Preface

Like cells, organisms or ecologies, economies are complex adaptive systems. What such systems have in common is the capacity for self-regulation of the activity levels of their various components. These capacities are never unbounded. Beyond certain limits, they will break down. More generally, their effectiveness will depend both on internal structural characteristics of the system in question and on the magnitude of external shocks to which they are exposed.

What are the limits to an economy’s capacity to coordinate the activities of its members? How does the behavior of the system change under extreme conditions? In what ways does its performance depend upon the institutions that govern the market process? In what circumstances might the coordinating capabilities of the economy be improved by institutional design or by deliberate intervention in markets? These exemplify the coordination questions which have been my main interest as an economist. I regard them as the central ones in macroeconomics. With one exception, all of the essays in this volume deal with them. This could be said also of my book *Information and Coordination* (1981a), but Parts III–V of the present collection are a good deal more ‘institutionalist’ than that earlier one.

The essays in Part I attempt to put the development of macroeconomics from Keynes to Lucas in historical perspective. The misunderstandings of Keynes’s *General Theory*, which I worked on thirty years ago, remain important today because of the sequence of later muddles that they originated and that eventually led to the virtual disappearance of the coordination problem from macroeconomic discussion. My paper from the Keynes centennial conference in Cambridge (Chapter 1) outlines the story as I see it. Two short sketches in this paper get their own chapters later: the ‘Swedish Flag’ story is told at greater length in Chapter 2 and the section on monetary regimes is elaborated in Chapter 6. As an appendix to Chapter 1, I have included a short piece from 1988 pointing out that evidence from Keynes’s *Collected Writings*, which had appeared subsequent to my 1968 book, proved my interpretation of the *General Theory* to have been correct, contrary to the assessments of Yeager, Grossman, Coddington and others.

Chapter 2 was written for the introductory session to a summer school on ‘Alternative Approaches to Macroeconomics’. This was the first of four such
scho...Schools hosted by the University of Siena at the Certosa di Pontignano for which E.S. Phelps and I were responsible for the programs. Ned Phelps has some responsibility also for Chapter 3 (although, let it be said, not for its content). It was written some years previously for a conference on rational expectations arranged by him and Roman Frydman. My concerns about the New Classical economics at that time were two, namely that it left no room for the effective demand failures that I saw as the theoretical legacy of Keynes, and that the emblematic model of anticipated inflation reflected a theory of inflations that was seriously misleading with regard to their economic costs and social consequences. The ‘blueback scheme’ with which I sought to dramatize the deficiencies of that model is sketched in this chapter, to recur repeatedly in Part II.

The friendship of John and Ursula Hicks has been one of the privileges of my life. No other author’s work was as helpful to me in graduate school as that of John Hicks. Although his late works did not find the audience of his most famous contributions, I have found that they also reward close reading. Three of the chapters in this volume are essentially ‘Hicksian’. My attempt to size up IS–LM (Chapter 4) dates from a session arranged by Jean-Paul Fitoussi where Sir John was the other speaker on the same subject! Used in static textbook fashion, I maintained, IS–LM had sown confusion in the Keynes and the classics discussion, in the liquidity preference versus loanable funds controversy, and finally in the Monetarist debate. If the underlying theory is understood as one of an adaptive system, where agents modify their behavior in the light of current market outcomes, it is possible to make sense of IS–LM and to handle it without danger to life or limb. In the wake of the rational expectations revolution, however, such adaptive theorizing was rather out of fashion.

What I most admired about John Hicks was his ability to ponder a difficult question for decades on end without ever fooling himself that it could be resolved or disposed of by some facile assumption or other. Chapter 5, which was written for a Festschrift to his 80th birthday, traces one such struggle through fifty years, namely his persistent attempts to find a treatment of time that would accommodate both history and equilibrium.

Hicks insisted that ‘monetary theory belongs to monetary history’. The paper dedicated to Hicks from an Oxford conference devoted to his monetary economics (Chapter 6) tries to follow his lead in fleshing out the distinction between monetary regimes relying on convertibility and on quantity control, respectively. The interpretation of the cyclical patterns of money, prices and output hinges on whether variations in the money supply are to be interpreted as endogenous changes in inside money (as in a convertible regime) or as primarily exogenous changes in outside money (as will be the case when quantity control is driven by fiscal exigencies).
During most of the period that the papers in this collection were written, my main preoccupation was to try better to understand the disorganizing effects of inflation. Back in the 1970s, professional opinion quite generally trivialized these effects. The welfare costs from the inflation tax were often portrayed as of a lower order of magnitude than those of unemployment. It did not seem to me that economists knew what they were talking about. But my first attempt to articulate a contrary view (Leijonhufvud 1977, written in 1974), although it made a number of valid points, was not very satisfactory and no one paid much attention to it. Chapters 7 through 11 return to the fray. ‘Theories of Stagflation’ (Chapter 7) came about as an attempt to convince a classroom of French students that the simultaneous occurrence of inflation and unemployment did not prove the bankruptcy of all the macroeconomics that had gone before.

