Being PostKeynesian in the Medium Term and Classical-Marxian in the Long Term?

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Abstract :

This note questions the relevance of the postKeynesian perspective as a theory of long-term positions when the notion of "long term" is taken in a sense conform to the Classical-Marxian perspective. A framework is put forward in which the postKeynesian model is described as the possible theory of a medium term. The existing confusion surrounding these issues obscures the discussion between economists belonging to either one perspective.

Outside of mainstream economics, the notion of a broadly defined lack of demand is widely accepted. While most heterodox economists share this view concerning a short-term time frame, viewpoints differ with respect to the long term. In the *Classical-Marxian perspective,* the contention is that capitalist economies gravitate around long-term positions (also denoted long-term equilibria, long-term trajectories, or steady states), in which the use of productive capacities can be described as "normal", that is, independent of the levels of demand. The notion of structurally deficient levels of demand is obviously opposed to this Classical-Marxian analysis. In the *postKeynesian perspective*, the economy also gravitates around a long-term position, but for any capacity utilization rate, depending on demand levels. There is also a broad field of what could be denoted as "Keynesian-Marxian" economics, in which the lack of demand is not always precisely defined, either in the short or long terms, often in reference to a bias in income distribution in favor of profits.

The present note is devoted to the empirical foundations underlying these diverging assessments. We contend that significant obscurity results from the ambiguous character of the terminology. Our main conclusion is that, rather than a theory of the long term, the field of the postKeynesian approach is the "medium term". The situations portrayed by postKeynesian refer to particular states of the aggregate economy prevailing during periods of about 5 or 10 years. The Classical-Marxian approach describes much longer periods of time, encompassing several of these medium-term episodes, a several-decade long time frame. More research will be necessary to investigate the theoretical and empirical implications of this new approach.

The first section analyses the trend of the capacity utilization rate within U.S. manufacturing industries. A downward trend of the capacity utilization rate, u, is observed since the 1970s. Thus, assuming a constant normal value, $\bar{u}$, of u, it is clearly impossible to defend the Classical-Marxian view of a gravitation around $\bar{u}$. If such gravitation exists, its "normal" center, $\bar{u}$, must be trended downward. The second section compares the two interpretations. Along postKeynesian lines, the decline of u could be said to reflect the *diminishing levels of demand* in the long term along a four-decade trend downward. In the Classical-Marxian view, the decline of u must be interpreted as a consequence of the *decline of $\bar{u}$,* the expression of technical-organizational (or "institutional ") transformations. To the eyes of somebody familiar with the well-known macroeconomic features of the period, a comparison of the fluctuations of u, when assessed with respect to either a constant $\bar{u}$ or a $\bar{u}$ trended downward, supports the second reading. Correspondingly, it rules out the straightforward interpretation of postKeynesian models as a likely description of such long-term trends.

This note prolongs the synthesis we initiated years ago. An important step forward was the publication of our article "Being Keynesian in the Short Term and Classical in the Long Term"[1]. There, we showed that a sequence of short-term Keynesian equilibria may converge toward a Classical-Marxian long-term equilibrium.

Involved is a synthesis between the Keynesian and Classical-Marxian frameworks, but also a synthesis *internal to the Marxian tradition*. There, two distinct frameworks are alternatively considered, namely the theory of accumulation, in which the normal use of productive capacity is assumed, and the theory of business-cycle fluctuations. The relationship between the two frameworks can be established within models that prolong the framework of our 1999

[1] G. Duménil and D. Lévy, 1999, "Being Keynesian in the Short Term and Classical in the Long Term: The Traverse to Classical Long-Term Equilibrium", *The Manchester School*, 67(6): 684-716. A preliminary version of our paper is available in our webpage, http://www.jourdan.ens.fr/levy/dle1999o.pdf.

study. A special attention must be devoted to the stability of the short-term equilibrium, crucial in the theory of business-cycle fluctuations.[2]

It is the object of Section 3 to present this general synthesis. Three components in the overall movement of aggregate demand are distinguished: (1) a *short term*, which we link to the description of the phases of the business cycle; (2) a postKeynesian *medium term*; and (3) a Classical-Marxian *long term*.

