



Society matters: A post-Keynesian approach to economic development

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Abstract:

This paper discusses methodological individualism and the perceived “need” for microfoundations in economic theory. It argues that the persistent focus on microfoundations has led a large part of the field to overlook the complexity of social interactions, the relevance of historical processes, and the characteristics of each society in understanding economic growth and development. The paper suggested focusing on social foundations as an alternative to microfoundations that is particularly relevant for studying economic development processes. It proposes framing the post-Keynesian view of demand-led growth and distribution-led growth within a conceptual framework of socio-economic development as a valid approach, consistent with social foundations, to understand a phenomenon as complex and multi-causal as development.

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This essay proposes an approach to analysing long-term economic development based on social foundations. First, I address the issues with methodological individualism and the perceived ‘necessity’ of microfoundations in economic theory, questioning the emphasis on individual behaviour as the ultimate explanation for economic phenomena. This perspective often neglects the complex relationships and environments that accurately reflect reality. I argue that the relentless pursuit of microfoundations has led much of the discipline to overlook the intricacies of social interactions and the significance of historical processes and societal characteristics in understanding economic growth and development. Following King’s (2012) approach, I suggest that social foundations offer a particularly relevant alternative for analysing economic

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development processes. Building on this, I propose framing the post-Keynesian theories of demand-led and distribution-led growth within a conceptual framework of proximate, intermediate, and ultimate sources of growth and development. This approach, consistent with social foundations, provides a robust means of understanding long-term economic development.

The remainder of this paper is organised as follows. Section 1 presents the conceptual framework of the proximate, intermediate, and ultimate sources of growth and development. Section 2 summarizes the neo-Kaleckian theory of growth regimes and problematizes the Lucas critique. Sections 3 and 4 go further into the latter, arguing the dogmatic nature of the need for microfoundations (section 3) and criticizing the methodological individualism (section 4) of mainstream macroeconomics. Section 5 follows with an approach viewed as an alternative to the search for microfoundations for theory: social foundations. Section 6 complements the previous section by focusing on the specific case of the analysis of growth and development in the long run. It proposes the post-Keynesian theory of demand-led and distribution-led growth, framed within a scheme of proximate, intermediate, and ultimate sources of growth and development, as an approach consistent with the social foundations for the analysis of development. Finally, section 7 presents the concluding remarks.

1. Development and growth

Development can be understood as a social process that enables changes aimed at improving living conditions, both materially and culturally, and that involves economic, social, and political factors. Two main approaches can be identified in the literature on development: the fight against poverty and the analysis of long-term social and economic development (Szirmai, 2015). The latter approach is particularly valuable for examining economic disparities, as it explores a wide range of factors that could explain the different development processes and their characteristics. Of course, this distinction between the “two approaches” is extremely broad; there are many ways of understanding development, which are not necessarily opposed. Development can be conceived as a synonym for economic growth, as a synonym for improved social welfare, as structural change (Abramovitz, 1989; Kuznets, 1966; Pasinetti, 1983), as modernization (Myrdal, 1968), as poverty reduction (Seers, 1979), as sustainability (Brundtland, 2010), or as freedom (Sen, 2001). Beyond the debate about what development is, it could also be debated whether it is a desirable process for human societies: development may involve the destruction of traditional lifestyles, the expansion of capitalist mass culture, the exploitation of workers, and the “westernisation” of the values of other societies, among other issues (Szirmai, 2015).

Without delving into the debate on the aforementioned criticisms, it is important to highlight two points: first, development is a costly process, and, second, the concept of development has strong historical specificity and reflects the dominant cultures and powers of each historical period (Szirmai, 2015). It seems clear that the concept of economic development is normative and involves choices and values. While conceptualizations vary, there is some consensus that productivity growth is a necessary condition for development, although it is clearly not sufficient to generate it.

From the above, it is evident that the choice of a conceptual framework to analyse development processes must necessarily consider the complexity of the concept, its multiple dimensions, and historical specificities. In this sense, it is particularly interesting to consider Szirmai's (2012) approach, which, more than a theory, should be understood as a way of ordering the study of development and its sources. Indeed, various perspectives and theoretical

approaches can be integrated into this analysis. This framework, developed by several authors (Abramovitz, 1986, 1989; Maddison, 1988; Rodrik, 2003; Szirmai, 2012, 2015), proposes to analyse which forces drive growth and development at the proximate, intermediate, and ultimate levels of analysis, and to contribute to the debate about the relative relevance of internal and external factors as drivers of long-term growth. In this framework, four levels of analysis are distinguished: ultimate sources of growth and development, intermediate sources of growth and development, proximate sources of economic growth, and socio-economic outcomes.

Immediate or proximate sources are those that are directly measurable sources of output growth (Szirmai, 2012): discovery and exploitation of natural resources and wealth; higher labour utilisation intensity; savings and capital accumulation; investment in education and human capital; appropriation of resources and capital from other societies; increased productivity; greater efficiency; structural change; exploitation of economies of scale; technological change. These factors can be represented by a basic production function that relates output to the proximate sources of growth. Once these proximate sources of growth have been quantified, it will be possible to explore their links to broader economic and social growth and development sources (Szirmai, 2012).

The intermediate sources of growth and development include three sets of factors: the evolution of domestic and international demand; economic, social, and technological policies; and the evolution of the terms of trade. Considering demand patterns is key to understanding the trajectory (and path dependence) of the economic development processes (Szirmai, 2012).

These proximate and intermediate sources are underlain by deeper social factors, called ultimate sources of growth and development. These include: geographical conditions; demographic characteristics; political, economic, and social institutions; culture; class, and power relations between social groups; historical shocks; long-term developments in science and technology; and distance from the international technological frontier. It is worth noting the difference between institutions, which regulate human interaction in specific areas, and culture, which encompasses a broader set of values, norms, and social knowledge. Institutions rely on culture but are oriented towards more specific domains (Szirmai, 2012).

