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The economic policies of the political economy of the Australian patriot and Cambridge economist

Philip Arestis and Malcolm Sawyer***

Geoff Harcourt has been a thoroughgoing Keynesian committed to the achievement of sustainable (environmental and otherwise) and equitable (nationally and internationally) economic development and growth, and full employment of the available labour force. Achieving such an objective would require, inter alia, the maintenance of a high level of aggregate demand consistent with the full employment of labour, and the provision of sufficient productive capacity to enable that full employment, where sufficient is to be interpreted in terms of quantity, quality and geographical distribution. In this paper the ways in which fiscal policy should be used to sustain high levels of aggregate demand, necessary though not sufficient for full employment, are explored. Geoff has been a long-standing advocate of incomes policies to contain inflation without resorting to demand deflation. We argue that with the failures of inflation targeting, itself based on demand deflation, the need to develop incomes policies should again be on the policy agenda. This is an important ingredient in Geoff Harcourt's economic policy toolkit.

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1. Introduction

Geoff Harcourt has been a thoroughgoing Keynesian committed to the achievement of sustainable (environmental and otherwise) and equitable (nationally and internationally) economic development and growth, along with full employment of the available labour force. In this contribution we discuss Geoff Harcourt's approach to economic theory before we turn our attention to, and focus on, the economic policy dimension of his way of thinking. He is a strong supporter of fiscal policy and, of course, of the ways in which fiscal policy should be used to sustain high levels of aggregate demand. This is viewed to be necessary, though not sufficient, for the achievement of full employment. Then we argue that in this way of thinking monetary policy should not be directed to inflation targeting, as was the prevailing consensus prior to the 'great recession'. Furthermore, fiscal and monetary policies should be coordinated in pursuit of macroeconomic stability. Geoff Harcourt has been a long-standing advocate of incomes policies to contain inflation without resorting to demand deflation. We argue that with the failures of inflation targeting, itself based on demand deflation, the need to develop incomes policies should again be on the policy agenda. This is an important ingredient in Geoff Harcourt's economic policy toolkit. We continue with Geoff Harcourt's theoretical framework in Section 2 and proceed to more policy aspects in Section 3. Section 4 summarises and concludes.

2. Geoff Harcourt theoretical framework

2.1 Objections to mainstream economics

It is important to begin by stressing that in addition to his own contributions to economic theory and policy, Geoff Harcourt has been critical of non-Keynesian economics. His valedictory lecture (Harcourt 2010a) is a case in point. This contribution is acutely critical not merely of the Old Consensus in Economics but also of the New Consensus. To quote at length from that paper:

»There are similarities between this [...] episode and what has happened in the last 30 years or more, now brought into sharp relief by the ongoing crisis in the capitalist world. Despite its great technical sophistication, in its conceptual essence, mainstream economics, now argued by its proponents to be increasingly converging on agreement and uniformity, is what Joan Robinson dubbed (as early as 1964) 'pre-Keynesian theory after Keynes'. Dominant figures in this transformation include Friedrich Hayek, Milton Friedman, Robert Lucas and Eugene Fama, with Lucas and Fama currently the patron saints of Chicago and modern macroeconomics (real and financial) and macroeconomists, including Michael Woodford and John Cochrane. Now that it is put to its first really challenging test, following the period of 'the great moderation', let us examine whether its explanatory power and relevance have been found wanting.« (Harcourt 2010a: 3)

Harcourt (2010a) makes further very critical and apt remarks on both the micro and macro aspects of these schools of thought. He has been particularly critical of the basic assumptions of these theoretical frameworks, namely the intertemporal optimisation assumption of the representative agent and that of rational expectations. Both are completely unacceptable to Harcourt's way of thinking about economic theory and policy. He argues persuasively that they sit very uncomfortably with his basic approach where distributional effects especially are of paramount importance.

