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WORK AND INEQUALITY

WORKERS, ECONOMIC CRISIS AND THE STATE

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47. P. Mattick, *Marx and Keynes: The Limits of the Mixed Economy*, Merlin Press, London, 1969.
48. *Labour's Share of the National Product*, *op. cit.*
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Economic Theory as Ideology: A Kaleckian Analysis of the Australian Economic Crisis

Melanie Beresford & Bruce McFarlane

I: Introduction

By the time Keynes' *General Theory of Employment, Interest and Money* came out in 1936, governments were already beginning to implement the policies which were implied by the theoretical apparatus contained therein. The New Deal had been in effect in the United States since 1932 and even in Britain, under pressure from the increasing organization of the unemployed who, through their hunger marches, seemed to threaten the social order, expansionary fiscal policies were being tried. Keynes' theory was accepted because it provided a theoretical rationale for the policies towards which governments were instinctively groping. As the advanced capitalist economies boomed in the post-War period, the more radical implications of Keynes' work were rapidly forgotten and many of his insights were reabsorbed into orthodox neo-classical economics. The Grand Neo-classical Synthesis grew up, under which it was assumed that the economy could be 'fine-tuned'—minor adjustments of fiscal and monetary policy would maintain the capitalist economies at full employment levels of output without running the risk of too much inflation.

In the 1970s, however, this dream world came to an end. Rising unemployment seemed unable to stem the rapidly rising rate of inflation and orthodox economics was thrown into distress. The knight in shining armour who came to the rescue in this case was Milton Friedman. In 1975 he visited Australia at the invitation of a member of the stockbroking firm, Constable and Bain[1], and as the wave of political pressure for the introduction of monetarist policies built up, the economics profession (or a large section of it) was converted *en masse*. At this time, the coalition of political forces pressing for monetarist policies consisted mainly of big business interests, especially the financial sector whose profits were daily eroded by the high rates of inflation. These formed a powerful alliance in contrast to the then tiny minority of unemployed who were mainly school leavers with little political influence or experience at organizing themselves. The trade unionists who might have been the main political allies of the unemployed were, by 1975, still relatively unaffected by unemployment in the sense that they continued to be able to press for and win large wage increases. It was in these circumstances that monetarist policies gained wide acceptance among businessmen, politicians and academics. In fact monetarism provided the theoretical rationale for the type of policies that big business in Australia wished the government to implement and these policies involved higher rates of unemployment in order to bring down the rate of inflation. Monetarist concepts of a rising 'natural' rate of unemployment, an 'equilibrium' wage level which is consistent with full employment and the notion that Australian wages were currently too high in relation to this 'equilibrium' so that 'one man's wage rise meant the loss of another man's job', fitted the bill perfectly. And the idea that in order to create a stable price environment, the money supply had to be controlled rigidly (hence the need to cut down on government fiscal deficits) whatever the consequences for unemployment, provided the means to achieve the desired end.

The orthodox economic theory which has dominated economic policy thinking in the post-War period has thus fulfilled a highly ideological function. In contrast, Michal Kalecki, using Marxist political economy as his starting point, has developed a number of concepts which enable us not only to explain the existence of inflation, depression and stag-flation, but also to explain the types of government policies used to combat them and the ideological nature of the theories used to justify such policies.

A preliminary comment is in order on Kalecki's work, as we shall be using it in this chapter.[2] Kalecki's work on industrial capitalism has been rediscovered in the 1970s[3], but only at a fairly general level. Either Kalecki's affinity with Keynes has been spelled out in detail[4], or his suggestions about a 'political trade cycle' have been mentioned as an insight[5] and left at that.

Kalecki is rightly associated with the Keynesian revolution, but it is important to understand what this actually means, for it is only formally true. Kalecki's use of class analysis and of a Marxian theory of the state radically departs from Keynes' pro-capitalist stance[6] and 'neutral referee' approach to the state. We will argue, moreover, that the Keynesian difficulties in explaining stag-flation paved the way for the rise of Friedmanism and monetarism (not least in the ALP in 1975!). The same charge cannot be levelled at Kalecki's analysis which does explain, clearly and essentially, the present contours of the capitalist crisis. It has stood the test of time, whereas the 'Keynesian revolution' has either failed to sustain its relevance, or has been re-integrated into neo-classical mainstream economics, gutted, and turned into a 'grand synthesis'[7] at the hands of liberal Keynesians bitterly opposed to the Left or even to the Cambridge critique of orthodox economics.

Into the vacuum left by the inability of Keynes and the 'grand synthesis' to explain the nature of the present economic crisis, have stepped Friedman's followers, to say nothing of the followers of von Hayek[8] and

even Ludwig von Mises. It is time for an alternative analytical framework that socialists can readily use to enter the debate and Kalecki gives guidelines for achieving something more substantial than sociological surveys or older formulas.

II: Stag-flation in One Firm

Unlike most orthodox economic theory, Kalecki's analysis enables us easily to integrate the micro-economic and macro-economic aspects of inflation and recession. It also provides an explanation of stag-flation, the problem besetting advanced capitalist countries in the 1970s, in a very simple way. In this chapter we will use a 'building blocks' approach—beginning with the analysis of stag-flation at the level of the firm and proceeding to the sectoral level and, finally, extending the analysis to the level of the whole economy.

Neo-classical economics argues that prices are determined by the interaction of supply and demand in the market place. But the various ways in which this theory has been worked out, show a high degree of reliance on the assumption that modern capitalist firms are highly competitive. Kalecki is one economist who worked out a theory of how prices are determined for each individual producer which is based on the assumption that most markets are controlled by just a few firms—that oligopoly is the rule of the day. Such a starting point would seem to be more in accordance with what we know from the empirical evidence of industrial concentration and the rapid growth of multinational corporations in the 1960s and 70s.

