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## KALEÇKI'S MICROECONOMICS RECONSIDERED\*

Romar Correa *University of Mumbai, India*

*Kaleçki's microeconomics is recast in a strategic framework. The transformation is made in two steps. First, the relationship between capitalist and worker is modeled as a cooperative game. It is shown that the outcome is 'more favorable' to the capitalist than any other point on the payoff frontier. The game is then converted into a perfectly antagonistic game. The saddle-point is shown to be the outcome of a capitalist maximization problem (JEL B3, D74).*

### 1. INTRODUCTION

We attempt a nonstandard analysis of Kaleçki's microeconomics. The motivation is provided by recent appraisals of the body of his work, which indicate that the economics of Kaleçki must be appreciated as a response to the historical conjuncture of his time (Halevi, 1992; Kriesler and McFarlane, 1993). The literature suggests that he sought to capture the emergence of the monopolistic corporation in Germany and the United States using the microeconomic tools at hand. In its organizational aspects, the large firm had a hierarchical structure, which was a response to a stable environment in which it was able to control the market. As a result, long-term planning and heavy investments were feasible. The use of specialized equipment led to the law of increasing returns. Once the production process had been designed for a specific commodity, unit costs declined with market size. Markup pricing permitted constancy in profit share with respect to value added. This mechanism allowed an increase in investment particularly when demand was increasing. Kaleçki (1965) would have described his efforts as the writing of an "econometric model". Such a model, in his definition, is an equation system in current and lagged values of the variables. A mathematical model cannot, he cautions, forecast the future values of the variables. "Historical materialism", on the other hand, is concerned with the (often) nonlinear transformation of modes of production as captured by formal structures into new modes of accumulation. The two methods of perceiving capitalist reality are perfectly consistent with each

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other. It is natural, therefore, to reconsider the microeconomics of Kalecki in the light of the new relations of production that characterize regimes of production in the developed world. National oligopolies everywhere are being destabilized through foreign competition, overcapacity in some sectors and, notably, new technologies. There is a premium now on small batch production. Product variety has taken the place of product differentiation. Industries need to constantly alter their products in response to changing tastes and in order to maintain their share of markets. In order to effect just-in-time production, the costs of hierarchical organization need to be cut. Conception and execution get reintegrated (Correa, 2000). In the new mode of regulation, workers and contractors become allies in production. Strategic planning at distant headquarters tends to vanish. The system becomes vertically disintegrated. We continue with this line of inquiry in the next section in the context of a discussion of the methodological underpinnings of the economics of Kalecki, concluding with the outline of a game between capitalist and worker. The problem is addressed in the third part of the paper. The conclusion follows.

## 2. THE METHODOLOGY OF KALECKI'S ECONOMICS

Marxian economics has been traditionally founded on the methodology of functionalism. Functionalism is the claim that certain correspondences hold based on repeated historical evidence in the absence of knowledge of the microfoundations of the correspondence. Roemer (1982) has characterized functionalist propositions as theorems about equilibrium states. Therefore, he concludes, the mechanisms of class struggle are relatively uninteresting here as class struggle is unimportant in equilibrium. The laws of motion of capitalism are expected to deliver results on, say, the rate of exploitation and relations of production at the workplace will conform. An aspect of functionalism is to posit purpose without purposive agents. In political economy it is the thesis that the functions of capitalists are both necessary and sufficient to explain their existence. The functions are those that are conducive to the accumulation of capital. Consider, for example, the truism that if prices are in a fixed ratio to the historic costs of producing output then prices in any period would be a constant proportion of the value of sales in that period. This result is consistent with a large set of theories about price-setting behavior (Godley and Cripps, 1983). If competition causes prices to settle at levels yielding a constant share of profits in the value of sales, then prices move as if they have been set by adding a constant average profit markup to costs. The proposition is an illustration of what Elster (1978) has called a structuralist argument, a mode of reasoning close to functionalist reasoning. The common core of both is that the beneficial consequences of a set of actions are regarded as explaining them. In the structuralist mode these agreeable results are transmuted into individual motives for actions. It is possible to commit the fallacy of division employing structuralist-functionalist reasoning. Elster (1978) has described the pitfall thus:

