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A Post Keynesian view of transition to market capitalism: developing a civilized society

The transition from centrally administered socialism to market capitalism was dominated by the orthodox model, in both the economic literature and economic policy. The IMF, World Bank, and mature market economies, the representatives of the orthodox thought, ensured that the conservative policies were introduced in transition economies. The provision of financial aid was tightened to the implementation of the shock therapy model. The results were a substantial fall in outputs, double-digit rates of unemployment and inflation, sizable depreciation of the exchange rates and current account deficits and the development of a Mafia economy. The aim of this paper is to offer an alternative goal for transition economies, based on Post Keynesian propositions. The goal of transition should be the development of a civilized market capitalist society.

In what follows is a set of ideas about the desirable economic system proposed by Post Keynesian economists. The view of a good society expressed is a construction based on the Post Keynesian values, which most Post Keynesian economists subscribe to. The model developed is a stylized version of a view of a good society suggested by Post Keynesian economists. The foundation of a good society can be traced to Keynes, since "he indulged in an agreeable vision of a world where economics has ceased to be important and our grandchildren can begin to lead a civilised life" (Robinson, 1974, p. 10).

What is the desirable economic system?

Post Keynesians are in favor of a social-democratic capitalist system, which implies: a variety of property forms, and a market with state intervention within a democratic political system. Post Keynesians are

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seeking only as much freedom as is compatible with a socially desirable outcome, thereby justifying a series of interventions by the state. Post Keynesians are therefore prepared to trade freedom for other dimensions—such as equality, stability, security, and social justice. They disagree with the view that all that governments can do is produce oscillations from equilibrium positions, and that they are thus unable to influence economic activity (De Carvalho, 1995–1996, p. 159).

The schism between equity and efficiency of the orthodox model does not appear. Both equity and efficiency can be achieved as long as there is a redefinition of the concepts of freedom and efficiency. Efficiency does not designate maximization of output at minimum cost, but rather the maximization of social welfare. This is due to the extensive nature of externalities associated with the production and consumption of goods and services. "If it is necessary to give up a bit of market efficiency or a bit of aggregate income, in order to contain democracy-threatening uncertainty, then so be it" (Minsky, 1996, p. 364). Thus, the aim of economic policy should be the development of an open, democratic, civilized society, which should not be sacrificed for narrow efficiency considerations (Minsky and Whalen, 1996–1997, p. 162).

Consistency within capitalist systems is achieved by structuring the economic system so as to achieve freedom, interpreted as active participation in civil life (Davidson and Davidson, 1996, p. 14). However, Post Keynesians, in contrast to orthodox economists, do not define freedom in a negative sense as "freedom from coercion," but rather as "freedom to" (Rider, 1994, p. 17). Individuals can exercise their free will and human action is nondetermined due to uncertainty. In contrast, for the orthodox model the future is knowable, which is not consistent with free will (McKenna and Zannoni, 1997–1998, pp. 238–247).

What is the desirable economic behavior?

Market behavior is consistent with non-self-interest behavior. Actually, self-interest does not adequately explain economic behavior. Individuals are not only motivated by self-interest but also by loyalty, responsibility, the pursuit of excellence, love, and compassion. Individuals are motivated by internalized moral values. Market participants require honesty, maturity, and civility to finalize transactions. People act on the basis that personifies moral values and self-interest. In the meantime, the economy requests ethical behavior by individuals so as to achieve efficiency (Wilber, 1996, p. 51). As such, "the difficulty is not getting ethics and history into economics but in imagining or crediting an economics that excludes them" (Brockway, 1999, p. 165). For example, the enforcement costs of contracts for a society without trust would be substantial (Bowles and Gintis, 1993, p. 95). Hence, the exchange of goods and services in an economy is not simply the result of the aggregation of individual maximizing behavior, as assumed by orthodox economists (Nee, 1996, p. 909).

Davidson and Davidson (1996, p. 7) argued that this type of individual motivation is based on "civic values." It cannot be assumed that interests are well-defined and obvious. Information costs, cognitive processes, and ideology were relevant in influencing individual behavior (Oberschall, 1996, p. 1039). Consequently, antagonists may cooperate to achieve common goals—society's goals—based on civic values. In this context, any transition process that fell short in stimulating a "reasonable economy" (Schlack, 1996), a "capitalism with a human face" (Minsky, 1996, p. 358), an "open and humane 'shared-prosperity' capitalism" (Minsky and Whalen, 1996–1997, p. 161), a "civilized society" (Davidson and Davidson, 1996), would be inapplicable and dishonored by society. A civilized society cannot prosper on the hardships of its members (Davidson and Davidson, 1996, p. 24) as the shock therapy model recommended. Meanwhile, civic values were not ahistorical, fixed, given, or inherited. Rather, they were the result of a particular historical process, an amalgam of community, and social and personal intercourse between members of society.