The final component of this conceptual framework consists of socio-economic outcomes, the 'results' of development: the health of the population; levels of education and literacy; levels of consumption; the number of people living in poverty; income and wealth distribution; decent employment opportunities; and environmental sustainability. Socio-economic outcomes encompass both economic and social dimensions. In this paper, development is defined as the process of improving these socio-economic outcomes. These outcomes are what truly matter in the development process (Szirmai, 2015).

Adopting this framework, it can be argued that economic growth is a necessary condition for development. If an economy achieves high growth rates but the living conditions of its population do not improve, it is not possible to talk about development; nonetheless, the importance of increasing productive capacity remains crucial. At least in today's developing societies, improving social outcomes is not possible without a long-term sustainable increase in productive capacity. Economic growth is an essential precondition for improving social outcomes. It is important to clarify that this article does not aim to discuss the concept of development; what is relevant here is the study of the factors that facilitate this process, understood as the long-term improvement of socio-economic outcomes.

It should be noted that the use of the terms "ultimate", "intermediate", and "proximate" does not imply a linear model of causality. In this conceptual framework, causality is circular at all levels

(Szirmai, 2015). The difference between the ultimate, intermediate, and proximate sources of causality lies mainly in the ease of quantification and the temporal extension of causal chains.

In this essay, I propose adopting a post-Keynesian (specifically, neo-Kaleckian) approach to analyse how demand factors are determinants of long-run economic growth and, through this, of development. In other words, the framework of proximate, intermediate, and ultimate sources of growth is narrowed to examine how the evolution of demand (an intermediate source) affects growth. Going a step further within this framework and following the neo-Kaleckian approach, demand is considered a variable closely related to income distribution between social classes. Functional income distribution depends on: long-term trends in scientific and technological knowledge; demographic trends and conditions; economic, political, and social institutions; historical developments; culture; social attitudes and capabilities; and changes in the class structure and relations between social groups. In other words, distribution depends on the balance of power between social classes and its determinants. Within this framework, all these factors are regarded as ultimate causes of growth and development.

2. Distribution, demand, and development

A common topic in economic science is the analysis of the relationship between distribution and growth. Among the classics, there was a long tradition of analysing the effects of low wages on consumption levels and aggregate demand, as well as the link between aggregate demand and the accumulation process (Blecker, 2002). In the mid-20th century, Kalecki formalized the link between distribution and production in a model with two social classes, workers and capitalists, each with different propensities to consume (and thus to save) (Kalecki, 1996). In this model and its derivatives, prices are determined in oligopolistic markets, where firms set prices by establishing mark-up rates on their costs. Economies are assumed to have excess capacity; that is, aggregate demand determines the equilibrium levels of effective output (Blecker and Setterfield, 2019; Marmissolle, 2021). Kalecki's work inspired a series of neo-Kaleckian (or, more generally, post-Keynesian) macroeconomic models that give functional income distribution a central role in explaining the level and evolution of output.

Within the post-Keynesian tradition, the seminal work of Bhaduri and Marglin (1990) spurred a prolific literature on the influence of functional income distribution on countries' macroeconomic performance. This literature analyses the various channels through which the wage share of income (and profit share and, more recently, land rent share) affects consumption, investment, and net exports. From these effects, it can be determined whether increases in the wage share of income contribute to economic growth. If they do, it indicates that the growth regime of the economy is wage-led and, if not, profit-led (Blecker, 2002; Lavoie and Stockhammer, 2013). Identifying an economy's growth regime is extremely useful for understanding its past growth performance and future prospects. The nature of a growth regime is not determined by the economic policy implemented by a given government; it is not designed by policies but by the institutional structure of the economy. It is influenced by the country's income distribution, the propensity to consume of different social classes, the responsiveness of entrepreneurs to changes in sales possibilities and profit rate, the responsiveness of exporters and importers to changes in costs, exchange rates, external demand, and incentives to innovate that distributional changes may generate (Blecker and Setterfield, 2019).

While the literature on growth regimes is framed within demand-led growth theories (Blecker, 2002), supply-side analyses have also been incorporated into these models.¹ Changes in the wage share of income (or in real wages) can impact productivity growth (or technological progress, from a broader perspective). For example, the impact of distributional changes on productivity can be considered from the perspective of efficiency wage theory (Shapiro and Stiglitz, 1984). Another possibility is to consider an approach in line with the Kaldor-Verdoorn “law” (Kaldor, 1966; Verdoorn, 1949), which proposes that wage increases will positively impact firms’ incentives that, seeking to satisfy demand and reduce their costs, will achieve improvements in the production processes, thus generating productivity gains (Bengtsson and Stockhammer, 2021; Storm and Naastepad, 2013).

Post-Keynesian macroeconomic theory is useful for both short- and long-term analyses (Mott, 2002). Contrary to the mainstream views,² in long-run post-Keynesian analysis, output and employment are not determined by the supply of labour and capital remunerated according to their marginal productivities. Equilibrium is determined by the components of aggregate demand, whose evolution is linked to income distribution, among other variables. The supply of productive factors will determine the activity level only when aggregate demand exceeds the output of full employment and full capacity utilisation. However, as Steindl (1952) argues, this scenario is not very plausible, because firms tend to accumulate productive capacity in excess of demand. In this context, firms with lower costs will be able to sell at lower prices than their competitors, displacing them and growing faster in the market, thereby generating economies of scale. In the long run, this process leads to oligopoly and overcapacity (Steindl, 1952). This excessive installed capacity implies output levels below full employment levels, supporting the use of models focused on demand and income distribution to study long-term economic growth.