All members of  $A$  do  $x$

When all members of  $A$  do  $x$ , this has the known and good results  $y$

Therefore, all members of  $A$  do  $x$  to get  $y$

This is the outsider's, the political economist's way of describing the matter, not that of the capitalist or worker. It could be, for example, that as a result of union militancy the share of labor income in the national cake increases. The outcome need not be the consequence of motivated planning or could be the outcome of an entirely different objective. In macroeconomics, this mode of theorizing has long been seen to be tautological. Usually some economic aggregate is divided into its component parts. National income, typically, is divided into profits, wages and raw material costs in macroeconomic models of distribution. These divisions are identities. Thereafter behavioral relations are posited between some of these sub-aggregates, which are alleged to explain them. The theory follows straightforwardly from the defined breakdown of the macroeconomic aggregates.

An approach that is distinct from functionalism is intentional explanation.<sup>1</sup> The method is deductive. An attempt is made to deduce historical observations from basic postulates on individual behavior. Class struggle and game theory, which is a natural language to discuss class struggle, are important components of this research strategy. Intentional explanation cites the intended consequences of behavior in order to account for it. Objectives sought may not be attained or may even be unattainable but in either case the explanans cannot succeed the explanandum. Thus, by setting high margins a firm only ensures a potential profit per unit of output. The accrual of profits depends upon the level of demand and costs over which the individual firm has no control (Bhaduri, 1986; Pen, 1971).

The polar positions sketched above are for the purpose of contrast and actual research practices of each side, typically, would be sensitive to the concerns of the other. If structural explanation simply means structural constraints, there would be no conflict in research designs. Structural constraints would include the given configuration of class interests and other objective facts of history as a framework within individuals are expected to make their choices. However, when to structural explanation is added what van Parijs (1993) calls a "structural imperative", the pure form of structuralist explanation delineated above applies. Here are demands which emerge from the mode of production and whose causal impact cannot be reduced to the agglomeration of individual actions. For her part, an advocate of intentional explanation might argue that the structural constraints of individual choice problems are the behavior of others, which might either constrain or enable. It would appear, then, that all social relationships dissolve into the properties of individuals. There is a problem of infinite regress here (Howard and King, 2001). While it is possible to

decompose a given set of structural constraints into individual actions, these actions will entail, in their turn, other structures and so on, ad infinitum.

It is not clear whether Kalecki's economics is intentional or functionalist (Elster, 1982).<sup>2</sup> Kalecki and Keynes are regarded as the modern founders of the analysis of the level of output as a whole. The progenitors were different, Marx in the former, Pigou in the latter. Keynes criticized the classical theory for committing the fallacy of composition, that is, deriving conclusions related to the economy based on individual choice. He was impatient with microeconomics. Kalecki, on the other hand, directly engaged with the formulation of imperfect competition and was concerned with integrating the analysis of prices with effective demand (Kriesler, 2002). The movement from one level to the other might not have been without its hazards (Skott, 1989). For example, his proposition that money-wage claims directly influence distribution is founded on microeconomic reasoning and cannot be extended to the macroeconomy. Increasing money wages in any given firm will make that firm less competitive and give its workers a rising real wage. The production of the firm is likely to decline. Other firms and industries will be stimulated and the net effect on output and employment might not be negative. Increased militancy and higher wages in any one firm will lessen the competitive pressure on rival firms. They may raise their profit margins leaving the overall effect on the share of profits indeterminate. Kalecki argued that an increase in worker militancy and money wages will (a) raise real wages and the share of wages in income and (b) stimulate demand leading to an increase in output and employment. The case for an increase in real wages depends, however, on the assumption that real demand falls if firms raise their prices *pari passu* with money wages. It is the inability of firms to compensate for rising wages that explains the power of trade unions to affect real wages. It is not easy to reconcile this argument with the view that rising real wages stimulate aggregate demand and employment.