Orthodox economists argue that individual behavior is motivated by greed, disregarding the cost associated to the society. For orthodox economists, loyalty, responsibility, the pursuit of excellence, love, and compassion are all goods with a price that can be traded freely in the market. Based on such assumptions, whatever the market outcome was, that was what people preferred. Meanwhile, individual behavior motivated by civic values results in benefits to the whole society, not only to the individual. In some circumstances there might not be any individual benefit at all—not as a result of a mistake, but rather as a result of non-self-interested behavior. This would be "irrational" behavior for orthodox economists, because they ignored civic values in their analysis and only emphasize the importance of economic efficiency. In contrast, Post Keynesians highlight the harmonious blending of civic values and self-interested behavior to realize a civilized society as conceived in the ideals and institutions of the society (Davidson and Davidson, 1996, p. 43). Consequently, "there is no a priori reason why a society should choose efficiency considerations (even in a dynamic sense) over other values, such as those relating to security, democracy, and equity. In other words, political economists believe in a world where society drives the market rather than the reverse" (Whalen, 1996, p. 16).

Civic values could not be ignored in the transition process. While the self-interest aspects of economic efficiency were applicable to any society, the civic aspects were essential for the transition economies to achieve civilized market societies. It was not an accident that there was an increase in corruption taking place concurrently with the transition process. "Without civil society, capitalism will not create a civil economy" (Fish, 1994, p. 41). The introduction of market relations and the rise of entrepreneurship took place in an environment without any administrative central control. In such circumstances civilized motivation had evaporated and the only motivations remaining were based on greed and fear, giving rise "to the values of barbarism" (Poirot, 1997, p. 241). This was not a recipe for the development of a democratic and civilized society and of a legitimate private sector as a dynamic engine of economic growth (Stark, 1996, p. 999; Oberschall, 1996, p. 1040). Meanwhile, it could be argued that the absence of a civil society in transition economies might be considered an advantage for the shock therapy model. Policy could be implemented unconstrained by the autonomous voluntary organizations that a civilized society gives rise to. Once the civil values have been eroded in transition economies it would be extremely difficult to reestablish them. That was why the transition process could not be based on some simple rules of the ahistorical orthodox economic model. Because "without civic values in economics—our chief tool of government—we will never be able to achieve justice, domestic tranquillity, a secure national defence, prosperity or the blessings of liberty" (Davidson and Davidson, 1996, p. 59). In contrast, Post Keynesians would expand the role of government intervention in order to drive the market closer to civic values.

What is the desirable economic structure?

With respect to economic structure, Post Keynesians in no way discredit the primacy of individual values, the principle of private property or the advantages of the market. They emphasize the importance of the right combination of these elements with the common good, state property, and planning. "A prosperous civil society combines self-interest and civic values so that the citizens may reap the benefits of each" (Davidson and Davidson, 1996, p. 1). The private sector remains the employer of first resort and the state sector the employer of last resort. However, this does not suggest that public sector employees could not be equally efficient. The distribution of property and income influence efficiency outcomes, and, as such, it cannot be left to the free market. Full employment is the main goal of economic policy: "A full employment economy is supportive of democracy whereas an economy based on transfer payments supports resentment" (Minsky, 1996, p. 367).

In contrast to the orthodox view, for Post Keynesians state property had a major role to play. State property is justified in special cases of market failure, market regulation, and antitrust rules due to externalities and economies of scale. The state, through state ownership and through its monopolization of economic policy, can influence the functioning of the economic system in a positive direction. While there is government failure associated with state ownership in transition economies, these failures were quite small compared to the numerous imperfections of the market, which emerged after 60 years (since 1929) of unbalanced growth (Kuznetsov, 1992, p. 488). What the orthodox economists did not recognize was that the transition process did not just involve the development of markets but also the development of the state. These two "cannot be divorced from one another because much of state building is about market building" (Fligstein, 1996, p. 1080). Polanyi (1975, [1944], p. 140) revealed the oxymoron that the free market was initiated and remained free by an enormous increase in continuous, centrally administered and controlled intervention.

