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HAS KEYNES'S THEORY GONE PALE?

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SUMMARY

The central question this paper purports to answer is the reality of Keynes's theory today.

The historical flow of economic thought has been considered, as well as the conditions in which Keynes's theory appeared, its significance in the context of the time, and the most important events in the development of economics during the last sixty years, i.e. since the publication of General Theory.

It is pointed out that, despite the passage of time and the new ideas which came forward, Keynes's teaching is still valid.

INTRODUCTION

Great ideas and works do not appear so often. That is exactly the reason that they last for a long time and remain the basis for other ideas and practice.

Such is the case with Keynes's teaching too, both praised and contested, through the last sixty years. Despite the numerous new ideas and models which have tried to find out the "right" solutions, Keynes's inspiration has always been present.

Time is then inexorable. One can feel the traces of changes - new relationships demand new postulations - but Keynes's approach remains recognizable still and valid.

1. THE HISTORICAL FLOW OF ECONOMIC THOUGHT

The basic social changes in relationships, procedures and institutions occur when the existing state of affairs is not satisfactory[1] , i.e. when the available apparatus cannot answer the challenges of the time and establish a social balance.

The same rule is also valid for economic theory and economic practice within the existence of humanity and economics; from early times and primitive economics, until contemporary economic relationships, a highly sophisticated production, varying demand and consumption, complex forms of financing and a highly developed economic science using to a large degree complex models by means of a mighty information technology and technique. Economic history shows numerous "revolutions" in the field of economicthought which occurred when existing models were outworn and were unable to explain the phenomena and relationships, and find solutions for economic problems.

The time systematization is unavoidable in the development of economic thought. The people and their works are put in certain frameworks - time boundaries characteristic for their teaching and the time of acting. These limits then almost always occur, because it is not possible to put the ideas and works, and also their carriers, into prepared samples; they interlace, complement, arise one from another, surpass the boundaries of periods, and specific economic thinking. Such endeavours are made more difficult when we take into consideration that economic science in various periods developed more in scale than in originality and wisdom.[2]

The rudiments of a more coherent economic thought can be found in the works of ancient philosophers such as Plato and especially Aristotle, and continue with the modest contribution of the Roman thinkers in the first century A.D. until the late medieval

1 Ekonomski leksikon, Leksikografski zavod Hrvatske "Miroslav Krleža", Zagreb, 1995, p. 790.

2 Schumpeter, J.A., *History of Economic Analysis*, vol. I, II, Croatian translation. Informator, Zagreb, 1975, p. 315, 627-628.

canonists (scholastics) of whom the most outstanding representative was Thomas Aquinas - a great systematiser of his time.[3]

We can positively say that systematic economic thinking began only in the late mercantilism of the seventeenth (J. Child) and the eighteenth century (J. Steuart).

The Physiocratic school appeared in the 18th century with its severe critique of the mercantilistic theory and policy (F. Quesnay, A.R.J. Turgot), which did not last a long time but had a strong influence on the further development of economic thought in the same way as did English economists of the early classical period (W. Petty, D. Hume, J. Tucker). A. Smith combined the contribution of both directions in the development of economic thought into an unique system.[4]

Modern economic thought has been developed since A. Smith, who founded, by his famous work *The Wealth of Nations* (1776), the ideology of laissez-faire and created a strong intellectual basis for a free enterprising spirit without the interference of government into economic matters. He became thus the most enthusiastic advocate of economic liberalism, and the inefficiency of the governmental regulation.[5]

Liberal classical economy continued through the teachings of D. Ricardo, T.R. Malthus, J.B. Say as far as J.S. Mill, but its vitality decreased considerably. Life, in fact, demanded new ideas, theories, and the explanations of market mechanisms.[6]

The Neoclassical school (W.S. Jevons, C. Menger, L. Walras, A. Marshall) gave the answer to the unexplained questions up to that time. Their representatives tried to connect marginal utility

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3 ibid., vol. I., pp. 45-63.

4 Samuelson, P.A. and Nordhaus, W., *Economics*, 14th ed., Croatian translation, MATE, Zagreb, 1992, p. 376; Schumpeter, J.A., vol. I, pp. 301-312; Ekonomski leksikon, o.c., p. 240, 512, 757.

5 Wonnacott, P. and Wonnacott, R., *Economics*, 4th ed., John Wiley and Sons, New York, (etc.), 1990, p. 5.

6 Robinson, J. and Eatwell, J., *An Introduction to Modern Economics*,rev. ed., Croatian translation, CEKADE, Zagreb, 1981, pp. 31-53.

with subjective real expenses. Thus, the non-existent link was offered in the overall theory of market mechanism, expressed by the dependence of demand on the marginal utility.[7]

Despite the significant progress of economic science at the end of the 19th and at the beginning of the 20th century, an ever grater void occurred between microeconomics and macroeconomics. Economic problems appeared for which classical or neoclassical theory could not give a complete answer.