On the one hand, there is evidence that Kalecki commits the 'sin' of what Elster calls "long-term functionalism", that is, manipulates the time dimension to support functionalist conclusions. He argues that this dimension of functionalism suffers from inconsistency because positive long-term effects can only dominate negative short-term effects in the presence of a purposive agent. In Kaleckian economics the key strategic variable is the level of capital expenditures derived from the investment plans of firms. Capital is regarded as autonomous and self-sustaining creating the microfoundations necessary for its continuance (Crotty, 1980; Weintraub, 1979). When an investment project presents itself, firms are able to adjust the prices of their existing output in order to get the profits they require to finance it. There is thus an implicit repudiation of theories of individual choice as explanations of the historical behavior of macroeconomic aggregates. The empirical long-term relationship between prices and unit costs has to be rationalized in microeconomic terms. On the other hand, over thirty-seven years of writing on the subject Kalecki incessantly sought to improve on his theory of investment behavior

(Kalecki, 1971). He regarded "the determination of investment decisions (to be) the central *pièce de résistance* of economics" (Kalecki, 1971, p.165). Again, he directed a Swedish period critique against Keynes' *General Theory* in his observation that Keynes' theory of investment is silent on the sphere of investment decisions of the entrepreneur who must make her calculations in a state of strong uncertainty. The theory only determines the *ex post* level of investment (Targetti and Kinda-Haas, 1982).

There is an emerging consensus in radical political economy today that neither pure functionalist accounts nor an individual choice approach unconstrained by systemic exigencies is adequate to encapsulate the complexities of capitalism. The middle ground recommended is the political economy of norms or institutions (Bowles and Gintis, 1993). *Régulation* theory is regarded as an umbrella under which most modern non-neoclassical research practices can reside. Individuals are regarded as occupying social niches that vary across time and space. In order to derive propositions it is imperative to establish a precise characterization of the network of constraints under which agents operate. An elaboration of this agenda in the context of Regulation Theory is Convention Theory (Thompson, 1997). Game theory in both its cooperative and noncooperative aspects is believed to be an ideal tool to employ in order to model conventions. Agents can only orient themselves through procedures that support collective arrangements. These arrangements are not governed by an individualistic calculus alone (Boyer, 2002a). They emerge from the construction and maintenance of a social bond. In the Marxian tradition, *régulation* theory takes off from the institutional forms that define a mode of production. These institutional forms socialize the heterogeneous behavior of agents, forging a passage from the micro to the macro. A meso level of explanation might be formulated thus (Taboso, 2001):

1. The assumption of rationality: Agents act rationally in a given situation
2. Description of the situation: Agent *A* is in type *C* situation
3. Institutional individual analysis: In type *C* situation, the rational thing to do is *X*
4. Explanandum: Therefore, *A* does *X*

*Régulation* theory sees the two extremes of arms-length relationships characteristic of atomistic markets and the strong coupling of hierarchical controls as near-extinct modes of organizing production. In their place various coordination alternatives are emerging to organize economic activity (Boyer, 2002c). For example, alliances are a mode of governance maintained through an implicit contract between the parties concerned while also obeying the laws of the market. Their advantage is that the participants

share the uncertainties associated with, say, the adoption of new technologies.

One leg of a progressive Kalećkian political economy then must be the postulate that class conflict is endemic to capitalist societies and is impervious to the distinction between short-run and medium-run analysis. The resilience of the capitalist mode of production is the result of the transformation of the wage-labor nexus. The wage-earning class has evolved as an adjunct to the imperatives of accumulation because it has modified the nature of class conflict. For instance, it is not sufficient to invoke the iron law of wages of Marxian economics. Consumption norms are endogenous (Boyer, 2002b). Under a certain configuration of competition, increases in the nominal wage may introduce a transformation in the life style of workers.

