In the preceding, theoretical, chapter the classical-Keynesian and the neoclassical approaches have been compared with respect to content and method. In this policy chapter the question as to which of the two approaches provides more secure foundations for socioeconomic policies naturally arises. In the initial section the different equilibrium notions associated respectively with the two approaches are taken as a starting point for discussing this question. This is done in the light of the arguments set out in the preceding chapters which seem to suggest that classical-Keynesian political economy ought to be preferred to neoclassical economics as a basis for policy actions.

Classical-Keynesian or third-way economic policies require a positive theory in order to explain given situations and a normative theory to fix the aim of policy actions. The former was sketched in chapters 3 and 4 while the latter is outlined in the second section of the present chapter. In the subsequent main section some policy principles along classical-Keynesian lines are set out. The emphasis is laid on long-period policies associated with the organization of the socioeconomic system.

The notion of equilibrium and economic policies

From the preceding chapter it emerges that the notions of equilibrium implied in neoclassical economics and in classical-Keynesian political economy are entirely different. This implies that the explanations of facts and the respective policy prescriptions also diverge. In this section the equilibrium concept contained in each approach is elaborated further to prepare the ground for comparing some policy elements associated with the two approaches. This provides the basis for selecting the more suitable approach to economic policy-making.

Two notions of equilibrium

Liberal economic theory conceives of the economy as an autonomous subsystem working within a social, legal and political framework. Under competitive conditions the rational – utility- and profit-maximizing – behaviour of individuals, co-ordinated by markets for final goods and for factors of production, is supposed to produce a tendency towards some *market* equilibrium position. Hence markets functioning satisfactorily are presumed to solve all the great economic problems, most importantly value, functional income distribution, employment and external trade relations. In this process marginal magnitudes – marginal costs, productivities and utilities – associated with substitution and competition play an essential role. These render possible rationality in the economic sphere of society through the rational behaviour of individuals in this very sphere. Hence behaviour is primary and the system secondary; the latter is merely derived from the former. In principle, the central policy problem consists in setting up a framework enhancing the functioning of the market mechanism. This may mean breaking up monopolies and cartels, reducing the power of trade unions and scaling down the activities of the state.

The classical-Keynesian equilibrium notion is, however, not merely linked up with a specific sphere, the economic sphere, but with the socioeconomic and political *system as a whole*; this is due to the essential *complementarity* of economic, social, political and cultural institutions that is characteristic of the humanist vision of society sketched in chapter 2 (pp. 20–57). The – normal – prices of production depend upon the conditions and the relations of production and the institutions regulating income distribution; normal quantities and, consequently, the level or the scale of trend output and employment are governed by long-period effective demand, which, in turn, depends upon all the institutions of a society; this emerges from the supermultiplier analysis set forth in chapter 4. Hence normal prices and quantities are not independent of each other: both depend upon the rate of profits or the profit share. This suggests that the regulation of distribution is of primary importance in political economy. Ricardo was the first to perceive this point.

A classical-Keynesian system equilibrium – made up of normal prices and quantities – is *not* socially rational or desirable since it does not imply full employment. This means that the rationality of the system does not coincide with the rationality of individuals; Keynes's paradox of thrift is the prime example. Individuals and collectives act rationally in different spheres, i.e. economic, social and political, according to their specific point of view or value system: individual rationality is severely bounded. But the aggregate of individual rational actions does not produce *social rationality*. The latter is linked up with the socially appropriate organization of society, that is with *social or political ethics*. Hence, as Keynes explicitly stated, the social sciences are *essentially* moral sciences (chapter 2, pp. 39–53). The central problem of political ethics is to provide guidelines for increasing social harmony, i.e. to reduce alienation or to enhance the common weal or the public interest. This means establishing socially more appropriate proportions between the various spheres of human activity; for instance, from the supermultiplier theory it follows that specific proportions between distribution, private and public spending, investment activity, export quantities, the import coefficient and the terms of trade must hold if full employment is to be achieved. This requires a socially appropriate institutional set-up, which will, on account of varying circumstances, differ between countries and regions.

Problems with the liberal approach to policy-making

Liberal economic policies could only be successful if the market mechanism produced a strong tendency towards a full-employment equilibrium under ideal circumstances, that is in a situation with perfect competition: perfectly functioning markets must bring about such a tendency *in principle;* specific real-world obstacles, such as imperfect information, monopolies and cartels, and temporary market failures, obstructing a tendency towards full employment are always there and would give rise to second-best solutions, which could be improved by appropriately acting upon the framework surrounding the market.

In chapter 5 (pp. 281–93) it has been argued that, even if conditions were ideal, a permanent tendency towards a full-employment equilibrium brought about by market forces is very unlikely for both theoretical and historical reasons. Hence it is not appropriate to ground economic policies upon neoclassical theory. An exchange-based conceptual framework is simply too flimsy to carry the policy actions required in a modern monetary production economy with extensive division of labour. This does not mean that the market is not important: in the classical-Keynesian view, the main task of this institution is to create a continuous tendency for market prices to adjust to the prices of production. (This, incidentally, implies that the latter are fundamental in a monetary production economy, not the former.) However, the market cannot solve the great economic problems – value, functional distribution and employment – on a fundamental level, i.e. in principle. In the light of the argument set out in the preceding chapters, especially in chapter 5 (pp. 281–93), this implies that the neoclassical policy problem cannot be solved in principle either. On the one hand, the market cannot produce a tendency towards full employment because production is a social process which prevents pricing being separated from distribution and, consequently, means that marginal products are not defined; long-period factor markets simply do not exist. On the other hand, the position of the long-period demand and supply curves – if they existed! – would depend upon the institutions located in the framework. With a spontaneous tendency towards full employment lacking, liberal long-period economic or system policy is faced with an impossible task: ideally, an institutional framework would have to be set up such that the actions of rational economic agents result in a full-employment equilibrium. This would require a frightening amount of planning, including regulation of behaviour.

The above relates to an important aspect of economic history since the Industrial Revolution: socioeconomic policies were – and, in fact, still are – based upon a *normative* theory, i.e. the economic theory of liberalism or neoclassical economics, in order to attempt to solve *real-world* problems that arise within monetary production economies. This means that concepts associated with the rational behaviour of individuals and with the co-ordination of behaviour by markets were and are used to tackle issues pertaining to the rationality of the socioeconomic and political system. The results are well known. In periods of crisis, liberal policies require austerity. Saving must increase to finance additional investment required to create new jobs; this may require lower real wages and cuts in government spending, including expenditures for social welfare. From the classical-Keynesian view on the functioning of a monetary production economy sketched in chapter 4, such policy measures are very likely to result in an increase in involuntary unemployment. Hence actions which seem rational from the point of view of the individual produce opposite results if applied to the social system, which possesses its own laws. As a consequence, liberal policy measures are largely ineffective in the face of growing involuntary unemployment and its social and political effects. As a rule, liberal policies aim at influencing the behaviour of individuals, not at organizing the social system within which behaviour takes place. More and more regulation of behaviour is required to deal with the problems arising if the system does not work properly. For example, attempts are made to tackle involuntary unemployment with vocational training (which is certainly required to cure *structural* unemployment), or, if the number of crimes increases, security measures are reinforced. This is to deal with effects (inappropriate behaviour), not with the underlying causes, i.e. the misfunctioning of the system, which results in involuntary unemployment.

The policy problem in political economy

The central problem of politics is fundamentally of an ethical nature. The basic aim is to reduce, as far as is humanly possible, system-caused alienation, which has been defined as the gap between some actually existing social situation and a state of affairs embodying the common weal or the public interest (chapter 2, pp. 39–53). This requires attempts to set up a harmonious and rational social structure, that is to create the social preconditions within which individuals and collectives may prosper. The policy principles have to be proposed by the science of politics (in the traditional Aristotelian sense) of which political economy is a branch (chapter 2, pp. 20–57). The state (the government and the civil service) ought to apply these principles to specific real-world situations.

In the humanist view, the state is by far the most important social institution since its concern ought to be the public interest, i.e. a matter related to *all* aspects of social life. In the socioeconomic sphere, the most important tasks of the state ought to relate to securing full employment and a fair distribution of incomes. Both aims embody the *principle of solidarity*: nobody ought to be excluded from society or to be treated in an obviously unfair way therein. Other important aims to be pursued by the state relate to increasing national wealth such as is compatible with the preservation of the environment, to spending tax incomes in a socially useful way and to contributing to organizing international trade relations in a way that is beneficial to all trading partners. In doing so, the state ought to co-operate with non-governmental institutions which might be subsumed under the heading of *non-profit organizations*. Examples are various associations and co-operatives of workers, employers and consumers and non-profit organizations in the social and cultural sphere. However, the state ought to intervene in socioeconomic affairs only if some individual or some social entity is not in a position to solve some vital problem by itself. This is the *principle of subsidiarity* which implies that state intervention must be such as to leave the greatest possible scope for freedom of action for all citizens (for a philosophical treatment of this principle see Utz 1964–94, vol. I, pp. 277ff.). Hence, the policy problem is, positively formulated, to create appropriate social foundations, not to influence the behaviour of individuals. The latter ought to be regulated by individual ethics, i.e. *Individualethik*.

Because of the permanent presence of alienation on the political level, real-world state activity will – often very widely – diverge from the normative picture just sketched. There are various causes for political alienation to arise. Corruption and the pursuit of particular interests by politicians are perhaps most important. However, well-intentioned politicians may also enhance political alienation if their policy actions are based upon inappropriate principles, for example if austerity policies are pursued in a crisis situation. In this context it ought to be recalled that alienation in some sphere of social life, as a rule, produces alienation in other domains; for example, political alienation – corruption and the pursuit of particular interests by politicians – is likely to bring about alienation in the economic sphere, for example involuntary unemployment, and, subsequently, in the social sphere: crime increases with persistent unemployment.

Since the rational economic actions of the economic agents and their co-ordination by the market cannot solve the most important economic problems, the state and society must intervene and take policy actions based on the global or macro rationality of the system. This is the point of view of political economy which is, in part, contrary to the view first expressed by Adam Smith and subsequently refined by the neoclassical economists. James Steuart anticipates classical political economy (in the sense of Ricardo and J. S. Mill) and the essence of modern classical-Keynesian political economy:

> What oeconomy is in a family, political oeconomy is in a state . . . The *statesman* (this is a general term to signify the legislature and supreme power, according to the form of government) is neither master to establish what oeconomy he pleases, or, in the exercise of his . . . authority, to overturn at will the established laws of it . . .
>
> The great art therefore of political oeconomy is, first to adapt the different operations of it to the spirit, manners, habits, and customs of the people; and afterwards to model these circumstances so, as to be able to introduce a set of new and more useful institutions.
>
> The principle object of this science is to secure a certain fund of subsistence for all the inhabitants, to obviate every circumstance which may render it precarious; to provide every thing necessary for supplying the wants of the society, and to employ the inhabitants . . . in such a manner as naturally to create reciprocal relations and dependencies between them, so as to make their several interests lead them to supply one another with their reciprocal wants (Steuart 1966 [1767], pp. 16–17).