The ‘blueback’ currency reform idea was one I had used for years in class as a pedagogical device to make students think twice (at least) about what might be wrong with the anticipated inflation model. My standard punchline had been: ‘if real world inflations were like those assumed in the model, we could cure them overnight. Since we cannot get rid of inflation that easily, there must be something wrong with the model.’ Chapters 8 and 9 use the idea in this way. I doubt that it ever occurred to me that bluebacking might be found useful in any actual policy context. But, thanks to the initiative of Daniel Heymann, it came to be used in Argentina in the 1985 Austral Plan – and it worked. Overnight, disinflation was achieved without significant redistributive effects. Variants of bluebacking were then tried in Brazil and Peru the following year. But disinflation does not by itself bring stabilization. In none of these cases were the fiscal reforms required to stabilize at low inflation achieved, so all three of these ‘heterodox’ plans eventually failed. So the popularity of bluebacking was fleeting. While it lasted, however, Heymann and I became concerned that it might be used in the wrong circumstances, since the quite restrictive conditions under which it would work were not well understood. The paper that we wrote to spell these conditions out appears here for the first time in print as Chapter 10. Chapter 11 also stems from my collaboration with Daniel Heymann. It is in the nature of an interim report on the work we did for our 1995 book, *High Inflation*.

For more than two decades, I argued the dangers of inflation at virtually every opportunity. Today, I find myself somewhat mysteriously in the minority again – on the other side of the issue. Now, low or even zero inflation targets are suddenly supposed to be the be-all and end-all of monetary policy. This is rather baffling, since the theory of the costs and consequences of inflation that is still taught remains on the whole as it was in the early 1970s. Exclusive attention to inflation targets will mean neglect of credit policy. At a
time when one credit crash after another is heard around the world, I doubt that this can remain the state of the art for very long.

Several of the papers in this volume (for example, Chapters 4, 7 and 18) had their beginnings in the classroom. The simple example in Chapter 12 of how a collectively adaptive market process may be modeled is one such which goes back more than thirty years. When I did my work on the ‘Economics of Keynes’, I thought of his system as composed of markets like this. For some twenty years, starting in 1971, I taught a course in European economic history for undergraduates as my annual respite from a money and macro diet. A much appreciated stay at the Institute for Advanced Study under the aegis of Albert Hirschmann allowed me to tie some of these lectures together in what is here Chapter 13, a piece continued in the chapter following. I do not understand the hold that the neoclassical constant returns production function has over the profession, unless it be that it is handy to manipulate. But it gives us no clue as to why economic growth brings increasing differentiation of productive functions, or why so high a proportion of international trade goes in cross-shipments of products of similar factor intensities, or why capital hires labor and controls production rather then vice versa, or why the ‘factory-system’ brought unionization and a new type of industrial conflict, or why, with the factories, unemployment becomes a novel social problem, quite different from the ‘vagrancy’ of the past. The production theory tradition that runs from Adam Smith to Allyn Young (via, among others, Karl Marx!) brings understanding of these and a host of other interesting issues.

One of these issues is the ‘nature of the depression in the former Soviet Union’, as I argue in Chapter 17. By a twist of fate, I came to do some work on market ‘reform’ during what was to be the last year of the USSR. That story is told in Chapter 16. For a UCLA economist to lecture the Central Committee of the Communist Party (of Kazakhstan) on supply and demand was a unique experience. But thinking of the Gosplan economy as a ‘factory system’ writ large made me skeptical of ‘big bang’ reforms which seemed not to pay sufficient attention to the myriad complementarities that imparted such rigidity to the inherited system and made it, therefore, so vulnerable to all sorts of supply interruptions. These reservations, as I found out, did not fit the line of American foreign policy journals at the time.

I am grateful to my wife, Earlene Craver, for many discussions of the issues in this part, where her insights as a contemporary historian became especially valuable to me. Her constructive criticism also helped make the arguments of Chapters 8 and 9 clearer.

All of these essays were written during the many years that I served on the UCLA faculty. Putting them together has given me many occasions to remember with gratitude how much I learned from my colleagues, and especially
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from Armen Alchian, Robert Clower, Harold Demsetz, Jack Hirshleifer, Ben Klein, John McCall, Joseph Ostroy and Finis Welch. In more recent years, Daniel Heymann, Kumarraswamy Velupillai, Dan Friedman and Peter Howitt have been the friends that have influenced me most.

Joannes Mongardini at UCLA was tremendously helpful to me in putting these essays together and obtaining all the permissions. So, somewhat later, were Alberto Baldessari and Maurizio Binelli, at the University of Trento, in completing the bibliography.