EDMOND MALINVAUD

A PIONEER OF THE THEORY OF ECONOMIC IMBALANCE

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The French economist Edmond Malinvaud was born at Limoges in 1923 and lived there until he went to university. His interest in science led him to the Polytechnique, where he took an interest in economics, initially as a hobby. After completing his studies at the Polytechnique, he went to the USA for a study visit, on the advice of Allais. He gained an economic education at the Cowles Foundation in Chicago.

From 1961 to 1966, he was director of the École nationale de la statistique et de l'administration économique (ENSAE), where he participated in educating the French elite in the area of mathematical economics.

From 1967 to 1972, he headed the Prognoses Division at the Ministry of the Economy and Finance. In 1972, he became general director of the Institut national de la statistique et des études économiques (INSEE). In 1988, he was appointed a professor at the College de France, where he will work until his retirement.

Edmond Malinvaud has contributed to economic theory, not only as an author of brilliantly written textbooks in the area of statistical econometric methods, micro-economics and macro-economics, but meanly as a pioneer of the theory of economic imbalance.

He produced a typology of states of unemployment in the 1980s, a time when economic policy was failing. Expansionist policies of Keynesian character have a tendency to strengthen inflationary pressures and external imbalances. A policy based on deregulation, proposed by supply side economists, also has an inbuilt risk of causing social pressures and reducing aggregate demand.

In precisely these social circumstances, a stream of economic thought – the theory of economic imbalance – emerged. It atttempted a new synthesis between Keynes and neo-classical economics. It developed primarily in France, with Malinvaud standing at its head. In working out the theory of economic imbalance, Malinvaud relied on the work of the founders of this theoretical conception: A. Leijonhufvud and R.W. Clower from the 1960s.

The basic theoretical postulates of the new synthesis

The new synthesis (the theory of economic imbalance) preserves the assumption from neo-classical economics of the optimal behaviour of economic entities, but it rejects the idea of immediate adaptation of prices. As soon as we abandon the idea of Walras' auctioneer, variable adaptation of supply and demand are more important than prices.

The theory of economic imbalance starts from the hypothesis that prices are fixed in the short-term and that changes in the market can happen with unbalanced prices. In contrast to neo-classical theory, which assumes the simultaneous establishment of balance in all markets, imbalance theorists consider the possibility of only one side of the market adapting. The economic entity, which finds itself there, strikes against limitation, since it cannot fully achieve its aims in the given market. As a result, it changes its behaviour in other markets. The company with stagnating demand for its product, reduces its demand for labour. The worker, who is involuntarily unemployed reduces his consumption.

Money as the connecting link between income and expenditure

After rejecting Walras' hypothesis, according to which no exchange is carried out outside balance, the theorists of economic imbalance had to re-evaluate the role of money in the economic system, which they analyse.

For Walras, money was not important, because its function was reduced only to a calculating unit. Everything occurs just as if goods were directly exchanged with each other. All the goods were in a state of balance with money, because all were perfectly liquid. Nothing was out of balance with money, no tranaction was possible. Therefore, Walras' economy is a barter and not a monetary economy.

The theory of economic imbalance criticizes this conception and brings money into economic analyses. It does this, simply because we observe it there in reality. Money really exists, so theory must take it into account, it cannot consider an exchange economy, which does not exist in practice.

For goods to be sold for goods, a state of balance in the exchange economy must exist in the exchange economy, which is only possible when the goods are liquid. However, this never happens in reality, because money enables the implementation of normal transactions.

However, the theorists of economic imbalance do not address their criticism only to the static Walras model, but also to the contemporary representatives of neo-classical economics and the Keynesian – neo-classical synthesis, in the way they integrate money into their theoretical conceptions.