A number of arguments have emerged from previous assessment exercises of the New Consensus Macroeconomics (NCM) framework and of the inflation targeting (IT) policy as implemented in a number of countries (see Arestis 2009b for a comprehensive critique). It is worth summarizing the arguments that are relevant here. Low inflation and price stability do not always lead to macroeconomic stability. Insufficient attention is paid to the exchange rate. There is insufficient evidence for a long-run vertical Phillips curve. There is insufficient evidence that the NAIRU is unaffected by aggregate demand and economic policy and affected by flexible labour markets. Countries that do not pursue IT policies have done as well as the IT countries in terms of the impact of IT on inflation and locking-in inflation expectations at low levels. There is insufficient empirical evidence to support the downgrade of fiscal policy; indeed, there is insufficient evidence to validate the NCM theoretical propositions in more general terms. The IT policy framework can only pretend to tackle demand-pull inflation but not cost-push inflation. The financial crises starting in the second half of 2007 has vividly testified to this problem of the NCM economic policy aspect.¹ Three further criticisms are of particular importance: the absence of banks and monetary aggregates in the NCM theoretical framework; the heavy reliance of the NCM theoretical framework on the 'efficient markets hypothesis' (EMH), which assumes that all unfettered markets clear continuously thereby making disequilibria, such as bubbles, highly unlikely – witness the credit crunch of August 2007; and the use of the equilibrium real rate of interest as in the monetary policy rule of the NCM model. Not to mention what Harcourt (2009: 2) suggests, namely that 'Commitment to full employment was downgraded or dropped altogether'.

In Harcourt (2010a) it is clear that most of the criticisms just summarized are strongly supported. The implication of this critique is summarized in the following quote:

»To sum up, there is a crisis in mainstream economics, in the teaching of it and in its application to theory and policy. For, by and large, it neither makes sense of what has happened or of what should and could be done about it. I would not go anywhere as far as Joan Robinson in 'Spring cleaning' (1980, 1985) – scrap the lot and start again [...]. We do need a thorough rethink and regrouping in order to back up the tentative measures being taken at the moment to tackle the present crisis (they are very much a curate's egg approach, often more bad than good in parts), to better explain how our

1 Interestingly enough, Buiter (2008: 31, fn9) laments that over the last 30 years we have had 'too little Minsky (1982b) in our thinking about the roles of money and finance in the business cycle'.

modern world functions and malfunctions and what may be done about it by people of goodwill who are humane, progressive and pragmatically practical. Immodestly, I hope I may be regarded a member of this band.» (Harcourt 2010a: 11–12)

Indeed, Harcourt (2009: 11–12) believes that there is still room for better days ahead despite the developments of the last 30 years or so in that despite »policy advisors and academics alike were still urging us to trust the workings of ›freely competitive markets‹ and arguing that, overall, governments should remain in the background« and bubbles emerging »in key markets and now, as we know, the whole box of tricks has been exposed and a major crisis, both financial and real, has emerged«. And in view of the fact that »our pre-Keynesian advisors are unable to tell us either why or what should be done, [...] fortunately, common sense has prevailed in many countries and old-fashioned Keynesian and post-Keynesian policies are emerging«. However, »whether they are of great enough magnitude to succeed remains, alas, to be seen«. And indeed, whether common sense is still prevailing as public expenditure cuts and fiscal consolidation becomes the order of the day (as we write in mid 2010), is questionable.

We would very much wish to highlight Geoff Harcourt's approach to economics along the lines he portrayed in the latter quote. To do so we turn our attention to the more theoretical aspects of his work.

2.2 *Theoretical considerations*

In Geoff Harcourt's work the starting point is Robinson's (1964) suggestion that the pre-Keynesian theory after Keynes's approach would have to be reversed to a Keynesian/post-Keynesian, and a little Marxian, »vision« and analysis of the world. As he puts it in Harcourt (2010b: 238):

»I have argued that Keynes, Kalecki and Marx, were they still with us, would have made far more sense of what has been happening over the last 30 years and more than do the Lucasians, modern classical macroeconomists, the inappropriate application of Frank Ramsey's model, or even the New Keynesians' concentration on imperfections. Not least does Marx come into his own with his insight that when financial capital is out of kilter with industrial and commercial capital, instability and crises are likely to result.«

Not to forget of course Minsky's (1977) related proposition that the credit system could potentially have a role in producing financial instability, which is closely related to another of Minsky's proposition that financial crises are credit booms gone wrong (see, for example, Minsky 1982a). There is a related Minsky (1982a: 60) suggestion, argued about three decades ago, that

»from the perspective of the standard economic theory of Keynes's day and the presently dominant neoclassical theory, both financial crises and serious fluctuations

of output and employment are anomalies: the theory offers no explanation of these phenomena». ²

It is also important to note at this stage the influence of Karl Marx's writings on Geoff Harcourt's thinking; this should be emphasised more in explaining the true objectivity of monetarism, as is clear in Harcourt (2007). With all this as a strong background to Geoff Harcourt's thinking, a rich theoretical framework emerges. We briefly summarise it below.