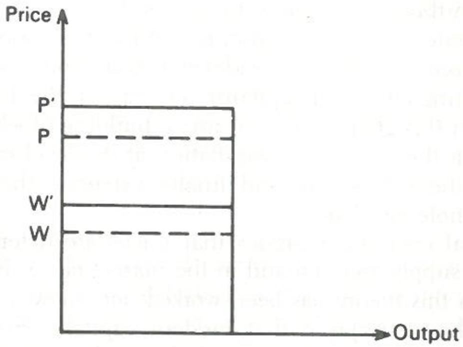
The radical departure from neo-classical price theory began in the late 1930s. Two Oxford economists named Hall and Hitch showed, by their empirical study of the pricing behaviour of manufacturing firms, that entrepreneurs tended to set prices by adding a fixed percentage mark-up for profits onto prime costs (raw materials plus wages).[9]

At about the same time, Kalecki had developed a theoretical model based on a similar idea.[10] He reasoned that the 'degree of monopoly' existing within an industry would determine the extent to which firms would be able to offset rising prime costs by increasing their prices in the same proportion as the cost increase. In the less competitive industries, the normal practice of firms would be to maintain a given profit margin in the face of a rising trend of wages or raw materials costs.

Increases in demand, on the other hand, were less likely to be met by price increases because, under monopoly capitalism, firms usually maintained a certain amount of excess capacity which could be absorbed by sudden demand increases. In other words, firms would respond to rising demand by increasing output rather than prices.

Here we have a relatively simple explanation of inflation—a 'cost push' theory which is based on a considerable amount of empirical evidence as to the pricing behaviour of firms. It can be illustrated by the use of a simple diagram (Figure 1) in which it will be assumed, for the sake of simplicity, that prime costs consist only of wages (this assumption is in keeping with Kalecki's own emphasis in his article on 'Class Struggle and the Distribution of the National Income'[11]).

Figure 1

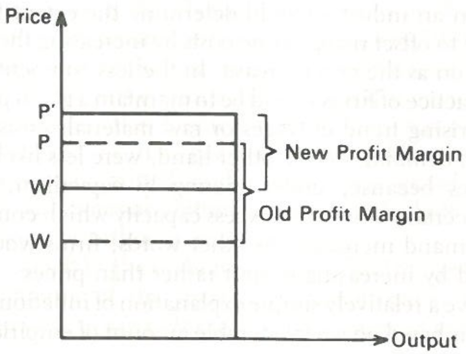


NB: Prices in the initial situation and after the increase are represented by P and P' respectively. Wages/unit output are W in the initial situation and W' after the increase.

In this example, output remains constant while prices rise in order to maintain profit margins.

In the case of an abnormally large increase in wage costs, however, the situation would be somewhat different. Even large multinational corporations face some degree of competition. The large American-owned car firms in Australia, for example, have to guard their share of the market against the inroads being made by Japanese companies. BHP, the steel monopoly, faces competition in some areas from aluminium

Figure 2

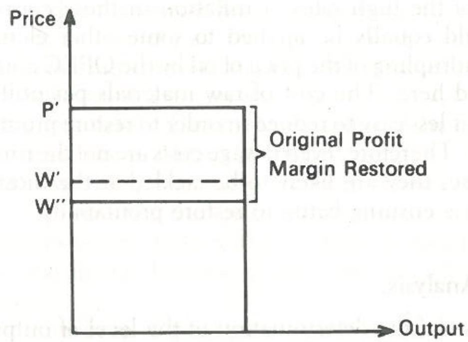


products. Kalecki argued that in the face of unexpectedly large increases in prime costs, competition would force many such firms to absorb the increase in reduced profit margins. Prices may still rise, but not in the same proportion as the wage increase, as is illustrated by Figure 2. This is because firms set their prices with reference to an 'average industry price' which is determined by the average unit prime costs of the industry and the 'degree of monopoly' in that industry.[12] A firm setting its price too far in excess of the average industry price will lose sales to its competitors. Moreover, in the case of a full scale monopoly, the average industry price itself is restricted by the fear that too high a profit margin would attract new investment to the industry.

At this point of the argument we need to bring in another aspect of the capitalist economy which Kalecki, unlike the majority of orthodox economists (including Keynes), brought explicitly into his analysis. For Kalecki, the feature which distinguishes capitalism from other economic systems (socialism or feudalism, for example) is that it is a system of production for profit. It is *not* a system in which production is motivated by the needs of consumers. Indeed the massive waste that occurs in capitalist societies, the vast sums spent on armaments and the constant search for new markets are, for Kalecki, confirmation of the Marxian insight that decisions by capitalists to invest and produce are motivated by the drive for profits, not by the desire to meet genuine needs of consumers.[13]

In the light of this approach to the activities of capitalist entrepreneurs and managers, it does not seem likely that firms will be content to accept the reduction of profit margins forced upon them by the combined effects of unexpectedly large cost increases and competitive pressures. If prices cannot be marked up to cover the full extent of the cost increase, firms will attempt to restore their profit margins by other methods. There are a number of means available: labour-displacing technology is one method of maintaining output while reducing the wage bill; laying off workers and speeding up the line (intensification of labour) is another example. Figure 3 illustrates the result.

Figure 3



The reduction in the wage bill has been achieved in this example, not by reducing the wage rate, but by reducing wages per unit of output (i.e., by reducing the workforce). Keynes had earlier pointed to the downwards 'stickiness' of money wages and in any case the ability of semi-monopolistic firms to offset normal wage increases by marking up the price leads to low resistance to wage demands and encourages the growth of strong trade unions. It is therefore unlikely that efforts to drive down money wages will be very successful. The ease with which the threat of unemployment can force workers to accept money wage reductions depends very much on the extent to which unionists know beforehand who will be sacked. If, for example, the 'last on, first off' principle is applied, workers who know they will be retained are likely to refuse any pay cut and the 'workforce reduction' solution seems the most probable.

Taking the points illustrated in Figures 2 and 3 together then, we have a simple model of 'stag-flation in one firm'. Prices have risen to offset the cost increase, and employment has fallen to offset the reduced profit margin. For the sake of simplicity, we have held the output of the firm constant in this discussion—the effect on output of the changes in costs and prices will depend on a variety of factors to be discussed below. Suffice it to say at this point that either reduction of money wages or workforce reduction *could* simply lead to a lowering of effective demand and therefore declining output. The primary factor determining the effects on output of individual firms will therefore be the overall growth rate of effective demand prevailing in the economy.