In modern terms, the state and parts of the civil society – trade unions, entrepreneurial associations, professional corporations, for instance – have to create the social preconditions such that individuals may prosper. On the most fundamental level this means the broad regulation of the level of economic activity and of the production of the social surplus, its distribution and its use.

This humanist conception of socioeconomic policy-making has a very long tradition in social and political thought, although the application of the basic principles has taken on very different forms because of widely differing economic, political and intellectual circumstances. Presumably, the appropriate historical starting point is Aristotle's *Politics* taken together with his *Ethics*. Some of the great scholastic philosophers, Aquinas in the main, carried on the tradition which, in turn, was taken up by many mercantilists and, in Germany, cameralists; the latter coined the notion of *Staatskunst* which subsequently gave rise to the development of the *Staatswissenschaften*. The Aristotelian tradition of politics was continued by representatives of the physiocratic and classical schools including Marx; his famous remarks on the 'realm of necessity' (*Reich der Notwendigkeit*) and the 'realm of freedom' (*Reich der Freiheit*) (Marx 1973/74a [1867–94], vol. III, p. 828) are important in this context. The American Institutionalists and the members of the German Historical School, above all the 'socialists of the chair' (*Kathedersozialisten*) are also in the humanist line of political thought. At the end of the nineteenth century, a specific Christian Social Doctrine was established in which, subsequently, typically classical-Keynesian views regarding employment and distribution were incorporated. In the twentieth century, the tradition was taken up by Maynard Keynes and by many Keynesians and classical-Keynesians (on this, see also Deane 1989; Harcourt 1986, pp. 250–72; and Schumpeter 1954).

A normative classical-Keynesian system

Classical-Keynesian political economy is essentially positive and may as such be used to approximately explain real-world phenomena set in space and evolving in historical time. In positive analysis, values, ethical standards and the extent of alienation are, explicitly or implicitly, assumed to be *given*.

However, explanation of socioeconomic reality is not sufficient to set up a coherent system of policy actions. The aims to be reached must also be specified: *pure normative systems* picturing what desirable socioeconomic states of affairs ought to look like *in principle* have to be elaborated; for instance, the meaning in principle of an 'equitable distribution of incomes' has to be defined; moreover, since there is no automatic tendency towards full employment, the *right to work* as a basic human right must be firmly anchored in a classical-Keynesian normative system; this requires a theory on how full employment may be reached in principle. Starting from pure normative models, corresponding real-type models may be elaborated. However, the latter ought to be 'moderately' normative only, i.e. they must imply a state of affairs that may be achieved by purposeful human actions and not imply a utopia as is the case with liberal and socialist models: starting from a specific concrete situation it must be possible to specify the path leading to the state of affairs pictured by the normative real-type model. The perfect world cannot be created simply, because detailed knowledge about ideal states is lacking. In fact, all attempts to realize subjectively conceived utopias have utterly failed. In recent history this is true of both socialist *and* liberal utopias, if a global view is taken.

The outstanding historical example of a 'moderately' normative real-type system is Quesnay's *tableau économique* which describes a healthy (natural) situation for the French economy as opposed to the chaotic heritage left by a lost mercantilist trade war (against England). Large parts of the classical system of political economy are moderately normative whenever *natural* states of affairs are considered. The same is true of Lowe's work: 'The Mecca of the modern growth theorist does not lie where prevailing opinion looks for it; namely, in "positive" analysis' (Lowe 1976, p. 7). '[Therefore] we should base our trust in *prescriptive* rather than in *descriptive* analysis' (p. 8).

The *natural system* set out by Pasinetti (1981, 1993) constitutes a fully fledged modern normative system along classical-Keynesian lines. This system may be termed *natural* because it deals with the normative nature, i.e. the normative essentials or principles associated with monetary production economies. Because of its normative dimension the *natural* differs from the *normal*; the latter is positive and attempts to capture the essentials of actually existing monetary production economies. The two are separated by alienation which may be caused, for example, by a very unequal distribution of incomes and by high unemployment levels.

Hence the *natural system* is a pure or ideal-type normative model which is, as such, independent of institutions:

It is my purpose . . . to develop first of all a theory which remains neutral with respect to institutions. My preoccupation will be that of singling out, to resume Ricardo's terminology, the 'primary and natural' features of a pure production system. [Problems that relate to the institutional mechanisms which characterize any society are subsidiary to the 'natural problems'] and may actually be solved in many different ways (Pasinetti 1981, p. 153).

Pasinetti's essentialist approach clearly emerges here. The search for essentials or first principles results in pure models which are always independent of specific institutions. This is also true of the Walras–Pareto model. However, pure models *imply* a specific ranking of institutions. In Pasinetti's natural system it is implied that the institutions associated with production and distribution are fundamental, while the Walrasian model implies a pre-eminence of markets, which are also institutions.

The starting point of Pasinetti's analysis is indeed the *process of production* which is a social process (production of commodities by means of commodities and labour) directed towards a common (social) aim, i.e. the production of the 'social' product including the surplus over what is used up in the production process. On this basis, one of the central problems of classical macroeconomics is solved, i.e. the question of the appropriate proportions between sectors of production if structural change is going on in time. Hence, the distribution of employment between sectors is also determined in any period of time.

The Keynesian employment problem is dealt with in a very general way. The *natural system* contains 'a *macro-economic* effective demand condition, referring to total demand in the economic system as a whole [which, together with the] *sectoral* new investment conditions [guarantee] full employment and full capacity utilisation' (Pasinetti 1981, p. 128). The normative character of this condition comes out clearly from Pasinetti's considering '[f]ull employment as an actively pursued target of economic policy' (p. 88ff.) which requires '[a] central Agency entrusted with the task of keeping full employment' (p. 91). Full employment is an absolute requirement because, in a monetary production economy, involuntary unemployment means squandering the unique and most precious factor of production. Hence the all-important *right to work* is firmly anchored in the *natural system*.

Functional income distribution is dealt with in an ingenious way:

When there is both population growth and technical progress, there are as many natural rates of profit as there are rates of expansion of demand (and production) of the various consumption goods. Each natural rate of profit is given by the sum of two components: the rate of population growth, common to all of them, and the rate of increase of per capita demand for each consumption good (equal to the rate of increase of per capita production, as we are considering dynamic equilibrium situations) (Pasinetti 1981, pp. 130–1).

Thus, ideally, the social function of profits is to finance full-employment investment.

This theory of the functional income distribution has a particularly interesting implication with respect to the theory of value: '[once] natural [rates] of profit [are] introduced [t]he theory of value implied [in the natural system] becomes a theory in terms of simple labour – *a pure labour theory of value*' (Pasinetti 1981, p. 132). This proposition has far-reaching implications for economic theory. For example, the labour theory of value implies that the various kinds of labour have to be evaluated, i.e. the reduction coefficients have to be determined. The latter govern, together with the conditions of production, the relations of exchange. If, on average, one day's direct and indirect labour is required to produce a coat and if two days are needed to make a cupboard, then one cupboard will exchange against two coats. This implies, however, that the labour of the tailor is put on an equal footing with that of the carpenter. If now, in a specific society, for technical and social reasons, one day of a carpenter's labour is considered to be equivalent to two days of a tailor's labour, then a cupboard would, in principle, exchange against four coats. To fix the reduction coefficients on the basis of the social quality of the various types of work performed amounts to determining the *social status* of workers and employees; materially, the status shows up in work conditions and in the relative wages and salaries. The determination of the reduction coefficients is a complex and ongoing social process, since, with technical change going on, new kinds of labour continuously come into being. In a society organized by humanist or natural principles trade unions will have to play a crucial role in determining the reduction coefficients by means of a socially appropriate wages structure.

The problem of reduction coefficients and hence of social status plays a prominent role in the work of many classical economists and Marx. In relation to the concept of the *just price*, Aristotle and Aquinas dealt with the problem of social status under the heading of *distributive justice*, or *iustitia distributiva* (Salin 1967, p. 31). This notion was elaborated in order to establish an ethically appropriate relationship between individuals and society in the economic and political sphere, particularly regarding the distribution of income and wealth. In this view, distribution is not a relation between individuals but is a social problem; it deals with a specific relationship between parts (individuals and collectives) and the corresponding entity, i.e. society (on this, see chapter 4, pp. 154–90).

The essentially normative character of Pasinetti's *natural system* requires that personal income distribution be in line with the generally accepted social status of the individuals making up society, i.e. that reduction coefficients be fixed in a socially equitable way. Hence the *natural prices* are *just prices* in the sense that they reflect properly society's efforts embodied in the final products. Moreover, if transactions (exchange of goods and services) are carried out on the basis of just prices, *justice in exchange* prevails, a concept which broadly corresponds to the concept of *iustitia commutativa* of Artistotle and Aquinas (Salin, 1967, p. 31). Trade at just prices implies that exchange relations are fair and right and that distribution (relative wealth) is socially equitable. The concept of the just price is not only of paramount importance for exchanges going on inside an economy, but also for economic relations between nations, i.e. foreign trade. Hence, the labour theory of value is a *social* theory of value of immense complexity and variety since different material contents may be given to the formal concepts of 'distributive justice' and 'justice in exchange' in various countries and regions. This stands in sharp contrast to the relatively simple neoclassical theory of value which, in its being based upon utility, is *primarily* individualistic. To be sure, the classical-Keynesian labour theory of value, or of labour equivalents, does not imply that utility, i.e. demand, plays no role. With respect to value, however, utility (demand) is of *secondary* importance in that it records deviations from already determined normal prices which are based on labour equivalents (positive analysis) or from labour values in normative analysis. In the long run, utility and demand do not influence prices and values anyway; their primary role is to determine the structure of output. This fact comes out very clearly from Pasinetti (1981, 1993) and is also implied in the earlier chapters of this book.

