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14

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BARRIERS TO EMPLOYMENT POLICY

Fiscal and Monetary Policy in the Keynes-Kalecki Tradition

Alois GUGER und Ewald WALTERSKIRCHEN*)

Introduction

The co-existence of rising inflation, unemloyment rates and budget deficits has discredited fiscal policy in the last decade.Keynesian economics, the dominant mode of thought in economic policy and economic analysis, has been depreciated and the old orthodoxy has gained ground again.

After the war, Keynesian demand management policies were adopted and, though there may be some disagreement about their active role, there can be no doubt that budgetary policies played a key part in avoiding a major set-back for more than twenty years. On the one hand, in most countries the widespread belief that governments will and can counteract cyclical fluctuations by fiscal action strengthened business confidence and thus acted in itself stabilizing upon the economic development (BAILY 1978; BISPHAN & BOLTHO 1982). On the other hand, the universal growth of public expenditures led to an overall expansive drive and the

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build-up of the welfare state increased the built-in flexibility of the system substantially. Though the degree of active commitment to demand management between countries varied - the UK, Sweden, Norwegen, and possibly Austria were much more committed to intervention than Germany and Switzerland, thus causing divergent rates of inflation and disequilibrium in the balances of payments which forced some governments repeatedly to restrictive actions - unemployment rates declined and the rates of growth reached an unprecedented high level.

Since the late 1960′s circumstances have changed entirely: In the face of cost-determined inflationary pressures,i.e. rising wages and raw material prices, the demand-side instruments of the orthodox Keynesians have been doomed to fail. Restrictive fiscal and monetary measures lowered inflation only with a long delay but caused a considerable decline in output and employment. Keynesian theory and policy-making have lost ground in these years. In many countries confidence in demand management policies has been shaken and restrictive monetary rules have revived. It turned out that the Keynesians were right in warning that full employment could not be maintained by relying on demand management strategies alone. In 1943 J. ROBINSON warned that unemployment in a capitalist economy has the function of preserving the value of money, and M. KALECKI pointed out that

> "Full employment capitalism′ will have ... to develop new social and political institutions which will reflect the increased power of the working class."(KALECKI 1943)1)

and in 1944, when the British Government incurred the responsibility for a "high and stable level of employment" (White Paper) Cambridge and Oxford economists gave a comprehensive account to the problems a policy of maintaining long-term full employment has to face in capitalism. They had envisaged the need for a number of controls because the pursuit of such a policy might be constrained by trade imbalances and inflationary pressures.

In the first part of this paper our point of departure is Keynes's attitude to the policies applied after the war under the auspicies of 'Keynesian conventional wisdom'.We are going to refer to Keynes himself and the scepticism of his fellow economists in Cambridge who have always been very sceptical about the long-run outcome of the demand management strategies of the 'Bastard Keynesians' in view of their failure to take into account the limits of such a policy stemming from inflationary pressures and trade deficits. Here we are concerned to look at the place of fiscal and monetary policy in Keynes's thinking and his policy recommendations for the post-war years.We shall learn that in Keynes's thinking fiscal policy didn't have such an exclusive place as it had in the conventional Keynesian models and in policy-making in the 1950's and 1960's. Keynes's policy advice is not so straightforward as Lerner's concept of 'functional finance' has led us to believe.

In the second part of this paper, our starting-point is Kalecki's view on post-war employment policy. At first, we are going to deal with the problems which, growing out of the era of high employment in the 1960's, led to major policy reorientations in many countries in the 1970's.Secondly, the consequences of these restrictive policies for both the employment and budgetary situation in the last decade as well as for possible future fiscal actions are analysed. In a final part we shall give a summary of the barriers, we would see, to full employment fiscal strategies in the near future and to remedies of which we think of to be necessary to make a further application of fiscal policies more hopefully.

Keynes on fiscal policy and post-war stabilization

When we come to Keynes's view on fiscal policy we have to keep in mind that Keynes was first and foremost a monetary economist. He always attached utmost importance to money; yet after the war Keynesianism has become largely identical with fiscalism; it was concluded from his theory that there is nothing that can be done with monetary policy. Employment policy would have to rely on government's budget alone.

Keynes on Monetary Policy

Keynes's theory is 'A Monetary Theory of Production', as he himself reminds us (KEYNES 1933,CWK XIII:408f;LEIJONHUFVUD 1968;DAVIDSON 1972;MINSKY 1975), explaining the need for government intervention to mitigate business fluctuations and prevent mass unemployment. In his 'The General Theory of Employment, Interest, and Money'(1936,CWK VII)he analysed the important role that money and interest play in determining output and employment in a capitalist economy. The central conclusion was that monetary policy has to play the primary part in keeping the economy on a stable growth path, though it is not sufficient to prevent unemployment and depression. Thus, monetary policy has to be supported by budgetary actions.

Keynes's views on the goals and instruments of economic policy gradually, sometimes suddenly, changed under the weight of events and with the evolution of his theoretical thinking(MOGGRIDGE&HOWSON 1974). In 1932, when Britain was in a slump, Keynes pointed out that

> "a reduction of the long-term rate of interest to a low level is probably the most necessary of all measures if we are to escape from the slump and secure a lasting revival of enterprise"(CWK XXI:114)

Monetary policy aiming at the long-run rate of interest was Keynes primary concern from the 'Treatise' up to well after the 'General Theory'. Late in 1934, the time when Keynes was completing his 'General Theory', he pointed out in a letter: "my main argument centres round the rate of interest."(CWK XXI:346) However, in the 'General Theory'(CWK

VII:164) itself he also expressed his scepticism about the possibilities of a purely monetary policy to counterbalance fluctuations in the marginal efficiency of capital by influencing the rate of interest. He rather held the State responsible for organizing investment more directly. But in 1937,a peak year,when he was dealing with the upper turning-point of the cycle he insisted on cheap money:

> "it is a fatal mistake to use a high rate of interest as a means of damping down the boom ... the long-term rate of interest must be kept c o n t i n u o u s l y as near as possible to what we believe to be the long- term optimum.It is not suitable to be used as a short-period weapon."(CWK XXI:389)

Contrary to many economists in the 1930's and 1940's Keynes always held the view that low interest rates play an important part in determining the volume of investment. But, by the time he was writing his 'General Theory' he began to loose confidence in purely monetary policies for influencing interest rates.

Keynes on Fiscal Policy

In 1943 Keynes wrote to a reader of his 'General Theory':

> "It is not quite correct that I attach primary importance to the rate of interest ... I should regard state intervention to encourage investment as probably a more important factor than low rates of interest taken in isolation."(CWK XXVII:350)

Looking at the, now published, written evidence of Keynes's involvement in the activities referring to post-war employment policies we have to realize that Keynes's position on fiscal action had been much more complex than it has been brought down to us by the 'Bastard Keynesians' and Lerner's 'functional finance' concept.

In the discussions of post-war employment policies Keynes drew a sharp distinction between stimulating investment or consumption and laid much more stress on the prevention of a slump than on its cure. Hence, as J.KREGEL (1985) supported recently by documentary evidence, he put much weight on long-term planning of government actions.