One final point is relevant to this section. In the above analysis we have considered an unexpectedly large *wage* increase as the proximate cause of the stag-flation. This is because it coincides with Kalecki's own emphasis, based on Marx's insight that it is the class struggle over the distribution of income (in Marxian terminology, the determination of the rate of surplus value) which is the key to the dynamics of the capitalist economy. As a matter of fact, the western industrialized capitalist economies did experience such a 'wage explosion' in the late 1960s and early 1970s and it has been suggested by Kaldor[14], among others, that this was one of the main causes of the high rates of inflation in those countries. But the argument could equally be applied to some other element of prime costs—the quadrupling of the price of oil by the OPEC countries in 1973 comes to mind here. The cost of raw materials per unit of output is, however, rather less easy to reduce in order to restore profit margins than is the wage bill. Therefore, even if wage costs are not the immediate cause of the price rise, they are likely to be tackled as the most amenable to reduction in the ensuing battle to restore profitability.

III: Sectoral Analysis

Keynes' analysis of the determination of the level of output in terms of

aggregate consumption and investment decisions is inadequate because it hides the different effects on the behaviour of the economy of different types of consumption and investment. Something more structural and related to the behaviour of real corporations, and not individual economic agents as in Keynes, is therefore needed to explain the determination of output levels. Kalecki can provide such a disaggregated approach to the determination of output by linking mark up behaviour with the key role of capitalists' investment and consumption decisions. The framework of a two-sector model is used by Kalecki in a way that links 'effective demand' with a theory of value in the manner of Marx and the better aspects of Keynes himself[15], avoiding the banalities of the one-commodity world of the 'grand neo-classical synthesis' of economics textbooks.

A balance sheet of sectoral incomes and expenditures looks like this:[16]

Gross profits	Gross Investment
Wages & Salaries	Capitalists' Consumption
	Workers' Consumption
Gross National Product	Gross National Product

Hence, if P = Gross Profits, Ic = capitalists' investment and Cc = capitalists' consumption, and the simplifying assumption is made that workers do not save so that their consumption is equal to their incomes (wages & salaries), it follows directly that Gross Profit = Gross Investment + Capitalists' Consumption

$$P = Ic + Cc.$$

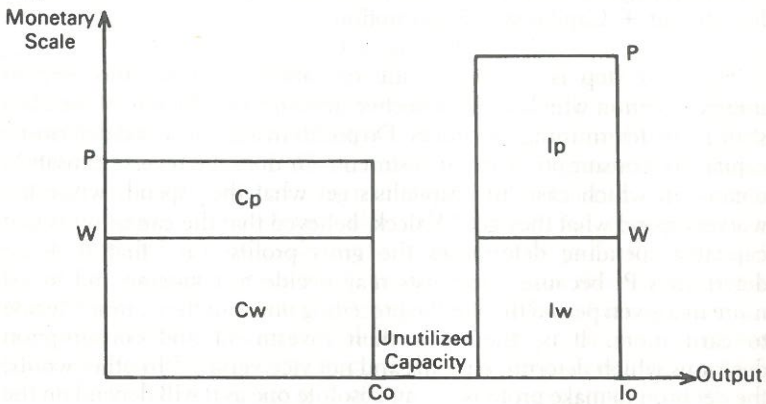
The next step is to look at the causation involved, the sectoral interconnection which affects effective demand and the role of the class struggle in determining the profits. Do profits in a given period determine capitalists' consumption and investment? Or does the reverse causation obtain, in which case 'the capitalists get what they spend, while the workers spend what they get'? Kalecki believed that the causation is that capitalist spending determines the gross profits; i.e., that Ic + Cc determines P, because 'capitalists may decide to consume and invest more in a given period than in the preceding one, but they cannot decide to earn more. It is, therefore, their investment and consumption decisions which determine profits and not vice versa'.[17] In other words, the decision to make profit is not an absolute one as it will depend on the behaviour of *other* capitalists. Due to the flexibility of the financial system which allows capitalists to obtain monetary resources, they can save without actually spending on real resources. Hence the capitalists' consumption or its obverse, the 'propensity to save', is affected by the ability of capitalists to add to or withdraw from a stream of resources, which means total demand in the system can be greater or less than current incomes.

Having got the volume of gross profits determined by Ic and Cc, the next stage of the argument involves the determination of the level of output. Whereas the 'bastard Keynesianism' of the 'grand neo-classical synthesis' would solve this problem in terms of total comsumption and total investment, Kalecki felts this was *too aggregative* and unselective an approach, disguising basic forces at work in a capitalist society. Instead he invoked prices, on the one hand, and the proportion of profits and wages in a unit of output, on the other. For the former he used the 'mark up' theory of pricing (outlined in the previous section) which linked the 'micro' and 'macro' aspects of capitalist behaviour and situated the firm at the centre of this relationship.

According to mark up theory, a dollar's worth of output can be divided into, say, 50 cents wages and 50 cents profits, so that the mark up is 100 per cent. It can now be shown that if we know the price mark up and we know what determines the volume of gross profit (and also the share of profit in a unit of output) we can move on to obtain the level of output.

For a more step by step sectoral analysis, it is useful to construct a diagrammatic representation of the economy, making a further simplifying assumption that capitalists do not consume.[18] The method of sectoral breakdown into investment goods and consumption goods sectors is Kalecki's version of the Marxian equations of expanded reproduction which also focused upon profits, wages and departmental breakdown.

Figure 4

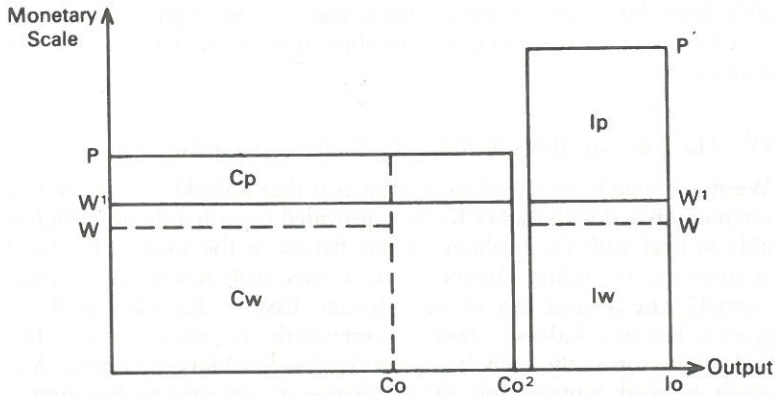


This shows that the wage bill in the investment goods sector (Iw) equals profit in the consumption goods sector (Cp), since Iw + Cw represents the total production of consumption goods (Cw + Cp). So output in the consumer goods sector is determined by output in the investment goods sector. Total investment will be equal to total profit since Iw = Cp, then Iw + Ip = Cp + Ip. Total profits in both sectors are now determined.