The pure or ideal-type natural system uniquely deals with principles and can therefore be associated with various institutional set-ups of the humanist type (chapter 2, pp. 20–57). Correspondingly, some basic principles for policy action can be derived from the natural system, e.g. the need to aim permanently at full employment. In order to put the natural system to practical use, desirable institutional set-ups will have to be specified, which means working out *normative real-type* models for specific countries and time-periods. Such models might contain concrete policy measures to secure full employment and a fair distribution of income; the latter relates to the functional distribution, i.e. the shares of wages, profits and rents in national income, and to the structure of wages. When implementing these policy measures, the state ought to co-operate with the non-profit sector, in general, and with entrepreneurial associations and trade unions, in particular. With employment and distribution fixed, entrepreneurs and entrepreneurial associations may rely on the market mechanism to establish structures of production such that outputs may be sold at, approximately, natural or just prices. Since the social nature of the process of production and the notion of social harmony are fundamental in an economy organized along humanist lines, the *principle of co-operation* and, when needed, the *principle of co-ordination* ought to regulate the relations between the state and civil society, of which the non-profit sector is one of the main components.

The natural system set forth in Pasinetti (1981, 1993) is essentially a piece of classical macroeconomics dealing with proportions. As such the *natural system* allows the treatment of a number of important economic phenomena from a normative point of view: value, distribution, technical progress, saving and interest, international trade, and others. To formulate policy principles the natural system must be combined with pure positive theories, e.g. with a macroeconomic theory of output and employment determination which has to explain how full employment may be achieved in principle (chapter 4, pp. 140–204). Since the natural system refers to a monetary production economy, money must play an essential role. This role is twofold: first, natural prices depend upon the conditions of production and money wages and, second, effective demand – a monetary magnitude – determines output and employment; hence continuous efforts are required to maintain full employment. Finally, it should not be difficult to link up classical-Keynesian microeconomics (behaviour) with the (structural) natural system; for example, prescriptions regarding price formation and the utilization of profits may be required. Hence Pasinetti's *natural system* provides the appropriate starting point for building the analytical framework of positive and normative classical-Keynesian political economy and of the associated socioeconomic policies (for some additional remarks on the significance of Pasinetti's natural system, see Bortis 1993). In spite of its being essentially normative the natural system may serve as the basis of both positive and normative political economy because the normative is but the ethically appropriate form of the positive, with the same variables and parameters entering both types of model.

Some classical-Keynesian policy principles

Two related sets of socioeconomic policy measures are required to promote the public interest. One is concerned with domestic issues, the other with external relations and the world economic and financial system. Domestic policies are closely associated with the internal employment mechanism; proposals on international economic and financial relations are linked up with the external employment mechanism (on both these mechanisms, see chapter 4, pp. 190–9). Both kinds of policy are dealt with in the subsequent subsections.

Classical-Keynesian socioeconomic policies naturally emerge from the broad conceptual framework suggested in chapter 4 and from the normative system sketched in the preceding section. Concrete policy proposals are made in 'The end of laissez-faire' (Keynes 1972b, pp. 272–94), in 'National self-sufficiency' (Keynes 1982, pp. 233–46), in the final chapters of the *General Theory* (Keynes 1973b) and *The Clearing Union* (Keynes 1980). Pasinetti's views on the nature of macroeconomics and on foreign trade (Pasinetti 1981, chapter XI) and Kuttner's *The End of Laissez-Faire* (1991) directly link up with Keynes's vision.

Long-period domestic policies

'The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes' (Keynes 1973b, p. 372). Employment and distribution are inevitably *the* great domestic policy issues in a *humanist* view of the economy. This emerges from chapter 4. Additional important policy problems are concerned with state activity, with entrepreneurial activity and with the organization of exchange and production. All these issues are associated with the internal employment mechanism described in chapter 4 (pp. 190–9). Some aspects of these policy problems are the object of the present subsection. We start by considering distribution, which is basic because normal prices and normal employment heavily depend upon it.

From the normative classical-Keynesian system sketched above two great distributional issues emerge. The first is associated with Ricardo: how are the shares of wages, profits and rents determined? In chapter 4 (pp. 154–90) it has been suggested that distribution is essentially a social phenomenon involving part–whole relationships: hence a social consensus is required to determine functional income distribution. Trade unions, entrepreneurial associations and professional organizations play a crucial role here. The state should intervene only if the distributional consensus cannot be reached on the intermediate or social level. This would constitute an application of the principle of subsidiarity: political or higher-level action should only be taken if a problem cannot be solved at the lower level, i.e. the social level in this case. To fix the socially appropriate profit rate is perhaps the central problem of functional distribution (it may be recalled here that the determination of the natural wage was Ricardo's central problem). In chapter 4 (pp. 154–90) reasons were given why profits should subsist even in the stationary state.

The second great distributional issue concerns the structure of incomes, particularly the wage structure. Relative wages should reflect Ricardo's and Marx's reduction coefficients. These, in turn, ought to be based upon the quality and the intensity of the intellectual and physical efforts made by the various categories of workers and employees. All the reduction coefficients are interdependent and express part–whole relationships. Hence job evaluations required to fix relative wages in particular enterprises must always take account of the entire wage structure on which each single enterprise constantly needs information. Trade unions seem best suited to collect and to disseminate the relevant information concerning relative wages. To ensure a fair wage structure seems to be one of the main trade union tasks in a monetary production economy.

Distribution is closely related to price formation and taxation. The normal prices governed by technology and distributional institutions are Ricardian in the sense that they approximately reflect social efforts of production in the most difficult circumstances. This is evident in agriculture and mining. In the industrial and service sectors 'difficulties of production' may occur on account of legal prescriptions, for example prescriptions concerning the protection of the environment, or of an unfavourable location, giving rise to high transport costs for instance. Rents may therefore accrue to producers in the primary, secondary and tertiary sectors. In chapter 4 (pp. 154–90) it was mentioned that rents may also accrue in the liberal professions, for example through entry barriers or special skills.

Rents are an ideal object for taxation. This is particularly valid for rents on land, i.e. rents in agriculture and mining. Taxes and subsidies have important distributional implications. For example, Ricardo held that all the taxes ultimately fall upon property income, above all profits. Kaldor argues to the contrary: if wages are the residual all the burden of taxation falls on wages (Kaldor 1955/56). This always holds with the classical-Keynesian framework suggested in chapter 4 *if* the employment level is given, particularly in a full-employment situation. However, if there is persistent involuntary unemployment (chapter 4, pp. 142–204) additional state expenditures and increased taxation may leave the distributional shares unchanged; instead a permanent change in the normal employment level may occur.

The securing of an equitable distribution of income, i.e. fair and thus socially acceptable wage structures and profit rates, is required not only for the ethical reasons summarized by the notion of *distributive justice* mentioned in the previous section. According to the internal employment mechanism (chapter 4, pp. 190–9), distribution is directly linked with the level of employment: a larger share of normal wage incomes ($1/k^*$) is, in principle, associated with higher trend levels of output and employment since the bulk of wage income is spent on consumption goods. If income distribution is too unequal, over-saving occurs: saving exceeds the exogenously determined full employment investment level. Too large a fraction of property incomes is saved, part of which may be used for speculative purposes (hot money), thus enhancing speculative activity in the short run; in the long run wealth held in money and/or near money form grows. This may lead to an increase and to fluctuations in the value of non-produced goods – land, old masters, etc. – and of share prices and to more takeovers and takeover attempts. In these circumstances the main purpose of saving is *not* to increase future consumption through productive investment but to increase wealth in whatever shape to get as much property income as possible; investments in land are the most obvious cases in point. Therefore, an unequal income distribution tends to generate more inequality, which leads, in turn, to higher unemployment levels as is evident from the supermultiplier analysis carried out in chapter 4 (pp. 142–204).

On the distribution of income and wealth in the United States, H. Inhaber and S. Carroll have done outstanding work (Inhaber and Carroll 1992); having identified an 'empirical law of distribution', their main policy proposal aims at eliminating *excessive* inequalities associated with approximately 3 per cent of the wealthiest households.

The preceding remarks suggest that an institutionalized incomes and distribution policy along classical-Keynesian lines is indispensable in a monetary production economy.

It follows from the supermultiplier relation that, in addition to an equitable distribution of incomes, there is a second means to increase the level of output and employment, namely to raise government expenditure in a socially useful way; this conclusion also emerges from Keynes's *General Theory*. In normal circumstances, this holds even for a balanced budget since higher direct taxes, required to finance higher government expenditure, are likely to reduce saving coefficients much more than the propensities to consume: the approximate constancy of the long-period average propensity to consume (a stylized institutional fact reflecting the appropriateness of the surplus approach) is taken account of in the supermultiplier model by postulating constant leakage coefficients. However, the most efficient way of levying taxes is, presumably, to levy not direct taxes but, instead, indirect taxes, mainly on luxury consumption goods, or to tax expenditures (Kaldor 1955).

This is not to argue that the sphere of state activity should be extended indefinitely. The problem is to establish a sound balance between state and private activity. On account of the different ways of life this balance will vary among the different countries; hence generalizations in this matter are hardly possible. However, as far as the link between state activity and the employment level is concerned, a reduction in the former will entail a reduction in the latter, unless increased private spending compensates for diminishing state expenditures. This emerges from the supermultiplier analysis of chapter 4 (pp. 142–204).

While the volume of government expenditures is an important determinant of the scale of economic activity, their composition also shapes the institutional set-up of an economy and of a society in an important way. Such structures grow historically over long periods of time and may be quite difficult to change. For example, in spite of *détente*, some countries have considerable difficulties in switching from defence expenditure to other types of expenditure. To bring about a socially appropriate structure of government expenditures is an intricate problem of political economy requiring a comprehensive and very long-run view on socioeconomic and political affairs.

At this stage the privatization issue has to be briefly considered (see also chapter 4, pp. 154–90). In classical-Keynesian terms privatization basically means transforming 'unproductive' activities (in the sense of the classicals) financed by the surplus into surplus-producing activities. The supermultiplier formula reveals the perils of privatization: effective demand is likely to be reduced since the activities hitherto financed by the surplus have now to be paid a price which covers the costs of production *and* includes a profit; the latter means that consumers have to spend more to get the same level of satisfaction; with given techniques of production it is unlikely that substantial efficiency gains and hence lower prices can be achieved through privatization. Hence privatization leads to real income reductions and, consequently, to reductions in activity and employment levels. According to the supermultiplier analysis this tendency is reinforced by reductions in government expenditures that are associated with privatization. Moreover, tax reductions that may accompany privatizations are unlikely to raise expenditures since, on the one hand, lower taxes are likely to result in increased saving and, on the other hand, the fact that consumers have to pay for the produce of privatized activity will reduce expenditures for other goods. Hence privatization may prove self-defeating according to the classical-Keynesian surplus approach: on the one hand, privatization aims at establishing new surplus-creating activities; on the other hand, government expenditures which are an engine of surplus creation are reduced (chapter 4, pp. 142–204). The final result will be less production and employment and hence a lower surplus.