Attaching primary importance to the stabilization of investment in the long run Keynes is interested in both a low and stable level of interest rates and in a Public Capital Budget, i.e. a long-term investment programm, whose principal purpose was to "balance and stabilise the Investment Budget for the national economy as a whole".(1945,CWK XXVII:409)

The idea was to counterbalance prospective fluctuations in private investment by capital expenditures of public and semi-public bodies in order to stabilize aggregate demand and maintain full employment. Having perceived a "somewhat comprehensive socialisation of investment " as the "only means of securing an approximation to full employment"(CWK VII:378) in his 'General Theory', later in 1943, he thought if public authorities based on a long-term investment programm could carry out or influence between two-third and three-quarters of total investment the range of business fluctuations would be much narrower.(CWK XXVII:353,322f)

Anticyclical budgetary actions would be operated by changes in the Capital Budget, though it should be balanced in the long run; yet "in the last resort...if the machinery of capital budgetting had broken down ... and the volume of planned investment fails to produce equilibrium, the lack of balance would be met by unbalancing ... the current budget"(1943 CWK XXVII:352)

Keynes opposed short-term variations in consumption because "people established standards of life"(CWK XXVII:319) and would be very upset to be forced to vary them constantly up and down, he therefore insisted on a long-term programm of capital formation to foster full employment and long-term growth to improve the standards of life in the long run.2)

Having made reference to Keynes's support to long-term public investment programms and his scepticism as regards stimulating consumption by public action, we would warn against putting too much stress on this point, since the whole discussion in these years referred to a particular situation in a certain time period3) which was clearly indicated by Keynes himself.

Keynes's vision of post-war development

In "The Long-term Problem of Full Employment" (written in 1943 but not published before 1980,CWK XXVII:320f) J.M.Keynes had envisaged three phases of post-war development:

1. For the first years after the war - the transition period, he thought of a 5 years time period, the inducement to investment would be higher than the desired ("indicated") level of savings. To prevent inflation he thought of limiting investment by suitable controls and of limiting consumption by some kind of rationing.4)

2. For the next 5 up to 20 years Keynes foresaw a second phase in which the "urgent level of necessary investment is no longer higher than the indicated level of savings"(CWK XXVII:321). The discussions of post-war employment policy of the Economic Section of the War Cabinet in these years were first and foremost related to this second period. The primary problem was to ensure a high level of employment by preventing business fluctuations and to foster the growth of welfare by encouraging "less urgent, but nevertheless useful,investment".

I think we can quite safely say that these circumstances were given in the 1950's and 1960's, when by fostering private investment and economic growth the univeral growth of public expenditures could be easily financed.

3. After 20 years of large scale investment, he thought, the economy would pass insensibly into a third phase in which "we shall be faced, if not with saturation of investment, at any rate with increasing difficulties in finding satifactory outlets for new investment"(CWK XXVII:360); the desired level of saving would exceed the demand for useful investment.

This stagnative perspective was taken up by A. Hansen in the USA. In 1943 Keynes drew the conclusion for this coming period

> "we shall then have to start on very important social changes, aimed at the discouragement of saving and a redistribution of the national wealth and a tax system which encourages consumption and discourages saving...-and to absorb some part of the unwanted surplus by increased leisure, more holidays(which are a wonderful way of getting rid of money) and shorter hours."(CWK XXVII:360,323)

While Keynes definitely preferred stimulating investment in the second period, he laid primary importance to "securing the right long-period trend in the propensity to consume" (CWK XXVII:326) for this later period.

At this point we may refer to one of the rare hints at fiscal policy in the 'General Theory' supporting fiscal action as an instrument for a more equal distribution of income and wealth by "income taxes especially when they discriminate against 'unearned' income. Taxes on capital-profits, death-duties and the like" being as relevant as the rate of interest to increase the propensity to consume. (CWK VII:94/95) While Keynes expected over the cycle a more or less balanced budgetary performance for the second period, he envisaged no escape from deficit budgeting (CWK XXVII:353,356) for the third phase:

"I should expect for a long time to come that the government debt or government-guaranted debt would be continually increasing in grand total."(CWK XXVII:278)

While Keynes had never dwelled upon the question how the transition from the second to the third period would come about the theoretical explanations of this saturation in investment demand have found expression in the ´stagnation thesis´ of A.HANSEN and R.HARROD and J.STEINDL´s ´maturity theorem´.

While A.Hansen´s and R.Harrod´s explanations relied on exogenous factors,i.e. population growth,technical innovations etc., J.STEINDL´s(1952) theory is based on endogenous factors inherent in the development of capitalism. According to Steindl´s theory the transition of the market structure away from competition to oligopoly, accompanied by an increase in the profit-margins, leads to excess capacities and, thus, to depressing effects on investment decisions.

The consequences of these ´vanishing investment opportunities´(Schumpeter) on the stability and the development of the economy were established by R.HARROD´s(1939) ´fundamental equation´:

$$g = s / c \qquad (1)$$

where s stands for the desired savings-income ratio,
c for marginal capital-income ratio and
g is the ´warranted´ rate of growth.

As is well known, this ´warranted´ rate of growth is that rate of expansion which is consistent with people´s desire to save and the planned investment of firms. Thus, g can be seen as the equilibrium rate of growth implying that the increase of effective demand is equal to the increment of capacity; hence leaving capacity utilization constant.

As Harrod pointed out, this ′fundamental equation′ brings two major problems of the cyclical nature of economic development to the fore: On the one hand, this ′warranted′ rate of growth is unstable, it sets a rigid pace for equilibrium growth; so that any deviation leads to a cumulative upward or downward process. On the other hand, g being defined by savings behaviour and technology has to be considered as fairly rigid and unable to counterbalance variations in the actual rate of growth.

Thus the ′warranted′ rate of growth sets the pace and the actual rate of expansion has to keep up with it for avoiding a slump. In accepting,in the tradition of Keynes and Kalecki, both Steindl′s ′maturity theorem′ and Harrod′s ′fundamental equation′ we have to expect

firstly, a secular tendency to stagnation;i.e. while, in a maturing economy capital accumulation tends to falter the propensity to save is rather likely to increase with rising income, thus driving up g; 5) and

secondly, if the economy′s saving ratio had been adapted to a high rate of growth any exogenous factor, like exploding raw material prices or restictive policy actions, pushing down the actual rate of expansion will cause cumulative downwards pressures.

This stagnative perspective has in the post-war period been substantially weakened by a considerable increase in the demand for public goods and the rapid extension of international trade. We shall take account of these factors by introducing into Harrod′s ′fundamental equation′ the budget deficit-income ratio and the trade balance-income ratio. (GUGER 1983)

Putting b = budget deficit-income ratio = $(G-T)/Y$

a = trade balance(i.e.net export)-income ratio $=(X-M)/Y$

We can derive an extended form of Harrod's 'equation' 6)

$$(2) \qquad g = (s - b - a) / c$$

This extended Harrod equation takes account of budget deficits and net foreign demand.

At the beginning of the 60's,in the USA Kennedy's tax reductions to weaken 'fiscal drag' and later on the Vietnam War neutralized the overall stagnative tendency by increasing the actual rate of growth and lowering the 'warranted' rate. While a large trade deficit weakened this expansive fiscal effect for the USA it fostered growth in the rest of the world by increasing the actual rate of growth and lowering the 'warranted' rate.