By determining the effect of price mark up increases as well, and combining with the above, we can obtain the level of total output with a sectoral approach and using the degree of monopoly (a key 'class struggle' element). The next step, then, is to look at changes in the distribution of income between profits and wages and their effects on the level of output and employment.

In order to do this we shall revert to the case, outlined in section II of this chapter, of an unexpectedly large wage increase which forces a reduction in the profit margins of firms facing competition. In Figure 4 we have illustrated how with a given wage per unit output and given mark up, the output of the consumption goods sector is fully determined by output of the investment goods sector. Figure 5 illustrates what happens to this output if the wage rate rises, forcing all capitalists to reduce their profit margins somewhat, but leaving output in the investment goods sector unchanged.

Figure 5



With the wage bill Iw increased, the amount of profit Cp must also increase. This is not possible given the same output of the consumer goods sector since profit margins have been reduced. Output in the consumer goods sector must therefore have increased (to Co^1).

The total output level is determined in a Kaleckian model because, given the investment effort (expansion of the I goods sector), the mark up leads to an expansion of *both* investment and consumption goods sectors.[19]

In applying this to the economic crisis we find the problem (noted in the last section and here at a sectoral and macroeconomic level) that capitalists in a recession might try to cut real wage bills and increase the mark up. In this case the level of total output will fall, as a result of the higher mark up. There will be a lower demand from the I goods sector. Wages will be satisfied—with a lower level of consumption output—also as a result of the higher mark up. Because there is a higher percentage of profit in a unit of output, there will be a higher propensity to save overall at a given volume of investment. Hence a rise in the level of mark up contracts output *even if investment is not contracted. This is a result which would not arise* in Keynes' model.[20]

Two clear conclusions emerge from a Kaleckian sectoral model in relation to the determination of the total levels of effective demand and output. These conclusions help to understand the present economic crisis:

(i) The capitalist system persistently gets into contradictions: it can only sustain the consumer goods output by cutting mark ups and reducing the rate of profit. Modern corporations, however, are unlikely to accept this as a way of ensuring the stability of the *system as a whole*. Further, it is hard to expand the economy by expanding the rate of investment if the propensity to save of capitalists and mark ups are given;

(ii) Investment is very volatile. It is subject to political influences and so can move independently. An independent movement is also possible from 'bunching' of replacement, and because capitalists have access to financial resources representing investment demand without savings.

IV: The Marxian Basis of Kalecki's Analysis of Crisis

We now come to a crucial issue: how is it that Kalecki, whose work is often compared with that of Keynes, provided us with a theory which is able to deal with the problem of stag-flation in the western capitalist economies, including Australia, in a way that Keynesian analysis cannot? The answer lies in the Marxian basis of Kalecki's work on economic crises. Kalecki's starting point was the acceptance of objective 'laws of motion' of the capitalist system analysed by Marx in *Capital*. As a result, his work contains none of the reliance on subjective factors such as 'confidence' or the 'state of the news' which was the hallmark of Keynes' work. More generally, Kalecki's discussion has none of the Marshallian 'baggage' of marginalism which prevented Keynes from breaking completely free of the neo-classical paradigm and rendered his work more amenable to the 'Grand Neo-classical Synthesis'.

The Marxian basis of Kalecki's analysis means that it is dynamic rather than static (or comparative static). It is focused on the relationship between the two major social classes of capitalist societies rather than individual economic agents of the classical liberal approach. It enabled him to deal with the concentration and centralization of industry which is the natural outcome of Marx's analysis of accumulation, corporate investment and competition and to make the 'degree of monopoly' rather than perfect competition the starting point for the analysis of price determination. Finally, Kalecki treated investment as the formation of physical capacity rather then merely a set of financial flows. This creation of physical capacity whenever 'investment' is undertaken has implications for the profitability of firms and for the rate of technical innovation going on in the industry.

The formal similarities between the analysis of crisis by Marx and Kalecki stem from the latter's use of Marx's 'reproduction schema' from *Capital*, Volume II. Marx had used these schema to illustrate the point that 'expanded reproduction' (steady economic growth) is possible under capitalist conditions. In doing so, he developed his critique of underconsumptionist writers like Sismondi who had argued that capitalism could not possibly experience sustained growth owing to the inability of the workers, with their restricted purchasing power, to consume the product. Rosa Luxemburg took up the underconsumptionist theme in her *Accumulation of Capital* which influenced Kalecki. Although he criticised the basis of her argument[21], Kalecki agreed that expanded reproduction was not a natural and obvious state of capitalism. According to Kalecki, Mark had recognized that the production and 'realization' of surplus value (profits) were separated not only in time, but logically as well. Because of this logical separation, the conditions required for the embodiment of surplus value in commodities were not the same as those required for its market realization, so that difficulties caused by lack of effective demand were bound to arise from time to time. Situating his own work in relation to that of Marx, Kalecki pointed out[22] that Marx had not systematically explored the consequences for capitalist economies of the contradictions inherent in the failure of effective demand. However, both Marx and Kalecki saw this as only one aspect of the breakdown of boom and the beginning of crisis.

For Kalecki, the mechanism of this 'business cycle' of boom and bust is determined by the relationship between investment orders, actual investment and the size of the capital stock (productive capacity). An increase in investment orders calls forth an increase in the production of capital goods, but when these begin to exceed the replacement requirements of the economy, the capital stock begins to expand. If this increase in the stock of capital equipment is represented as an increase of physical capacity it is clear that, under certain conditions (e.g., because of the 'lumpiness' of investment), a falling rate of profit will result because the increase in demand is insufficient to meet the available productive capacity. In Marxian terminology, there will have been an 'overproduction of capital'.