To begin with, Geoff Harcourt's post-Keynesian economics draws heavily on Robinson (1978: 12, emphasis in original) notion of it: ³

»To me, the expression *post-Keynesian* has a definite meaning; it applies to an economic theory or method of analysis which takes account of the difference between the future and the past. So we start by asking how key decision-makers behave, sometimes sensibly, sometimes not, in an environment of inescapable uncertainty, themes about which Keynes wrote incisively in *The General Theory*.«

It is, thus, not surprising to find that the focus of Geoff Harcourt's general theoretical framework is the emphasis on an economy, modern capitalism, of a monetary production type in which finance and credit play significant roles. It relates to an economy which has degrees of instability in the sense of being subject to the ups and downs of the business cycle and prone to crisis. The theoretical framework, which forms a coherent whole and underpins the analysis of this contribution, focuses on and draws from a number of main propositions. The first and most important proposition is that aggregate demand is vital for the level of economic activity. This proposition relates to expenditure, income and employment with the focus being on the level of economic activity, which is set by aggregate demand. No market-based mechanism exists to propel the level of aggregate demand to any specific level of output. For Geoff Harcourt, as for Arestis and Sawyer (2009) amongst others, investment has a dual characteristic in this model: it is a relatively volatile component; and it is also a potential promoter of productive potential. This establishes interdependence of demand and supply, which is closely related to path dependency.

The second main proposition is that money is endogenous and credit-driven. Money is endogenously created within the private sector with loans provided by banks themselves generating bank deposits. The central bank sets the key policy interest rate, which governs the terms upon which the central bank provides the 'base' money to the banking system. Building on this proposition, Harcourt (2010b: 243) generalised this proposition in the statement by arguing that

2 See also Arestis (2009b).

3 Harcourt (2010b: 240) distinguishes post-Keynesian analysis from that of the mainstream. He suggests that »there is a vast divide between how post-Keynesians think of how markets, indeed, systems as a whole, behave, on the one hand, and the mainstream view, on the other (though there has been *some* convergence in recent years with the emergence of path-dependent processes, hysteresis, and so on). Nevertheless, there is still a stranglehold of equilibrating notions on the mainstream in contrast to the increasing emphasis on cumulative causation processes by post-Keynesians.«

»a major post-Keynesian tenet is that there is an inescapable logical sequence of finance → investment → saving, a proposition going by default in much recent discussion of both national and international processes«. ⁴

The third main proposition relates to cycles and fluctuations in economic activity. The main assumption in this context is that they occur frequently and full employment is at best a rather infrequent occurrence. Kalecki (1943) is relevant to Geoff Harcourt's thinking on this score:

»The *maintenance* of full employment would cause social and political changes which would give a new impetus to the opposition of the business leaders [to full employment]. Indeed, under a regime of permanent full employment, the sack would cease to flag its role as a disciplinary measure. The social position of the boss would be undermined and the self-assurance and class-consciousness of the working class would grow. Strikes for wage increases and improvements in conditions of work would create political tension [...] true [...] profits would be higher under a regime of full employment than they are on average under *laissez-faire*, and even the rise in wage rates resulting from the stronger bargaining power of the workers is less likely to reduce profits than to increase prices, and thus affect adversely only [...] rentier interests. But ›discipline in the factories‹ and ›political stability‹ are more appreciated than profits by the business leaders. Their class instinct tells them that lasting full employment is unsound from their point of view, and that unemployment is an integral part of the normal capitalist system.« (Kalecki 1943 (1990): 351, emphasis in original)