The second leg of a (re)vitalized Kalećkian economics is the strand that attempts to absorb the radical subjectivism of Keynes' *General Theory*. The familiar Kalećkian determinants of the markup like the compulsions of investment, the maintenance or increase of market share, barriers to entry and potential competition have received poor empirical support. Custom and convention are predominant among the modern determinants of the markup (Lee, 1998). Furthermore, the salient empirical fact about administered prices is the frequency with which they change. The frequency of change is not significantly different from the frequency with which wage rates or profit markups change. The markup varies from market to market at a single point of time and in a particular market over time. Here as well, the separation of short-period and long-period is unhelpful. The institution of pricing emerges when agents must function in evolving environments that are characterized by fundamental uncertainty. In such circumstances, it is reasonable to assume that if there is some data that recurs, firms are stimulated to work out simplified algorithms to deal with such contingencies when they arise. It would then not be necessary to incur the same information costs each time. Firms would prefer to adopt fixed responses to known stimuli than predict uncertain future events. Therefore, since information about costs is more reliably known to each firm than information regarding variations in the level of demand it is natural for a firm to evolve an institution that is more sensitive to costs than demand (Bhaduri, 1986). At the same time, institutions are "socially embedded" (Granovetter, 1991). They are constructed by individuals whose actions are both facilitated and coordinated by the structure of the networks in which they operate. In an oligopolistic industry, for example, cost changes are unambiguously coded and facilitate joint action. If a firm cuts prices due to a fall in its labor costs, competitors would not regard it as an aggressive price move. Changes in demand, on the other hand, affect firms unevenly. A price cut following a fall in demand would be resisted.

In like manner, according to the institutionalist model of the labor process, wage-determination and unemployment can be analyzed as distinct phenomena (Piore, 1979; Ulman, 1990). The kind of variations in market conditions that would reveal some information about the structure of

demand and supply do not exist. A regime of generalized unemployment would create excess supply in all markets. These surpluses are not included in the procedures through which these data are perceived. From the perspective of the agents, concerned institutions of price and wage setting represent the best interpretation of their environment. They do not see the market fundamentals from which these rules derive. The wage thus does not and cannot function to equate demand and supply. Unionists ignore the long-term effects of wage increases on employment through substitution by employers.<sup>3</sup> The effect of unemployment on wages comes via the financial and market pressures that impair the employers' ability to pay. Outsiders discipline the wages of insiders in the long run through competition from new products, new technologies and new firms.

It seems appropriate, therefore, to assume that corporations maximize their return on their costs of labor. At any rate, as Williamson (1986) reminds us, the textbook distinction between fixed and variable costs is an accounting division. What matters for the signing of contracts is whether assets are redeployable or not. Many assets that an accountant would call fixed are, in fact, redeployable like general-purpose buildings and equipment. Some other costs that accountants would call variable have a large nonsalvageable part like firm-specific human capital. Labor should be treated like a relatively fixed factor of production for although direct labor costs vary with production it is not always possible to eliminate them proportionately when volume decreases due to union contracts. Instead of the Fordist pattern of investment firms are moving away from dedicated machinery and developing versatile equipment which can be switched from the production of one model to another even on a daily basis. The worker is expected to be generally trained as a result. Cooperation is critical in an environment where production is continuously being reorganized to adapt to the market or to incorporate technical change. The attainment of the goals of the firm is then essentially a problem of defining a mutually beneficial relationship between itself and its workers. It enters into contracts with employees with the promise of specific payments over short periods. Profits are what remain of the proceeds of sale or the net value of additions to inventory for a given period after these payments are made. If these contracts are mutually profitable then an equilibrium is reached at some level of activity.

In sum, relations of production under modern capitalism contain elements of both coercion and consent. The threat strategies commonly employed by workers and capitalists, strikes and lockouts respectively, are double-edged (Burawoy and Wright, 1990; Elster, 1985). They increase the probability of getting a larger share of the total but by disrupting production reduce the total to be shared. Capitalists therefore have an interest in the survival and reproduction of the labor force. Unless there are many equally attractive jobs available, layoffs and unemployment represent costs to workers. Indeed, if workers are parties to durable contracts and if they expect capitalists to share some of the gains of productivity in the form of wage increases, their welfare increases if the firm grows. The basic

assumption that capital is a ‘factor of production’ entitled to a return on par with labor is not in question. In this purely static setting the only basis for class struggle is the division of the net product not its existence (Elster, 1982). In such bargaining, each side has limits below which it cannot go like a subsistence wage for workers and a minimal profit for capitalists.