In the 1970's explosive rising raw material prices leading to large trade deficits in the industrialised world pushed the economy into a slump by lowering the actual rate of growth and at the same time increasing g. But these restrictive effects were partly neutralized by enlarging budget deficits. While after the first oil crisis this relief from the fiscal side had been quite considerable, it was much weaker after the last oil price jump in 1979.

The economic development of the last decade, in this line of reasoning, can be examined in more detail by a flow of funds analysis. (MOOSLECHNER&NOWOTNY 1980; STEINDL 1982, WALTERSKIRCHEN 1984). Simple algebraic manipulations of the extended Harrod equation (2) (cp.fn 6) lead us to the well-known saving-investment identity for an open system that can be seen as the lending-borrowing identity of the flow of funds analysis.

(3) $$S - I = (G - T) + (X - M)$$

By distinquishing between households and firms we can write 7)

(4) $$Sh - Ih = (Iu - Su) + (G - T) + (X - M)$$

where Sh and Su stand for household and business saving and Ih and Iu for household investment in dwelling houses and business investment, respectively.

From identity (4) it follows that net lending of private households has to find its outlets either in borrowing by firms, or by the public sector, or by the foreign sector. A fall in business net borrowing (e.g. by a fall in investment demand) leads

- either through a decline in income and employment (automatic stabilizers) to smaller household net lending, higher budget deficits, and higher net foreign demand,

- or it is timely neutralized by discretionary measures through an increase in public expenditures or lower taxes.

In Table 1 data are presented to illustrate the financial interplay of these sectors. Net lending or net borrowing is expressed in percentage of GDP.

While households are typical net lenders the business sector is generally a net borrower. Household saving amounts to 10 up to 25% (Table 2) of disposable household income and household net lending between 5 and 10% of GDP (Table 1).

The household savings ratios indicate, on the one hand, with rising income in real terms an increasing trend and, on the other hand, an anti-cyclical behaviour.

Table 1

Financial Balances by Sectors

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984 2)
	Surplus/Deficit in % of GDP											
USA												
Households	2,8	4,0	4,7	2,7	1,2	1,2	1,3	2,6	3,3	3,4	1,6	1,4
Enterprises	-2,9	-3,3	0,7	-0,2	-1,0	-2,0	-2,0	-1,2	-2,3	0,1	0,1	-1,0
Public Sector	0,6	-0,3	-4,2	-2,1	-0,9	0,2	0,6	-1,2	-0,9	-3,8	-3,9	-3,7
Foreign Sector1)	-0,5	-0,3	-1,2	-0,3	0,7	0,7	0,1	-0,2	-0,1	0,3	2,2	3,3
Japan												
Households	8,0	9,9	9,6	10,7	9,9	9,7	8,5	7,8	10,3	11,9	12,6	12,8
Enterprises	-8,7	-11,2	-6,9	-6,2	-4,6	-2,4	-4,6	-4,4	-5,9	-7,1	-7,2	-7,7
Public Sector	0,7	0,4	-2,8	-3,8	-3,8	-5,5	-4,8	-4,5	-4,0	-4,1	-3,4	-2,5
Foreign Sector1)	0,0	1,0	0,1	-0,7	-1,5	-1,7	0,9	1,1	-0,5	-0,7	-2,0	-2,6
Germany												
Households	7,9	8,6	9,4	7,8	7,0	6,7	7,0	7,3	7,9	7,5	6,5	5,9
Enterprises	-7,8	-4,7	-2,7	-3,6	-3,9	-2,8	-5,2	-6,3	-5,3	-3,5	-2,5	-2,9
Public Sector	1,2	-1,4	-5,7	-3,4	-2,4	-2,5	-2,7	-3,1	-3,9	-3,5	-3,1	-2,1
Foreign Sector1)	-1,3	-2,6	-1,0	-0,8	-0,7	-1,3	0,9	2,1	1,2	-0,5	-0,8	-0,8
France												
Households	3,5	3,7	5,7	3,8	4,3	5,2	3,8	3,2	4,5	4,5	4,3	4,7
Enterprises	-4,6	-6,8	-3,6	-5,0	-4,2	-2,8	-2,8	-4,9	-4,1	-4,9	-1,7	-0,5
Public Sector	0,9	0,6	-2,2	-0,5	-0,8	-1,9	-1,1	0,3	-1,9	-2,6	-3,4	-3,8
Foreign Sector1)	0,2	2,4	0,1	1,6	0,8	-0,5	0,1	1,4	1,4	3,0	0,7	-0,4
United Kingdom												
Households	4,0	5,1	5,4	4,8	3,8	4,9	5,2	7,2	5,6	3,8	3,6	3,2
Enterprises	-2,7	-5,3	-2,3	-0,6	-0,8	0,0	-2,3	-2,3	-0,2	0,3	-0,5	-0,3
Public Sector	-2,7	-3,8	-4,6	-4,9	-3,2	-4,2	-3,2	-3,5	-2,8	-2,0	-2,7	-2,3
Foreign Sector1)	1,4	4,0	1,4	0,7	0,2	-0,7	0,3	-1,4	-2,6	-2,0	-0,4	-0,6
Italy												
Households	11,9	12,1	17,5	13,7	14,2	15,1	14,2	9,7	12,2	11,6	11,7	12,2
Enterprises	-6,7	-9,8	-6,1	-6,2	-5,1	-3,0	-3,0	-4,1	-2,8	-1,3	0,7	0,6
Public Sector	-7,0	-7,0	-11,7	-9,0	-8,0	-9,7	-9,5	-8,0	-11,7	-11,9	-12,0	-12,5
Foreign Sector1)	1,8	4,7	0,3	1,5	-1,1	-2,4	-1,7	2,4	2,3	1,6	-0,4	-0,3
Austria												
Households	4,7	4,8	6,2	6,6	5,0	7,1	7,2	6,1	4,8	5,3	4,4	5,0
Enterprises	-6,3	-7,0	-3,8	-5,1	-6,3	-5,1	-5,7	-7,1	-5,3	-1,2	-0,9	-3,4
Public Sector	1,3	1,3	-2,5	-3,7	-2,4	-2,8	-2,4	-1,7	-1,6	-3,1	-3,4	-2,4
Foreign Sector1)	0,3	1,0	0,1	2,3	3,6	0,7	1,0	2,7	2,0	-1,1	-0,3	0,8

Source: OECD (1983B), WIFO.
1) The Balance of the Foreign Sector corresponds to the current account with a negativ sign (M-X). 2) Preliminary.

First, the implications of the increasing saving trend: The data of Table 2 indicate generally an increasing trend in the saving ratios for the time period of rising real incomes (1960-1975); since 1975, however, real household incomes have stagnated.

Household savings have to be absorbed by borrowings of the business sector, the public, and the foreign sector. Though there were considerable differences between the various countries for the 1960's and early 1970's (STEINDL 1982) the data for all OECD-countries taken together indicate a broad accordance between business borrowings and household net lending in this period. Thus the net borrowings of the public and the foreign sector had amounted just to 0.3% of GDP, respectively. (OECD 1985: tables 6.7 and 6.15).

