minimum wage grew stronger. The US Congress, in fact, did raise the national minimum wage shortly after the Card and Krueger results became well known, their results are generally thought to be important in generating the political support for this action.

REFERENCES


University Press.


Kaldor, N. (19xx) "Theories of Distribution,"


Kalecki, M. (19xx)


Robinson, J. (19xx) "History versus Equilibrium,"


Tomass, M. (2001) "Incommensurability of Economic Paradigms: A

