ACCOMMODATIONISM, STRUCTURALISM, AND SUPER-STRUCTURALISM

Thomas I. Palley
Assistant Director of Public Policy, AFL-CIO

Post Keynesians object to Milton Friedman's notion of a "helicopter drop" of money. I think their objections are appropriate. Basil Moore asserts the central bank just holds the line on interest rates, and accommodates everything. How does it do this? What are the asset transactions (T-account entries) between the central bank and the private sector that accomplish this injection of reserves? Moore never specifies this, which leads one to think that there may be a helicopter in the background. If the central bank buys assets from the private banks, then balance sheets will be transformed. Private banks will have to choose which assets to sell, and when they sell them they will have an incentive to alter their liability positions which are cross-linked to asset holdings. This is the essence of asset and liability management. Such balance sheet transformations will change risk positions, and this will likely lead to changes in the structure of interest rates, both by asset and liability type and by term to maturity.

The above argument maintains that private sector interest rates will change even if the central bank holds the line on the federal funds rate. This is what I call "super-structuralism".

In practice, the central bank monitors the financial sector and real economic activity, and responds according to its policy reaction function. This is another source of interest rate change, and gives rise to an iterative interaction with the financial sector that I sought to outline in my paper (Palley, 1996a).

Moore misrepresents me by claiming that I say structuralists maintain that monetary policy is based on targeted adjustments of the quantity of reserves. For structuralists, the monetary authority may choose to target interest rates, or it may choose to target the monetary base, or it may use either as an instrument conditioned on reaching some other target. If it targets interest rates, open market operations involving swaps of base are still required.

In practice, we seldom see the monetary authority targeting the base, though there was a period in the late 1970s and early 1980s when the Fed appeared to be verging on this practice. Given initial expectations of economic activity derived from its econometric models and other sources, the Fed targeted the money supply. As price and financial market data emerged, the Fed sought to extract signals from this data about the real economy, and responded by adjusting the quantity of base in a fashion that it thought would get it back to its money supply target. These adjustments then caused a rise in interest rates. Ultimately, the policy was abandoned because the effect on interest rates was disastorous, and the Fed's belief in the usefulness of targeting monetary aggregates waned.

Moore's note is a combination of arguing from the specific to the general, and arguing by assertion rather than by reason. Monetary theory should be developed at a general level, such that it can then be applied to specific instances or specific institutional settings. This is what I have tried to accomplish in my exposition (Palley 1987, 1994) of the structuralist model. Thus, the accommodationist position is nested within the model, and corresponds to a particular policy stance on the part of the monetary authority. My own model is not "super-structuralist" in that interest rates don't rise if the Fed targets the Federal Funds rate. This is because private banks have buffer stock holdings of bonds (secondary reserves), and they just swap these holdings with the Fed. However, were these buffer stocks to be exhausted, the model would become super-structuralist.

The last part of Moore's note fractures the discussion. Ergodicity and non-linearity are loosely bandied about in a fashion that promotes an "anything goes" approach to economics. The fact that the world is non-ergodic does not rule out people having views about how the world works, and using these views to guide their actions and form expectations. Economists call a view of the world a "model", and they express this view algebraically rather than verbally. I think this is a useful practice. It helps tease out the implications of a particular view of the world, helps identify whether the view is internally consistent, can help guide actions such as policy making, and can yield predictions implied by a particular view. None of the above is inconsistent with non-ergodicity.

Such an approach also sheds light on the Keynesian distinction between short and long run expectations. In my recent book (Palley, 1996a, p.84) I write "Long run expectations refer to both the time horizon and the "model" through which agents interpret economic activity. Keynes (1936, p.152) referred to this model as a "convention". Short run expectations refer to the current predictions of the model based on currently available information." All agents have models (a.k.a. view of the world), and they use them. Post Keynesians are still arguing about what this model should be. I know my own view of the world is changing over time as my understanding increases. None of this is inconsistent with non-ergodicity, and non-ergodicity is not the issue.

The long and the short of it is that the structuralist model of money supply determination is a better model. It incorporates loan demand, money demand and non-bank portfolio behavior, profit maximizing asset and liability management by banking firms, and the possibility for a range of different policy reaction functions on the part of the monetary authority. The real world is complex, and where germane, these complexities need to be captured. Case closed.

References

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