But, since the first oil crisis the situation has considerably changed: While the borrowings of the business sector has been strongly reduced by a low level of investment demand and the trade balances have often been in deficit, public sector borrowings increased strongly. (Table 1). For all OECD-countries together public sector borrowings amounted to 2.3% of GDP in the period 1974-1979 and 3.5% for 1980-1983.

Coming back to the perspective of vanishing investment opportunities we have to conclude that constant or even rising household savings will lead to a rising trend in budget deficits.(MATZNER 1978)

Second, the implications of the anti-cyclical saving behaviour: While, according to the conventional view, household saving ratios are falling in a recession because people try to maintain their standards of life when their income is falling, in the recessions of 1974/75 and 1981/83 the saving ratios increased (Table 1). People postponed spending for consumer durables and dwelling-house

Table 2

Savings Ratios

	1960	1965	1970	1975	1980	1982[1)]
		in % of disposable income2)				
USA	11,3	12,3	13,2	14,1	11,8	13,0
Canada	9,4	11,3	10,9	15,3	14,6	17,0
Japan	-	-	22,3	26,6	25,0	25,0
United Kingdom	7,0	8,7	8,7	11,2	15,2	12,0
France	15,2	16,2	16,7	18,6	14,1	15,0
Italy	-	-	22,5	26,5	23,0	24,0
Germany3)	8,6	12,2	13,8	15,1	12,8	13,5
Austria3)	-	7,7	11,9	9,9	11,0	10,1

Source: OECD (1983A).

1) Preliminary. - 2) Including small enterprises. - 3) Level not Comparable with other countries.

expenditures. Thus, the decline in business borrowing, i.e. the fall in investment demand, has been enforced by a lower propensity to consume in the years of recession since the first oil crisis. Since 1979 this development has been reinforced by an enormous increase of interest rates.

The economic development of the 1970's has tought us, on the one hand, that an increasing trend of budget deficits can only be prevented if fiscal policy is able to stimulate private investment and to increase the consumption-income ratio by redistributing income and, on the other hand, that to reduce public deficits by restrictive measures will be doomed to fail if private investment or foreign demand,i.e. by passing on the burden to the trading partners, cannot be stimulated at the same time.

Kalecki's three ways to full employment and post-war experience

While Keynes was more of a pragmatic thinker, finding the right answer to ever-changing actual questions of economic policy, always considering whether the implications of theory are acceptable to the politicians, Michal Kalecki's thinking was more abstract and uncompromising, a clear-cut analysis in its essentials and implications.

Characterising unemployment as a consequence of demand-deficiency KALECKI(1944) offers three ways to full employment: deficit spending, stimulating private investment and income redistribution.

Deficit spending would be labelled today as typically Keynesian policy. Kalecki did not only think of bond-financed public investment but also of subsidies for mass consumption(e.g.family allowances). He suggested that public expenditure should be financed as long as possible by higher income taxes, after that by government bonds.

Stimulating private investment - by income tax reductions or low interest rates - has only a temporary effect and must be repeated since the higher capacity created reduces the degree of utilisation and therefore after a certain time tends to depress investment again. Apart from problems of overcapacity there may arise a conflict with income redistribution. Kalecki was very sceptical concerning this second way to full employment, he rather preferred deficit spending and income redistribution.

Income redistribution from high to low income classes is intended to raise the propensity to consume. This is a way of stimulating demand without running into budget deficits. But one must be careful not to impede investment by income redistribution. We see that Keynes and Kalecki were very much in accordance concerning employment policy. Perhaps Keynes put more stress on monetary policy, Kalecki on income redistribution.

What was the relevance of these ideas in the past decades and what is it now?

Public expenditures were rather widely used over decades - especially in war times when its effect was most evident (Second World War, Korean and Vietnam war, etc.). Since the majority of countries pursued an expansive strategy budget deficits represented no balance-of-payment problem up to the seventies. Keynes argued that if a budget deficit results there is something wrong. With a successful demand management no budget deficit arises. MATTHEWS(1968) was wrong when he concluded from balanced budgets that there were no Keynesian policies adopted.The general attitude towards growth and public expenditure was the crucial point. The self-financing of government expenditure worked quite well. Demand management was used alternatingly in Britain as a Stop- Go-strategy and no one doubted that demand could be influenced by state intervention. It was too evident.

Stimulating private investment was also widely used in the past decades (depreciation allowances, interest subsidies, etc.)which found its expression in falling taxes on profits. It may have been overdone in some countries (with respect to income redistribution) in the last decade when it was seen as a supply-side strategy. After all this could not prevent a marked decline of investment quotas in most industrialised countries since the early seventies. Industrial policy - very much stressed by J.Steindl to counteract long-run underinvestment - was only adopted by Japan but with great success. In Western Europe, depreciation allowances and subsidies to declining firms in general favored the wrong structure (capital-intensive processes vs. research- and employment-intensive innovation).

Income redistribution (from saving to consuming groups) was in general not consciously used as an instrument of employment policy, it was regarded as an instrument of social policy. On the contrary, savings were still promoted in most countries.

During the last decade as a consequence of the Monetarist revolution all the three ways to full employment remained predominantly in a restrictive position, even after unemployment had risen dramatically. Discretionary fiscal measures were restrictive in most countries to stop the rise in budget deficits brought about by recession and increasing interest payments. Private investment was impeded by extremely high real interest rates, and income distribution was shifted to the wealthy by high interest rates, high unemployment of the poor and welfare cuts.

Fundamental questions of employment policy

All the fundamental questions of employment policy that the critics are raising today have already been discussed by Keynes,Kalecki and the Oxford and Cambridge groups in the thirties and fourties, namely inflation, balance of payment, crowding out and interest payments.

Inflation

The Keynesians wanted to stop deficit spending once full capacity was reached. Otherwise this would necessarily lead to inflation. They not only saw the problem of demand-deficiency, but also saw the process of inflation caused by excess demand for raw materials, monopolisation and rising money wages at full employment. KEYNES proposed buffer stocks to stabilize raw material prices (CWK XXVII,Part.I). (KALDOR (1983) recently took up this idea.)Some others proposed a central board for wage negotiations to counteract inflationary tendencies from the wage side.

The prediction that full employment would lead to inflation proved right. But no major country had pursued an incomes policy to keep real wages in line with productivity growth and there were no buffer stocks to stabilize material prices as Keynes had suggested.

Inflation certainly turned out to be the crucial obstacle to employment policy in the seventies. Most governments adopted a tight monetary policy (partly after the first oil shock and generally after the second one)and accepted deliberately an enormous rise in unemployment to stop inflation.

At the same time, Keynesian policies have been rejected as inflationary and ineffective. However, the latest business upswing in the United States gives another illustration that deficit spending does not necessarily lead to inflation as many critics argue. The crucial points are full capacity, full employment and bottlenecks of raw materials.

We must see this shift in priorities from employment to price stability in a broader socio-economic context as Kalecki (1943) had done in his famous article on the political business cycle. They have called for stability of prices and consolidation of the budget, but they have meant more: stability of the social structure and of the existing distribution of income and wealth, after the rapid social changes that the period of full employment has brought about.

Where did this policy lead to? The inflation rate was reduced, but only after some time and at the very high cost of mass unemployment and high interest rates. The goal of a reduction of budget deficits, however, could not be achieved since tight monetary policies increased budget deficits in two ways:They caused cyclical deficits by aggravating the recessions and they dramatically increased interest payments for government debt by high interest rates.