Discretionary economic management by the state is the means whereby economic performance is linked with the community's values, objectives, and tradeoffs. The use of discretionary power by the central authorities could guide individual choices toward the achievement of social goals. To create the conditions of transition to a civilized society, Post Keynesians stressed the importance of an active state in economic affairs because a weak state was inconsistent with a prospering private sector (Bim, 1992, p. 186). This is because the capitalist economic system, based on free markets, is inherently cyclical and unstable (Arestis and Sawyer, 1993, p. 3). A weak state was not able to hinder the abuse of monopoly power, which undermined the attainment of social goals and economic justice. "Government's vantage as a major economic actor not driven by self interest permits government to take actions on behalf of the economy as a whole" (Davidson and Davidson, 1996, p. 215). Experience shows that successful developing country adjustments were not the result of the invisible hand (Clower, 1999, p. 2). Meanwhile, the role of the state in a social-democratic system is a derivative. Its scope and content depend on the efficacy of the market outcomes (Caporaso and Levine, 1993, p. 220). In no way could the state be a substitute for market decisions. The role of the state in directing the transition process has not been widely discussed in the transition literature (Taylor, 1994, p. 71).

Because output and employment were constrained in transition economies, aggregate demand and investment were extremely unstable. Employment in the private sector economy depended on expectations of future sales. This involved existing and impending orders or guesses. When there is an expectation of a future sales decline, entrepreneurs reduce production, and thus employment. Hence, in a market economy only the expectation of consumer expenditure could create jobs (Davidson and Davidson, 1996, p. 114). Keynes (1936) argued that investment depended on "animal spirits": spontaneous urge for action rather than inaction. In Keynes's (1936, p. 150) words, entrepreneurs invest because investment is their "way of life." Entrepreneurial expectations depended largely on culture, civic values, economic conditions, and confidence. Thus, investment was autonomous and independent of savings and the rate of interest (Shapiro, 1977, p. 544). In contrast, investment for the orthodox economists was determined as calculated decisions made by the entrepreneur who maximizes profits based on statistical data of past results, determining a weighted average of quantitative returns multiplied by quantitative probabilities. Meanwhile, in an uncertain market economy, especially in the conditions of transition, people were not able to make accurate calculations about the future. The preoccupation of orthodox economics with rational expectations and efficient market outcomes ignored the implications of incomplete information, the complexity of the real world, and subjective perceptions of the external world by individuals (North, 1990, p. 111), which were all relevant for the transition economies.

By its own nature, the market system encourages investment only for short-run returns. Meanwhile, the scientific discoveries, which offer returns in the long run, would be underinvested. This had to become the responsibility of the state (Galbraith, 1996, p. 274). The flexibility of market relations aided by a government strategy of regulation and intervention created the necessary conditions for technological and enterprise development. The government provided both well-educated workers and funds for research and development that made the industries of the future possible. This required a technology policy, which was part of a national industrial strategy (Thurow, 1996, p. 221).

Full employment versus inflation

While the Post Keynesians would insist on full employment as a policy objective, they would question whether it could be achieved in a capitalist market economy (Arestis and Sawyer, 1993, p. 23). Meanwhile, "full employment is the civilized and humane way of getting rid of welfare as we have known it, but the achievement of a fully employed economy requires a larger and more innovative government sector" (Minsky, 1996, p. 365). Prosperity in capitalist societies had been the result of the courage of the entrepreneur to act in the face of ignorance regarding the future (Davidson, 1994, p. 99). However, in circumstances in which entrepreneurs became pessimistic about the future, such as in transition economies, this automatically resulted in unemployment. There is an inherent tendency of the system toward instability and unemployment (Peterson, 1996, p. 159). For the orthodox economists, "lasting full employment is unsound from their point of view, and that unemployment is an integral part of the 'normal' capitalist system" (Kalecki, 1996, [1943], p. 148). High levels of employment required steady, rapid, and high growth rates of investment. Due to the inherent unstable character of investment, the role of the state was to implement discretionary economic policies, which ensured that there was adequate aggregate demand to sustain an acceptable level of growth and employment, so that whoever wanted to work could do so. Demand management by the state could maintain the appropriate levels of aggregate demand and employment, counteracting the instability resulting from unregulated and uncoordinated decisions by individuals. This may involve government increasing its expenditure on goods and services from the private sector, or reducing taxes, or the monetary authority influencing interest rates. These policies should be implemented without being restricted by groundless concerns about deficits. The increase in aggregate demand would increase confidence and stimulate expansion. At the micro level, the state had a role to play by providing the necessary ingredients, which facilitate enterprise efficiency, such as the provision of information, training, social infrastructure, and social security. "Historically, even relatively open economies that have created conditions for private sectors to save, invest, absorb new technologies and grow have not done so in an unregulated market regime" (Taylor, 1994, p. 73).