The weakness of the existing theory was revealed particularly in the 1930-ies during the Great Depression, which so forcibly shook the entire industrial world.

It was in such crisis circumstances, that new progress in economic theory occurred, founded on Keynes's work *The General Theory of Employment, Interest, and Money* (1936). New ideas were injected into the economic theory, so that it would never be the same again. This time, too, a dangerous disease was decisive in finding the remedy. Keynes's prescription was efficacious even as far as the beginning of the 1970-ies, but old-new diseases appeared in new conditions and with additional characteristics of 'stagflation', for which Keynes's model was not efficacious enough. That was the reason for new elements and further contemporary formation of already known ideas into monetarist theory, supply - side economics, and rational expectations theory.[8] Business cycles and political turmoils are often accompanied by radical currents in the economy, which would like to change the existing systems radically and suddenly. But, fortunately enough, they appear suddenly and disappear quickly without more serious consequences.[9]

With the breakdown of the communist system in middle and eastern Europe, and in ex USSR, economic theory faced another challenge - finding out how to pass, with as little pain as possible, from a non-market economy to a market economy. Time will show which solutions will be offered, but it is evident now that wavering

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7 ibid., pp. 54-81.

8 Galbraith, J.K., *Economics in Perspective, A Critical History*, Croatian translation, MATE, Zagreb, 1995, pp. 197-208.

9 Samuelson, P.A. and Nordhaus, W., o.c., pp. 381-382.

and chaos are present,[10] and that all will not fit into place by itself alone.[11]

Besides all the risks in the time systematization of the development of economic thought, and among its representatives, we can conclude that all changes, from the first beginnings up to the present time, came under the pressure of the forces of life and that the periods of change became shorter. It is clear that social and economic development on a higher scale demanded more complex and more sophisticated solutions. The rule that difficult circumstances encourage the processes of thought, and that easy ones slow them down or freeze them, was confirmed in the field of economic theory as well.

If we analyze systematically the events and the development of economic thought, we can conclude that all the theories [12] were right for their own time, but they outworn, to a greater or lesser extent, by passage of time, and so weakened they were not able to cope efficaciously with newly arisen problems. [13]

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[10] Khanin, G., *The Soviet Economy - from Crisis to Catastrophe* in Aslund, A. (ed.), *The Post-Soviet Economy, Soviet and Western Perspectives*, London, 1992, pp. 10-22.

[11] Estrin, S. and Cave, M. (ed.), *Competition and Competition Policy - A Comparative Analysis of Central and Eastern Europe*, Pinter Publishers, London, 1993, pp. 1-ff.

[12] It refers only to the theories which left deeper traces in the development of the economic thought.

[13] Galbarith, J.K., o.c., p. 208.

2. THE CONDITIONS IN WHICH KEYNES'S THEORY APPEARED

The traditional, or "classical theory"[14] , as Keynes called it, registered and studied cycles of conjuncture even before the Great Depression, but that problem was not the central theme of economic thought. The causes of economic fluctuations were dealt with mostly outside the economic system, because everyone believed in the existing Say's paradigm of self-correctiong relationships in economics.[15] The theory of depression did not exist, which is understandable because classical tradition, to which almost all the economists belonged, excluded depression.[16]

The economists believed that there were no serious illnesses, that depression comes and goes, and that there was no need for a strong remedy and therapy. The balance of full employment is the essential characteristic of the existing economic system; after disturbance, recovery is inevitable and certain in a short period and without long-term consequences. That was the basic view of classicists and neoclassicists.[17]

However, as was pointed out in the first chapter, only difficult economic conditions could provoke a basic economic discussion and changes in the views and opinions of economists, because those who were predestined to think were on the other side - at the side of not too numerous and relatively privileged.

That is to say, through all the 19th and the beginning of the 20th century, economic thinking was dominated by the problems of

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14 Keynes decided to call the existing approach (in that time, r. I.B.)"classical theory", which he explained in the note 1 in the first chapter of the General Theory (cf. Keynes, J.M., *The General Theory of Employment, Interest and Money*, Croatian translation, CEKADE, Zagreb, 1987, pp. 13, 23.