The redistributional effects of tight policy are evident: High interest rates favour the creditor and hurt the debtor. That means in general: It favours the old at the cost of the new. Young developing countries are typically high debtors, the same is true for young households and new firms.So it turns out that tight monetary policy is a "conservative" policy in its strictest sense: conserving the old, obstructing progress.

Interest payments for government debt

The problems of a high level of interest was clearly seen by Keynes. He advocated very low interest rates also in the boom. In 1937 he warned: We must fear high interest rates like hell-fire.

The problems of high interest payments for government debt, however, have not been seen in its full dimension in the thirties and fourties,partly because it was not expected then that the Keynesian policy of low interest would soon be given up and would be later (in the eighties) be replaced by its very opposite. Kalecki and the Oxford group were fully prepared to accept long-run budget deficits up to the long-run growth rate of GDP to be financed by a small capital tax. Capital controls were advocated to stop capital outflows. In Abba Lerner's concept of "functional finance" government debt did not matter at all, the high it may be. Apart from foreign debt public borrowing is considered to be just an internal transfer, a distributional problem.

In fact, interest payments are now a major impediment for employment policy. While the rise in inflation rates in the early seventies was the starting point for the radical change in economic policies rising interest payments for government debt are now the main reason for not envisaging expansive fiscal policies, even after inflation rates have dropped.

The rapid growth in interest payments is certainly the consequence of high real interest rates and persistingly large deficits. Interest payments have nearly no expansionary effect (because of their high savings ratio) and their redistributional effect runs into the wrong direction from the point of view of employment policy.

We'd like to draw your attention to some facts (Table 3): In the OECD-countries general government net borrowing was rising between 1970 and 1985 by 3.9 percentage points of GDP. Cyclical effects raised the

Table 3

Effect of Business Cycle and Interest Payments on General Government Budget Balances

	OECD-countries		
	1970	1985	1970-1985 Change
		% of GDP	
Budget Balance	+0,2	-3,7	-3,9
Cyclical Effect	-0,3	-2,1	-1,8
Structural Budget	+0,5	-1,6	-2,1
Interest Payments for Government Debt	1,9	5,2	+3,3
"NET" Interest Payments1)	1,3	3,5	+2,2

Source: OECD and WIFO calculations.

1) Under the assumption that roughly one third of interest payments will be reembursed by various taxes.

budget deficits by nearly 2 p.p. of GDP (according to OECD-calculations) so that structural deficits rose by about 2 p.p.. This is totaly attributable to higher interest payments. Interest payments for public debt rose by 3.3 p.p. of GDP. Even if we assume that the government can reimburse about 1/3 of these incomes of interests this implies that governments actually pursued a restrictive fiscal policy (in terms of discretionary measures).

For both, the high interest payments and the high cyclical deficits tight monetary policies can be held responsible. And we may conclude that tight monetary policy after a decade or so has also forced fiscal policy to subordinate itself to the restrictive course of policy.This was, of course, intended. Quoting an international monetary institution: Since fighting against inflation has the highest priority the main task of fiscal policy is to support the restrictive stance of monetary policy.(The same was also intended for wage policy - to tighten one's belt.)

The experiment with tight monetary policies, however, found an abrupt end in the United States when a change in monetary policy was enforced by the world debt crisis that was evoqued by the tight policies themselves. US-monetarism was in fact abandoned in August 1982 when Mexico's inability to pay threatened the world banking system. To save U.S. banks from bankruptcy the Federal Reserve had to loose the belt. But still all the monetary institutions and many economists also in Europe have their eyes fixed on money supply.

Balance of Payment

The Keynesians paid great attention to the balance-of-payment implications of employment policies. They considered it to be a crucial point, viewing it, as they did, from the British point of view.

The current account actually turned out to be a major problem for employment policies, but - as long as they were adopted by most countries - not the crucial one. Apart from Stop-Go-Policies induced by the balance of payment no major troubles turned up. Rising imports were met by rising exports.

But in the seventies when international trade further increased (tariffs were removed or reduced in the European Community)and many countries started a restrictive policy trade deficits became more and more an obstacle to the practical implementation of employment policies. With rising import quotas and fast increasing interest payments the multiplier became lower and lower.

In France expansive fiscal policies in the early eighties were dramatically reversed as France gained less from them than the neighbour countries (Germany). The United States with their low import quota could afford to play their locomotive role for a couple of years, but at the end a high trade deficit stopped the U.S.-business upswing.

Certainly the locomotive role is leading to current account and budget deficits in the country adopting them. On the other hand, the trading partners experience an export-led growth, followed by a recovery of investment.

In Germany it is often argued that expansionary fiscal measures would have no lasting effect, just a passing fancy. This argument seems to be linked to the observation that all the problems stay with the expansive country, all the advantages remain with the "free-rider". This, of course, reduces the willingness of a country to play a locomotive role on its own. Germany and Japan now strictly reject the idea that they should do something for expansion.

Crowding out

The view that budget deficits would crowd out investment is so widely held nowadays that it can be called public opinion. The crowding-out argument builds upon the well-known fact that the financial balances of the economic sectors must add up to zero. Many economists (Feldstein, OECD,IMF etc.)interpret this tautology in the following way: The budget deficit is absorbing too great a part of domestic savings (in the U.S. about two thirds). Reducing private investment to the remainder raises interest rates exorbitantly.(Sometimes it is admitted that capital inflow would finance some additional investment.)

Keynes's argument against crowding-out was that public credit demand would have no other effect than the credit demand of large enterprises. If however every credit demand had crowded out some other then we would never have experienced a business upswing. An accommodating monetary policy was taken for granted. In the case of restrictive monetary policies interest rates will rise with increasing credit demand wherever the latter may come from (private or public).

The wide majority of economists who expected the large deficits in the USA to paralyse investment (and keep interest rates and dollar high) were on the wrong track. On the contrary, deficit spending and expansive monetary policy have led to higher capacity utilisation, higher profits and higher investment. This is even admitted in a journal of an economic research institute in Hamburg (HWWA) that is certainly not suspected to be Keynesian.

STEINDL(1982) has shown that the explanation for the high budget deficits since 1974 lies in another direction: The long-run world-wide decline in investment - reflecting restrictive economic policies and the structural troubles of oligopolistic industries - have caused high budget deficits by automatic stabilisers. If this decline had not been matched by budget deficits an even greater demand deficiency would have resulted.(The rapid decline of GDP in Switzerland in 1975 where there were hardly any automatic stabilisers working is a good illustration for this.)

Steindl added that it would not be possible to reduce budget deficits worldwide by restrictive policies since tax revenue would be cut by the fall in incomes which would be the more drastic since durable consumers expenditure and instalment credits would fall abruptly and after a time investment of the business sector would decline. Only those countries which restrict their internal demand more than their trading partners could consolidate their budget.

That's exactly what has happened (Table 4). Tightening of monetary policy has increased the financial surplus of the private sector by restricting spending on durables including housing and investment. The budget was consolidated mainly in three countries during the last years: Germany, Japan and Belgium. In all these countries the reduction in budget deficits was completely matched by a higher surplus in the current account and thus made possible. This implies, however, that other countries (USA) had to be prepared to accept higher deficits in the current account and in the budget.