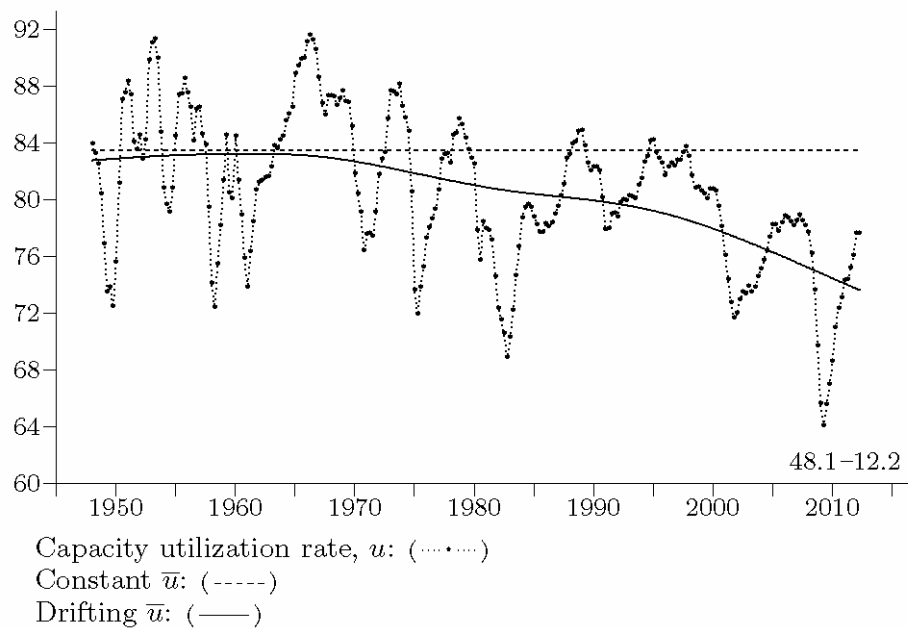## 1. Alternative interpretations of the declining trend of the capacity utilization rate

Figure 1 describes the movement of the capacity utilization rate, u, within the U.S. manufacturing sector (black dots). The interpretation of these movements remains controversial. The continuous line is a trend line over the entire period, a *de facto* drifting gravitation center. It is, clearly, trended downward. (The series is non-stationary.[3]) A common interpretation among Keynesian, postKeynesian, and Keynesian-Marxian economists, assesses the levels reached during the recent decades as well below normal, the result of a four-decade long trend downward.[4] This reading of the data implicitly considers $\bar{u}$ as constant, measured by the average levels of u during the first decades after World War II. (The horizontal line in the figure denotes this average values for the period 1948-1973, that is, prior to the crisis which began in 1974) The distance between the two lines provides an estimate of the allegedly growing lack of demand.

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[2] Duménil G., Lévy D., 1993, *The Economics of the Profit Rate : Competition, Crises, and Historical Tendencies in Capitalism*, Edward Elgar, Aldershot, England.

[3] The Augmented Dickey-Fuller test shows that the hypothesis of non-stationarity cannot be rejected. The KPSS test yields coherent results, showing that the symmetrical hypothesis of stationarity can be rejected. In this test, for any number of lags (tested up to 12), the statistic is always higher than the critical value, at a significance level of 1%. Thus, we can reject the null hypothesis of stationarity.

[4] The assessment of a deficient demand is common. The difference lies in the interpretation of the mechanisms: (1) the low purchasing power of the bulk of wages (many Keynesian-Marxian and PostKeynesian economists); (2) the low levels of investment due to low profitability levels (a number of Marxist economists); (3) neoliberal restrictive macro policies (a number of Keynesian economists); and (4) excess competition worldwide, notably from emerging countries. The two first perspectives led to the definition of, respectively, "wage-led" and "profit-led" regimes.

Figure 1: The capacity utilization rate in the U.S. manufacturing sector and its gravitation center

Capacity utilization rate, u: ($\cdots\bullet\cdots$)
Constant $\bar{u}$: (-----)
Drifting $\bar{u}$: (——)

The trend of $\bar{u}$ has been computed using Whittaker filter.

To the contrary of the above, the standard Classical-Marxian approach contends that the capacity utilization rate gravitates in the long term around a normal value. The finding in Figure 1 shows that, assuming a constant $\bar{u}$, this interpretation is not supported by the data. The option of gravitation around a constant $\bar{u}$ must, therefore, be ruled out.