Post-Keynesian theoretical models usually consider the impact of distributional changes on different macroeconomic variables, treating distribution as an exogenous variable. This raises the following questions: What underlies functional income distribution? What determines wage and profit shares, and how do they evolve over time? Similar to the classical economists of the 19th century, Bengtsson et al. (2020) explore these questions, motivated by a stylised fact: the decline in the wage share in many countries. This trend is associated with various economic and political changes in developed countries since the end of the “Golden Age”, such as globalisation, production automation, and labour market deregulation (Bengtsson et al., 2020; Karabarbounis and Neiman, 2014). From a theoretical perspective, many variables could influence functional income distribution. However, throughout the 20th century and so far in the 21st century, the most relevant factors have been institutional. Party politics, unionisation of workers, and fiscal policy are the main determinants of functional income distribution in the long run (Bengtsson et al., 2020).

The factors mentioned in the previous paragraph are identified by Bengtsson et al. (2020) as proximate causes of changes in income distribution, but they all arise from a single fundamental cause: power balances in society.³ In other words, power relations are key to defining what lies behind the income distribution between different productive factors (or social classes), which, in

¹ The emphasis on the evolution of effective demand to explain economic growth is not opposed to supply-side considerations, even when the latter is not explicitly considered in the models. See Blecker (2002), Botta et al. (2018), Blecker and Setterfield (2019) and Lavoie (2022) for more details on these aspects.

² To simplify, I assume the position of Lavoie (2022) and use the terms “mainstream”, “orthodox economics”, and “neoclassical economics” as if they were synonyms. Although this is common in the literature, Colander (2000) and Davis (2006) have argued that this is a mistake. See Lavoie (2022) for more detail on this topic.

³ Bengtsson et al. (2020) understand “proximate” and “fundamental” causes in the sense proposed by North and Thomas (1973); it is interesting to note the parallelism with the conceptual framework adopted by Szirmai (2012).

turn, is key to defining how demand will behave and, ultimately, the economic growth and socioeconomic achievements of a given society.

In summary, the determination of the growth regime of an economy and the analysis of how income distribution impacts economic growth (and, therefore, the development process) depend on the impact that different income shares have had on aggregate demand and/or growth rates. Based on these effects, it is possible to identify whether the regime has been wage-led or profit-led (among other options).

One might ask whether identifying a wage-led (or profit-led) regime implies that policies favouring wages (or profits) should be implemented. A priori, the answer to this question should have some nuances: concluding that the growth regime has been wage-led in a given period may indicate that the country's "future" economic growth would benefit from pro-wage redistributive policies, but this may not necessarily be the case (Marmissolle, 2021). Palley (2014) argues that the wage-led or profit-led character of an economy is not necessarily exogenous; it can be affected by policy decisions taken from a certain point onwards. In this sense, Palley (2014) suggests what could be understood as a post-Keynesian analogue of the Lucas critique (Marmissolle, 2021).

Against this Lucas critique of post-Keynesian theory, it is relevant to highlight the position of Storm (2021), which, although not strictly referring to models of growth regimes but to macroeconomic models in general, discusses the relevance of the Lucas critique. Storm (2021) argues that the requirement that macroeconomic theories must overcome the Lucas critique is, in a sense, a fallacy.

Lucas's (1976) original proposition is that macroeconomic models using fixed parameters fail because their estimated values are unstable and may change in response to policy interventions during the study period. In his own words, the statement can be summarised as: "...given that the structure of all econometric model consists of optimal decision rules of economic agents, and that optimal decision rules vary systematically with changes in the structure of series relevant to the decision maker, it follows that any change in policy will systematically alter the structure of econometric models" (Lucas, 1976, p. 41). As a result, macroeconomic models are not useful for counterfactual policy analyses. There are two ways to interpret the Lucas critique: (i) take it as a positive statement about the application of a model, i.e., as a criticism of models used to do out-of-sample counterfactual analysis, or (ii) interpret it not positively but prescriptively, as a 'purist' methodological rule, a theoretical absolute (Storm, 2021).

Regarding (i), it is claimed that, while it is true that drawing policy conclusions from an estimate when it is possible that policy changes may modify the relationships between macro variables in the structural models involves risk, very few policy changes are capable of generating these modifications (Storm, 2021). Empirical evidence shows that the impact of policy changes on the parameters of macro models is, in most cases, insignificant. Moreover, micro-founded dynamic stochastic general equilibrium (DSGE) models generally fail the (self-imposed) Lucas critique (Storm, 2021).

Regarding (ii), it can be noted that this position has been adopted in mainstream DSGE models. The reasoning behind this approach is tautological, given that the idea is: (a) models that are robust to the Lucas critique have deep parameters that are invariant to changes in policy; (b) only models that are robust to the Lucas critique are useful; (c) let us assume that the parameters of DSGE models are invariant to policy changes; and (d) therefore, DSGE models are robust to the Lucas critique (Storm, 2021). This conclusion is incorrect because, in the end, the microfoundations of the model that set the estimated parameters are always potentially affected by policy. In recent years, there have been significant efforts to identify more "deeper" microfoundations for DSGE models; however, these can always be criticised using Lucas's

approach.⁴ Against this, Storm (2021) argues that actually the estimated parameters in a model change and evolve continuously, and it is impossible to predict the future without modifying it. After all, models that are robust to the Lucas critique do not exist; the behavioural rules of individuals or groups of individuals (such as social classes) will always be affected by policy changes.

Storm (2021) concludes that it is not recommended for macroeconomics to insist that models be robust to the Lucas critique, while noting that this is not a problem because the impact of policy changes on the parameters of macro models is generally insignificant. The key to drawing policy conclusions from a model is to be cautious, especially when the estimated coefficients can be expected to be affected by policy. The Lucas critique can be ignored for practical purposes (Storm, 2021). The same arguments can be developed for the specific case of post-Keynesian growth theories in response to Palley's (2014) critique.