Changes in economic activity impact the rate of change of prices and wages, and consequent changes in the distribution of income between wages and profits. Changes in the distribution of income have effects on the level of aggregate demand, with the nature of the effects depending on whether there is a wage-led or a profit-led regime. These interactions contribute to the generation of cycles. In this way, Geoff Harcourt's theoretical work rejects

»the distinction between trend and cycle, putting in their place theories of cyclical growth. This contrasts strongly with modern mainstream practice where growth is discussed in supply terms independently of demand, as though short-term fluctuations occur around a full employment trend.« (Harcourt 2010b: 244)

3. *Economic policy implications*

3.1 *General comments*

Full employment should be one of the major objectives of economic policy in Geoff Harcourt's view. However, he recognises that cyclical fluctuations are inevitable and in this sense the aim of economic policy should be to minimise the amplitude of fluctuations and

4 See also Harcourt (2001).

to keep average levels of employment near to full employment. Allowance should be made for frictional and seasonal unemployment as well as for the outcomes of restructuring. The possibility of the latter taking a long time should be recognised and proper account should be taken in the process. On all these Geoff Harcourt looks to the Scandinavian model for relevant fruitful lessons (see, for example, Harcourt [2010b])

Geoff Harcourt's views on economic policy are that it is primarily fiscal policy that can help the economy in terms of cyclical fluctuations and push it to full employment. Monetary policy in Geoff Harcourt's view is not such a powerful instrument of policy. By contrast, incomes policies should be used for controlling inflation rather than the current concerns with inflation-targeting monetary policies. We elaborate on these views in what follows.

3.2 Fiscal policy

Geoff Harcourt is a firm believer and supporter of fiscal policy. While net government spending adds an equal quantity of net financial assets to the combined non-government sectors by identity, the impact of fiscal policy on aggregate demand and economic activity depends heavily on the theoretical model and its assumptions about the real world where the policy is implemented. In the old macroeconomic models with sluggish prices, fiscal policy has positive demand implications. Expansionary fiscal policy adds to aggregate spending, and allows demand-constrained firms to sell more output, thereby increasing income and employment. The inflexibility of prices due to mark-up pricing makes output demand-determined. Prices adjust gradually and they follow cost-push increases in wages as captured in some versions of the Phillips-curve type specifications. The fiscal policy multiplier is positive, although its size can be affected by a number of factors, of which the main ones are as follows: productive capacity close to full use; higher interest rates from anticipated central bank interest rate changes that may crowd out private demand; fiscal policies that may cause the central bank to implement higher interest rates, reflecting higher risk premia; currency depreciation in a flexible exchange rate open economy; composition of the fiscal measure, where government spending is thought to be more effective than tax changes. These factors are likely to produce a positive, but small, fiscal policy multiplier.

An important further aspect we would like to emphasize is the importance of distinguishing between developed and developing countries in terms of the role of fiscal policy. One aspect of this distinction is the difference in the evidence adduced from developed and that from developing economies. This is necessary, we maintain, for reasons that have to do with data deficiencies in developing countries. This explains to a large extent why there is rather less evidence on the short-run impact of fiscal policy for developing rather than for developed countries (Arestis 2009a). An important observation in this context is that significant differences between developed and developing countries may arise from the nature of the tax systems in the two sets of countries. A progressive tax system, which may be more typical of the developed country case, would generate counter-cyclical behaviour, whereas a regressive one, most likely to prevail in developing countries, would generate pro-cyclical behaviour.

A further important distinction is the extent to which the level and degree of economic development affects the effectiveness of fiscal policy. Unfortunately, it is true that most of the literature on the effectiveness of fiscal policy has focused on developed countries. But then it is not difficult to come up with arguments that show that fiscal policy could be more effective in developing countries. For example, a factor that enhances the effectiveness of fiscal policy in developing countries is the possibility of a relatively high marginal propensity to consume identified for these countries. Such a result would, of course, increase the size of the impact of fiscal policy significantly.