### 3. THE MICROECONOMICS OF KALEŃKI AS A GAME

KaleŃki’s microeconomics is similar in many respects to the conventional theory of a monopolist with given capital equipment. Constant marginal costs are assumed. The assumption is not unreasonable, he argues, because monopoly capital operates with some amount of planned or unplanned excess capacity. Therefore, output can be increased using additional units of labor and raw materials in the same technical proportions as before. The firm’s average costs are therefore assumed constant and equal to marginal costs over the range of output over which the firm is likely to produce.

It is possible that the assumption of a degree of monopoly, given in the short-run to be relaxed in the medium-run, is an assumption of the KaleŃkians. It turns out that KaleŃki was comfortable with the description of a capitalist economy as an arena of incessant competition and did not regard imperfect competition as fundamental to his theory of unemployment and the role of aggregate demand (Sawyer, 2001). For example, a change in average variable costs can result from a change in the price of labor and raw materials and such a change is possible in the short run. KaleŃki recognized that the power of trade unions can cause a change in the degree of monopoly. A high price relative to the wage rate strengthens the bargaining position of trade unions in their demands for wage increases since higher wages are then compatible with normal profits at a lower price. Therefore, a high ratio of price to the wage rate cannot be sustained without creating a tendency towards rising costs. This adverse effect on the competitive position of the firm compels it to adopt a price lower than the monopoly price. Instead of taking the price to be fixed, it is reasonable to assume, therefore, that it is a variable. The firm’s profit function associates to every price the value of the solution to the profit maximization problem. The profit function is convex in price. In a monopoly market buyers are price takers. Their demand as a function of price is given by the demand function  $D(p)$ .  $D$ , as usual, is assumed to be a continuously differentiable function whose derivative is strictly negative and finite at any positive price level. The objective of the union is assumed to be maximization of the total income of its membership. The firm is therefore a monopsonist in the labor market and is committed to a given endowment vector  $l$ . The optimization problem of the firm is to choose  $p$  to maximize its revenue function. We therefore have the following payoff functions of the capitalist and the union with the subscripts  $c$  and  $w$  distinguishing them respectively.

$$u_c \equiv pD(p) - wl$$

$$\text{and } u_w \equiv wl$$

The following account is drawn from Harsanyi (1977). We have a “simple bargaining game” in which the “conflict point” to which the players are reduced if they cannot agree on how to divide the payoffs between them is given. The union can set a wage so that the wage bill is equal to total revenue. The capitalist can set a price equal to zero choosing not to produce and thereby not enter into any relationship of production with the union. There is just one “conflict-payoff” vector in this case,  $(0,0)$ , that is, simple noncooperation. We confine ourselves to games with “binding threats”. The players announce their corresponding conflict strategies  $p$  and  $w$  at the beginning of the game. Thereafter the players are bound to implement them in case they cannot decide on which payoff vector to adopt. These “threat strategies” will therefore have to be completely credible rather than mere bluffs.

Assuming that the payoff point is an element of the payoff space and that the payoffs of both the agents are greater than their conflict payoffs, the Nash solution of the two-person bargaining game is given by the following result.

*THEOREM (Harsanyi). The solution  $u^* = (u_c^*, u_w^*)$  to the two-person simple bargaining game is the point satisfying*

$$u_c^* \cdot u_w^* = \max[u_c \cdot u_w]$$

Given the properties of the aggregate demand curve, the payoff function of the capitalist is strictly convex in output price while the payoff function of the worker is linear in the wage. The maximum for the capitalist is unique. In that case,

$$u_c^* > 0$$

$$\text{while } u_w^* \geq 0.$$

In other words, cooperation by the capitalist has “strong-reply dominance” over any other strategy against cooperation by the worker whereas cooperation by the worker only “weakly\*ureply