In these circumstances unemployment would not be a serious problem and the distribution of income would become more equitable. Providing everyone who wants a job could get a job, it also increased the personal feelings of usefulness and self-respect, which stimulated the development of civic values and civilized behavior. The push toward full employment did not necessarily result in inflation (Davidson, 1994, p. 8). This was in contrast to the process adopted in transition economies—but also in mature market economies—where the opportunities to earn an income have been substantially diminished so as to reduce inflation, thus making individuals "naturally" unemployed. The current anti-inflationary policies adopted in transition economies created additional sources of social, economic, and political conflict. This resulted in encouraging individuals who did not have civic values and thus did not belong in a civilized society. Individuals were motivated only by self-interest. Meanwhile, "a revitalized and improved economy where unemployment and unnecessary business losses are no longer perpetual threats can provide the basis for evolving the most powerful economic system yet devised on the face of the Earth" (Davidson and Davidson, 1996, p. 111).

Post Keynesians were very critical of the orthodox economists' view on the impossibility of the attainment of a society with full employment and—at the same time—controlled inflation. The illogical assumption that inflation was more dangerous than unemployment resulted in transition economies, with people being refused employment so as to achieve low levels of inflation. This was by definition uncivilized: "To base social prosperity on the hardship of others is a barbaric philosophy of government" (Davidson and Davidson, 1996, p. 60). In the zero-sum society of the orthodox transition model, citizens' beliefs that for some to gain others must lose perpetuated rivalry, which eroded civic values. Ash (1996, p. 288) could not see any elements of civilized society in Russia and Eastern Europe. This is a familiar set of policies, which has dominated economic thought for the last thirty years in mature market economies. These strategies have to be challenged (Smith, 1996, p. 136). Instead, "the aim of policy is to assure that the economic prerequisites for sustaining the civil and civilized standards of an open liberal society exist" (Minsky, 1996, p. 364).

What is the desirable welfare structure?

The failure of the free market process in transition economies to provide full employment and an equitable distribution of income and wealth hindered in this way the achievement of equality of opportunity. The government was required to step in to ensure that social goals were accomplished. Income inequality was the result of many factors other than markets: Thus, action was required in spheres other than the market, especially in the institutional framework (Tilly and Albelda, 1996, pp. 196, 199). What was required was "the introduction of an entirely new strategy of transition, one that would emphasise active government intervention in privatising, developing national industry and providing financial backing for savings, investment, and growth, which is the only way to ultimate financial stabilisation" (Yavlinsky and Braguinsky, 1994, p. 111). Experience revealed that backward economies were able to develop only as the result of an active state and by an autonomous bureaucracy embedded in the society (Taylor, 1994, p. 85). Thus, the shock therapy supporter who wanted to establish a free market in the mould of Friedman and Hayek was living in a vanished world.

Capitalism's institutional structure must incorporate citizens' limited tolerance for uncertainty and insecurity. When detrimental consequences that cannot be covered by private insurance arise from uncertainty, it is the responsibility of the society to intervene (Minsky and Whalen, 1996–1997, p. 161–162). Economic insecurity should be reduced to make possible prosperity to all members of the society (Minsky and Whalen, 1996–1967, p. 161). The welfare state is an expression of the common good, the means of attaining the objectives of society—especially those of minorities and disadvantaged groups. By supporting private incomes with socially provided incomes, "civility and civic responsibility are promoted" (Minsky, 1996, p. 364). Poverty in mature market economies is due to unwillingness to tax, in order to fund essential welfare programs (Minsky, 1996, p. 365).

Conclusion: what is a good society?

The analysis of the market capitalist system envisioned by Post Keynesians revealed that consistency was achieved through individualism, which required predominantly private property and the market. Equity was expressed through participation, economic planning, and the common good. Thus, individuality was reconciled with the common good through a participatory process, where individuals come together to plan for this common good. As such, there was an unbreakable link between individualism, participation, and intervention. In this way, participation in public affairs reinforced economic freedom and planning, and was stimulated by ideology of self-interest and common good. Government intervention was essential and the government is responsible for economic performance (Amsden, 1996, p. 257; Arestis and Sawyer, 1993, p. 3). State intervention ensured full employment and the achievement of social goals, and state property avoided market failure. This perception of a society was in total contrast with the orthodox view, which was the dominant ideology imposed on Russia and Eastern Europe. As such, "everyone who tried to talk about the role of the state or industrial policy was branded a conservative or an institutionalist unaware of basic truths of economic analysis at best" (Yavlinsky and Braguinsky, 1994, p. 114). The Post Keynesians recommended to the transition economies social-democratic capitalism and not competitive capitalism. The transition economies have the opportunity to establish the institutional prerequisites for market capitalism—which naturally is unstable—to provide full employment, spur economic growth, reduce insecurity, and promote high living standards for a successful twenty-first-century capitalism (Peterson, 1996, p. 167; Minsky and Whalen, 1996–1967, p. 168).

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