At the same time, though, there are arguments that suggest the existence of serious constraints in the use of fiscal policy in the developing world. Agénor et al. (1999) argue that because the developing world is more likely to be influenced by supply shocks, fiscal policy as a tool of demand management is most likely to be used far less frequently and intensely than in developed countries. Furthermore, there is the argument that suggests that a possible deficit bias may be relatively higher in developing countries. In fact, Hemming et al. (2002: 12) argue that governance, as it relates to poor tax administration and expenditure management, is probably the most important and significant factor that affects this bias. Still, a further major constraint on fiscal policy in developing countries is the unavailability and high cost of domestic and external finance. It follows that access to finance should determine to a large extent the size of the fiscal deficit. An increase in the fiscal deficit beyond a level that can only be financed on unacceptable terms may be associated with severe crowding-out effects. Relaxing these constraints, therefore, enables fiscal policy to have significant stimulative effects.

The empirical evidence strongly supports fiscal policy. Blanchard and Perotti (2002) employ the Structural VAR (SVAR) approach in studying the quantitative impact of fiscal policy. They argue that this approach is superior to those that utilise large-scale econometric models or reduced-forms. Large-scale econometric models »largely postulate rather than document an effect of fiscal policy on activity« (Blanchard/Perotti 2002: 1), while the reduced-form approach registers the effect of a summary statistic of fiscal policy, and yet no theory suggests this is pertinent. The SVAR approach is argued to be more appropriate in the study of fiscal policy simply because, unlike monetary policy for example, decision and implementation lags imply that there is no response of fiscal policy to economic activity. Accordingly, fiscal shocks can be identified and their dynamic effects on economic activity can be traced through the SVAR approach. Blanchard and Perotti (2002) employ post-war US data along with SVAR to conclude that spending multipliers for consumption and output are anything between one third and unity.

However, Perotti (2005) and Mihov (2003), using VAR-based evidence, argue that after 1980 the effectiveness of fiscal policy weakened substantially in the US. Three possible explanations for this change have been put forward. One relates to the financial liberalisation era, which took place at the time. The increasing asset market participation has enabled households to smooth consumption in the desired way, thereby influencing the impact of fiscal policy. Another explanation refers to the increasing use of monetary policy since the 1980s relative to the pre-1980s. It is true that a considerable change has taken place in the

way the nominal interest rate is adjusted in response to expected inflation; monetary policy has been more hawkish ever since the 1980s. And a third explanation emphasizes the change in the degree of deficit financing, which has assumed more persistence post-1980. These explanations imply that while fiscal policy has a strong and persistent effect on economic activity, this is less significant and persistent post-1980. Bilbiie et al. (2006) attempt to throw light on the empirical support of the three explanations just summarized. They conclude that increased asset market participation accounts for some of the change, while the degree of deficit financing is crucial. But the key quantitative factor is, in their empirical findings, monetary policy. The complementarity of the three factors is also very important.

Of equal, if not more, importance for fiscal policy is public investment, which assumes particular significance in view of the emphasis placed upon it in the UK over the recent past. 'Golden rule' was the term used by the UK Treasury in its approach to public investment, though it was suspended with the onset of the financial crisis. Government deficit should only be undertaken for public investment but the current account should be balanced over the cycle, implying a balanced current account. This 'golden rule' is associated with a 'sustainable investment rule', which limits net public debt to a 'stable and prudent level' of no more than 40 per cent of GDP. Such a golden rule implies public investment of two per cent of GDP with a five per cent nominal growth rate (applying the well-known formula of $g = p i_g / b$, where g is the nominal growth rate, $p i_g$ is public investment as a percentage of GDP, and b is the debt to GDP ratio). A question in this context is whether the golden rule can ensure a sufficient level of public investment without hurting the sustainability of public finances. Recent research appears to be supportive of assigning a significant role to public investment. In their attempt to test for these propositions, Creel et al. (2009) elaborate on the Blanchard and Perotti (2002) approach, which, as implied above, popularized the VAR technique in a short-run analysis to account for the long-run properties of fiscal policies. Creel et al. (2009) account for debt dynamics in the case of a closed economy, and by utilizing the SVAR approach, they conclude that public investment, and current outlays, in the UK have positive and permanent effects on real GDP. Indeed, there is now a substantial body of literature (see for example, Aschauer [1989], Easterly and Rebelo [1993], Erenburg and Wohar [1995], Martinez Lopez [2006]), which argues that public investment, notably on infrastructure, can have a positive supply-side effect on private capital formation and the supply-determined rate of growth.