optimization decree that workers can move out of the working class, workers are forced to sell their labor power (Elster, 1985). Relations of production are objective. The statement implies the following (Cohen, 1983). The worker is more intimately connected with her labor power than the capitalist is with her capital. When a worker sells her labor power she puts herself at the disposal of the capitalist and that is not true when a capitalist invests her capital. Insofar as workers have no feasible alternative to selling their labor power, they can be said to be coerced to sell their labor power. Capitalists, it could be argued, do have a feasible alternative to investing their capital. They are free to sell their labor power instead. There is a basis here for a critique of the defense of capitalism that commits the fallacy of composition, that is, argues that since an individual worker is free from an individual capitalist, workers are free from capital *an sich*. The game above has no noncooperative solution (Elster, 1982). In the intentional explanation provided, it is not assumed that the cooperative solution with the particular characteristics will be realized only because of the need for it; rather a causal mechanism is exhibited whereby it will be achieved. One of the modes of coordination as an alternative to state and market are institutional hierarchies (Boyer, 2002c). Due to the nature of economic coalitions at the heart of institutional compromises, some subset of collective actors can restructure the compromises in their favor. In any case, the determination of the wage, both real and nominal, is independent of the rate of exploitation.

The game is similar to a two-person zero-sum game (Harsanyi, 1977). This is because the solution always lies on the upper right boundary of the payoff space. Hence  $u_c^*$  and  $u_w^*$  are decreasing functions of each other.

Consequently maximizing  $u_c^*$  is equivalent to maximizing

$$y_c \equiv u_c^* - u_w^* = p^* D(p^*) - 2w^* l$$

Similarly, maximizing  $u_w^*$  is equivalent to maximizing

$$y_w \equiv u_w^* - u_c^* = -p^* D(p^*) + 2w^* l$$

The sum of the payoff functions is zero making the game a zero-sum game. Confining ourselves to combinations like  $(w, p)$  and  $(w^*, p^*)$  on the upper right boundary of the payoff space, we have

*PROPOSITION 2. For  $w \leq w^*$ , the perfectly antagonistic game  $(y_c, y_w)$  is a capitalist maximization problem.*

Proof. Let  $\max_p y_c(p, w) \equiv y_c(p^*, w)$

$$\therefore y_c(p, w^*) \leq y_c(p^*, w^*) \text{ for any } w^*$$

For  $w \leq w^*$  and noting that  $y_c$  is linear and decreasing in  $w$ , we have

$y_c(p, w^*) \leq y_c(p^*, w^*) \leq y_c(p^*, w)$ , that is, the (saddle point) equilibrium of the game.

Once more, the result is an illustration of the structuralist fact that under capitalism freedoms like the freedom of workers to maximize utilities are no more than “formal” (Cohen, 1983). We also have a variation on the familiar theorem that under capitalism outcomes depend on the differential endowments of profit takers and wage earners. In the present case, the solution to the game depends on the shape of the payoff function of the capitalist. If outcomes do not depend on the initial endowments of the two protagonists (in this sense), all distributions of utility that sum up to a given level of utility can be represented by a line with a slope of  $-1$  in outcome space (Przeworski, 1991). A perfectly egalitarian outcome is possible. This symmetric outcome lies at the intersection of the Pareto possibility frontier with the  $45^\circ$  line.

#### 4. CONCLUSION

It has long been believed that KaleŒki's late article “Class Struggle and the Distribution of National Income” (KaleŒki, 1971) contains the seeds of a research program in KaleŒkian economics. We have attempted to deal with the subject using no more than the rudiments of a well-known language to handle problems of struggle. The argument is conducted against the backdrop of the methodological divide between functional and intentional explanation. The results show that the tension between the two stances can be nicely resolved. We argue that contemporary capitalism contains elements of both cooperation and perfect antagonism. In the cooperative mode, despite workers having the freedom to maximize their wages, the result of the bargaining game with capitalists is more favorable to the latter. In the classic case of a zero-sum conflict between the two classes, expectedly, workers merely solve a capitalist optimization problem.

#### ENDNOTES

<sup>1</sup>There is a family resemblance between intentional explanation and the old Swedish period analysis wherein the outcome at a point of time is completely determined by

the actions taken during the period and the actions, in their turn, are derived from plans formed at an earlier point of time.