Another argument against employment policy was that budget deficits could not be financed any more. The financial identity of lending and borrowing of the various sectors makes clear why there are in general no problems to finance the public deficits: Since there must be a corresponding surplus of the private sector unless a trade deficit occurs. (In this case the country is dependent on foreign credits.)

We would now like to follow the different paths of employment policies in various countries. The traditional Keynesian way to stimulate growth by discretionary fiscal actions predominant in the sixties was recently only adopted in a few countries. The more typical way was to reduce growth by discretionary fiscal actions with the aim of long-run budget

Table 4

Budget Consolidation via Trade Balance

	Budget	Current Account
	% of GDP Change 1981-1985	
Germany	+ 2,3	+ 2,9
Belgium	+ 3,8	+ 3,8
Japan	+ 2,6	+ 2,8

Source: OECD.

consolidation. But many countries tried to keep unemployment low (despite a poor employment situation) by an increase of public employment or by a reduction of labour supply.

Step 1: Budget and growth in various countries

There is undoubtedly a positive correlation between expansive fiscal measures (measured in terms of discretionary actions) and economic growth. The effect of fiscal policy was most obvious in the United States during the last years. But also in France domestic demand could be raised in the early eighties when an expansive policy was pursued.

Fiscal policy has certainly influenced growth but it was in some cases not the main factor (crude oil in Norway, industrial policy and rising market shares in Japan, etc.).

On the other hand, those countries which restrained demand more than others experienced lower growth rates (Switzerland in the seventies, Germany in the first half of the eighties.) The effect of fiscal policy on growth can be illustrated by a comparison of the German and Austrian development (Table 5): in every year in which fiscal policy was more expansive in Austria than in Germany the growth of GDP was higher in Austria; in every year in which fiscal policy was more restrictive in Austria also GDP growth was lower.

But it must be admitted: Increasing cyclically-adjusted deficits did not lead to higher growth rates in every case. There were quite a few countries with large deficits where the increase in the budget deficit was only due to higher interest payments (Italy,Belgium and others see Table 6). In this case the rising deficit had nearly no expansive effect.On the contrary, it led to restrictive measures affecting final demand.

Table 5

Fiscal Policy and GDP-Growth in Germany and Austria

	Growth Differential	Change in Structural Budget (% of GDP)		
	Austria/ Germany	Austria	Germany	Austria/ Germany
1981	-0,1	+1,4	+0,3	+1,1
1982	+2,1	-0,7	+1,4	-2,1
1983	+1,1	-0,6	+1,2	-1,8
1984	-0,6	+0,8	+0,4	+0,4
1985	+0,5	-0,1	+0,5	-0,6
1981-1985 (p.a.)	+0,6	+0,2	+0,8	-0,6

Source: OECD and WIFO calculations.

Table 6

Budget Deficits and Interest Payments

	Budget Deficits		Interest Payments	
	1980	1985	1980	1985
	% of GDP		% of GDP	
Italy	-8,0	-13,1	6,3	10,1
Belgium	-8,6	-10,3	6,1	10,1
Netherlands	-4,0	- 5,6	3,7	6,5
Sweden	-3,7	- 3,0	4,2	8,0
Denmark	-3,3	- 3,0	3,9	9,8

Source: OECD.

Step 2:Growth and employment

There is a fairly close positive relationship between economic growth and employment in an international cross-section analysis. In those countries where economic growth is higher also employment grows faster. The same is true for lower growth and employment.

But there are two types of positive deviation from this correlation:
a.USA and Canada

b.the Nordic countries

For Northern America the reason for that deviation has been shown in many articles: High employment growth in the low-wage service sector has been identified as the main factor.

In the Nordic countries it was the effect of the welfare state. It can be shown that employment in the public sector increased at a fast pace (Table 7). They can and will afford to have no unemployment (without caring too much about economic growth). This rather seems to be a short-run alternative, in the long run these are limits of taxation (Sweden).

In a welfare state not only public expenditures for employment but also automatic stabilisers are high. On the other hand, in Germany the federal budget was consolidated largely by restrictions of public employment and unemployment benefits.

Many economists nowadays try again to explain low employment growth in Western Europe by too high real wage increases and relatively too low interest rates (compared with the U.S.) If this neo-classical hypothesis of factor substitution was true investment quotas should have increased in Western Europe compared to the U.S. during the seventies. Just the contrary was true.

Table 7

General Government Share in Employment

	1970	1982
	%	
Sweden	20,6	31,8
Denmark	16,8	31,1
Norway	16,4	22,9
Finland	11,8	19,5
Belgium	13,9	19,5
Austria	13,7	19,2
USA	18,1	16,7
France	13,4	16,1
Germany	11,2	15,6
Italy	11,8	15,3

Source: OECD.

Besides this in an international cross-section analysis (1979-84) there is no relationship at all between increases in real wages and in employment. (See diagram 1 indicating that the relationship between real wages and employment is unclear, it may be positive or negative). A reduction in real wages may certainly lead to an increase in employment by improving international competitiveness (similar to a devaluation). But this, of course, cannot be a strategy for all countries.

Normally there is a positive relationship between real wages and employment (in time-series analysis) that is induced by changes in demand: An increase in effective demand raises real wages and employment. A trade-off between real wages and employment may occur in response to supply shocks. A rapid increase of the population in the working age can increase (low-wage) employment and reduce the average level of real wages. (This was an important reason for high employment growth in the USA in the last decade.)

Those countries which tried to stimulate employment by real wage cuts (to be measured by the real wage gap) did not succeed. The idea that excessively high real wages are the major impediment to full employment has gained wide credence in Western Germany and the United Kingdom. That's just the two countries where real wages were rising in line with productivity(terms-of-trade adjusted) - in most other countries they were rising faster in the last ten years (Table 8). At the same time, the reduction of employment in Germany and the United Kingdom was even greater than would have been expected from their low rates of economic growth (See diagram 2).

Step 3: Employment - unemployment

In the 1970's the rising labour force was an important factor for increasing unemployment. Higher investment would have been necessary to

Table 8

Real Wage Gap and Employment

	Real Compensation per head	Productivity corrected for terms of trade	Real Wage Gap1)	Employment
	1972 - 1982			
France	+39,8	+25,6	+11,4	+ 6,5
Italy	+25,8	+14,1	+ 9,9	+13,0
Canada	+10,4	+ 1,6	+ 8,6	+28,5
Japan	+34,9	+24,6	+ 8,1	+18,3
Austria	+30,1	+22,4	+ 6,3	+10,1
USA	+ 3,9	+ 1,1	+ 2,6	+21,6
United Kingdom	+23,5	+21,6	+ 1,0	- 4,0
Germany	+23,4	+25,1	- 1,4	- 1,1