One way out in defence of the Classical-Marxian perspective would be to contend that the data are wrong. The reliability of the data can certainly be questioned. Capacity utilization rates are determined by way of inquiries, and the meaning of the answers may vary considerably along decades, as technology and organization are transformed. The discussion in what follows assumes that the data carries enough information to be worth interpreting, but the contrary could be asserted. If the data are taken at face value, the only option in line with the Classical-Marxian viewpoint is the contention that there is a gravitation around a declining $\bar{u}$. This is our interpretation.

Below we consider the simplest expressions of the postKeynesian and Classical-Marxian frameworks, compatible with the data above[5]:

- In the *postKeynesian* perspective, Figure 1 is said to reflect the declining levels of demand in the long term, along a four-decade long trend downward.

- In the *Classical-Marxian* view, the decline of $\bar{u}$ mirrors technical-organizational (or "institutional ") transformations, and u gravitates around it
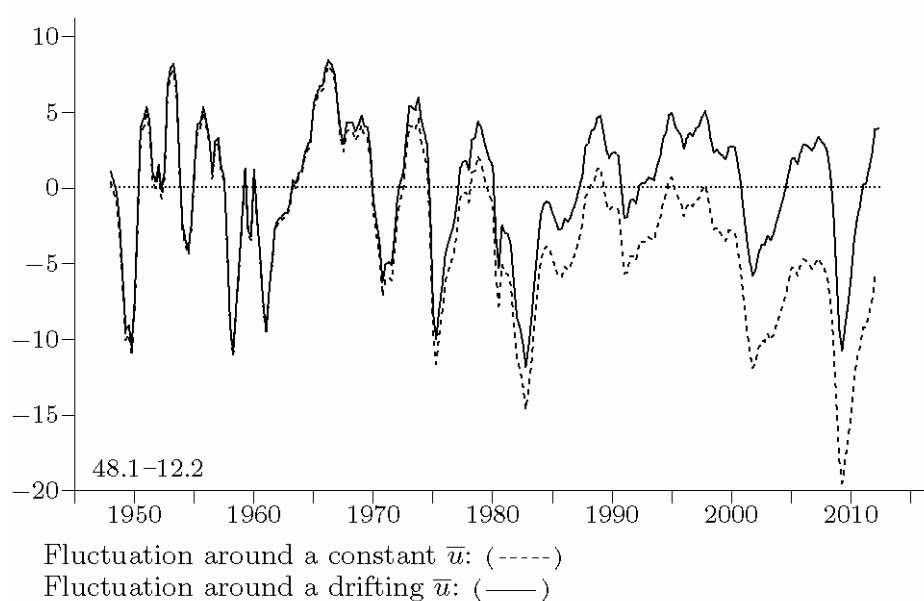
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[5] Obviously, more complex patterns could be considered, namely $\bar{u}$ and u follow their own ways.

2. Classical-Marxian vs. postKeynesian readings?

This section prolongs the earlier investigation, comparing the consequences of the alternative references to a constant or declining $\bar{u}$ on the characterization of the successive phases of the aggregate economy during the latter decades.

Figure 2 shows the two measures of u - $\bar{u}$: (1) the deviation from a constant $\bar{u}$ (- - -), and (2) the gravitation around a declining $\bar{u}$ (—). The two variables depict well-known sequences of events, basic episodes of the period, which macroeconomics should allow interpreting. In the two measures, one can recognize: the stimulus of the Korean war during the 1950s, the stagnating growth in the late 1950s that initiated the action of Kennedy's advisors, the Vietnam war and the policies of the Kennedy administration during the 1960s, the deep recessions of 1974/75 and 1981/82, the boom of new technologies during the second half of the 1990s, the crisis of 2000/01, the reprieve during the housing boom after 2000, the crisis of neoliberalism (with the recession beginning in 2008) and, finally, the fragile recovery. The only difference between the two measures is the comparative level, increasingly lower during the second half of the period when $\bar{u}$ is assumed constant.

Figure 2. Alternative measures of the fluctuations of u (the difference between u and $\bar{u}$)

Fluctuation around a constant $\overline{u}$: (-----)
Fluctuation around a drifting $\overline{u}$: (——)

In the "constant $\bar{u}$" measure (- - -), the peak value reached during the long boom of the second half of the 1990s appears as a period of "average" activity (or slightly below) and the housing boom after 2000, as a durable period of depressed activity (without precedent). In our opinion, this interpretation cannot be defended. As is well known, during, the second half of the 1990s, the U.S. economy was booming, not stagnating, with growth rates of about 4 percent, a dramatic wave of investment[6] (in particular, the tremendous building of capacities

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[6] G. Duménil, D. Lévy, *The Crisis of Neoliberalism*, Harvard University Press, Cambridge MA, 20011, Figure 12.2.

in Manufacturing[7]), and a spectacular surplus of the government budget. The same is true concerning the period 2002-2007. The situation during those years was not exceptionally brilliant (with comparatively low growth rates) but not an outstanding depression. Overall, assessing the levels of the capacity utilization rates during the latter decades in comparison with a "norm" defined in reference to the first decades after World War II is misleading. The results in the other measure (—) are much more plausible.