This way of understanding the causes of the downturn in the business cycle can be traced directly to Marx's analysis of Volume 3 of *Capital*. Taking an extreme example, that of 'absolute' overproduction of capital, Marx argued that this would occur at the point where any increment to the existing capital stock would produce exactly the same, or even less, surplus value than before. This might happen when 'neither the absolute working time supplied by (the labouring) population, nor the relative surplus working-time, could be expanded any further'.[23] In such a case there would be a sudden fall in the general rate of profit as the same (or lower) mass of surplus value must be shared by an increased capital. A competitive struggle then ensues as individual capitalists seek to preserve their share of the surplus available: this ensures that at least a portion of the increment in capacity will remain unutilized. That part of the increment which is in the hands of *existing* capitalists will either remain unutilized (in order not to depreciate the existing capital equipment), or temporarily operate at a loss in order to force others' capital out of use. That part which is in the hands of *new* capitalists will struggle to obtain a place at the expense of old capital. Thus competition leads to the existence of excess capacity as well as to the forced depreciation of a portion of the old capital stock.[24] Since the root of the problem is that there has been overproduction relative to a given rate of exploitation of the workforce, the capitalists will also seek to increase this rate in order to restore the conditions for a 'normal' development of accumulation. Both Marx and Kalecki assign a key role in this restoration to technical innovation.

In this interpretation, the rate of profit falls due to an overproduction of capital and a competitive struggle ensues which forces the depreciation of certain capital values through underutilization of capacity and rising unemployment. It is the opposite of the usual interpretation of Kalecki because it is the overproduction of capital and falling profitability which explain the failure of effective demand and not vice-versa. Keynes would never have seen the problem in this way.

Kalecki's work on the determinants of the wages share of national income[25] as well as his later work on 'Class Struggle and the Distribution of the National Income' provide support for our interpretation of his business cycle theory. These writings argued that it extremely difficult for capitalists to alter the share of national income going to wages. In the case of an increase in productive capacity, therefore, or in the case of a sharp increase in the cost of raw materials (part of constant capital in the Marxist argument) it may be difficult to achieve any increase in the amount (mass) of surplus value produced—especially if the economy is already operating at or near the full employment level. Kalecki did show, however, that the share of profits can be *reduced* by strong trade union action in semi-monopolistic sectors of the economy which are nevertheless faced with some competition (see section III above). The fall in the rate of profit which follows from events like these may induce an economic downturn as investment decisions falter.

Summarizing the argument so far, we can see that Kalecki's analysis of the cyclical behaviour of the capitalist economy confirms and extends Marx's insights developed in *Capital* a century ago. In particular, by focusing on the problem of excess capacity, Kalecki has revived an important area of investigation which has been neglected by Marxists, with the exception of Josef Steindl.[26]

V: The Political Trade Cycle

The outstanding divergence between Kalecki and Keynes is in their respective understandings of the role played by the state in capitalist societies. In his article entitled 'Political Aspects of Full Employment' written in 1943, Kalecki elaborates three reasons why, in the liberal democracies, governments will not attempt to maintain full employment over long periods: instead they will concentrate on ironing out cyclical fluctuations. This is in marked contrast to Keynes' view that government intervention would operate to correct such imperfections in the market system as tended to push the economy away from a full employment equilibrium.

Kalecki argues, in the abovementioned article, that the 'captains of industry' will be averse to government spending which is aimed at maintaining full employment for the following reasons;

(i) Industry dislikes government interference in the problem of employment as such. This is because under a *laissez-faire* free enterprise system, the level of activity (and employment) depends upon the 'state of business confidence' and therefore anything which upsets this 'confidence' must be avoided by governments. If the government could, through its own expenditure, maintain the level of employment, then business would lose a powerful device for controlling the working class. It therefore vigorously opposes deficit financing and promotes the doctrine of 'sound finance' whose social function is to make the level of employment dependent upon the 'state of confidence'.

(ii) Capitalists oppose expenditure by government on many types of investment projects on the grounds that it would compete with the private sector. They are not averse, however, to government spending on infrastructure and other projects which enhance the profitability of enterprise and indeed in the face of periodic crises of profitability, the demand for this kind of expenditure increases constantly. In many cases, Kalecki argued, the demand for an increased government expenditure is met by armaments production.[27] Expenditure by the government on subsidizing mass consumption, although it increases effective demand and aggregate profits, is also opposed by the capitalists because of the high 'moral' principle that 'you shall earn your bread in sweat'—unless you happen to have private means.[28]

(iii) Although capitalists would favour government expenditure to aid recovery from a slump, they would be completely opposed to expenditure aimed at *maintaining* full employment. Prolonged full employment would bring about certain social and political changes which are undesirable from the capitalist point of view. These changes include the growth of self assurance and class consciousness of the trade unions, an increase of industrial action for improved wages and conditions and other threats to productivity such as a rise in the rate of absenteeism. The ability of employers to use the threat of 'the sack' as a disciplinary measure would be correspondingly reduced.[29]

The conclusion Kalecki draws from this analysis of the attitudes to full employment is that a powerful coalition will form, made up of capitalists—both industrial and *rentier*—who have become 'boom tired'.[30] In a period of sustained full employment, 'the workers would get "out of hand" and the "captains of industry" would be anxious to "teach them a lesson".'[31] This 'boom tiredness' on the part of industrialists need not necessarily coincide with a redistribution of income from profits to wages or a fall in the rate of profits. Under 'normal' boom condititions, according to the argument outlined in sections II and III above, increases in money wages will be met by increased prices so that profit margins are maintained. The pressure from industrialists for the government to introduce a deflationary policy will be from those who wish to create for themselves an 'industrial reserve army', to restore discipline to the workforce and raise its productivity.

On the other hand, Kalecki's analysis also raises the possibility of a shift in the distribution of income under the combined effects of powerful trade unions and competitive pressures on individual firms. Under these circumstances a competitive struggle will break out between firms as each attempts to increase its profits at the expense of the others, but pressure will also be on the government to introduce deflationary policies in order to restore the disciplinary powers of unemployment. This occurs in spite of the detrimental effect of the slump on aggregate profits because each individual capitalist hopes to maintain his own profits by grabbing his opponents' share of the market.

The *rentier* capitalists also become 'boom tired' if full employment is sustained for too long. *Rentiers* are people who derive their income primarily from interest; that is, people whose capital consists of financial assets or money. They are adversely affected by a regime of rising prices since the value of money falls.