Privatization may also mean transferring profitable, i.e. surplus-producing, activities from public into private hands. This reduces government receipts which may, in turn, lead to cuts in government expenditure, lower activity levels and, consequently, a reduced social surplus.

In the classical-Keynesian view, privatization is not primarily an efficiency issue but is a matter of social organization, the basic question being which activities should yield a surplus and which activities should be financed by the surplus.

An active employment and distribution policy not only follows from the short-period analysis of the *General Theory*, but also from the long-period supermultiplier relation and its implications: effective demand *always* governs the levels of output and employment. Involuntary unemployment may thus occur at any moment of time and may persist through time. Persistent unemployment favours the emergence of a *divided society*, that separates those included in the socioeconomic system from those excluded. In the highly developed countries the former category of people make up a large majority, and vice versa in the economically underdeveloped regions. The immense dangers of social division for society as a whole need not be stressed here, nor need the immense *system-caused* suffering be described. Involuntary unemployment and its direct consequences are certainly the most important cause for system-caused alienation in complex monetary production economies (chapter 2, pp. 39–53).

As can be seen from the supermultiplier relation the gross investment ratio is an important determinant of the global activity level. Moreover, this ratio is of fundamental importance for the pace of technical progress. Hence a legal and cultural framework favouring entrepreneurial activities in Schumpeter's sense is an important domain of domestic economic policy.

Distribution, employment, state activity and the investment activities of entrepreneurs are the central socioeconomic policy issues in modern societies. A fifth important policy domain is related to the spheres of exchange (markets) and of production. Markets must be organized to some extent by cartels or similar institutions in order to reduce uncertainty for the individual producer. The central reason is that 'production takes time' (Paul Davidson): given the initial costs for research and development, marketing and production, several years may elapse before an investment project becomes profitable. No entrepreneur would engage in production and in the introduction of new methods of production and of new products if there was ferocious competition associated with very high degrees of uncertainty for the individual enterprises. The main reason is that competition is not a struggle for relative positions at the full-employment level as the liberals see it. In a monetary production economy with no tendency towards full employment (chapter 4, pp. 142–204) competition becomes a struggle for survival. No entrepreneur will therefore undertake long-term projects when the survival of his enterprise is subject to the unforeseeable vagaries of the market. If competition is too intense and uncertainty too great, entrepreneurs will more and more engage in short-term activities, mainly in the financial sector. Speculation in the stock market, in the markets for real estate, raw materials, land and other non-reproducibles – old masters for instance – becomes increasingly important. Excessive activities in these domains may gravely damage production in that the technical dynamism of the economy is reduced, for example. Why engage in long-range productive activities when quick speculative profits may be made? This important issue was recognized by Keynes, Kaldor, Galbraith and Minsky.

Cartels and similar institutions are therefore damaging only if they allow for excessive profits. On the whole, however, cartels may be socially useful in that they contribute to creating a more stable environment which is indispensable for long-period entrepreneurial action. On this issue Gustav Schmoller remarks:

> Cartels developed in line with monetary production economies with large industrial enterprises and banks. As a rule these enterprises are endowed with huge amounts of fixed capital and are therefore particularly

vulnerable to an uncertain future, excessive competition and periodic crises. For these reasons, the growth of cartels became inevitable. This process corresponds to the technical and economic conditions of our time. Cartels may degenerate and lead to the formation of huge profits. However, this institution may become socially useful . . . if cartels are controlled by representatives of the state, of the enterprises concerned and of the working class . . . Hence cartels should not be eliminated but should be put on a sound basis: they should become the natural institutions for the long-range planning of production in highly developed industrial societies (Schmoller 1901, vol. I, p. 452; a.tr.).

This view of market organization has its roots in the work of several members of the German Historical School and of American Institutionalism and has proved successful in Japan, Germany and Switzerland. (However, the danger associated with powerful industrial organizations in times of economic and/or military conflict should never be lost sight of; this problem will shortly be dealt with in the next subsection.) Kuttner mentions the Japanese example in this context:

The Japanese . . . have never believed in Adam Smith. Rather, Japan can be located precisely in a line of descent from the German Historical School . . ., the school of Friedrich List . . . The Japanese government decided to work with and through private corporations, rather than sponsoring state-owned industry. The government sold them pilot plants, provided them with exclusive licenses and other privileges, and often provided them with part of their capital funds . . . Though ownership was private, development was based on cartelization rather than price competition (Kuttner 1991, pp. 160–1).

To organize production and exchange is to favour the growth of an intermediate sphere between individuals and the state. Apart from cartels, other entrepreneurial associations and trade unions, this is the domain where most of the various non-profit organizations are active. Keynes also held the opinion that intermediate institutions ought to be strengthened in a monetary production economy, for example in 'The end of laissez-faire' (Keynes 1972b) and 'National self-sufficiency' (Keynes 1982).

The crucial importance of production was emphasized by Friedrich List, particularly in *Das nationale System der Politischen Oekonomie* (List 1920 [1841]). In chapter 12 of this book List explicitly states that the long-range development of the productive powers of an economy is far more important than short-term gains of exchange – this theme has recently been taken up systematically by Luigi Pasinetti (1993). To maintain and enhance the productive powers of a society is all-important since average labour productivity determines the material welfare of a country. The productivity of labour and its increase depend upon all the institutions making up a society: technical dynamism, which in turn depends upon the quality of research and development and on the stability of the institutional environment enabling entrepreneurs to implement long-term investment plans; the education system; the political institutions; the social climate, which partly depends upon the quality of the social insurance system and of the degree of fairness of distribution: if workers feel secure materially in case of temporary unemployment, they will be ready to accept more easily the structural changes that are inevitably associated with technical progress; a high employment level greatly improves the social climate: the terrible pressure associated with the fear of becoming unemployed largely vanishes. Moreover, a fair distribution of incomes enhances productivity since workers will be more motivated to achieve higher quantity and quality standards. With labour productivity rising, real wages will increase in the long run. This, in turn, enables a society eventually to reduce labour time and thereby increase the scope for leisure activities. In Marx's terms this means a reduction of the realm of necessity and determinism and an extension of the realm of liberty and freedom of choice (Marx 1973/74a, vol. III, p. 828).

Long-range domestic socioeconomic policies require a global view of social affairs and of society's long-period evolution: society is an entity since the institutions composing it are largely complementary (chapter 3, pp. 89–95). This is implicit in the classical-Keynesian humanist vision pictured in the preceding chapters of the present study. The immense complexity of the task and the breadth of knowledge required must be stressed: all the spheres of social life – economic, social, political and cultural – must be considered and their relationship to society as a whole evaluated. And complications dramatically increase if an open economy is considered.

Long-period socioeconomic policies in open economies

To secure full employment in an open economy in the long run is linked up with a peculiar difficulty: *given* exports, the terms of trade *and* full-employment imports, the import coefficient (b) has, in principle, to adjust itself to render possible a long-period current account equilibrium (chapter 4, pp. 190–9). In the long run, a country cannot import more than it exports: imports have ultimately to be paid for by exports if chronic indebtedness and its devastating consequences are to be avoided.

Several important policy conclusions for domestic economic policy and for organizing international economic relations follow from the fact that some management of foreign trade relations, specifically a broad management of imports, is required to secure full employment in an open economy. Three issues seem to be particularly important. These are related to domestic economic policies in an open economy, to the problem of indebtedness and to some features characterizing a world economic order along classical-Keynesian lines. The following remarks on these issues are based upon the *employment (or scale) effect of international trade* (chapter 4, pp. 185–9) which results from the *external employment mechanism* (chapter 4, pp. 190–9). The latter is dominated by quantity adjustments which are a fundamental characteristic of classical-Keynesian political economy.

The relationship between foreign and domestic policy issues

The possibility of broadly managing imports is of decisive importance for economic, social and environmental policies in an open economy. If the import coefficient (b) can be adjusted to full-employment output (equations 7, 20 and 22), countries will no longer have to worry about their respective foreign balances when pursuing policies adapted to the specific situation of each individual country. A few examples may illustrate this point. Consider, first, a situation of persistent unemployment prevailing in some country. If output is governed by the external employment mechanism ($Q_e^* < Q_i^* < Q_f$), the country in question will *not* be in a position to pursue an active long-period full-employment policy by stimulating internal (public and private) demand (equations 20 and 22, and figures 4 and 5, pp. 192–3). *Given* trend exports, the normal terms of trade and the normal import coefficient – which are all determined by institutions – a chronic import surplus would arise at once if gross domestic product grew faster than exports. Consequently, foreign exchange reserves would be run down and/or indebtedness would increase. Liberal economists now argue that the country is living above its means and that, consequently, austerity policies have to be implemented to reduce private and public consumption. Effective demand, output, employment and imports decline to eventually equilibrate the foreign balance. Evidently, the argument in question – living above a country's means – is true only with respect to the foreign balance situation (imports are larger than exports) but not with regard to the productive capacity of the economy considered. With involuntary unemployment which implies unused productive capacities, it would be more appropriate to say that the country is living *below* its means since effective demand is not sufficient to absorb potential full-employment output.

However, a socially appropriate management of imports allows output to increase until full employment is reached. On the one hand, *necessary* imports needed in the production process (b_1Q^* in equation 22) must rise together with output since b_1 is fixed by technology. On the other hand, *total* imports have, given exports and the terms of trade, to remain in line with exports, if a chronic current account deficit is to be avoided. Consequently, non-necessary imports, related to the use of the surplus (b_2Q^* in equation 22), have to be cut to make available the foreign exchange required to buy additional necessary imports: the coefficient b_2 in equation (22) has to be lowered. This may be painful, but it is unavoidable. For, what are the consequences of a permanent import surplus? In the short and medium terms indebtedness grows; in the long run, output and employment have to adjust to the level determined by exports and the foreign trade multiplier. Growing unemployment eventually results in *forced* emigration which is one of the most tragic features of capitalism, above all if the potential host countries rely on immigration restrictions to keep the size of the immigrant population to politically manageable proportions. This is a very difficult task, frequently compounded by a high level of unemployment in the potential host countries themselves: the argument that the presence of foreigners is directly responsible for home unemployment is, as a rule, of a devastating social and political force.