The representatives of the theory of imbalance consider the attempts of contemporary neo-classical economics to introduce money into analyses of the Walras balance, either by the Patinkin-Friedman or Pesek-Saving methods, to be unsuccessful because they neutralize the money by making it only an ordinary witness, which makes no essential change to the functioning of the barter economy. According to supporters of the theory of economic imbalance, money is not passive. It has its own role in the process of exchange and by fulfilling it, puts markets into a state of imbalance.

In the Keynesian – neo-classical synthesis, money is understood as a sort of goods while goods are understood as money, but in reality they are not. Thus, although the authors of the Keynesian – neo-classical synthesis bring money into economic analysis, their ideas do not really go beyond the framework of the barter economy.

The theory of economic imbalance places the conception of the monetary economy against the conception of the barter economy. Since it introduces money into the economic analysis in the phase of exchange, it emphasizes the transaction function of money and does not devote attention to its function as a preserver of value. (Money as a preserver of value represents a link between the present and the future and so enables speculation. This function of money is emphasized in the Keynesian theoretical system).

Thus, we find ourselves in a monetary economy, in which goods are not exchanged for goods, either directly or indirectly, by means of one of the goods, which serves as a measure of value. The fact that goods cannot be exchanged directly for each other means that a supply of goods does not automatically create a demand for other goods, so that in a monetary economy, the functions of demand are exposed to limitations, which the economics of a natural economy do not recognize. By introducing money into economic analysis, the way is opened to research limited demand, that is, a type of demand in which purchasing ability is limited by various factors.

According to Malinvaud, money enables the implementation of normal transactions in the market. The only condition, which must be fulfilled is that the participants in the exchange agree on the price. This is usually different from a balanced price, in spite of the fact that the participants in the exchange act voluntarily always if they think that it suits their preference. This is entirely possible, because individual actors in exchange are situated in unequal positions, where the quantities of goods and money available to them are concerned.

The prices at which transactions take place are fixed and deformed prices. They are called fixed to distinguish them from prices in economic balance, which are produced by a process of tatonnement. The designation deformed prices is used in the sense that they are prices determined outside balance.

This means that exchange at deformed prices is associated with economic imbalance, and since transaction money leads to exchange at deformed prices, this means that money is also associated with imbalance. A monetary economy is, therefore, inevitably an imbalanced economy.

Malinvaud's contribution to researching the connection: money – imbalances - markets

According to Malinvaud, money does not create imbalance by itself. It is not the cause of the origin of the imbalances. However, the existence of money makes it possible for imbalances to arise, because money enables the implementation of normal transactions outside balance, that is, at prices, which are not balanced, but deformed. The presence of money is an obstacle to the reduction of imbalances, because when exchange occurs at deformed prices, it means that the process of „tatonnement" is suppressed, annulment of surpluses of supply or demand does not occur, and the result is the origin of quantitative limitations. Quantitative limitations, like deformed prices, are gradual processes of contamination transferred from one market to another. This presupposes that vertical links should exist between markets.

Malinvaud's analysis starts from the hypothesis of the existence of two markets – the market for goods and the market for labour - each of which may be in a state of imbalance. Four different configurations can occur:

Malinvaud calls the first of them Keynesian unemployment. Companies, which do not find enough demand for their products, reduce employment. Households, which do not have enough employment opportunities, reduce their consumption of goods and services.

This situation, therefore, means a surplus of supply in both markets. The surplus of supply in the market for goods is a result of the fact that the market price is higher than the balanced level, and so companies cannot sell as much output as they would like.

Malinvaud explains the surplus of supply in the labour market in a similar way. The valid wage is higher than the balanced level and so the household cannot sell the quantity of work it would like.

Malinvaud called the second possible configuration classical unemployment. It corresponds to the coexistence of insufficient demand in the market for goods with unemployment.

In this situation, there is surplus demand in the market for goods, caused by market prices lower than the balanced level, and a surplus of supply in the labour market, caused by excessively high wages.

Therefore, households are exposed to limitations in both markets, which are explained by insufficient profitable opportunities for companies.