Beyond the application of this critique to the neo-Kaleckian theory of growth regimes and Storm's (2021) replication noted in the last paragraphs, it is worth noting that the Lucas critique has become one of the cornerstones of modern (at least mainstream) macroeconomics. The basis of this cornerstone is the search for microfoundations for economic theories and econometric models. The idea is that macroeconomic models must be based on structural parameters that reflect the fundamental and immutable rules of individual behaviour and therefore do not change when macroeconomic policy changes. These microfoundations would ensure that the models can be used to make robust predictions of the effects of macroeconomic policies. According to this approach, macro models without microfoundations would not be useful because they would not be able to generate predictions that would overcome the Lucas critique.

The Lucas critique led economic science to a persistent search for microfoundations. I consider that this focus has led much of the economics discipline to ignore the complexity of social interactions in the real world and the relevance of historical processes and the characteristics of each society in understanding complex issues such as growth and development.

3. The microfoundations dogma

The 'microfoundations dogma' refers to the claim that all propositions in macroeconomics can be reduced to microeconomic propositions, that is, statements about the behaviour of individual agents (King, 2012). This dogma is not unusual in modern macroeconomics. Since the 1980s, both mainstream and heterodox economists have regarded microfoundations as a mark of rigor in their theories. Philosopher Alan Nelson (1984) identified the microfoundations doctrine as an example of micro-reduction, concluding that the project was highly unlikely to succeed, given its long history of failure dating back to classical antiquity debates about the reduction of one science to

⁴ The criticism of DSGE models is not exclusive to heterodox economics. As Lavoie (2022) argues, Solow – considered the father of neoclassical growth models – has himself repudiated DSGE models, claiming that their foundations were “dumb and dumber macroeconomics”, and that adding realistic frictions does not make these models plausible (Solow, 2008). Hoover (2023) considers that DSGE models deserve to be considered by academia and evaluated against other alternatives, but he criticises the position of mainstream macroeconomists who defend the set of “prior constraints” on model form (representative agents, rational expectations, dynamic optimisation, general equilibrium), which, when absent in alternative models, automatically make them inadmissible. Hoover (2023) concludes: “I sometimes think of the DSGE models as haiku. The 5/7/5 syllable pattern of haiku is arbitrary. That's OK for poetry. But the arbitrary rules of DSGE are not OK for science. Haiku is not the only admissible form of poetry; nor should the DSGE model be the only admissible form of macroeconomics” (Hoover, 2023, p. 87).

another. This scientific pyramidism suffers from two issues: the fallacy of composition and downward causation (King, 2012).

To illustrate these concepts more concretely, consider this example provided by King (2012): What is a car, and what are its attributes? We can know all the pieces of the car, but it is impossible to infer the characteristics of the vehicle from the knowledge (however, complete) of all the pieces. A car has social, economic, and cultural significance. Denying this implies a fallacy of composition. Cultural, economic, environmental, and social changes directly affect the car as a machine and its different pieces. Causality, in this case, goes from the largest to the smallest units (top-down), and not just bottom-up. We can know everything about the pieces, but this would not allow us to explain the social, economic, and cultural significance of cars (King, 2012).

Returning to economics, the anti-reductionist principles of the fallacy of composition and downward causality are closely related to the need for microfoundations in the study of macroeconomics. As King (2012) points out, the microfoundations dogma is a clear example of the fallacy of composition: something true and valid for an individual agent may not be true and valid at the aggregate level. There are many examples in economic science.⁵

The idea that the economy is based on “isolated atoms” is an essential feature of the lack of realism of orthodox theories (Lavoie, 2022; Vergés-Jaime, 2023). In contrast, heterodox schools, including the post-Keynesian, have adopted a more holistic approach. For example, social classes are present in several heterodox models. Considering their existence becomes necessary once it is assumed that individual preferences are not sufficient to understand how society works (Lavoie, 2022).

Recognising that individuals are social beings rather than atomistic beings allows institutions to be introduced into the conceptual frameworks of economics. While, for the mainstream, institutions are market imperfections that limit perfect competition, for heterodoxy, institutions are a factor that generates a certain stability (Hodgson, 1989; Lavoie, 2022).

However, what has been said does not mean that we should eliminate the microfoundations of macroeconomics and impose macrofoundations for microeconomics. What is important is that economic theories, whether micro or macro, have social foundations (King, 2012). Economic theories require social foundations rather than microfoundations. In other words:

Economists need to be aware (as Marx would have said) that they are attempting to model capitalism, not simple commodity production. Hence there are two classes of agents, capitalists and workers, and it is the former who own the means of production and control the production and sale of commodities. Firms are not simply the agents of households. Production is motivated by profit, not – at least, not directly – by the utility functions of asocial, classless ‘consumers’. Since profit is by definition the difference between revenue and costs, that is, the difference between two sums of money, it is pointless to model a capitalist economy in terms of barter. These social foundations of any meaningful economic theory are exceedingly obvious, but they are routinely violated in the mainstream models that employ RARE⁶ microfoundations (King, 2012, p. 25).

Of course, these social foundations are far from theoretical elusions as far removed from reality as the representative agent, which does not represent society as such (Hodgson, 2001; Kirman, 1992). The dogma of microfoundations implies thinking about social issues only by considering the relationships of upward causality, eliminating the possibility of relationships of

⁵ Some examples could be the paradox of thrift (higher savings rates can reduce output and growth), the paradox of public deficit (imbalances in public accounts can generate a growth in private sector profits), and the paradox of costs (higher wages can generate higher profit rates for capitalists), among many others. See Lavoie (2022) for more on these questions.

⁶ Representative Agent with Rational Expectations.

downward causality. In this sense, thinking about social foundations allows for a more comprehensive approach.