Turning next to the developing-country case; we may note that in terms of the evidence produced on the impact of fiscal policy, this is not dissimilar to that obtained for developed economies. If anything fiscal multipliers tend to be rather higher in the case of developing rather than developed economies (see, for example, Hemming et al. [2002: 33]). This is due to the relatively high marginal propensity to consume, which can increase the size of the impact of fiscal policy significantly, a possibility discussed earlier in the paper.

A point that relates to both developed and developing countries is the extent to which budget deficits are measured appropriately in the studies referred to above. Eisner (1989) was very persistent on the importance of proper definitions. In another contribution, Eisner and Pieper (1984: 23), it is suggested that

»an appropriately adjusted high-employment budget turns out to have been not in deficit in recent years, as usually supposed, but in considerable surplus. The view that fiscal policy has generally been too easy and overstimulatory is contradicted«.

In the same study it is also argued that

»official measures of the federal debt and budget deficits are misleading by any of several reasonable standards. Gross public debt figures ignore financial asset accumulation as well as the real assets, which have contributed to a growing government net worth. Budget flows have failed to distinguish between current and capital accounts, and measures of surplus and deficit have been inconsistent with changes in the real value of net debt.« (Eisner/Pieper 1984: 23)

It is clear from the discussion in this section that fiscal policy does have a significant role to play in macroeconomic stabilization, provided fiscal measures are appropriately measured. This is a clear confirmation that the views of Geoff Harcourt on fiscal policy matters are validated empirically.

There are a few qualifications of which Geoff Harcourt never fails to remind us. In more general terms, Geoff favours spending by governments on infrastructure. This is determined by medium- to long-term needs (given the philosophical stances of the governments in power), with short-term aggregate demand requirements tackled by changes in taxation. An overall tax structure, which reflects equity and efficiency, should be designed. However, the structure of such planning should be adjusted according to the anticipated state of aggregate demand from other sources. There are of course exceptions to this particular rule. One such example is the »great recession« experience. It is the case that in Australia, China, Continental Europe, the United States and the UK, all with varying degrees of enthusiasm and competence, increases in government expenditure associated with bringing forward plans already in the pipeline, or waiting their turn, has made a great deal of sense and success one might suggest. And to quote Harcourt (2010b: 245):

»We have been presented with a golden opportunity to do something substantial about deficiencies in social housing, city infrastructure, out-of-date or inadequate school buildings and hospitals, transport inadequacies and so on, not to mention reducing student-staff ratios in schools and in universities and increasing the provision of trained people to tackle reading and writing problems, and care for the disabled and elderly. For those who are worried about rising (especially external) debt to income ratios, may I suggest that until unemployment falls to levels relatively close to full employment, extra government expenditure should be financed by writing cheques on the central banks, not by issuing new debt?«

3.3 *Monetary policy*

Geoff Harcourt is much less enthusiastic about monetary policy. Indeed in Harcourt (2006: 66) he argues:

»In 1974, Jim Cairns, my former teacher at the University of Melbourne who at this time was Treasurer in the Whitlam ALP government, asked me to be Governor of Australia's central bank (the Reserve Bank of Australia). I replied: »You know me, Jim, I'm a real man not a money man, so thanks but no thanks.«

He is certainly not in favour of the over-reliance on interest rate manipulation as a fine-tuning monetary means to achieve an inflation target. He would no doubt object to the long-run equilibrium rate of interest so central to the monetary policy rule of the New Consensus Macroeconomics (see, for example, Arestis 2009b). The discrepancy between the actual and the long-run equilibrium rate of interest has been termed the »real interest rate gap« and can be used to evaluate the stance of monetary policy. It is thereby a useful theoretical concept in the analysis of the relationship between the independence of monetary policy and economic fluctuations (Weber et al. 2008). In other words, when the real rate of interest is reached, then there is no problem of deficient (or indeed excessive) aggregate demand. This equilibrium rate is often seen to correspond to what is called the Wicksellian »natural rate« of interest. Wicksell (1898) distinguished between the money rate of interest (as observed) and the »natural rate« of interest, which was the interest rate that was neutral to prices in the real market, and the interest rate at which supply and demand in the real market was at equilibrium.