A similar line of reasoning appears in a second example. In some country, social allowances or expenditures for environmental protection are raised; taxes and contributions increase. Given the money-wage level, domestic prices rise somewhat. It may not be possible to lower the exchange rate in order to maintain the current account equilibrium. Exports decline, imports increase and a permanent deficit in the foreign balance becomes established; the latter requires selective import controls. Hence reasonable standards for social security and for environmental protection can be secured only in conditions of full or near full employment: in an unemployment situation, it may always be argued that, with additional expenditures for social security and for environmental protection, the foreign balance will deteriorate and raise unemployment in the long run.

A third example is related to the influence upon the way of life of the external employment mechanism. In chapter 4 (pp. 190–9) it is argued that the size and the structure of exports, the terms of trade and the strength of import dependence determine the level of trend output and employment. With intensive competition on world markets and with world economic activity governed by global effective demand, this implies that everything has to be done to maintain or to increase competitiveness on foreign and domestic markets. In highly developed countries, exporting mainly sophisticated high-technology products, rapid technological change associated with huge efforts to keep the technological leadership in at least some sectors is all important: technology constitutes an immensely powerful weapon in international economic warfare aimed at securing high-quality jobs. For successful countries, the advantages obtained will be important: large export volumes, favourable terms of trade and a relatively low import coefficient will bring about high employment levels; moreover, favourable terms of trade imply that imported products (raw materials, agricultural products and standard industrial products) are cheap, which raises domestic living standards. In the technologically less developed countries this mechanism is reversed. In their desperate attempts to maintain already low employment levels, the terms of trade have to be depressed in order to attempt to increase the volume of exports: money wages have to be kept low in relation to labour productivity. As a consequence exports are cheap and, possibly, quantitatively large, while imports will be expensive and quantitatively small. The quantity of goods and services available at home declines and depresses living standards. Many underdeveloped countries are actually forced to squander precious raw materials, agricultural products and even standard manufactured products on world markets in order to be able to earn the foreign exchange necessary to finance the import of necessary (and non-necessary) goods and the servicing of debt. An important side-effect of this way of proceeding is the severe damage done to the natural environment. Deforestation is but one case in point.

The doubtful economic sense of trying to maintain employment levels through unfavourable terms of trade was brought into the open by some of the old mercantilist thinkers. Daniel Defoe, for example, argued that low wages linked with unfavourable terms of trade, large export volumes and small import quantities led to immiseration; high wage levels, however, had a double positive effect: first, small but high-quality export volumes, combined with cheap and plentiful imported goods, raised living standards; second, high wages led to increased domestic demand for goods and services and added to prosperity (Heckscher 1932, vol. II, pp. 153–6).

The necessity to remain competitive on world markets at any price governs to a large extent the way of life in open economies by exerting an immense pressure on the population; for example, increases in productivity do not, as a rule, lead to a reduction in working time and to more leisure. This results from the fact that world economic activity is not resource-constrained but demand-constrained, with no tendency towards full employment prevailing. Therefore, the struggle on world markets is not about relative positions in a (neoclassical) full-employment position but is a battle for survival in the face of threatening involuntary unemployment.

These examples suggest that presently open economies have to rely on the external employment effect in order to secure high levels of employment and to avoid current account deficits (figures 4 and 5). *Given* that world economic activity is governed by world effective demand through the internal employment mechanism (the world economy is a closed system), it follows that there is ruthless competition on world markets, mainly for manufactured products since the employment effect of producing these is relatively high (chapter 4, pp. 190–9). This type of competition *partly destroys sovereignty* over economic, social, cultural and environmental policies in individual countries. It is no longer possible to pursue a full employment policy by stimulating *internal* demand; progressive social policies become utopian; expenditures for environmental protection have to be severely limited: such policy actions would diminish competitiveness and would worsen the foreign balance position. Moreover, the requirement to remain competitive dictates the way of life in open economies: it is hardly possible to organize life according to cultural and social principles, based either on tradition or on contemporary values. The ways of life are determined to a large extent by so-called economic considerations – remaining competitive is all important. In this view, playing *pétanque* or even *cricket* instead of working harder and longer is evidently disastrous for productivity levels, for the pace of technological progress and, as a consequence, for the competitive position on world markets. Last, but not least, one could mention that with the struggle for survival intensifying and with competition getting more and more ferocious, the means used to ensure survival are, in many instances, increasingly devoid of conventional ethical standards; many experienced managers are speaking of growing 'ethics deficits'. In most cases this is probably not due to individual ethical standards declining but is produced by alienation caused by the inappropriate functioning of the world economic system as a whole (chapter 2, pp. 39–53).

The attempts of individual countries to increase trend employment levels through the employment (or scale) effect of international trade thus constitute a mutual threat to national sovereignty which is required for the pursuit of the public interest. But the economic warfare involved here is also a potential source of conflicts as is evident from recent events and from the history of international trade relations. Struggles about the location of enterprises to secure jobs are obviously most important. Moreover, economic domination entails the temptation to dominate politically. All this is not to deny that there are aspects of international trade which promote co-operation and mutual understanding: here, the welfare effect associated with the principle of comparative costs, given full employment in all trading countries, is perhaps most important.

The meaning of a socially appropriate management of imports, i.e. adapting the import coefficient relating to non-necessary goods (b_2 in equation 22) to full-employment output, now becomes somewhat clearer. This type of policy action restores, in the first place, national sovereignty with respect to long-period economic, social and environmental policies. Pursuing a full-employment policy by stimulating domestic demand, private and public, and securing an equitable distribution of incomes becomes possible again. Second, and of equal importance, freedom with respect to organizing a country-specific way of life, based upon the system of values prevailing in each country, is also restored. This would contribute greatly to maintaining cultural diversity worldwide which is, in fact, threatened by the outrageous and standardizing domination of the *economic factor*. The essence of freedom consists in the possibility of individuals organizing their social and individual lives in accordance with a generally accepted hierarchy of values. Perhaps, the citizens of some countries want to work very hard to achieve material aims. However, the international economic order should be such that this does not lead to a disruption of the way of life in other countries through the external employment mechanism. It is precisely through this mechanism that the now rich countries have developed economically.

Hence import management also renders possible the elimination of the external – mercantilist – employment effect aimed at increasing the level of economic activity in some countries at the cost of others, and the elimination of the potential sources of conflict associated with the external employment effect. Keynes was very explicit on these issues: 'I sympathise . . . with those who would minimise, rather than maximise, economic entanglement between nations. Ideas, knowledge, art, hospitality, travel – these are things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible; and, above all, let finance be primarily national' (Keynes 1982, p. 236). Or: 'the policy of an increased national self-sufficiency is to be considered not as an ideal in itself but as directed to the creation of an environment in which other ideals can be safely and conveniently pursued' (p. 240).

The policy measures proposed above do not imply that competition is not important. A considerable degree of competition between firms and between nations is required in order to ensure that the goods produced are of satisfactory quality and that, given money wages, normal prices be not too high and hence distribution too unequal. What has been criticized is competition as a means of securing high levels of employment on the basis of the exernal employment mechanism (chapter 4, pp. 190–9). With world economic activity determined by global effective demand, implying limited markets worldwide, this type of competition is destructive. While the economically strong countries (with large export shares of high-quality goods and services in output and/or a high foreign trade multiplier) claim relatively large fractions of world effective demand, the weaker countries have to be content with remaining market shares. Any attempt by all of them to improve their position by relying on foreign demand is bound to fail as *world demand is given* though not invariable. On the contrary, the situation may get worse if, in individual countries, internal demand is diminished (money wages are depressed relative to prices, and/or government expenditure is cut) in order to get higher market shares abroad, because then effective demand is depressed worldwide.

Hence competition associated with the external employment effect as a means to secure high employment levels has to be eliminated, because, given world effective demand, the possibility of some countries improving their employment position at the expense of others is a permanent source of conflict. Trade wars may easily break out of the economic sphere to become conflicts on a social, political or even military level. The problem is to bring about a balance-of-current-account equilibrium at the full-employment level through selected import controls. This enables a country to rely on the internal employment mechanism in order to pursue a full-employment policy (chapter 4, pp. 190–9, and pp. 319–26 above).

The foreign debt issue

The second point to be dealt with here, world indebtedness, is closely linked with Kaldor's cumulative employment effect which is briefly considered in chapter 4 (pp. 185–9). Flows of finance from rich to poor countries lead to a *surplus* of exports over imports in the former and to a *deficit* on the current account in the latter (chapter 4, pp. 190–9). The export surplus strengthens the employment effect of international trade since this is equivalent to additional effective demand which is subsequently magnified through the supermultiplier. On the other hand, in the receiving country, more goods are available for consumption and investment, although part of domestic investment may be displaced by foreign investment: with trend effective demand and technology given in certain periods of time, normal investment opportunities are also fixed (Bortis 1979). Hence in the early stages of borrowing (and lending) positive effects are likely to occur both on the creditor and the debtor side, mainly because interest payments and reimbursements are still negligible. Once the foreign debt reaches a critical size, however, negative effects for both, borrowers and lenders, appear (equation 23). The annual debt service (interest payments and repayments of debt due) eventually exceeds gross capital flows; in this case, the lenders will no longer realize an export surplus and the borrowers will no longer dispose of goods and services in excess of their social product. On the contrary, the indebted countries will eventually have to realize an export surplus in order to service the debt. Given exports, the terms of trade and the import coefficient, drastic reductions in output and employment will ensue (equation 23) because the necessary goods needed in the process of production cannot be imported in sufficient quantities.

An eventual repayment of the debt seems only possible if the creditor countries are willing to accept substantial import surpluses (implying export surpluses of the debtor countries) brought about by a considerable increase in the export of manufactures on favourable terms of trade by debtor countries: the industrialized countries would have to open their markets for manufactured goods to the indebted and economically underdeveloped nations. In view of the employment situation in the creditor countries, this seems impossible, at least in the near future.

Hence the debt cannot (and will not) be repaid, mainly because the creditor nations do not want repayment for fear of more unemployment. The only way out is gradually to cancel large parts of the debt until it has reached proportions manageable for creditors and debtors. In doing so, account would have to be taken of capital that has been transferred illegally from debtor to creditor countries. Moreover, the costs of cancelling part of the debt should be distributed evenly between and within the creditor countries since, in these countries, most individuals and institutions will have benefited from the positive effects that occurred in the early stages of lending; it would be unfair to make the commercial banks entirely responsible for the actual debt crisis. Finally, it ought to be borne in mind that countries, like individuals, should incur significant indebtedness only in order to overcome exceptional situations, due to the negative economic effects of natural calamities for instance. Incurring debts on a regular or institutionalized basis inescapably leads to an unmanageable situation (Bortis 1979).