4. Behind the microfoundations: methodological individualism

The Lucas critique of the literature on growth regimes, which follows King (2012), can be understood as an example of the “microfoundations dogma” leading to a reflection on why there has been so much insistence on this micro reduction (Nelson, 1984). Like most scientists, economists often work with little or no explicit reflection on the philosophical assumptions underlying their research. When these assumptions are explicit, adherence to “methodological individualism” is common. Although the term has different meanings, it essentially emphasizes the centrality of individuals and their intentional behaviour in understanding social phenomena in general, and economic phenomena in particular. Reviewing the history of the concept of methodological individualism, the first notable point is that it was not introduced by a philosopher but by the economist Joseph Schumpeter in the early 20th century. According to Schumpeter (1909), the concept involves starting from the individual to describe certain economic relations; it is neither a universal principle of social scientific research nor a mandatory rule for all social scientists. In the 1940s, leading economists of the Austrian School linked the concept to their own methodological position (Hayek, 1942; Mises, 1949). From Hayek, it went to Popper, landing in philosophy and other disciplines (Hodgson, 2007).

But what is methodological individualism? There is no consensus on its definition. Typically, it is interpreted differently from Schumpeter’s original meaning. Schumpeter used the term “sociological individualism” to describe the idea that the autonomous individual is the ultimate unit of social science, implying that all social phenomena are the result of individual decisions and actions rather than supra-individual factors. Sociological individualism is quite similar to what is commonly referred today as methodological individualism. Schumpeter rejected this doctrine of sociological individualism as unworkable as a complete explanation of social phenomena, considering methodological individualism as a limited analytical option (Hodgson, 2007).

Currently, most advocates of methodological individualism treat it as a universal principle that must be used in the social sciences (Hodgson, 2007). Among the different possible interpretations of the concept, the idea that we need “explanations in terms of individuals” is the most classical, but also problematic. One might ask: Should explanations of social phenomena be solely in terms of individuals, or should they also consider the relationships between them? The social world, precisely because it is social, must involve such relationships. As Hayek pointed out, society consists not only of individuals but also of interactions between individuals and between individuals and their (natural and social) environment. Starting from the individual to describe certain economic relations should not imply the negation of social relations.

Views of methodological individualism range from those requiring social phenomena to be explained entirely in terms of individuals to those that “only” require them to be partially explained in terms of individuals (Hodgson, 2007). This may seem a minor detail, but the difference is significant.

Hodgson (2007) shows that all satisfactory and successful explanations of social phenomena involve interactive relationships between individuals. These relationships are present even when explanations are reduced to individuals. As agents do not live and make decisions in isolation from the rest of the world, each individual choice always requires a conceptual framework that makes sense of the world. This conceptual framework, or cognitive system, implies a process of

socialisation, a process in which there are necessarily interactions with other agents. As individuals, we understand the world in a certain way through social interaction. This occurs in an environment influenced by institutions, which, in turn, are determined by social behaviour itself. Individual choice is impossible without such institutions and interactions. In other words, methodological individualism, in its strict version, has a problem: attempts to explain each emerging layer of social institutions are always based on prior institutions and rules. If one admits the influence of institutions on individuals, one must also explain where those institutions emerged. Analysing social phenomena, we will never arrive at an end point where there are only isolated individuals “free of institutions” or, in other words, an initial state of nature. If we follow strict methodological individualism, we fall into a circle in which the actions of agents could then be explained in part by institutional factors, which in turn are explained in part by the actions of other individuals, and so on and so forth, indefinitely. Approaches based on microfoundations must analyse social phenomena based simultaneously on individuals and institutions. It is not possible to explain the emergence of institutions on the basis of individuals and nothing else, because there is no way to conceptualise the initial state of nature from which institutions are supposed to emerge (Hodgson, 2007).

On the other hand, the broader version of methodological individualism, which assumes that explanations must be in terms of individuals and the relationships between them, is equivalent to stating that explanations of social phenomena must be in terms of both individuals and social structures. This can be understood as the correct approach but, if so, why label it methodological individualism? Ultimately, social structures and individuals would be equally relevant in explaining a given social phenomenon (Hodgson, 2007).

Given that reducing the analysis of social phenomena to studying individual behaviour in isolation makes no sense, why does orthodoxy assume that using microfoundations provides greater validity to claims when studying the economy at the aggregate level? Why has so much emphasis been placed on methodological individualism? As Hodgson (2007) points out, there may be several reasons for this. First, there may be an (erroneous) view that it is a necessary component of political individualism. This would imply mixing ideology with scientific analysis. Second, it can be argued that an explanation in terms of smaller and smaller (or more micro) components is a key purpose of science. However, many examples show that scientific explanations are never solely in micro terms. Explanations always involve consideration of interactive relationships. In the social sciences, if one accepts the need to explain everything in micro terms, one would ultimately have to explain social phenomena exclusively in terms of elementary subatomic particles (Hodgson, 2007). This extreme reductionism is unreasonable, because “the very existence of social entities, and the social sciences devoted to their study, counters such an extreme reductionist agenda” (Hodgson, 2007, p. 10).

One way to distinguish orthodox economics from heterodox economics is based on their definitions of the concept of the “individual”, as well as the emphasis placed on individuals in economic science (Davis, 2003). Orthodox economics emphasizes the individual as an autonomous, atomistic being, while heterodox economics recognises the individual as a unit of analysis embedded in social and economic relations. Davis uses the terms “internalist” for orthodox economics’ definition of the individual and “externalist” for that of heterodox economics; according to Davis (2003), while heterodox economics offers an adequate conception of the individual, orthodox economics lacks one.