However Geoff Harcourt no doubt would not support these contentions. He would definitely agree with Keynes (1936), who in *The General Theory of Employment, Interest and Money* explicitly rejects the idea of a unique natural rate of interest, and in effect argues that there is a natural rate of interest corresponding to each level of effective demand, which would bring savings and investment into balance.

»In my *Treatise on Money* I defined what purported to be a unique rate of interest, which I called the natural rate of interest – namely, the rate of interest which, in the terminology of my *Treatise*, preserved equality between the rate of saving (as there defined) and the rate of investment [...]. I had, however, overlooked the fact that in any given society there is, on this definition, a *different* natural rate of interest for each hypothetical level of employment. And, similarly, for every rate of interest there is a level of employment for which the rate is the »natural« rate, in the sense that the system will be in equilibrium with that rate of interest and that level of employment. Thus it was a mistake to speak of the natural rate of interest or to suggest that the above definition would yield a unique value for the rate of interest irrespective of the level of employment. I had not then understood that, in certain conditions, the system could be in equilibrium with less than full employment.« (Keynes 1936: 242–243, emphasis in original)

Keynes went on to argue that

»if there is any such rate of interest, which is unique and significant, it must be the rate which we might term the *neutral* rate of interest, namely, the »natural« rate in the above sense which is consistent with full employment, given the other parameters of the system; though this rate might be better described, perhaps, as the *optimum* rate [...]. The above gives us, once again, the answer to the question as to what tacit assumption is required to make sense of the classical theory of the rate of interest. This theory assumes either that the actual rate of interest is always equal to the neutral rate of interest in the sense in which we have just defined the latter, or alternatively that the actual rate of interest is always equal to the rate of interest which will maintain employment at some specified constant level. If the traditional theory is thus interpreted, there is little or nothing in its practical conclusions to which we need take exception. The classical theory assumes that the banking authority or natural forces cause the market-rate of interest to satisfy one or other of the above conditions.« (Keynes 1936: 243–244, emphasis in original)

Geoff's writings on the Cambridge capital controversies would, in any event, dramatically undermine the Wicksellian framework based on a monotonic negative relationship between the volume of capital and the rate of interest.

If no such unique equilibrium rate of interest is in place, then Geoff Harcourt must be right to argue that such emphasis on manipulating the rate of interest to achieve a set inflation target cannot achieve its objective of price stability. Without the knowledge of the equilibrium rate of interest, monetary policy makers cannot be moving in the right direction and mistakes in implementing monetary policy are inevitable. Harcourt (2010b: 245) is then correct to conclude that

»there is a lot to be said, within given constraints, of setting relatively low interest rates and keeping them there, using other measures to tackle short-term fluctuations and long-term needs«.

3.4 *Incomes policy*

If monetary policy should not be used to fight inflation, then one may ask is there no policy for such an objective? In terms of the inflationary process, to the extent that inflation is viewed as multi-causal and the sources of inflationary pressure vary over time and economy, then the obvious answer is to suggest an incomes policy. To the extent also that the range of factors which impact on the rate of inflation include factors such as struggle over income shares, the level and rate of change in the level of aggregate demand, and cost-push factors emanating notably from the foreign sector (change in import prices and the exchange rate), then such a policy becomes desirable. As far as inflation is concerned, we would like to make the point that it need not be the focus of economic policy in view of the fact that inflation at relatively low rates is not in general harmful to growth, and since there are many influences

on the rate of inflation. Using a policy such as inflation targeting which is based on a single cause (excess demand) is thus unwise. In fact, the control of inflation is regarded as a side issue unless inflation is exhibiting tendencies to continue to rise and to exceed something of the order of ten per cent – on the basis that inflation above ten per cent begins to distort decision-making and that the evidence on the relationship between inflation and growth does not indicate detrimental effects at rates less than (say) ten per cent (see, for example, Ghosh and Phillips [1998] and also Ferguson [2005]).