These conclusions regarding the debt problem seem inevitable in the light of the classical-Keynesian framework set out in chapter 4 (pp. 190–9). Moreover, they are broadly in line with the argument Keynes put forward in his *Economic Consequences of the Peace* (Keynes 1971a) in the context of the German reparation problem. Here, Keynes was already tackling employment problems of open economies and implicitly taking account of the principle of effective demand. His argument is perhaps reproduced best by the export multiplier equation (20) and by equation (23).

Some remarks on an alternative world economic order

A third range of conclusions derived from the principle of selective import controls is loosely related to the world economic order that would be desirable from a classical-Keynesian point of view. Because of the complexity of the problem, only the main issues can be mentioned.

First, selective import controls as a means to secure high employment levels may be practised by individual countries or by regions within a country, or, again, by regions consisting of two or more countries willing to pursue a common economic and social policy. This is not the place to inquire into the ‘optimal’ size of such economic (and partly political) entities, but a few points should be noted.

The regions in question should not be too vast in order to remain manageable. Presumably it would be best not to change currently existing national entities. The problems of social organization to be solved within each country are extremely complex: foreign trade has to be managed in the public interest; a social consensus regarding the distribution of income and wealth has to be established; full employment has to be approximately realized; an institutional set-up enhancing labour productivity and the size of the social surplus has to be created; and a balance between regions as well as between ethnic, religious and linguistic groups has to be found. These essentially social problems are unique for each country because they have to be in line with a specific way of life governed by a particular system of values. In some countries, people may want to work hard and enjoy less leisure time, while, in others, leisure linked with cultural activities may be very important. The diversity of values is the main reason why individual countries require sufficient sovereignty to carry out socioeconomic policies in line with the desired organization of their societies. This extremely complex task can be approximately solved only within relatively small political entities within which a broad social consensus may be obtained. Presumably, some of the larger European countries will have to decentralize and regionalize in order to render possible appropriate socioeconomic, legal and cultural policies. Moreover, it would seem that (Western) Europe is far too vast and diverse to allow the establishment of economic (or even political) unity. The attempt to bring about a single European market might end up in administrative (and legal) chaos: to regulate the *behaviour* of economic agents so as to bring about high trend employment levels and a fair distribution of incomes is a hopeless task; in the absence of a self-regulating mechanism the corresponding institutional framework required becomes immensely complex and presumably cannot be managed. The only way to solve the central socioeconomic problems (employment, distribution and a fair price system) is to set up an appropriate *framework of social institutions* within countries and regions. A similar point was made by Keynes (1982) and, more recently, by Kuttner (1991). Friedrich List was perhaps the first systematically to express the idea that the state is an indispensable social and political entity between individuals and the world as a whole (List 1920 [1841]). The existence of sovereign nations would not exclude close relations between countries at all levels – economic, social, political and cultural (Bortis 1992).

The necessity broadly to manage imports to ensure full employment has a very important implication for the organization of the monetary system: each country, eventually each region within a country, will need its *own currency* to be able to pursue full-employment policies (fiscal and monetary) since import regulations may presumably be enforced most conveniently by foreign exchange management. The export earnings of a country consist of foreign exchange, or of foreign exchange *and* national currency if a region is considered. In the long run, exports have to pay for imports. Necessary imports, $b_1 Q$ (chapter 4, pp. 195–6), ought to get priority. If the remaining export earnings are not sufficiently high to pay for all the non-necessary imports wanted, a foreign exchange rationing scheme for some of these goods will have to be introduced. This means that, *given* export earnings, not every luxury good available on world markets can be imported. This is the price to pay if a country or region wishes to preserve the essentials of its way of life, to enjoy full employment and to prevent forced emigration.

To ensure a sufficient degree of flexibility for full-employment policies at least two kinds of currencies would be required: national moneys and a world currency. The former would be used for domestic purposes, the latter for international transactions. This broadly corresponds to Keynes's proposal at Bretton Woods which will be briefly dealt with below. Here, it should be mentioned that a European currency area implying the abandonment of national moneys would render regional and/or national economic policies exceedingly difficult; presumably, regional and national inequalities would widen, distribution would get more unequal and unemployment would grow: the Kaldorian cumulative processes associated with the external employment mechanisms would take effect (chapter 4, pp. 185–99). Given this, creeping protectionism might grow rapidly in the less successful countries to protect jobs (Bortis 1992).

A policy of import management to ensure full employment is rendered much easier if there is a certain degree of self-sufficiency for each sovereign nation with respect to *basic goods* in the sense of Sraffa (1960). Basic goods are technically required, directly and/or indirectly, in the production of *all* the goods of an economy and contribute to determining *all* the prices. Food, 'capital goods to make capital goods', i.e. the machine-tool industry, and raw materials are perhaps the most important cases in point. With respect to raw materials nothing can be done regarding self-sufficiency since this is a matter of natural endowments. However, to achieve an appropriate degree of self-sufficiency with respect to food and machine-tool production, suitable policy measures can be taken. The degree of self-sufficiency required will mainly depend on the strength of the desire to prevent too heavy an economic dependence on other countries which, above all if unilateral, might render political pressure from outside more probable. However, each country will, to some degree, depend on the outside world with respect to basic goods. Therefore, to avoid too strong a unilateral dependence, some diversification of imports of basic goods will be required as a rule. Moreover, too heavy a concentration of production of basic goods and the corresponding decision centres will need to be avoided since these factors determine *where* production takes place, and hence where jobs are created or destroyed.

Hence with division of labour on a worldwide scale, the old ideal of autarky has to be replaced by a mutually advantageous regulation of trade in accordance with the public interest in each country. On this point utmost realism is required since it would seem that economic warfare of the neomercantilist type has partly replaced military warfare. Economically powerful countries, dominating world markets for basic industrial goods, might sometimes be tempted to extend domination and, eventually, to exert political or even military pressure to derive unilateral advantages. Realism in these matters is the firmest basis for fruitful co-operation and mutually beneficial exchanges between nations and regions in various spheres: political, economic, social and cultural.

Moving now to a second issue:

> if nations can learn to provide themselves with full employment by their domestic policy there need be no important economic forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour [based upon the principle of comparative costs] and for international lending in appropriate conditions. But there would no longer be a pressing motive why one country need force its wares on another or repulse the offerings of its neighbour, not because this was necessary to enable it to pay for what it wished to purchase, but with the express object of upsetting the equilibrium of payments so as to develop a balance of trade in its own favour. International trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle, but a willing and unimpeded exchange of goods and services in conditions of mutual advantage (Keynes 1973b, pp. 382–3).

Hence the external – mercantilist – employment mechanism need no longer be put to use if full employment can be achieved on the basis of the internal employment mechanism (chapter 4, pp. 190–9). To replace the former by the latter perhaps constitutes the main characteristic of long-period classical-Keynesian economic policy.

Third, the principle of selective import regulation in the public interest must be mutually recognized by all trading nations and must rest on a network of bilateral and/or multilateral agreements; this implies that world trade policy has to take account of the welfare (structural) effect based upon the principle of comparative advantage *and* of the employment (scale) effect of international trade associated with the external employment mechanism. It is true that broad import regulations are equivalent to a mild form of ‘official (or open) protectionism’. However, since individual countries with severe unemployment will, in any case, try to protect themselves from the (negative) employment effect of international trade, there is presumably a choice to be made of either official protectionism, or uncontrolled, creeping and disguised protectionism. It is the latter which is really pernicious.

Fourth, selective import controls will not necessarily lead to a reduction in the volume of trade. Quite the contrary: with (near) full employment assured, in the major trading countries, international trade could be extended at will so as to reap the welfare effect of trade accruing by virtue of the principle of comparative advantage. Moreover, import controls along the lines suggested above do not mean that there would be no competition and unilateral protection of domestic producers. Various schemes may be imagined to secure a satisfactory degree of competition and, consequently, a high quality of traded goods and fair prices. These points are convincingly argued by Cripps and Godley (1978).

Fifth, the terms of trade ought to be fair and stable. This mainly concerns the terms of trade between agricultural products and raw materials on the one hand and manufactures and services on the other; the terms of trade between standard and high-technology products are another case in point. Fair terms of trade imply product prices such as to guarantee fair incomes to the producers of primary products as compared with the incomes arising to producers of manufactured goods. Prices for particularly scarce primary resources would have to be high in order to economize on their use. The problems linked with the determination of fair agricultural incomes on the national level are well known. On the international level, the difficulties relating to fixing fair terms of trade reach gigantic proportions. However, the possibility of broadly managing foreign trade should facilitate the task. Since imports may be adjusted to exports, countries need not sell at any price on the world markets to get foreign exchange.

Fair terms of trade are not sufficient, however. Stability is also important. To achieve this, various ingenious schemes have been put forward, e.g. by Kaldor (1963), who proposes to build up buffer stocks of important traded primary products. Stocks increase if supply is above normal and/or demand below normal and vice versa. Again, experience has shown that there are tremendous political obstacles to be overcome regarding the creation of buffer stocks on a sufficiently large scale.

To husband properly the still-remaining raw material and energy stocks of the world to the benefit of all nations a World Resources Agency should eventually be created within the framework of the United Nations. This should go along with setting up a solid and realistic world economic order, implying a strong (supranational) role for the United Nations and its regional suborganizations. Presumably, this would be far more reasonable than the creation of huge trading blocs which, on the one hand, might lead to trade wars between these blocs and, on the other hand, to the political domination within a bloc of some economically outstandingly strong country. An appropriate conceptual starting point for setting up a sound world economic order is Quesnay’s *tableau économique*: on the basis of the world’s natural resources – food, raw materials and energy, and the natural environment – an industrial and handicraft structure (including services) may be set up. The surplus of the system allows, in turn, the erection of a political, social and cultural superstructure upon the economic basis. If full employment were achieved worldwide, available natural resources would, in the very long run, limit world economic activity. The socially appropriate management of these resources would be, and already should be, a matter of crucial importance. This is an immense task: *the problem is to achieve and to preserve the reproducibility of the world production system.* To face this task, classical-Keynesian political economy, which takes a global view of nature and society, seems far better equipped than the rather one-sided economic theories of liberalism and of centrally planned socialism.

The Kaldorian proposal on buffer stocks was made in relation to reforms of the international monetary system. This is a sixth point to be touched upon here. In the spirit of Keynes, Kaldor and others suggested the issue of a world currency ('bancor') on the basis of buffer stocks. The quantity of bancor would be linked with the size of buffer stocks. This would stabilize fluctuations in world economic activity: with slackening activity, stocks would increase since the demand for primary products would be declining; this would lead to an increase in the quantity of bancor thus stimulating world economic activity, and vice versa.