One of the earliest incorporations of relationships between individuals in orthodox economics was game theory. Since its formalisation by Von Neumann and Morgenstern (1947), neoclassical marginalist economics has used its tools and results to explain the strategic interaction between

agents, with their own preferences or production functions and their own endowments. In this framework, an agent's decision is conditioned not only by his own characteristics but also by the information he has about the characteristics of the other agents, and so on for all agents in an environment. Game theory represents significant progress in considering interactions between individuals, reaching equilibrium outcomes that emerge from processes that are more than the sum of their parts. However, how is this knowledge of individuals formed, and how do we incorporate the formation of social structures linked to individual behaviour, in the sense of Hodgson (2007)? One answer provided by the literature is the possible emergence of "evolutionary stable strategies" as a result of repeated games (Davis, 2003). In the process, agents create "conventions", which they then internalise in their individual strategies. Nevertheless, game theory does not extend beyond the atomistic conception of the individual in orthodoxy, where it is treated as an abstract concept, devoid of subjectivity, which only follows certain established "rules" (Davis, 2003).

Following this line of thought, it could be said that the only alternative theorisation of the individual that has emerged within mainstream economics since the second post-war period is an abstract conception of the individual (Davis, 2003). This conception contrasts with that of rational choice theory, which we might call subjectivist. In short, Davis (2003) argues that it is possible to include characterisations of individuals from experimental economics, bounded rationality, evolutionary economics, new institutional economics, behavioural economics, and other recent research strategies, within the abstract conception of the individual coming from cognitive science. This conception is characterised by "the view of the mind as a computer and of the individual as a symbol-processing system" (Davis, 2003, p. 82), which is embodied in ad hoc characterisations of individuals. This metaphor aims to make explicit the notion of individuals' mental processes as a set of mechanisms with a high level of determination. Understanding mental processes in this way implies removing the more subjective characteristics of individuals. This conception fails to satisfy the criteria proposed by Davis to adequately account for individuality; thus, the characterisations of individuals derived from it would not be appropriate for improving methodological strategies based on microfoundations to answer questions in economics and, particularly, in macroeconomics.

Davis's (2003) heterodox perspective embeds individual behaviour in a social context. This approach, derived from social theory, a multidisciplinary field that emerged around the last quarter of the 20th century, rejects reductionist reasoning. His reasoning is framed in terms of the relationship between agency and structure or between individuals and society.⁷ The idea behind this reasoning is that individuals and social structures are interdependent and inseparable, with each part constituting and determining the other through recursive social practices (Davis, 2003; Giddens, 1976, 1984).

Institutionalism, social economics, complexity economics, critical realism, feminism, and intersubjectivist economics could be considered part of this perspective (Arthur, 2014; Davis, 2003; Kirman, 2010). In all these schools of thought, individuals are characterised by the fact that they do not lose their character as such and that they are reflexive (and therefore active) beings, as opposed to the individual that arises from the abstract conception mentioned above. Of the above-mentioned schools of thought, this brief essay implicitly posits an approach to institutionalism via the Hodgson critique of methodological individualism. Hodgson emphasises the need to account not only for bottom-up causality (from individuals to institutions) but also for

⁷ Recently, Cesaratto (2023) put forward a similar position. He argues for the historical reconstruction of the objective and subjective characteristics of economic formations, rather than the a-historical study of individual choices ("isolated" from the social context). In other words, he suggests that agency must be historically contextualized.

top-down causality. Learning is a good example of an aspect of human reality that can be better explained than is done by neoclassical economics. In what might be labelled as an (also) evolutionary view, Hodgson indicates that human psychology evolves through changes in habits and methods of conscious reasoning (Davis, 2003); this process enables and allows the learning process.

5. Social foundations

Sections 3 and 4 discussed what King (2012) called the “microfoundations dogma” and questioned one of the philosophical assumptions underlying the search for microfoundations in economic theory: methodological individualism. Given this, it is worth asking: why are microfoundations still used in economics, and why is the emphasis on individual behaviour (whether “socially embedded” or not) still used to understand economic problems?

In the following paragraphs, I will attempt to answer these questions through a brief historical review of the changes in the object of the study of economics. Next, I will outline the main differences between orthodox and heterodox economics in their conception of social phenomena, considering the relevance of social and institutional factors specific to each period and location for understanding phenomena such as development.

Towards the end of the 18th century and for much of the 19th century, authors such as Smith (1776), Ricardo (1817), and Marx (1867) established the basis for a scientific discipline whose aim was to study the generation and distribution of the wealth of nations and the social relations linked to these processes. In other words, the object of study of economics (or, more accurately, of political economy) was the processes by which human societies generated value, how they distributed it, and how they consumed it. This is the classic definition of the object of study in economics, which generates a set of characteristics when studying reality, that is, an ontology. In this economics, although the individual was treated as a subject of analysis, the level at which economic phenomena took place was generally the aggregate, that is, society as a whole or different social classes. This did not imply denying the individual but, in the more “extreme” cases (e.g., in the Marxist view), it led to explanations of economic behaviour based on social dynamics, which exist beyond individual behaviour, as a sort of supra-individual element. In other words, it could be argued that classical economic theories were not based on microfoundations but were sustained on social foundations.

The classical view of economics is an objective one. However, influenced by various factors, including a general climate of faith in the progress of humanity and the natural sciences (positivism), it was transformed into a subjective view in the second half of the 19th century (Davis, 2003). Marginalism, under the influence of neoclassical authors such as Marshall and, mainly, Walras and Jevons, and of some Austrians such as Menger, gave way to the predominance of the individual as the subject of analysis of economics, on the understanding that the analysis of subjective characteristics such as personal preferences would provide a greater scientific understanding of economic phenomena (Roncaglia, 2017). This subjectivist view, with its own theory of value based on the market interaction between supply and demand, presents a definition of economic science that combines its main characteristics. This (neoclassical) definition is that of Robbins (2007) of 1932, which is used even today by the mainstream and the textbooks in the field: economics as a science that studies the allocation of scarce resources among alternative purposes.