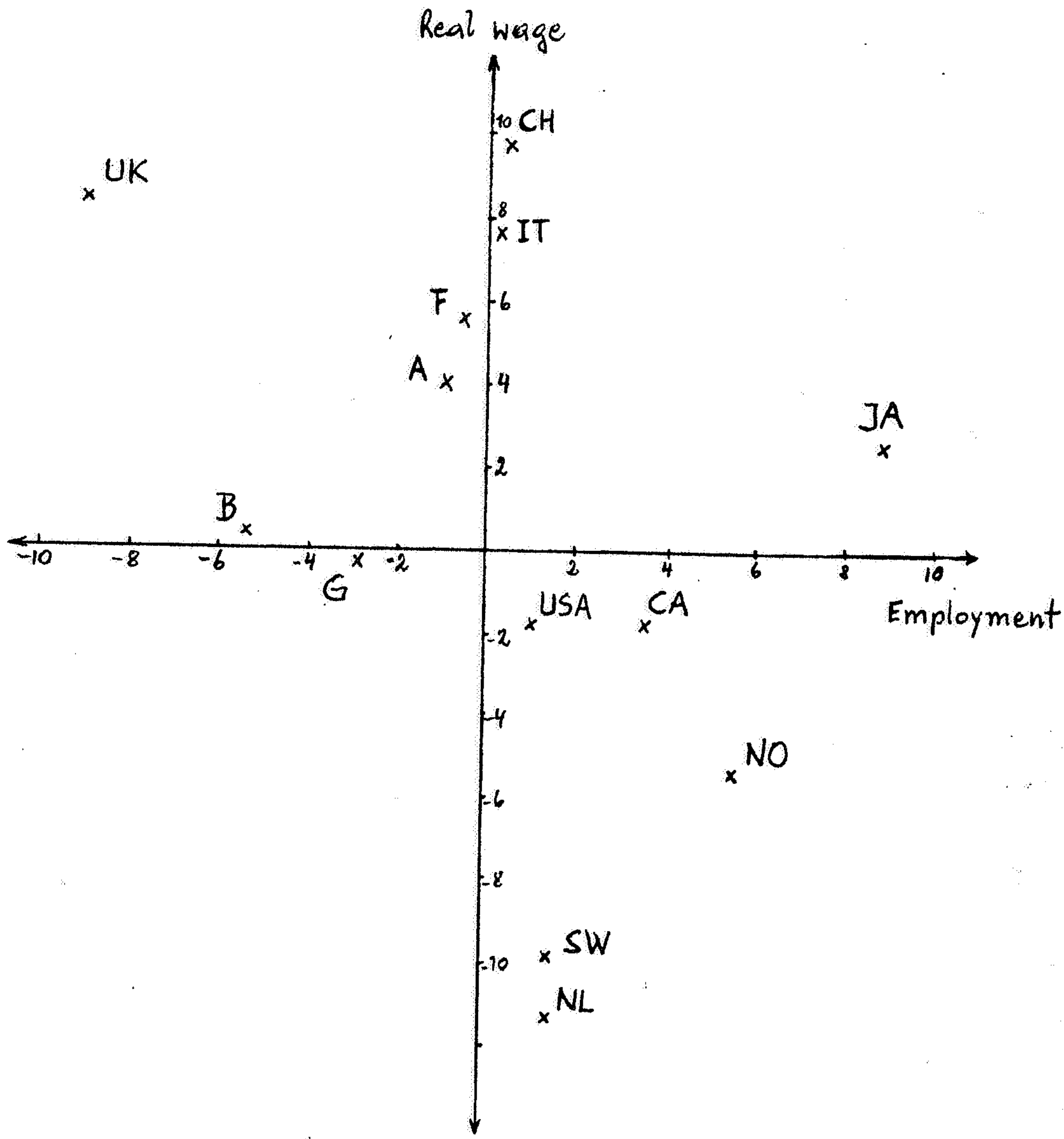
Source: OECD, Economic Outlook December 1982, WIFO-calculations.

1) Index of real compenstion per head divided by the index of productivity corrected for terms of trade.

Diagram 1

Real Wages and Employment 1979-83

increase in %

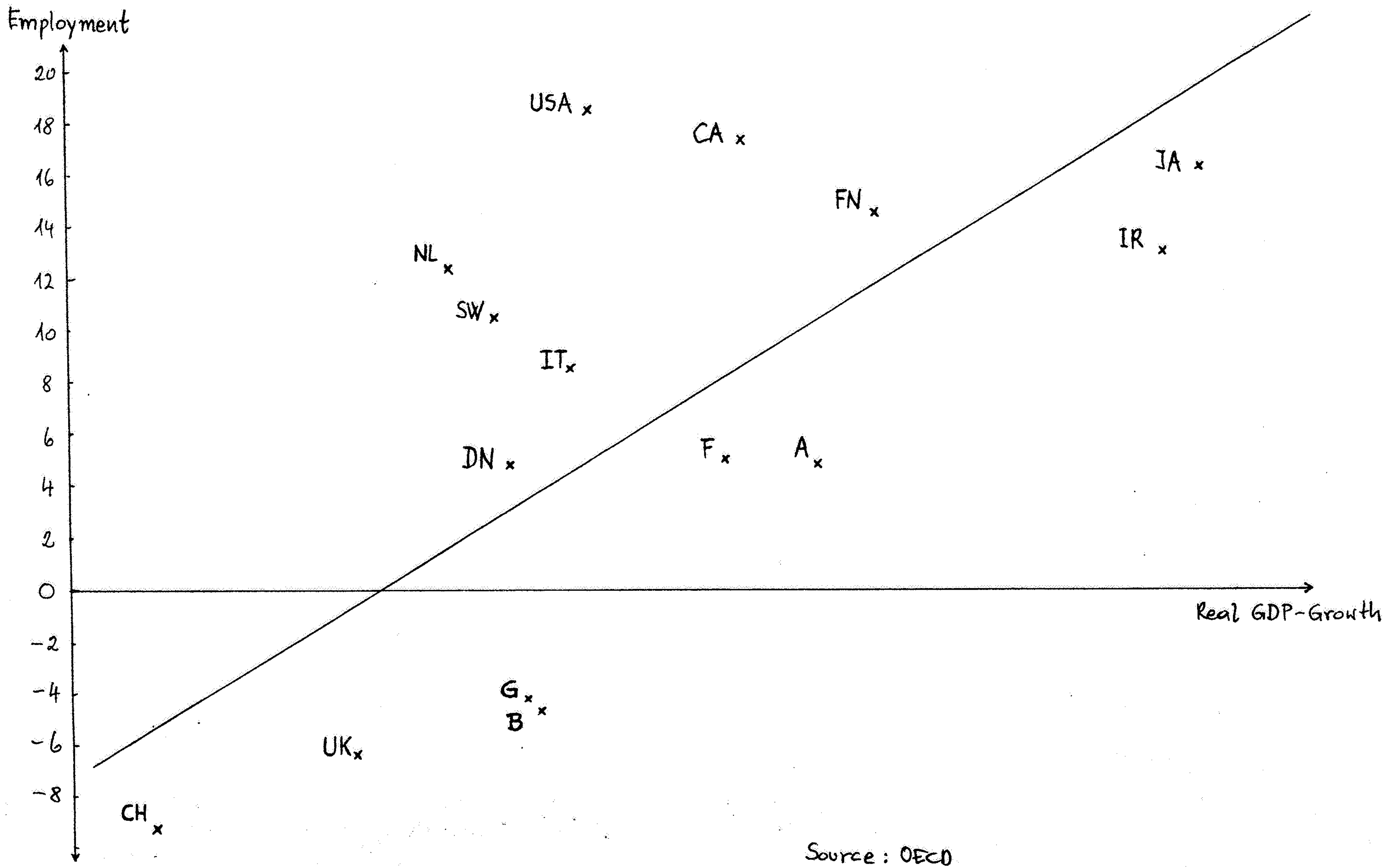


Source: OECD

Diagram 2

Growth and Employment 1973-83

increase in %



Source: OECD

employ this rising labour supply, but investment was faltering. The share of government in investment was reduced (see Table 9) despite the needs for environment protection, energy saving, etc.

