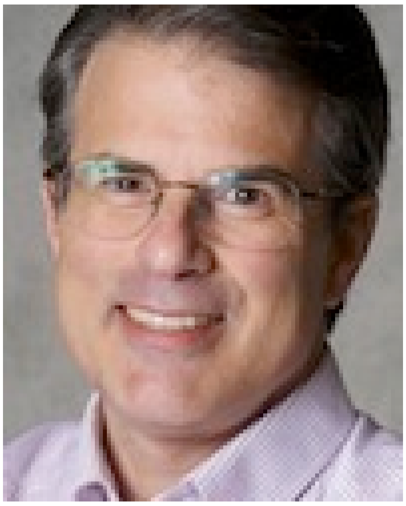
What's Up, Heterodox?

By Kerry Pechter *Thu, Oct 2, 2014*

Heterodox economics, though valid and perhaps even more intellectually honest than orthodox economics, has lost its political battles, and that has made all the difference.



At the 12th annual Post-Keynesian Economics Conference last week in sunny Kansas City (on the Missouri side of town), one of the older attendees recalled a federal welfare-to-work program during the Nixon administration called "Operation Mainstream."

Under this initiative, the Department of Labor funded Community Action Programs in rural Ohio and elsewhere. The CAPs then hired outreach workers to find idle welfare recipients in their mobile homes or farmhouses and "place" them in minimum-wage jobs in school cafeterias, Head Start centers and such.

Operation Mainstream, whose name matched its goal of bringing economic drop-outs back into the main stream of society, was the type of federally-led employment program that was the subject of presentations by the "heterodox economists" who attended the conference.

You may never have heard of this brand of economics; it's outside the so-called mainstream of economics. Hence the name heterodox: these academic reject the ideas established at temples of economic orthodoxy, especially the University of Chicago.

The patron saints of this sect include, above all, the late economists John Maynard Keynes, Hyman Minsky and Abba Lerner. Its elder statesmen are Lord Robert Skidelsky, Paul Davidson and Fred Lee. Its active proselytizers include L. Randall Wray and Stephanie Kelton of the University of Missouri at Kansas City, where last week's conference was held.

These folks wear their rebel status proudly and stubbornly—they do claim a sixth sense that lets them see phenomena that others can't or won't—but with irony and humor. As one speaker put it, American economics includes the Saltwater School (Harvard and MIT), the Freshwater School (Chicago) and the "Backwater" School (i.e., heterodox).

Demand-side economics

Heterodox economists place much more importance on the labor and resource aspects of production than on the capital aspect. You could call them "demand-side" economists. An economy's greatest evil, in their Keynesian view, is unemployment, which saps demand. They do not regard money or credit as an end in itself, but mainly as a catalyst to production and employment. Finance, financial markets, financial engineering or the financial system have rarely been mentioned at the conference, except in reference to their roles in fostering the risk-taking that led to the Great Recession.

One of the most heretical (and illuminating, for some) ideas within heterodox economics is known as Modern Monetary Theory. MMT disputes the common perception that entrepreneurs in the private sector create wealth, government confiscates some of that wealth through its taxing power, and deficit spending saps the economy and puts us all on the road to serfdom, as Friedrich Hayek put it.

In the MMT model, this is an upside down, outdated view of reality in a post-gold standard world. For the MMTers, central banks create bank reserves with keystrokes, governments can spend money into existence if they choose, and the private financial sector has the right to create credit through fractional lending and leverage.

Taxes (at the federal level, not at the state or local levels) are simply a method for draining excess money from the system. The federal government does not need to collect taxes or borrow money from the Chinese to meet its obligations. Federal tax policy (tax deferral on retirement savings and life insurance products, for instance) is simply a way to encourage or discourage certain desirable or undesirable behaviors.

Shocking and seditious—and loopy—as this view may be to many people (Ron Paul comes to mind), most heterodox economists come by it honestly. That is, they have not selected these ideas to serve some pre-conceived left-leaning ideology. Instead, they arrived at them after frustration with the failure of mainstream economics to explain what happens in real life.

It was the financial crisis, which was very real to many people, that has helped bring heterodox economics into the spotlight. If you recall, some people were calling the crisis a "Minsky moment." For many, including myself, only heterodox economics could explain how the financial sector was able to manufacture trillions of dollars in credit to pump up the economy. Or how the central bank was able to create trillions of dollars to prevent massive price deflation after it became apparent that too much credit had been created. (Heterodox economists do not believe that either the Chinese or an over-zealous exploitation of the Community Redevelopment Act of 1977 by liberals caused the crisis.)

Underestimating politics

I think that heterodox economists get the big picture right. But they tend to discount or underestimate of the centrality of partisan politics in U.S. economic life and the huge role of the private financial sector in politics. In his presentation on MMT last week, Wray mentioned political factors as an obstacle to assertive Keynesian fiscal policy almost as an aside. As realistic as they are about economics, the heterodox economists seem overly idealistic, and even naïve, about politics.

MMTers believe that, in a democracy, the federal government should use its more or less unrestrained fiscal muscle to solve problems, as identified and chosen through democratic processes. Uncle Sam does so to build weapon systems during wartime, the argument goes. Why shouldn't it do so to improve the national passenger rail system and put millions of people to work in the process?

The conventional answer is that the mob would vote themselves a guaranteed income. But, of course, they couldn't; the political resistance would be insurmountable. Too many people are justifiably afraid of letting the government wield such power (or even of openly acknowledging the existence of that power), except perhaps in wartime. More important, the private financial sector, using its political power, will never let itself be dis-intermediated or crowded out or circumvented by government.

That's where the fate of that obscure Nixon-era program, "Operation Mainstream," can be instructive. The program succeeded in rescuing a few people from poverty and isolation by getting them a job when they most needed it. Despite Ronald Reagan's quip, the outreach worker who arrived at the door of an Appalachian mobile home and said, "I'm from the federal government and I'm here to help you," actually did help some people get back on their feet.

But the outreach workers soon learned that many people don't work because they can't work (often because of mental illness). Their goal was unachievable with the means at their disposal. More importantly, the CAPs ran into political resistance.

The state departments of public welfare didn't like the fact that the Nixon administration had created a parallel, overlapping and rival effort to combat rural poverty. Nor did they like the insinuation that their bureaucracies were ineffective or obstructive. More importantly, they coveted the money that the Department of Labor was channeling through the CAPs.

Eventually, the states got their way and federal block grants replaced much CAP funding. The moral of the story: Heterodox economics, though more coherent and arguably more intellectually honest than orthodox economics, has lost its political battles, and that has made all the difference.