The combined power of these groups will, according to Kalecki, suffice to ensure that governments will adopt an orthodox policy of cutting down the budget deficit.[32] It makes no difference what the political persuasion of the government is at the time. A conservative government (the Liberal-Country Party coalition in Australia) is directly linked to big business and professes to act in its interests. A social-democratic party (such as the Australian Labor Party), while it may profess to be the party of the working class and have a 'socialization objective', will nevertheless be swayed by the threat of a 'strike of capital' if the government's commitment to a 'full employment objective' leads to a failure of 'confidence'. We have heard many times in the 1970s in Australia, the cry from ALP politicians and their advisers, that it is impossible for the government to redistribute income in favour of wages because this destroys the 'incentive to invest' on the part of employers. In consequence, Labor politicians have, in general, accepted the argument that, after the increase in the share of wages which occurred between 1969 and 1974, policies must be introduced to restore the original balance. In 1975 Treasurer Cairns put this view at a memorable ABC 'Monday Conference'. Some ALP politicians, including Bill Hayden, for a time accepted the currently fashionable monetarist doctrine which argues that deflation and higher rates of unemployment is the sacrifice that must be paid if investment in the private sector is to be stimulated.

Boom conditions will be restored again, according to the Kaleckian analysis, when rates of inflation have reached an acceptably low level, the growth of the industrial reserve army has depleted the strength of trade unions and restored discipline to the workforce, and when the 'captains of industry' become anxious over the declining aggregate profits caused by the slump. Governments will then be encouraged to enter a more expansionary fiscal and monetary stage. It should be pointed out, however, that Kalecki by no means intended to imply that the ensuing recovery would lead to full employment.[33] Indeed, Kalecki's concept of 'expanded reproduction' or 'steady growth' is exactly similar to that of Marx and in no way implies a 'full employment equilibrium'.

We have already shown the links between Kalecki's economic analysis and that of Marx (section IV above). Kalecki's analysis of the political trade cycle also owes its inspiration to Marx's theory of the state in capitalist societies. In contrast to Keynes, Kalecki saw government action as an integral part of the maintenance of both the material and *social* conditions of the capitalist system. Keynes and many of his liberal followers see state action as neutral, standing apart from the conflicts of economic life. For Marxists, on the other hand, and for Kalecki, the state is neither neutral nor separate from the basic class antagonisms of capitalist production. As Kalecki clearly stated in his essay on the 'Political Aspects of Full Employment', government intervention, far from being simple *ad hoc* adjustments aimed at a commonly shared goal of full employment, is in fact an instrument through which the capitalist class imposes its will upon the working class.

Whereas the Keynesian liberals see the state as a 'neutral referee' standing above economic life, Kalecki adopts the Marxian perspective that the autonomy of the state exists only relative to individual fractions of the capitalist class. Therefore, according to Kalecki, state activity to produce and reproduce the class relations of capitalism is part of the very structure of the mode of production itself. In such a system, where production takes place *not* in order to satisfy individual needs, but in order to make a profit for the owners of capital, there is nothing absurd or irrational in the massive state expenditures on armaments and imperialist wars.[34] Such expenditure is required to maintain the profitability of enterprise, as is expenditure on the provision of the socio-economic infrastructure (schools, roads, railways, hospitals). Far from being short run, *ad hoc* measures designed to correct market 'imperfections', as suggested by the liberal Keynesian approach, these expenditures lead to long term structural changes in the economy in a way which serves to maintain and promote not merely the material conditions of the capitalist mode of production, but its social class basis as well.

VI: Usefulness of the Kalecki/Marx Model

It is conceded by supporters of 'post-Keynesian' economics (Joan Robinson, Pasinetti, Garegnani) that while it forms a theoretical basis for the reconstruction of political economy, the new school has spawned few applied research projects, and that while the models are 'realistic' they are not practical.

Kalecki, by contrast, is very practical in his analysis of the political trade cycle, the class struggle, the pricing policies of modern corporations. He knew exactly what economics was all about. As Heiser pointed out[35], the Kalecki-Steindl model can incorporate, besides a 2-sector model in the Marxian sense of investment goods and consumer goods departments, a 2-sector model in the competitive/monopolistic sense. In this sense Kalecki extends Marx's more abstract analysis to the level of important surface phenomena: monopolies, their effect on the rate of technical change, the economic role of the state.

For example, according to the Steindl-Kalecki analysis we can explain the check to the rate of investment posed by the degree of monopoly. After this is established, it is also possible to show that, whether it is the whip of the falling rate of profit, or simply a low *marginal* rate of profit in monopolistic industries, eventually the need for action emerges, because of the necessity of 'realizing' or capitalizing investments already made.

There are two major elements of the model: entrepreneurs invest because they have savings, and two key factors determine the *rate* of investment—the relative indebtedness of business and the degree of utilization of capacity. The former means that the greater the internal savings of business in relation to external indebtedness, the greater the inducement to investment. The latter acts as a controller of investment, the increase in the level of excess capacity acting to inhibit new investment. The model divides the economy into a monopolistic and a competitive sector. In the monopoly sector there are monopoly profits, inelastic profit margins and so it is difficult to eliminate excess capacity. In the competitive sector, profits are more precarious, profit margins more flexible and surplus capacity more easily forced out. Now we may introduce Kalecki's idea that 'the workers spend what they get, the capitalists get what they spend'. As we saw, total profits equal capitalists' investment plus capitalists consumption and the rate of profit is

determined by the rate of accumulation and the propensity to save of the capitalists.

Under these assumptions, with a given rate of growth of investment, any increased share of profits accruing to the monopoly sector involves a *reduced rate of profit in the competitive sector*. Then, as the importance of the monopoly sector increases, the internal accumulation of the capital in the competitive sector is reduced, and thereby the rate of investment. Now the problem is that this reduction in investment *cannot be offset* by more investment in the monopoly sector. This is because the *marginal* rate of profit (taking into account not only new capital but the need to capitalize on previous investment locked up in the capital stock) is low or even negative.

It follows that *any check to the rate of investment results in excess capacity*. In a competitive regime, this would be eliminated by price-cutting and the closure of marginal firms. But the higher the degree of monopoly, the less likely it is that this mechanism, so beloved of our 'orthodox' economists, will operate. The more likely result is that in the monopoly sector, profit margins are inflexible in the face of a fall in demand. So excess capacity remains, and enterprises in this position must eliminate excess *capacity* by slowing the rate of investment. Investment ought to be seen then as in Marx's work, as creating its own fetters. As Kalecki concluded, a rise in the actual rate of investment being subject to political and other forces, cannot go on indefinitely. When the rate of investment does eventually cease to rise, the level of *current* profit also stops rising. But the amount of productive capacity competing for sales is steadily growing. The rate of profit begins to decline and so a boom will always break. In Kalecki's words, 'the tragedy of investment is that it causes crisis because it is useful'. And Kalecki also has an excellent summing up phrase: 'Doubtless many people will consider this theory paradoxical. But it is not the theory which is paradoxical but its subject—the capitalist economy'.