An international buffer-stock scheme (on the lines worked out by Keynes) . . . is essential if market economies are to resume economic expansion without generating unacceptable inflation due to the consequential rise in commodity prices, resulting from speculative influences of a perverse character, and to enable the changes in stocks to be carried which are necessary to tide over short-period differences between absorption and accrual of commodities without any large deviation of the current price from the 'normal' price (Kaldor 1983, p. 249).

The institution of bancor, incidentally first proposed by Keynes in 1944 at Bretton Woods, has a number of desirable implications: all international transactions, real or financial, have to be carried out with the help of bancor. Each national currency stands in a fixed, though not invariable, relation to the world monetary unit. National moneys are *not* to be allowed to cross their respective boundaries in order to finance international transactions; speculative movements of financial capital are thus greatly hampered; foreign balances can be equilibrated quite easily since deficit *and* surplus countries have to take appropriate measures: deficit countries reduce non-necessary imports and surplus countries stimulate effective demand to increase imports; finally, financial and real capital flows can be synchronized more easily: countries experiencing a surplus of exports over imports at full employment accumulate bancor balances, which can be lent to debtor countries which, also at full employment, import more than they export. However, steps would have to be taken to prevent excessive indebtedness of the borrowing countries.

Seventh, the fair allocation of manufacturing and of service activities (banking, for example) worldwide would seem to be an important feature of a world economic order set up along classical-Keynesian lines. The problem is related to the role played by the manufacturing sector within the Kaldorian cumulative process (chapter 4, pp. 185–6) and to the fact that, for the world economy as a whole, the primary sector must stand in a certain relation to the industrial and service sectors (Kaldor 1970). Exports of high-quality manufactures, rendered possible by the existence of a broadly based and technologically dynamic industrial sector, are important to a country for three main reasons: on the world markets, the demand for the produce of its labour is likely to be strong, hence the international reduction coefficient of its labour will be large and the terms of trade favourable; import dependence is relatively small, above all if the manufacturing sector includes a strong machine-tool industry; and the employment effect is high. This means that any country would like to produce and to export as many advanced manufactured products as possible and to import agricultural products, raw materials and standard industrial products. The success of one nation in exporting such goods is bound to imply the failure of another since world production, determined by world effective demand, is given and the three basic sectors have to stand in certain proportions on the world level: the successful countries will be overindustrialized and the losers in the struggle for industrial jobs will be condemned to producing and exporting raw materials, agricultural products and standard industrial goods at unfavourable terms of trade. All this raises the question of a fair allocation of manufacturing production among nations and among regions within nations. It seems reasonable to allocate real capital (factory buildings and equipment) in regions where (qualified) workers can be found: capital has to follow labour and not the other way round. To be sure, there are other considerations when trying to answer the question of a fair allocation of manufacturing activities, e.g. the location of mining and of agricultural activities and environmental problems. A fair allocation of manufacturing (and service) activities implies huge structural adjustments on a global scale. These constitute a formidable problem in international economic relations which can only be tackled in conditions of full employment or near full employment worldwide. However, a more appropriate distribution of world manufacturing and service activities seems indispensable if the immense gaps in material well-being actually existing are to be reduced and if, simultaneously, huge forced migrations from poor to rich areas are to be prevented.

Finally, some important propositions relating to technical progress and international economic relations emerge from Pasinetti's (1981, ch. XI; 1988) work. Pasinetti starts from the huge differences in labour productivity that have developed on a world scale over the last two hundred years. These are due to the very unequal pace of technical progress which has prevailed in different areas of the world. Presumably, technological gaps are widening at present for two main reasons. First, there is the tremendous pace of technological progress in some areas of the world; computer technology and its applications to manufacturing and the services are perhaps most prominent. Second, a vicious circle linked with the external employment mechanism greatly hampers technological development in many countries (chapter 4, pp. 190–9). The starting point is insufficient export earnings. The ensuing lack of foreign exchange prevents the import of technically advanced investment goods. Hence the technological gap widens, which, in turn, acts negatively on export performance. These effects are reinforced if available foreign exchange is further diminished by a heavy debt service, capital flight and by the fact that non-basic goods in Sraffa's sense are imported. The very large differences in labour productivity are linked with equally large differences in real wages and, eventually, profits and profit rates. From this, Pasinetti draws two important conclusions regarding international economic relations:

> First . . . single individuals do benefit from migration from low-income countries to high-income countries. At the same time, the low-income countries suffer from this migration. The people who are most likely to be lured abroad are the more-than-average educated ones. They bring with them knowledge and 'brain'. In the most spectacular cases, the phenomenon has become known as the 'brain-drain', but the phenomenon has wider implications. It is the young, the more adventurous, the more knowledgeable that are more likely to leave the low-income countries. For the countries they leave, they represent losses of embodied technical knowledge and of entrepreneurship (Pasinetti 1988, p. 143).

The brain-drain reinforces the vicious circle referred to above: lower technological standards and less entrepreneurship negatively influence the competitive position of the economically underdeveloped countries on world markets; the lack of foreign exchange prevents the import of sufficient high-standard investment goods which, in turn, leads to worsening export performances. This implies ‘that the traditional tenet that immobility of labour does not matter is false’ (p. 143). It is evident, however, that to reduce or even to stop the brain-drain is extremely difficult. An attractive way of life embodying fundamental values worth to be persued permanently is certainly most important. This would reduce the presently almost irrestible appeal of Western civilisation. Moreover, political stability seems indespensible. However, without sound socio-economic foundations it seems difficult to prevent the emigration of the highly educated. An education system of high standard and in line with the way of life to be pursued is of crucial importance. So is full employment and a socially acceptable distribution of incomes. Hence, in the long run, an appropriate organisation of the socio-economic and political system would certainly be most efficient to prevent the brain drain.

In the short and medium terms policy measures on the behavioural level may be required. However, the ‘problems involved [here] are very complex, because they easily impinge upon human rights and personal freedom of movements’ (Pasinetti 1988, p. 143). Nevertheless, eventual policy measures should not be misunderstood: the problem is to stop *unidirectional* brain-drain. Intellectual and cultural exchanges, which may include movements of highly educated people between countries and regions, are highly desirable.

A second conclusion follows from international productivity differences: ‘[T]he major and primary source of international gains is *international learning*, not international trade . . . For any country (advanced or underdeveloped) any increase of knowledge (from international contacts) represents a net gain, subject to no condition and no loss to anybody’ (Pasinetti 1988, p. 143): in international economic relations, the two-way flow of scientific knowledge related to an exchange of ideas between countries and regions is of crucial importance. Modern science is a shared achievement of mankind. Western technology and science would not be there without the preparatory work done by the old civilizations (which now make their own contributions to scientific progress). Scientific knowledge is, therefore, a common good of humanity which should benefit *all* countries. However, principles like these can be realized in conditions of full employment only: the individual countries would not then be forced to rely on technology as a weapon to conquer larger shares of manufactured products on world markets.

These few remarks show that, in the field of international economic relations, there is a solid and realistic conceptual basis on which classical-Keynesian political economists can build when proposing socially appropriate third-way type institutions. In a classical-Keynesian world, the exchange of *basic* goods and services, required in the process of production, is of primary importance; trade in non-necessary products, related to the use of the surplus, is less important. Therefore, international trade is, essentially, a means for maintaining and improving the material basis, that is the productive forces, of all the countries of the world. This enables the individual country to erect an improved institutional superstructure (political, social and cultural) on a more solid economic basis. All this does not imply that there should be more nationalism and narrowmindedness worldwide. Quite the contrary: the free flow and exchange of scientific ideas (and of cultural achievements) should be a hallmark of a classical-Keynesian world. However, scientific and cultural exchange makes sense only if there is considerable intellectual and cultural diversity. It is a well-known historical fact that exchanges between fundamentally different cultures are most conducive to the creation of new ideas.

This leads to some brief consideration of the relationship between international trade and cultural diversity. Presently, international trade is not based primarily on the principle of comparative costs. The scale or employment effect of international trade is much more important (chapter 4, pp. 190–9). In a situation of chronic unemployment, the main problem consists of maintaining or, if possible, extending the scale of activities to prevent unemployment from growing. The main aim is to sell (to export) more and more to secure jobs and to earn some ‘hard’ currency which may eventually serve as a convenient store of value. In a monetary world economy there is, primarily, exchange of goods against money, not exchange of different goods, as should occur according to the principle of comparative costs. The attempts by all countries to extend profitable activities to maintain or to increase employment levels may lead to trade wars and to cultural standardization, possibly on a low materialistic level. The latter occurs because the incessant struggle to extend economic activities implies the continuous creation of new goods which, as a consequence, requires the creation of new needs. Materialistic values are imposed on people through marketing campaigns. The quantitative aspect of consumption (in the widest sense) comes to dominate the qualitative one, or in Erich Fromm’s terms ‘to have’ eclipses ‘to be’: industrial mass products frequently replace high-quality handicraft products in spite of the fact that the latter frequently include artistic elements and, on account of their durability, are far less of a burden to the natural environment than throwaway industrial products; or, after having succumbed to the hammering of publicity, many consumers finally prefer industrial food and beverages to far superior and much healthier traditional aliments: nature is partly replaced by chemistry.

Marx saw the problem most clearly: the unlimited desire to consume more and to acquire material wealth, including money, leads to the partial effacement of individuality and hampers or even destroys the capacity of man to prosper in the social and cultural sphere (Marx 1973/74a, vol. I, chapter 3, section 3). Cultural alienation increases.

In a world where economic activity is governed by effective demand the creation of too large trading areas should be avoided, not only for socioeconomic reasons (unemployment may increase, income distribution may worsen and regional inequalities may deepen owing to the Kaldorian principle of cumulative causation), but also for cultural reasons. For cultural exchange is fruitful only if there is diversity which, in turn, can be maintained only if there is a sufficient degree of national sovereignty in socioeconomic matters. Individual countries should be able to erect, without unwanted outside interference, a political, social *and* cultural superstructure in line with the system of values specific to each country. This is the essence of freedom.

