

# KALECKI'S CRITIQUE OF OPEN- ECONOMY KEYNESIANISM

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***'At Bretton Woods, Keynes forgot everything that he had learned in writing the General Theory'***

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# Summary

1. Introduction
2. The Revolution (of the *General Theory*)
3. The *Tract* and Bretton Woods.
4. Kalecki's critique of exchange rate policy.
5. Sustainability of full employment in an open economy.
6. Coordinated Keynesianism vs. military Keynesianism.

# 1. Introduction

Paper examines contradictions at the heart of 'open economy Keynesianism' highlighted by revolt against austerity, Syriza, Labour leadership election etc.

## 2. The Revolution (of the *General Theory*)

- The capitalist economy is not brought into 'equilibrium' by the price system, but by the level of investment: '... it is the pace of investment that determines income and employment.' (H.P. Minsky *John Maynard Keynes* 1975, p. 128).
- Investment determines the level of profits (Kalecki, from Marx & Luxemburg).

... and the function of the price system  
is ...

The price system determines the *distribution* of profits (Kalecki, Marx), not 'equilibrium'.

So ***income*** effects dominate ***substitution*** effects;

Vs. Walrasian/neo-classical system in which ***income*** effects are transitory; ***substitution*** effects dominate.

Application to exchange rate policy.

### 3. The *Tract* and Bretton Woods

*Tract on Monetary Reform*: Exchange rate as substitute for wage reduction to bring labour market equilibrium

→ fixed, but adjustable exchange rate policy

→ *Bretton Woods* settlement;

Separation of 'internal' vs. 'external' equilibrium.

## 4. Kalecki's critique of exchange rate policy

In small and medium-sized economies, exchange rate changes affect real domestic incomes, i.e., devaluation increases purchasing power abroad, and reduces domestic purchasing power.

Currency appreciation increases domestic purchasing power vs. foreign purchasing power.



# So

The level of investment still determines the amount of profit;

The exchange rate determines what proportion of that profit is obtained from foreign trade;

(vs. Milton Friedman, 'neo-mercantilist' theories in international political economy)

## 5. Sustainability of full employment in an open economy

‘Multilateralism and Full Employment’:

Full employment demand management → global pattern of trade surpluses/deficits;

→ balance sheet effects (shifts in reserves and cross-border liabilities);

→ declarations of ‘manifest unsoundness’ of state of full employment + demands for deflationary measures.

# Exchange rate adjustment

- Does not add to aggregate demand (vs. M. Friedman, Keynes of *Tract* & Bretton Woods)
- But shifts demand for given output & employment between domestic market and export market;
- Perversely impacts on foreign currency indebtedness.

## 6. Coordinated Keynesianism vs. military Keynesianism

- Unilateral efforts at full employment using Keynesian techniques of demand management cause changes in foreign currency reserves and external indebtedness (viewed as 'manifestly unsound').
- Solution is 'coordinated' Keynesianism: all countries expand demand simultaneously, so all increase imports and exports at the same time.

# Problems of coordinated Keynesianism

- Not all countries have similar excess capacity to accommodate similar expansion of demand. So not all countries can expand demand at the same rate without inflation or shifts in reserves/foreign indebtedness (→ accusations of 'manifest unsoundness').
- Coordinated Keynesianism is idealistic 'world government' (but feasible in EU?)

# Military Keynesianism

An alternative form of coordinated  
Keynesianism:

Rising military expenditure and border  
manoeuvres force neighbouring countries into  
similar fiscal expansion.

Leads to war.

# Conclusion

- It is not enough to oppose austerity.
- Economists opposing austerity also need to understand the limitations of 'Keynesianism in one country' or coordinated Keynesianism.
- From that understanding more effective policies may emerge.