The 'home truths' about investment in Kalecki's approach compare more then favourably with the non-physical approach of neo-classical ideology with its assumed 'divisibility' of equipment, instead of the lumpiness and two-fold character (investment as a stream of spending but also created physical capacity) of capital accumulation. Thus Kalecki could answer the question: why do capitalists build new factories when the old ones are still not fully exploited, when they have excess capacity? His answer was that in order to employ existing capacity it is necessary that it be expanded.[36] Let us suppose that two towns are connected by two railway lines, both of them little used. What should be done? Kalecki says a *third* railway line should be built—for then the first two can be put to use carrying men and materials needed for building the third. And after the third line was completed, there should be a fourth, and then a fifth. Kalecki warned his readers that the example was paradoxical in the sense that some *other* investment near the two railways would obviously be better. Nevertheless, this example 'reflects the laws of overall capitalist development splendidly'.[37]

The 'indigestibility' of Kalecki for the neo-classical synthesis and also for many post-Keynesian economists is in fact an argument for his usefulness. In particular, his refusal to use undifferentiated economic agents and insistence on using classes creates a problem, as Keynes here did not depart from neo-classicism. His paradoxes, noted above, which derive from the fact that capitalism is a system which produces for profit and not need are a challenge to the ideology of the ruling class. Finally, his approach to the state as intervening on behalf of capital as a whole and not as a 'referee' smashes through ideological economic theory.

VII: Kalecki and the Australian Crisis

What key insights does the previous analysis give for the 1970s crisis in Australia?

(i) We know that in the few years up to 1974 there was a temporary profit squeeze caused by unions and international cost pressures.[38] After 1974, however, there was a massive shift of income to the corporate sector[39], restoring profit share in the 'national cake'.

In Australia, the share of wages in the national income rose during the 1940s and 1973–74.[40] In the calm economic growth of the 1955–69 period, shares of labour and capital remained almost constant. These rises took place in periods of boom, full employment pledges, trade union challenge to the state (the O'Shea struggle) and trade unions adopting 'militant economism'. They were followed by counter-attacks by the state: first the Fadden Horror Budget of 1951 distributed 6–10 per cent of national income from labour to capital, and then in 1953 cost of living adjustments were cancelled. Next came crisis conditions (1974–79) which weakened trade union struggle and led to a fall in labour's share. The counter-attacks in 1951–53 and by the Fraser government from 1976–79, succeeded in increasing the share of profit in the national cake at the expense of labour by 6 to 8 percentage points.[41]

It will be seen that these events from recent Australian economic history fully confirm the thrust of Kalecki's work.

(ii) Similarly with the 'political trade cycle'. In Australia we can trace the 'pricking' of the boom to the circumstances of the end of the primary commodities boom of 1973 coinciding with the swing to monetarism and Friedman's visit to Australia in the first quarter of 1975. The bipartisan economic policy of Jim Cairns and Bill Snedden favouring public works expansion and easier credit to stimulate effective demand was simply pushed aside by finance capital's desire to prick the boom and the fear of some 'captains of industry' about any continuation of the 'wage explosion' (and record strike level of 1974). In the ideological economics

profession and among civil servants and politicians were many looking for the simple panacea and single solution that Friedman promised. These forces combined to convert both the Hayden wing of the ALP and the Fraser wing of the Liberal Party to a policy of 'money supply restraint', the thrust of which was to puncture the boom.[42]

(iii) Kalecki was also right in his prediction that after the 'flushing out' of inefficient capital had been completed and the economy settled in a trough for a while, the political trade cycle would begin its upturn, with the same sections who were previously 'boom tired' now proclaiming that the recession had gone on too long and suddenly finding all sorts of reasons why state expenditure should be *increased* and effective demand boosted in a way that would benefit their particular sector.

(iv) Kalecki's estimate that the state allocations to subsidize industry would not be cut, but that welfare housing and social services would be cut, has been vindicated in Australian practice. Despite ALP rhetoric and misleading articles by ALP journalists in such newspapers as the *National Times* and *Nation Review*, Fraser has *not* cut the contribution of the public sector.[43] How could Fraser attack the public sector when hundreds of millions are needed as hand-outs to mining companies[44], when half of the $3 billion North West Shelf project will be coming from public subsidies and tax concessions?

In conclusion: those who have been patient enough to follow step-by-step through the analysis presented in sections II–V should now be in a position to posit answers to the following 'paradoxes'.

(a) Governments have replaced rapidly shrinking private investment in capitalist economies by huge budget deficits. Nevertheless, unemployment either keeps rising or is certainly not diminishing.
(b) Productivity per head in most capitalist countries is rising but income per head is falling.
(c) Mass unemployment is now accompanied by inflation whereas previously it was thought that falling prices caused unemployment and rising prices caused full employment.

Notes & References

1. See *Milton Friedman in Australia*, published by the group.
2. A Kaleckian analysis as used in this chapter is oriented towards the manufacturing sector. We feel it makes good sense for this part of the Australian economy, but does not describe the rural sector (where drought and the auction system determine prices and outputs) or the services sector. Nor does it account directly for the mineral sector, which is growing in importance, although the 'mining surplus' affects the rate of profit and hence manufacturing profit targets. In minerals generally, though, prices adjust to movement of the London metal market rather than to profit.
3. G. R. Feiwel, *The Intellectual Capital of Michal Kalecki*, University of Tennessee Press, Knoxville, 1975, *passim*; also Joan Robinson, 'Kalecki and Keynes' in her *Collected Economic Papers*, Vol. 4 Basil Blackwell, Oxford, 1951;

Bruce McFarlane, 'Michal Kalecki's Economics', *Economic Record*, March 1971; Joan Robinson, 'Michal Kalecki', *New York Review of Books*, 1976.