Economic policies in the medium and short terms

The state must also intervene in order to prevent unemployment in the medium term. This is tantamount to preventing large deviations of investment, output and employment from their respective normal values, ideally at full employment. Formally, this is equivalent to minimizing the size of the adjustment parameter q in order to reduce the amplitude of business cycles and hence instability to a minimum (equation 24, p. 208). To solve this problem Keynes proposed to regulate entrepreneurial *behaviour*: 'In conditions of *laissez-faire* the avoidance of wide fluctuations in employment may, therefore, prove impossible without a far-reaching change in the psychology of investment markets such as there is no reason to expect. I conclude that the duty of ordering the current volume of investment cannot be safely left in private hands' (Keynes 1973b, p. 320). This conclusion is not acceptable to classical-Keynesians: the problem is to create an *institutional set-up* such that trend output and employment are as close as possible to their corresponding full-employment trend levels (chapter 4, pp. 154–80). If the government succeeds in this, the stability of an economic system will be greatly enhanced since the bulk of investment will then consist of normal investment which is *derived* demand and not subject to fluctuations. However, since entrepreneurs do not know the fully adjusted situation associated with a specific institutional set-up, there are always deviations from the trend, and regular cyclical movements may occur. Presumably, it is impossible to eliminate these entirely. The problem is to minimize the amplitude of fluctuations. This does not, however, require state intervention; a close collaboration between the government and entrepreneurial associations seems far more appropriate.

Moreover, within an institutional framework guaranteeing full employment, there is no need to nationalize industries in order to bring about stability and full employment. This implies that the form of property is not of decisive importance (chapter 4, pp. 174–5). What is important is that firms must be allowed to make socially acceptable profits to induce managers to introduce better technologies which, macroeconomically, means to save the ultimately scarce resources, that is *labour* and *nature* (natural resources and the natural environment). The types of ownership adopted (private, public or mixed) will depend upon the way of life of a society governed by the prevailing system of values. As a rule, however, small and, in most cases, medium firms are far better managed if privately owned because private owners care about the resources they manage, which may not be always true in the case of public ownership.

Given a flexible framework of property rights, individual producers may enjoy considerable economic freedom. In fact, entrepreneurs have two great tasks in a modern economy. First, they ought to attempt to bring about the appropriate structures of production; this implies bringing in line market and (estimated) normal prices as closely as possible, given institutional, technological and natural constraints (chapter 4, pp. 177–80). Second, they have to transform inventions into innovations, i.e. to introduce new and more productive processes of production and new products, thereby bringing about a quantitative and qualitative rise in labour productivity. However, appropriate institutions are required to minimize the social side-effects of rapid and uneven technical progress, the prevention of structural and involuntary unemployment perhaps being the main medium-term problem. A deliberate slowing-down of the pace of technological advance must eventually be envisaged in order to render possible a transformation of technical progress into social progress which prevents massive structural unemployment.

Finally, state intervention is also required with respect to (temporary) short-period phenomena. State action in this field could be summarized under the heading of 'prevention of large-scale speculation'. This implies ensuring an equitable distribution of income, because excessive property incomes lead to abundant saving which, in turn, results in increases of the stock of money held for speculative purposes. The latter may set into motion cumulative processes associated with changes of demand-determined prices of produced goods, e.g. raw materials, and with price changes of non-produced goods and assets (old masters, shares and land). Rapidly increasing prices of land are particularly pernicious (chapter 4, pp. 132–5). Initially, rents on land increase, to be followed by rises in housing rents. This is reflected in a higher mark-up (k) which, in turn, raises the leakage (z) which depends on distribution. The latter implies that less money is available to buy consumption goods. Therefore, normal investment, output and employment decline according to the supermultiplier relation (7). On the other hand, rising property income, as is reflected in a higher k, means that additional funds are available for speculative purposes which may result in even higher land prices. Other cumulative processes are possible: rapidly rising share prices attract speculative funds, complemented by bank credits; subsequently, share prices increase even more. The same applies to currency speculation which may be associated with highly unstable exchange rates. The consequences of speculation for the financial system have been alluded to in chapter 4 (pp. 207–15).

Keynes clearly perceived that the financial sector ought, in normal circumstances, to be subordinated to production, i.e. to provide funds for productive investment. Once part of the financial sector engages in important speculative activity, instability may develop which may greatly hamper production: 'Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirl-pool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done' (Keynes 1973b, p. 159). This thread of thought has been continued by some classical-Keynesians, Hyman Minsky in particular. Policy measures directed at preventing large-scale speculation may require significant regulation of the financial sector.

The fact that speculation may influence production implies an interaction between behavioural outcomes and the institutional system of an economy, i.e. various layers of reality: rapidly changing short-term events, like speculation, may in fact greatly hamper the proper working of stable socioeconomic elements, that is institutions and technology. If speculation enables firms to make easy windfall gains, profits may not be reinvested or used to promote research and development. This may lead to a slowdown of technical progress and to a weakening of the competitive position of certain firms and industries or even of entire countries.

Therefore, in the classical-Keynesian view, the state has primarily to secure full employment, to render distribution broadly equitable and to favour the formation of a system of fair and just normal prices. The market has to steer structural adjustments: in each sector of production, entrepreneurs continuously compare (estimated) normal prices with market prices and/or take account of changes in capacity utilization. If there is a persistent tendency for market prices to exceed normal ones or if capacity utilization tends to be more than standard, productive capacity will be increased, and vice versa. This broadly corresponds to Ricardo's view of competition (Ricardo 1951 [1821], chapter XXX) which is also implied by Pasinetti (1981, 1993). This view entails that the prices of production are fundamental and market prices secondary.

Monetary policies

The role of money – and of the financial sector – may be considered from the point of view of the system as a whole and from that of the behaviour of the individuals and collectives that make up society. In the present subsection both viewpoints are very briefly considered and a few policy conclusions hinted at. In doing so some threads of thought mentioned in chapter 4 (pp. 154–90, 220–35) and in the preceding subsection are taken up.

From the point of view of the system, money appears as a social institution which is essential in a monetary production economy with extensive division of labour. For example, money enables the process of production to get started and, eventually, to be expanded through investment: banks provide entrepreneurs with short- and long-term credits which have to be repaid from present and future earnings. Money also makes possible productive and consumptive circulation. The former takes place with the social process of production and reproduction between industries – where intermediate product flows take place – and between sectors where consumption and investment goods are exchanged (chapter 3, pp. 89–103); the latter goes on between producers and consumers. Moreover, money has a role in regulating distribution: with money wages given, the size of the mark-up k determines prices in money terms and hence the real wage rate and the wages share (chapter 4, pp. 158–75). Finally, effective demand – a monetary notion – regulates the level of economic activity and hence the employment and unemployment levels (chapter 4).

The crucial point is that, given the rate of interest and the money wage rate, the 'quantity of money' *passively adjusts* to economic activity: with the amount of notes and coins given, the quantity of money adjusts through changes in the velocity of circulation in the short and medium terms; with the rate of interest, the velocity of circulation and the money wage all governed by the corresponding institutions, the Central Bank must adjust the quantity of notes and coins in the long run if the normal rate of interest is to be maintained. Hence in the classical-Keynesian view money is endogenous: on the basis of deposits banks provide credits which ultimately have to be repaid by future earnings. This implies that causality in the money multiplier relation linking the monetary base with M1 is reversed: in the classical-Keynesian view causality runs from M1 to the monetary base, and not the other way round as is conventionally postulated. From this a first policy conclusion follows: in a monetary production economy the Central Bank cannot regulate the quantity of money. It can only fix the rate of interest.

On the behavioural side, money is, first, a device that greatly facilitates transactions. Second, and equally important, money is a store of value and represents, as such, a part of wealth (chapter 4, pp. 180–5, 220–9).

The system and aggregate behaviour interact. Regarding money, this is particularly evident in the case of inflationary processes. Since money passively adjusts, inflation cannot be a monetary phenomenon. In the classical-Keynesian view there are three main causes of inflation. First, distributional conflicts may result in a wage–price spiral. Second, government deficits result in large profits, a fraction of which are saved and flow into the financial circuit (associated with money's role as a store of value); part of the new wealth in money form is invested in non-reproducible goods, the prices of which rise; a smaller amount of wealth is consequently held in money form, and the prices of non-producibles, land in the first instance, rise even more, which may, in turn, set into motion or reinforce a wage–price spiral. The process just pictured represents a third cause of inflation: if there is already inflation, money gets less adequate as a store of value and will move faster around the financial circuit, thus reinforcing the inflationary movement.

This briefly sketched theory of inflation leads to a *second* classical-Keynesian principle of monetary policy: inflation cannot be prevented by restricting the quantity of money; the most efficient means to combat inflation is to bring about an equitable distribution of income; moreover, the government's budget ought to be in equilibrium in the long run.

The case just presented is a long-period ideal type. In the short and medium terms inflationary movements may get started by distributional conflicts, temporary government deficits or through the Kaldorian distribution mechanism: investment increases quickly in a cyclical upswing; consequently prices and profits rise relative to money wages. In these circumstances, the classical-Keynesian monetary doctrine requires measures to prevent money from being massively abandoned as a store of value to be 'invested' in more secure stores of value (land, old masters, stable foreign currencies, and others) since the latter would enhance an ongoing inflationary process even more. For example, notes and coins could be made temporarily exchangeable into gold, or some other store of value more stable than money. This leads to a third principle of long-period monetary policy, that has traditionally been defended by conservative economists: in the long run the quantity of notes in circulation ought to be partly covered by gold (or some equivalent to gold) in order to enforce 'monetary discipline' (which, in the long run, essentially consists of a balanced state budget) and to maintain confidence in a currency in the short and medium terms. Such seemingly ‘old-fashioned’ propositions should not be rejected outright by classical-Keynesian political economists.

To aim at monetary stability and at the associated distributional equity in a full-employment situation is a complex problem of political economy. The corresponding policy effort is worthwhile, however, for two reasons. The first is negative and relates to the liberal alternative for combating inflation. In the latter, unemployment is a means of stabilizing money wages and hence prices. Since unemployment is the primary source of alienation on various levels, however, the liberal way to keep down inflation is inadequate: alienation on a grand scale is likely to lead to social disorder and thereby to stimulate inflation. Second, a stable value of money is essential to the proper functioning of a monetary production economy and hence of society as a whole. The reasons are economic and sociological: economically, money is a promise made by society to individuals, whose work is paid for in money, on the tacit understanding that – normal – money prices are given and, hence, that money may be exchanged against a definite quantity of goods. Inflation implies a break of this promise. Sociologically, the wealth of the middle classes mainly consists of money, deposits and bonds. These get devalued – in terms of some real numéraire, for example a bundle of necessary consumption goods – if there is inflation. Hence inflation worsens the socioeconomic position of the middle classes and may, consequently, contribute to their political radicalization, as the historical experience of the thirties suggests. Therefore, a stable value of money is – like full employment – not only of great importance for economic reasons. Social and political reasons are equally important.