Book Reviews

Marc Lavoie
Post-Keynesian Economics: New Foundations
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This book, which is an updated and expanded version of Foundations of Post-Keynesian Economic Analysis that the author published in 1994, is a massive effort to present the work of Post-Keynesian economics in all fields. As such, it does not convey a single 'message', except perhaps that Post-Keynesian (PK) economics is alive and well and can serve as a complement and/or alternative to orthodox economic theory in all respects, starting from its methodological foundations.

This is particularly clear in the treatment of PK microeconomics, discussed in chapter 2 and 3. In contrast to the principles of optimising rationality, PK choice theory is characterised by fundamental uncertainty and bounded rationality. Similarly, rather than maximising profits, firms behave according to the principle of mark-up pricing, in line with the principle of 'realisticness', which Lavoie argues to be a central proposition of heterodox and PK economics.

PK economists have long argued that a 'monetary analysis' of the economy is a crucial starting point for economic theory. Lavoie does that in chapter 4, by starting his treatment of PK macroeconomics directly from the endogenous money theory. He reaffirms the 'horizontalist' position that central banks set interest rates and the supply of money is endogenously created by commercial banks, a view now shared to some extent by New Keynesian economists. Liquidity preference in this analysis plays a role in determining the differential between rates across financial markets. In fact, the 'horizontalist' position and liquidity-preference theory based on Tobin's portfolio choice approach, can be combined in the stock-flow consistent modelling approach, which is also discussed in the chapter. These views effectively apply without major differences to the open-economy, as chapter 7 makes clear: money remains endogenous and central banks retain their ability to set interest rates, regardless of the exchange rate regime.

Chapters 5 and 6 discuss economic activity, growth and unemployment. The central feature of PK economics in this field is that output and employ-
ment are demand-determined, in both the short and the long-run. Lavoie’s analysis is largely based on the Kaleckian approach, and the key role that income distribution and capacity utilisation have in these models. The flexibility and success of the model is shown by the wide-ranging review that Lavoie gives to the several extensions to the basic model: e.g. technology, fluctuations and business cycles, finance, and open-economy considerations, which are discussed in the following chapter.

Aggregate demand determines output and employment, but not inflation, as discussed in chapter 8. Inflation is the result of unresolved conflict between workers and employers, but unlike for New Keynesians, lower unemployment will not automatically lead to higher inflation, and even less so to ever-accelerating inflation. Indeed, Lavoie argues that the Phillips’ curve is flat at normal levels of capacity utilisation, so the main drivers of inflation will be in practice commodity prices, which unlike those of manufactured goods tend to rise in conditions of high global growth.

A strength of the book is to give an impartial overview of all strands of PK theory. According to his own classification, it would not be unreasonable to put Lavoie in the ‘Kaleckian’ strand on most issues. However, he always fairly describes the different positions and always seek to synthesise them in a coherent framework. This is clear, for example, in the treatment of exchange rates. The author adheres to Godley’s view that current accounts are the crucial determinant of exchange movements in the long-run, but takes into account the ‘fundamentalist’ Keynesian argument of Harvey (2010) that expectations may play a role in the short-run, and incorporate such a view in his framework.

Overall, this is a wonderful and much needed ‘encyclopaedia’ of Post-Keynesian economics, that is likely become a standard reference in the future. It is by no means an introductory book, so undergraduate students or anyone else willing to approach PK economics for the first time could look at the introductory version of the book (Lavoie, 2009). But graduate students and academics who would like to strengthen their knowledge of Post-Keynesian economics, including for teaching purposes, would do well to read it.

References