4. Robinson, *op. cit.*; Feiwel, *op. cit.*, chs. 1–2; Joan Robinson, 'Introduction' to M. Kalecki, *Studies in the Theory of Business Cycles 1933–39*, Kelley, New York, 1969.

5. E. K. Hunt, 'Introduction' to E. K. Hunt & J. G. Schwartz (eds), *A Critique of Economic Theory*, Penguin, Harmondsworth, 1972.

6. Seymour E. Harris in S. E. Harris (ed), *The New Economics*, Dobson, London, 1948. For a Marxist account of Keynes' choice, in the class struggle, to be 'always on the side of the educated bourgeoisie' see John Eaton, *Marx against Keynes*, Lawrence & Wishart, London, 1954. For Keynes' own political views, see J. M. Keynes, *Essays in Persuasion*, Harcourt, Brace & Co, New York, 1932.

7. Neo-classical synthesizers who have 'gutted' Keynes' analysis, robbed it of any radical implications and turned it into a classroom toy-box include J. R. Hicks, 'Mr. Keynes and the Classics', *Econometrica*, 1937; P. A. Samuelson, *Economics*, McGraw-Hill, New York, 1970, and James Tobin. Among those who stayed loyal to Keynes' original vision one should mention Lawrence Klein (USA) and Richard Kahn (UK).

8. Michael Porter (a monetarist) recently lamented that 'like most Keynesian students of the 1960s I had been told that Hayek was dead', in M. Porter, 'Stabilization Policy and Misplaced Entrepreneurship', Sydney, 1978, p. 2.

9. R. L. Hall & C. J. Hitch, 'Price Theory and Business Behaviour', *Oxford Economic Papers*, 1939.

10 . See his *Studies in Economic Dynamics*, London, 1943. A revised version was published in *Theory of Economic Dynamics*, Monthly Review Press, New York, 1968 and reprinted in *Selected Essays on the Dynamics of the Capitalist Economy*, Cambridge University Press, Cambridge, 1971, ch. 5.

11. Reprinted in *Selected Essays*, *op. cit.*, ch. 14.

12. *Ibid.*, pp. 48–9.

13. See, for example, 'The Problem of Effective Demand with Tugan-Baranovski and Rosa Luxemburg' in *Selected Essays*, *op. cit.*, pp. 147–8, and Feiwel, *op. cit.*, p. 51.

14. Nicholas Kaldor, letter to *The Times* London, 6 April 1977.

15. In the *General Theory*, Keynes' analysis proceeds with real wage rates, wage units, etc., and an implicit theory of price and value connected to levels of output and employment through the principle of effective demand.

16. M. Kalecki, *The Theory of Economic Dynamics*, Monthly Review Press, New York, p. 45.

17. *Ibid.*, p. 46.

18. Kalecki argued that capitalists' consumption was in fact a fairly insignificant portion of production and that, in any case, the analysis could be easily modified to incorporate it.

19. Keynes, in criticizing Harrod's draft of his *Essay on Dynamic Theory*, warned Harrod to include a distinction between I-goods and C-goods sectors. See D. Moggridge & E. Johnson, *Works and Correspondence of J. M. Keynes*, Vol. 14, Macmillan, London, 1976.

20. This part of the analysis links up with P. Sraffa's *Production of Commodities by Means of Commodities*, CUP, Cambridge, 1960. Sraffa's analysis sparked off ideas by Garegnani and Pasinetti which show the mark-up to be a result of two things—the general rate of profit and the mark-up hierarchy—which equalizes the general rate of profit. In this sense 'value theory' describes the determination of mark-up in the sectors of the economy and strengthens Kalecki's analysis.

21. Kalecki, *Selected Essays*, *op. cit.*, ch. 13.

22. 'Marx's Reproduction Schema and Modern Economics', *Social Science Information*, Vol. 7, 1968.

23. K. Marx, *Capital*, Vol. 3, Progress Publishers, Moscow, 1971, p. 251.

24. Kalecki, *Selected Essays*, *op. cit.*, pp. 170–1.

25. Kalecki, *Theory of Economic Dynamics*, *op. cit.*

26. J. Steindl, *Maturity and Stagnation in American Capitalism*, Monthly Review Press, New York, 1974.

27. Kalecki, *Selected Essays*, *op. cit.*, p. 141. This is particularly so under fascism where capitalists do not require the same control over the employment level because the working class can be suppressed by police action.

28. *Ibid.*, p. 140.

29. *Ibid.*, pp. 140–1.

30. *Ibid.*, p. 144.

31. *Loc. cit.*

32. *Loc. cit.*

33. *Ibid.*, p. 151.

34. See, for example, *ibid.*, p. 155, and Feiwel, *op. cit.*, p. 51. In Brazil, which has fought no wars in recent history, the growth of state expenditure on armaments has been for the purpose of suppressing the domestic population.

35. R. O. Heiser, review of Steindl's *Maturity and Stagnation in American Capitalism*, in *Economic Record*, 1952.

36. See B. McFarlane, 'Price Level and Excess Capacity', *Australian Economic Papers*, July 1973.

37. M. Kalecki, *Polska Gospodarsza*, no. 37, 1933, quoted in E. Lipinski, 'Michal Kalecki', *Polish Perspectives*, 9, 1971, p. 28.

38. A. Glyn & R. Sutcliffe, *British Capitalism, Workers and the Profits Squeeze*, Penguin, Harmondsworth, 1973.

39. Frank Field (ed), *The Wealth Report*, Routledge & Kegan Paul, London, 1979.

40. Department of Labour and Immigration, *Labour's Share in the National Product*, Australian Government Publishing Service, Canberra, 1975, p. 29.

41. Jim Cairns, in a celebrated 'Monday Conference' on national television in February 1975, foreshadowed the need to 'roll back' this share to its 1969–70 'slice' of the cake.

42. The move from bipartisanship in economic policy from Cairns-Snedden in 1974 to Hayden-Lynch in 1975–6 is noted in Bob Catley, 'Socialism and Reform in Contemporary Australia', in E. L. Wheelwright & K. Buckley (eds), *Essays in the Political Economy of Australian Capitalism*, Vol. 2, ANZ Book Co, Sydney, 1977.

43. Budget Papers, 1978, Statement 6, Canberra.

44. T. M. Fitzgerald, *The Contribution of the Mineral Industry to Australian Welfare*, AGPS, Canberra, 1974, pp. 4,6,9,12,22.