We should not forget that many countries tried to keep unemployment low despite a poor employment situation. The standard way was to reduce the labour supply of foreign workers, older workers and women.

The Swiss way to low unemployment (and low budget deficits) was a restrictive economic policy leading to low growth rates and a very poor employment situation. This was combined with a massive reduction of foreign workers and female employment that kept unemployment low.

The Austrian way to low unemployment was an expansive economic policy leading to relatively high growth rates. Employment in Austria did not rise faster than would have been expected from higher growth rates (despite labour hoarding in the nationalised industries, reduction of working hours, etc.). Unemployment was additionally kept low by a reduction of foreign workers and by early retirement(a very costly way).

We would like to elaborate now a little bit on the so-called Austro-Keynesianism. Austro-Keynesianism can be seen as a strategy to keep unemployment low in a hostile world. It is mainly a policy of stimulating growth without risking inflation.

The main elements are:

1) An expansive fiscal policy - as long as possible from the point of view of the current account and interest payments. The most important instruments are investment promotion (a supply-side element), interest subsidies, public investment(construction), subsidies to firms suffering from recession, etc.

2) Hard currency policy to counteract inflation (backed by incomes policy).

Table 9

General Government Share in Investment

	1970	1982	1970/1982
	% of Gross Fixed Investment		percentage points
Japan	12,6	19,8	+7,2
Finland	12,8	14,2	+1,4
Italy	10,7	10,1	-0,6
Austria	18,0	16,5	-1,5
France	13,9	12,0	-1,9
Germany	17,3	13,9	-3,4
USA	14,4	9,2	-5,2
United Kingdom	15,5	9,4	-6,1

Source: OECD.

There are no monetary targets in Austria, but a constant relation of the Schilling to the D-Mark that implies a certain interest rate policy to prevent capital outflow.

3) Social partnership is an instrument of stabilisation policy (Wage and Price Committees). A voluntary wage and price discipline is preferred to a austerity policy.

4) Nationalised industries are a stabilising element accounting for about one fourth of Austrian industry. There are, however. great structural problems in the steel industry so that this "socialisation of investment" does not help very much in long term structural policy. In the traditional concept of Austro-Keynesianism industrial policy does not play the role that it should play. Long-term planning is neglected.

Conclusions and remedies

We are settled with an overhang of three enormous problems:

a. a large public debt and a large debt of developing countries

b. a large surplus of labour, due partly to the inability to absorb the increasing labour supply of the seventies

c. an inappropriate industrial structure (heavy industries and mass production).

The main barrier to employment policy today is the high interest payment for public debt and the lack of international coordination of economic policies.

As a legacy of a decade of monetarism budget deficits are so high in many countries that high and uncontrollable interest payments do not leave much room for manoeuvre in fiscal policy. Actually, a shift in employment policy from fiscal stimulus to MONETARY POLICY (lower interest rates) and income redistribution appears to be necessary. First we have to get out of the mess that monetarism has brought us, then we'll regain more room for manoeuvre in fiscal policy.Lower interest rates for consumer credits and mortgages would stimulate demand and hence investment. Lower interest rates would also reduce budget deficits directly since a substantial part of public debt is financed by bank credits with flexible rates. Higher demand induced by a more expansive monetary policy would also reduce the cyclical part of the budget deficit.With a reduction of budget deficits by these two ways no discretionary measures to reduce deficits would be necessary.

At the moment an expansive FISCAL POLICY is in fact only feasible in those countries where deficits (as a % of GDP) are relatively low (below the medium-term growth rate).Among the large countries this is in Japan, Germany and maybe in the United Kingdom.But these countries just prefer to live as a "free-rider", restricting internal demand (by real wage cuts and tight policies) more than the trading partners to make a high surplus in foreign trade. The continuous threat of protectionism in the U.S. may well be a weapon to remove these beggar-my-neighbour policies.

STIMULATING PRIVATE INVESTMENT as a means of employment policy has been largely misdirected from a structural point of view (favouring basic industries). Taxes on profits have been reduced at the cost of higher taxes for the employed. Industrial policy oriented towards employment-intensive research and development may well be an important instrument to stimulate investment and innovation.

WAGE POLICY is on a too restrictive course in most countries. This would have been advisable in the inflationary period of the early seventies, but now with low inflation rates and rising profits there is more room for expansion. The actual investment recovery in Western Europe is bound to end soon if there is no concomitant rise in the wage bill and in consumer demand.

INCOME REDISTRIBUTION from higher to lower income groups (respectively from saving to consuming groups) is an important way of employment policy especially in a period of high budget deficits. Higher indirect taxes on luxuries, reduction of income tax alleviations and redistribution by public expenditure would raise the propensity to consume and hence growth and investment without adding to budget deficits. Stopping savings promotion would be highly in time.

As a legacy of monetarism the share of interest returns in national income is extremely high. Since it is a main task of economic policy in an industrial society to encourage entrepreneural spirits and to discourage rentier attitudes higher taxes on interest returns are highly recommended. International coordination of such taxation and of other economic strategies is, however, advisable to prevent capital outflow. The problem is that the level of economic integration is much higher than the willingness of governments to cooperate. The economies of the industrial countries have become highly interrelated which has made them dependent on each other and, mainly, on the largest economic powers and financial centers. This interdependence limits the possibilities of an autonomous economic policy drastically. At the same time the large countries have become less prepared to cooperate with the aim of seeking rational solutions to the problems of employment.

N o t e s

1) Studies based on the interaction between the economic development and institutional constraints in various countries reveal considerable differences in the economic performance of industrial countries according to their institutional structures. (SCHARPF 1981, BLAAS&GUGER 1985)

2) Keynes only accepted J. Mead's proposal to vary the contributions of employers and employees to the social security funds anti-cyclically; but be opposed to variations of income taxe-rates.

3) Since Keynes's time the share of consumer durables in consumption expenditures has more than doubled; today between 10 and 15% of comsumer spending is on durables.

4) Kalecki estimated more than 6 years for the UK and Steindl about 2 years for the USA.(see WORSWICK 1985)

5) This tendency is enforced by the accumulation of 'unwanted amortisation funds' as KEYNES(1936:99f) had already envisaged. HARROD(1970),BHADURI(1972), and STEINDL(1979) have taken up this point.

6) Using the usual textbook symbols we can write

(2a) $dY/Y = ((S - (G-T) - (X-M))/Y)/(dK/dY)$

(2b) $(dK/dY)(dY/Y) = (S - (G-T) - (X-M))/Y$

(2c) $I = S - (G-T) - (X-M)$

7) We have to keep in mind that (2) is an equilibrium condition determined by ex ante factors, while (3) and (4) are ex post identities.

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