In this sense Harcourt (2010b: 245, emphasis in original) is right to refer to the case of Australia where such a successful permanent incomes policy was in place:

»Allied with maintaining full employment, we need institutions which as a start allow money incomes to be adjusted for prices and *overall* productivity (reflecting the terms of trade in open economies). This would allow all citizens to share in the rising prosperity associated with the complementary relationship between capital and labour at the economy level. (On occasions they would take their fair share of any decline in real standards.) Not only would this be equitable, it would also be efficient because it hastens the disappearance of low productivity, often declining industries and enhances the growth of high productivity, often expanding industries. The associated faster growth of *overall* productivity when reflected in the increase in money incomes may serve to tackle the Kaleckian dilemma of sustaining full employment alongside the accompanying shift of economic, social and political power from capital to labour.«⁵

But Geoff regrets that »[i]n Australia we have all but destroyed the institutions which could have delivered this goal« (Harcourt 2010b: 245).

3.4 *Other policies*

Finally three general points on the economic policy score have to be made. The first relates to climate change policies. Geoff Harcourt (2010b: 244), in particular, is clear on the matter:

»While I shall not discuss climate change policies explicitly, I assume that the policies I suggest will take proper account of the long-term constraints that global warming and responses to it entail.«

Second, it is also clearly suggested in the same publication that international cooperation with, and coordination of, some of the individual policies, is an extremely important requirement, for otherwise the economic policies suggested would not have a chance to succeed. In this sense, Keynes's Bretton Woods suggestion for an international monetary clearing union and that of Arestis et al. (2005) for a world central bank playing a central coordinating and regulatory role, along with a world currency, are on the right path and very much consistent with Geoff Harcourt's economic policy implications. In terms of the latter score, Geoff

5 See also Harcourt (1997 and 2001b).

Harcourt sees certain positive signs, for example the expansionary policies of the G20 in the eve of the ›great recession‹, but he is not terribly optimistic that substantial initiatives will materialise.

Third, a policy area which illustrates the essentially Keynesian nature of Geoff's approach, the ways in which ›vision‹ of the economic system informs policy, and a concern to develop relevant policy instruments, is the taxation of transactions in financial assets. His proposals here have overtones of the ›Tobin tax‹; but he did cast his net wider than foreign exchange transactions and included curbing ›speculation on the stock exchange and in the housing market‹. These policy proposals are related with his perceptions of the way in which markets operate. This is argued in Harcourt (2001b: 256) along the following lines:

»Let me briefly remind readers of the ›vision‹ of the nature of the economic processes that forms the backdrop to the policy proposals that follow. [...] there are two alternative ›visions‹ in economics: one likens markets, or even whole economic systems, to a wolf-pack running along smoothly. If, per chance, one or more wolves get ahead or fall behind, forces immediately come into play which quickly returns them to the pack. In the other ›vision‹, the forces which come into play when the breakaways get ahead or fall behind are much more likely to allow them to get even further ahead (or to fall further and further behind), at least for long stretches of time. The latter ›vision‹ underlies the following analysis.«

Speculation in markets is then seen to lead to volatility and bubbles rather than have the stabilising effect envisaged in the mainstream (= first ›vision‹) literature. Geoff viewed his proposals as a Pigovian type tax (Harcourt 2001b: 258) – that is use taxes to give incentives for people to change their behaviour. He proposed a tax on the volume of transactions, with different rates according to the manner in which the transactions were classified. On foreign exchange transactions, those relating to trade and long-term investment would be subject to a much lower rate than that levied on speculative short-term transactions.

4. Summary and conclusions

We have argued in this contribution that Geoff Harcourt has been a thoroughgoing Keynesian committed to the achievement of sustainable (environmental and otherwise) and equitable (nationally and internationally) economic development and growth, and full employment of the available labour force. Achieving such an objective would require, inter alia, the maintenance of a high level of aggregate demand consistent with full employment of labour, and the provision of sufficient productive capacity to enable that full employment, where sufficient is to be interpreted in terms of quantity, quality and geographical distribution. Fiscal policy to sustain high levels of aggregate demand and permanent incomes policies to contain inflation, when required, are the main economic policies that follow from Geoff Harcourt's theoretical framework. International cooperation is of paramount importance.

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