<sup>2</sup>No attempt will be made here to distinguish between KaleŃkian economics and the Economics of KaleŃki. For a scholarly study of KaleŃki's economics, the definitive work is Kriesler (1987). The distinction might be relevant for the present discussion. Agliardi (1988) takes the internal fund generating function of prices to be a postulate of the KaleŃkians. In KaleŃki's theory, on the other hand, an expansion in the bank credit supplied to the banking sector is a precondition for the independence of investment from saving. Agliardi suggests, in the spirit of the present paper, that the agenda implicit in the microeconomics of KaleŃki is the analysis of prices as "conventions" or "rules of thumb" in response to fundamental uncertainty.

<sup>3</sup>A consequence of functionalism is the nonstrategic role given to trade unions in Post Keynesian theory. Thus Rowthorn (1977), citing Marx's writings on the reserve army of labor, argues that even the unemployed tucked away in rural hamlets tend to demoralize trade unions. However, by definition, collective bargaining means that organized workers will tend to get wage increases at a higher level of unemployment than would have been the case without them. This is achieved by imposing restraints on labor mobility or by restricting entry into jobs that have to expand. Elsewhere there is more symmetry in the assumption about the powers of both agents in Eichner's (1976) view that both the typical firm and the typical union are powerful enough to carry on protracted struggles. It is only in the case of an unusually long strike that the stock of their respective resources will be considered.

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Contact Information:

Romar Correa  
 Professor of Economics  
 Department of Economics  
 University of Mumbai  
 Vidyanagari  
 Mumbai 400 098, INDIA  
 E-mail: [romar77@hotmail.com](mailto:romar77@hotmail.com)

## HITLER'S MONEY

### The Bills of Exchange of Schacht and Rearmament in the Third Reich

Guido Giacomo Preparata *University of Washington, Tacoma*

*The economic recovery under Hitler stands as a remarkable feat of financial swiftness. Consummated in less than four years, the Nazi resurgence could vaunt by the end of 1938 the erasure of nearly eight million unemployed, the total absence of inflationary pangs, and the most ravaging army one could then conceive. The monetary contrivances behind such a conjuring of awesome potency were imagined by a team of traditional bankers, headed by Reichsbankpräsident Hjalmar Schacht. It is here argued that the financial underlining of the Nazi episode is but a variation of the famous 'monetary sleight-of-hand' that Mephisto played before the Kaiser in Goethe's **Faust**. Theatrical prophecy and war expectancy mix uncannily in this unique example of economic expediency achieved without the least concern for ideological etiquette. (JEL B0, E4, N0)*

Key Words: German Economy, Schacht, Nazism, Mephisto

### Fiction...

Goethe wrote *Faust* two centuries ago. It has been claimed that the second part of the opus is a great allegory of modernity—a prophetic vision of the economic era (Binswanger, 1995).

So let the play begin.

The curtain is drawn, and we find ourselves in the spacious hall of the imperial palace. Court retainers, in a nervous murmur, confabulate nearby the throne, whereon the emperor sits in manifest despondency. Chancellor, treasurer and squires are about to address the sovereign. What follows is a chain of laments, disconsolate invectives, and worrisome accounts of the empire's conditions. Agonizing trade, agitated folks, loose soldiers turned by growing rowdyism into a mob of knaves, cocksure vassals laying claim anew to ancient pretensions, indifferent kings in the neighboring demesnes, destitution, debts and acrimony everywhere. The vaults of the treasury are empty, and the air is rife with spiteful allusions to the deadlines and usurious accretions imposed by the Jewish loan shark. The Kaiser looks about himself, weary, in search of his buffoon—may this last grant him a little respite. Where's the fool? Can't be found. The rumor has it that he fell down the stairs the previous day, and so soon was he borne away. Dead or drunk? No one knows for sure.

Silence and irresolution...But all of a sudden, slowly emerging from the shade, a personage steps forward. Whispers waft through the air fancying the apparition to be the new fool. And striding on, the visitor introduces

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