The findings in this section refute the postKeynesian interpretation pointing to a historical decline of demand levels since the 1970s (also the Keynesian-Marxian viewpoint).

3. Being Marxist in the Short Term, PostKeynesian in the Medium Term, and Classical-Marxian in the Long Term?

Our interpretation of the findings in the previous sections is that the true object of the postKeynesian framework must not be sought in the long term but in a "medium term". The present section introduces the framework, which, in our opinion, should allow for a synthesis.

We use a common procedure in the treatment of economic models, sorting out variables according to distinct time frames under the assumption that one set of variables is involved within movements faster than another set of variables. In a similar manner, the movement of a given variable can be broken down into components corresponding to different time frames. In the investigation of properties related to a particular time frame, one can assume that the shorter term dynamics have converged, that is, assume that the shorter term equilibrium prevails. This is the general method of *temporary equilibrium*, equivalent to the common practice of "abstracting" from shorter term fluctuations. Along such lines, longer term dynamics are approached as the succession of temporary shorter term equilibria. Thus, the dynamic properties of the model can be investigated in a stepwise fashion. In our 1999 study, two time frames were distinguished, namely a Keynesian short term and a Classical-Marxian long term. The present note introduces a third time frame, the medium term, intermediate between the two previous.[8]

This methodology is used in Figure 3. Three components of u (which sum up to u) are distinguished, namely u^S, u^M, and $\bar{u}$, corresponding to the three time frames.[9] Both the *equilibrium* and the *fluctuations* around the equilibria are implied. In this framework, reference is made to two types of equilibria, respectively, medium-term (or postKeynesian) equilibria and long-term equilibria. The figure, correspondingly, distinguishes between sequences of medium-term (- - -) and sequences of long-term equilibria (—):
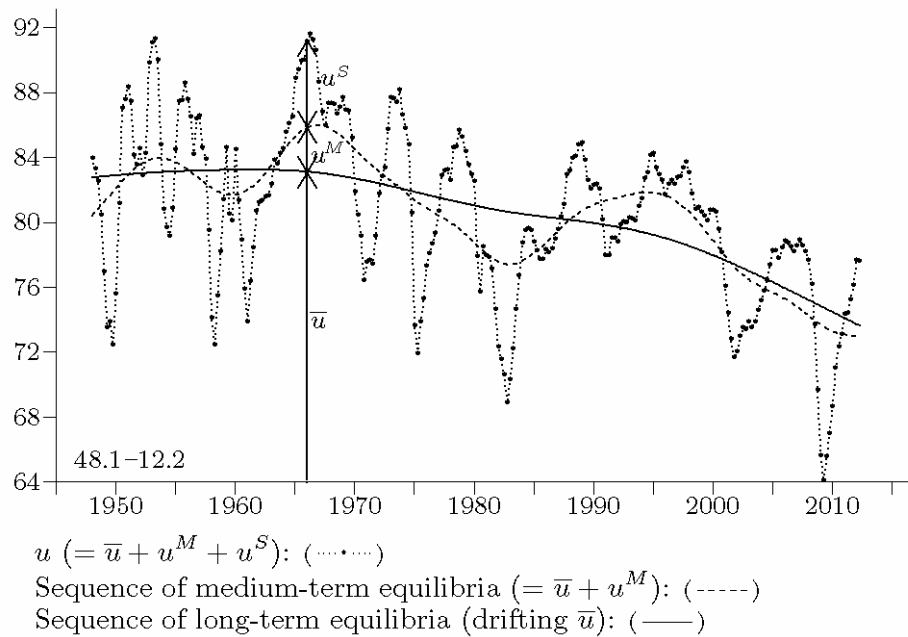
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[7] The growth rates of productive capacities within the U.S. manufacturing sector were: 3.3 percent for the entire period 1948-2012, 4.4 percent during the years 1948-1973 (defining the constant $\bar{u}$), and 6.5 percent during the long boom, 1995-2000.