Thereafter, the advancement of mainstream economics gave way to individuals who were increasingly devoid of subjectivity (Davis, 2003). As economic theory advanced in mathematical formalisation and relied increasingly on the basic assumption of rational preferences, the individual subject of study became increasingly abstracted. The social foundations of theoretical models have been gradually forgotten. In the second half of the 20th century, mainstream economics gave increasing weight to “cognitive science” (Davis, 2003), which could be expressed differently as the “science of decision-making”. As mentioned above, this reductionism, which increasingly relies on individual behaviour as an explanation of economic phenomena, has permeated both microeconomics and macroeconomics, transforming microfoundations into the basis of mainstream explanations of the behaviour of social aggregates.

Finally, it must be pointed out how the mainstream has attempted to incorporate *ad hoc* developments that consider the interactions between individuals, the behavioural biases that individuals may present in their actions, and the existence of “institutions” as supra-individual constructs, which are created and shaped by individual behaviour. In Lakatos’ (1976) terms, a “protective belt” has been created around the core of the mainstream which explicitly limits the criticisms (and the falsification itself) of the “hard core” of neoclassical theory. On the other hand, it should be noted that mainstream theories cannot adequately consider the influence of social phenomena on individual behaviour; it is necessary that theories explicitly recognise the social contexts in which individuals operate, influenced by them, and influence them in a unique process (Davis, 2003, 2011).

Although various streams of heterodox economics differ on many issues, they share the same conception of social phenomena, as well as the same metaphysical beliefs and presuppositions underlying the core elements of their respective theories (Lavoie, 2022; Lawson, 2008). Hein and Lavoie (2019) and Lavoie (2022) argue that the two research traditions in economics can be distinguished through five types of philosophical presuppositions. The authors’ statements are summarized in table 1.

Table 1 – *Differences between the orthodox and heterodox research programmes*

| Presupposition | Orthodox schools | Heterodox schools |
|---------------------------|---|---|
| Epistemology/ Ontology | Instrumentalism | Realism |
| Rationality | Hyper model-consistent rationality, optimizing agent | Environment-consistent rationality, satisficing agent |
| Method | Individualism, atomicism | Holism, organicism |
| Economic core | Exchange, allocation, scarcity | Production, growth, abundance of (non-natural) resources |
| Political core | Unfettered markets | Regulated markets |

Source: Lavoie (2022, table 1.3).

The points made by Hein and Lavoie (2019) and Lavoie (2022) on the differences between orthodoxy and heterodoxy will not be developed here, although it would be interesting to consider them, as they allow the inclusion of discussions about the connection between distribution, demand, and growth, and the debate on microfoundations and methodological individualism within a broader framework of debates between the two main schools of economic thought.

This section underscores the importance of social and institutional factors specific to each period and place under analysis when studying social processes in general, and growth and development in particular. Micro-founded models, based on the analysis of the behaviour of isolated individuals devoid of the set of social relationships inherent in life in society, cannot fully comprehend intrinsically social phenomena such as development. Paraphrasing King's quote from section 3: macroeconomic models are not merely modelling the production of commodities; they are modelling a capitalist economy, whose functioning varies across different historical contexts. Satisfactory explanations of social phenomena must consider the relationships between individuals. Even when explanations focus on individuals, these relationships remain crucial, as every choice requires a conceptual framework to interpret the world. Social interactions always occur within an environment shaped by institutions, which, in turn, are determined by social behaviour. What is important is that economic theories, whether micro or macro, are socially grounded. Economic theories, rather than microfoundations, require social foundations (King, 2012).

6. Historical foundations for the analysis of economic growth and development

There are several characteristics of post-Keynesian macroeconomics that make it particularly relevant for analysing development. As Hein (2017) points out, post-Keynesian economics is distinguished from other heterodox currents by certain central characteristics. Among these, the principle of effective demand stands first. According to this principle, aggregate demand is the main force that determines output and employment in the economy. Although there is little debate on the relevance of demand in the short run, the long-term impact of aggregate demand on employment and output is a matter of debate in economic science. In this sense, considering that, regardless of the time horizon, the economy is demand-led is a specific characteristic of the post-Keynesian tradition (Lavoie, 2022). From this perspective, the real path that the economy takes in the long run influences the determinants of growth on the supply side. However, this does not mean that the supply factors are not relevant. Technical change, the growth of the installed capacity of firms, and, ultimately, the productive capacity of the economy, are key to sustaining the growth process. What is argued here is that potential output growth responds to actual output growth (determined by demand), and not vice versa (see section 2).

A second characteristic of post-Keynesian economics that is particularly relevant for analysing long-term growth and development is the conceptualisation of time (Hein, 2017; Lavoie, 2022), particularly the distinction between "historical time" and "logical time" (Robinson, 1980). Unlike logical time in mathematical models, historical time (or chronological time) is irreversible.⁸ The

⁸ The difference between these concepts consists of the fact that historical time refers to the (actual) passing of time (in the real world), while logical time is nothing more than a theoretical construct used in models, which allows the analysis of static positions or movements between them. Historical time is time that moves continuously forward and makes it possible to analyse the evolution of the society (or, more specifically, of economic phenomena) over the course of history and to understand how different phenomena are linked to each other over time. Logical time, on the other hand, is used in a theoretical model to describe a steady state or a trajectory between states; in a correctly specified steady state or trajectory, there is no distinction between one day (or month, or year) and another, and there is no forward or

transition from one equilibrium to another is crucial; the conditions under which this transition occurs determine the endpoint, that is, the new equilibrium (Lavoie, 2022). In other words, the trajectory determines the equilibrium; history matters and becomes particularly relevant for economics. Path dependence and hysteresis are key to the post-Keynesian understanding of economic phenomena, which are necessarily situated in historical time (Lavoie, 2022).

The third characteristic of post-Keynesian theory that should be highlighted is its focus on distributional issues (Hein, 2017). Income distribution, both in personal and functional terms, has been particularly relevant within the post-Keynesian tradition in general and the neo-Kaleckian tradition in particular. For example, the rising trend in the profit share of income in developed economies since the end of the Golden Age and its impact on the slowdown of growth in these economies have been studied in depth by this school of thought. In the second half of the 20th century, it formalised earlier concerns about the effect that regressive income distribution can have on aggregate demand (Lavoie, 2022).