The third possible configuration corresponds to a situation with surplus supply in the market for goods and surplus demand in the labour market. In other words, the economy produces excessive goods and there is a state of full employment. Such a situation is improbable in reality: why should companies have an interest in employing more people, when there is a state of over-production?

In the fourth configuration, there is a surplus of demand in both markets, caused by excessively low prices both for goods and services and for labour. In this case the limitation presses hard only on companies. Malinvaud described this situation as suppressed inflation. By this, he wants to express the fact that if prices were flexible, inflationary tendencies would appear. In reality, it concerns an economy undergoing a process of reconstruction, or a socialist economy.

Malinvaud's typology of the states of unemployment, which we briefly presented, leads to two important conclusions:

1. The measures of economic policy directed towards reducing unemployment should depend on the specific type of unemployment found in the country.

2. Just as Keynes saw the neo-classical analysis as a sort of partial configuration of his own theoretical system, Malinvaud understands the theory of economic imbalance as a broader economic conception in relation to Keynesian economics.

Malinvaud's typology of states of unemployment can be regarded as a sort of culmination of the first developmental stage of the theory of economic imbalance. Naturally, like every emerging theoretical conception, it has some weaknesses. Some economists especially criticize the assumption of the homogeneity of the market for goods or the labour market. Heterogeneity is typical in the real world, with segmentation of the labour market and differentiation of goods and services.

Malinvaud's analysis also disregards the fact that real economies have a multitude of markets and the imbalances, which appear in them, have different natures. For example, unemployment in some sectors of an economy may be caused by insufficient demand, while in other sectors it may be caused by low profitability.

The second developmental stage of the theory of economic imbalance, which is inseparably connected with the name of E. Malinvaud, but also of P.Y. Henin, already takes into account the construction of models taking into account the structure of markets and the different degrees of openness of a particular economy.

From this point of view, an economy is divided into two sector. One sector is relatively "protected" against foreign competition and mainly involves businesses providing services. It usually suffers from imbalances of the Keynesian type. In the sector, which must confront international competition, widening of the market is changing the hypothesis concerning limitation by quantity. National companies cannot rely on being able to permanently sell at prices higher than world prices. The limitations to which economic entities are subject no longer have the nature of quantities, but of prices. The imbalances confronting the sector exposed to foreign competition have a classical character.

Malinvaud's contribution to the present stage of development of the theory of economic imbalance

The present stage of development of the theory of economic imbalance shows a greater effort to approximate to economic reality. This appears especially in the fact that its representatives are attempting, in their studies, to grasp the inter-connections between shocks, institutions and unemployment. Apart from oil shocks, they also concentrate their attention on the shocks caused by explosion of wages or by high real interest rates. Among institutions, they consider especially the introduction of a guaranteed minimum wage in France at the end of the 1980s, increased protection for employment and gradual reduction of payments into social funds from low wages.

The latest research of the representatives of the theory of economic imbalance has devoted considerable attention to the problem of long-term unemployment. In this context, they point to the risk of the trap of long-term unemployment. To prevent the economy falling into this trap, it is necessary to find work for the existing long-term unemployed, and to prevent people entering the labour market for the first time becoming unemployed.

According to Malinvaud, the solution to this problem can use two different approaches. The first of them starts from the fact that certain social groups, including single mothers, unsuccessful students and the long-term unemployed losing their qualification, still move on the edge of this trap. It is necessary to find a specific solution to stimulating each of these groups to work. Malinvaud points to the fact that such an approach increasingly strikes against the barrier that these groups are not clearly distinguishable and that frequent amendment of regulations is required.

For these reasons, Malinvaud prefers a second approach, which takes into account the whole set of transfer payments and contributions to social insurance funds. He claims that to eliminate harmful stimuli, which lead in the end to only a weak stimulus to seek work, it is necessary to build up a stable and transparent system of transfer payments and contributions to social insurance funds.

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