[8] The postKeynesian medium-term equilibrium is a Keynesian short-term equilibrium in which the monetary-financial stocks (money, loans, and securities) have converged toward given equilibrium values (See Godley-Lavoie). Such a medium-term time frame could be introduced in the framework of our 1999 study, assuming that the convergence of the "long-term money stock" toward its equilibrium value is faster than the convergence of u toward $\bar{u}$.

[9] The breakdown is performed in done in two steps: (1) the determination of $\bar{u}$ (as in Section 1 and Figure 1), then of $u - \bar{u}$ (as in Section 2 and Figure 2); (2) Then we break $u - \bar{u}$ into its two components, u^S and u^M, again using Whittaker filter, but with a smaller parameter.

- The fastest dynamic is that of u around the sequence of medium-term equilibria, defining the short-term fluctuation u^S, as the distance between u and the sequence of medium-term equilibria (between $\cdots\bullet\cdots$ and - - -).

- The sequence of temporary medium-term equilibria gravitates around the sequence of long-term equilibria, $\overline{u}$, defining the medium-term fluctuation, u^M, as the distance between the two lines (between - - - and —). This medium-term fluctuation manifests broad movements, about 5-10 years long.

- The trajectory of the sequence of long-term equilibria, $\overline{u}$, is much slower.

Figure 3: The three components of the capacity utilization rate

$u\ (=\overline{u}+u^M+u^S)$: ($\cdots\bullet\cdots$)
Sequence of medium-term equilibria $(=\overline{u}+u^M)$: (- - - - -)
Sequence of long-term equilibria (drifting $\overline{u}$): (———)

u^S *denotes the short-term fluctuation around the sequence of medium-term equilibria.*

u^M *denotes the medium-term fluctuation around the sequence of long-term equilibria.*
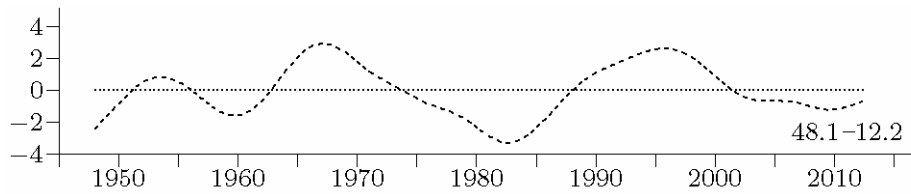
Abstracting from the declining trend of $\overline{u}$, for which, to our knowledge, no theory has been devised, this framework allows for the combination of the Marxian interpretation of the phases of the business cycle (u^S) and the postKeynesian medium-term fluctuations *(u^M)*:

- *Business-cycle fluctuations (u^S).*The short-term fluctuation manifests rather rapid departures and returns upward or downward. This is where the pattern of the business cycle must be sought with, notably, the rapid falls in recessions. Marx is certainly not the only economist who identified the "cycle of industry", but he was among the first analysts to describe these movements. This view is in line with the description of the business cycle, in the usual sense of the phrase. We devoted other studies to the analysis of this short-term fluctuation[10]. Our main contention is that the stability of

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[10] The dynamics around the medium-term equilibrium can be studied directly. Using the method of temporary equilibrium, these dynamics can be investigated in a stepwise fashion: (1) the dynamics around the short-term equilibrium ("Keynesian stability"); and (2) the traverse, that is the convergence of a sequence of short-term equilibria toward medium-term equilibrium.

short-term equilibrium is not always ensured, and periods of instability can be interpreted in terms of overheating, crash, and stagnation.

Figure 4: The medium-term postKeynesian component of the capacity utilization rate

The scale of the vertical axis is identical to the scale in Figure 3.

- *Medium-term fluctuation (u^M).* The notion of a lasting deviation as in the medium-term fluctuation, u^M , is alien to Marx's analysis. Conversely, we believe this component of the business cycle is the object of postKeynesian economics (see Figure 4). The postKeynesian "long-term equilibria", with any value of the capacity utilization rate, cannot be interpreted as describing the long term. They can only reasonably be thought as describing lasting phases of comparatively high or low activity as, for example, the high levels of the 1960s and low levels of the 1980s. In our opinion, the postKeynesian perspective points to such phases. Obviously, more research will be necessary to assess the theoretical and empirical foundations of these medium-term fluctuations and more rigorously articulate the various time frames.