A notable strength of the post-Keynesian theoretical framework for analysing economic development is the lower emphasis placed on the individual in the theoretical models. In contrast to the orthodox conception of the individual as an autonomous and atomistic being, post-Keynesian economics adopts a holistic approach, viewing the individual as a unit of analysis embedded in social and economic relations – an “externalist” definition, as per Davis (2003). This concept is based on the idea that individuals and social structures are interdependent and indivisible, with each part constituting and determining the other through recursive social practices (Davis, 2003; Giddens, 1976, 1984). In this regard, such an approach is particularly relevant for considering the existence of social classes when analysing income distribution and effective demand. This relevance becomes clear when it is assumed that individual preferences alone are insufficient to understand the functioning of society (Lavoie, 2022). Recognising that individuals are social beings and not atomistic entities allows institutions to be introduced into economic frameworks, not as market imperfections but as factors that generate stability in a realistic context of uncertainty and interdependence among agents (Hodgson, 1989; Lavoie, 2022).

Moreover, this approach explicitly enables the consideration of the historical specificities of the economy under study. It allows for an analysis of the historical and cultural contexts in which economic phenomena are generated and how these are shaped by social and political factors. Consequently, this creates more space for interdisciplinarity in economics. In this sense, the post-Keynesian growth regime approach is compatible with Hodgson’s (2001) proposal to “bring economic theory closer” to historical specificities. It can enhance the understanding of how an economy’s institutions have evolved over time and how this evolution is determined by broader social forces.

As discussed in section 1, the concept of economic development is normative and involves choices and values. Even though conceptualisations vary, there is some consensus that growth is necessary for development, although it is clearly not sufficient to generate it on its own. In other words, economic growth is one of the essential preconditions for improved social outcomes. I consider that, as a way of approaching the understanding of economic development processes, it can be valuable to frame the neo-Kaleckian theory on growth regimes within a conceptual framework of proximate, intermediate, and ultimate sources of growth and development. In this way, when analysing development, it becomes central to the analysis of how demand factors affect

backward movement in time. As a theoretical construct, it allows for the analysis of economic models and does not relate directly to the actual passage of time. See Robinson (1980) for more details on these concepts.

economic growth in the long run and, in the same vein, how income distribution affects demand. In this framework, growth, demand, and distribution are strongly linked to each other and depend on the correlation of forces among social classes, their determinants, and their historical evolution.

To analyse growth and development processes from a long-term perspective, the post-Keynesian approach gives a central role to the social and institutional factors of each historical context, or, in other words, to how history shapes the present.⁹ In contrast, models based on the analysis of the behaviour of isolated individuals, devoid of the interrelationships inherent to life in society, cannot fully understand an intrinsically social phenomenon such as development. Social interactions always occur in an environment influenced by institutions, which in turn are determined by the behaviour of individuals themselves. This does not mean that post-Keynesian macroeconomics lacks a vision of how agents define their choices or how firms operate. The difference lies in the fact that, in this theoretical framework, we start from an organic perspective of the world in which the bases of agents' behaviour are established on philosophical assumptions that are very different from those of mainstream micro-founded models (see table 1).

King's (2012) proposal to endow economic theories with social foundations rather than microfoundations can be refined for the particular case of growth theories, especially in cases where the aim is to analyse long-term development processes. In this sense, it can be argued that analytical models should have historical foundations. In other words, economic theories should give greater consideration to historical specificities (Hodgson, 2001). Cesaratto's (2023) proposal to pursue the historical reconstruction of the objective and subjective characteristics of economic formations, rather than the ahistorical study of individual choices, points in the same direction. I consider that the post-Keynesian (or more precisely, neo-Kaleckian) theory of demand-led growth and distribution-led growth, which analyses how growth regimes are defined, how they change over time, and how economic policies influence the direction and speed of these changes, fulfils these characteristics. It analyses economic growth by focusing on historical processes and the interaction between different social actors. If this perspective is integrated into a conceptual framework of proximate, intermediate, and ultimate sources of growth and development,¹⁰ it also becomes a good approach, consistent with social foundations, for analysing development processes.

7. Concluding remarks

In this essay, I propose an alternative to micro-founded macroeconomic models and methodological individualism, focusing on the search for social foundations for theories that aim to understand long-term economic growth and development processes. This does not imply denying the value of microeconomics and the analysis of individual behaviour. Rather, it suggests that macroeconomic propositions cannot be reduced to propositions about individual behaviour. Such reductionism necessarily leads to scientific pyramidism, which suffers from the fallacy of composition and denies downward causation. Mainstream macroeconomics tends to focus on individual-level analyses, neglecting many social and political factors essential to understanding economic development.

⁹ The growth and distribution models for developing economies put forward by Porcile et al. (2023) are a good example of this.

¹⁰ As developed by Abramovitz (1986, 1989), Maddison (1988), Rodrik, (2003), and Szirmai (2012, 2015).

To address this limitation, I propose analysing development processes using post-Keynesian theory framed within the approach of proximate, intermediate, and ultimate sources of growth and development. This perspective can contribute to the understanding of development by highlighting how demand factors and distributional conflicts shape long-term economic development. Among the characteristics of post-Keynesian macroeconomics that are useful for analysing economic development and consistent with the idea of social foundations are the principle of effective demand, the concept of historical time, the relevance of path dependence and hysteresis, the centrality of distributional conflict, and the view of individuals as social beings rather than atomistic entities.

In summary, this paper aims to provide an alternative to the conventional approach in economic theory. This alternative focuses on the “social foundations” for understanding economic growth and development and proposes a conceptual framework that gives a central role to the social and political factors that influence these processes.

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