15 Napoleoni, C. *Economic Thought of the Twentieth Century*, Croatian translation, CEKADE, Zagreb, 1982, p. 69.

16 Galbraith, J. K. o.c., pp. 143-144.

17 Chick, V., *Macroeconomics after Keynes - A Reconsideration of the General Theory*, The MIT Press, Cambridge, Massachusetts, 1984, pp. 285-286.

prices, wages, interest rates and profit. Additional attention was paid to the role of money and to banking. The dominant flow of economic thought was concentrated towards the explanation of prices, i.e. of the value and income obtained on this basis. Progress was obtained because: 1. attention was directed towards the buyer instead of to the seller (before); 2. the emphasize was given to the consumer's benefit instead of to the expense; 3, greater attention was paid to the demand in relation to the supply; and, prices were seen as the result of the fact that supply and demand are mutually conditioned and dependable, and not as the result of the expense of production.[18]

Despite a relative harmony, and economists belief (in classical and neoclassical schools) that the traditional, firm and stable rule about economic life being prone to balance - regardless of temporary signs of disharmony - was still valid, reality showed the signs of disharmony, contrariety and tension.[19]

Low wages, unequal distribution of income and power,[20] financial depression,[21] unemployment, the strengthening of trade unions and an air of hopelessness put the existing economic system more and more under pressure. Such a reality was theoretically incompatible with classical views.

The critiques in all industrial countries, and opposition to views and opinions which had defended that system, appeared in such conditions. (K. Marx and his predecessors and followers).

There was some excuse as well (excessive birth-rate - T.R. Malthus, J.S. Mill, distribution according to abilities and talent - V. Pareto; utilitarianism - J. Bentham), but at the beginning of the 20th century, such ideas could not be felt as completely safe in

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18 Galbraith, J.K., o.c., pp. 77-82.

19 Schumpter, J.A., vol. II, o.c., pp. 633-634.

20 A. Marshall, admittedly, also spoke about "evils of inequality" without explanations and reserves. He proved theoretically that laissez-faire does not bring the maximum of welfare to the society as a whole (cf. Schumpeter, J.A., vol. II, o.c., p. 637).

21 The period from 1873 to 1896, according to J.A. Schumpeter (quoted work, p.633) was called the "Great Depression", although there were opinions (H.L. Beales) that depression lasted "only" until 1886.

industrial countries, especially as in their proximity appeared an alternative - socialism.[22]

As classical theory[23] proved to be powerless in facing economic problems, new theories appeared which were "closer" to the actual practice. They were a forerunner to and/or in parallel with J.M. Keynes (K. Wicksell, E.R. Lindahl, G. Myrdal, B.G. Ohlin in Sweden, M. Kalecki, and W.T. Foster and W. Catchings in the USA).[24]

The classical economics, and especially the older one, was convinced that the distribution of income was unchangeable. It argued that the intervention of government for the alleviation of poverty would be counterproductive, as the final result would be the decrease of the total national income.[25]

However, Ricardian and generally classical limitations regarding the interference of government into economic flows did not prevent Otto von Bismarck in Germany from having recourse to governmental measures as early as the 1880-ies, evidently owing to ever more expressed social tensions, in order to amortize, at least to some extent, the existing state of affairs, i.e. to alleviate the "heaviest cruelties of capitalism".[26]

With great resistance, the Reichstag, nevertheless, passed the nesessary laws, in the middle of 1880-ies, which provided for help in the case of accident, illness, incapability and old age.

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[22] Galbraith, J.K., o.c., pp. 84-87, 132-137.

[23] J.K. Galbraith emphasizes, in the quoted work (p. 168, note 9), that, "as Keynes used to do", the expression "classical" is used for the economic thought from A. Smith and D. Ricardo furthermore. He points out that, in Keynes's time, "they spoke about neoclassical economy", which was considered to be "a step forward from the classical economy". As there was no stronger break with old opinion, but only some additions, the classical economy, the author quotes, is a more appropriate expression for traditional ideas.

[24] According to J.K. Galbraith, o.c., pp. 165-166; J. Robinson and J. Eatwel, o.c., p. 68; J.A. Schumpeter, vol. II, o.c., p. 957.

[25] Samuelson, P.A. and Nordhaus, W.D., *Economics*, International Edition, 15th ed., McGraww-Hill, Inc., New York (etc.), 1995, p. 372.

[26] Galbraith, J.K., o.c., p. 155.

The example of intervention in Germany has been especially emphasized, because it was the first official case of the interference of the state in the distribution of income, despite the rigid views of classical orthodoxy.

However, Germany was not alone in creating a welfare state.[27] Its example was followed by Austria, Hungary, and then Britain, and, in the 1930-ies, by the USA. Governmental social measures (of different and even of similar proportions) were applied in all industrial states. Thus the "correcting" role of government in the existing economic system was inaugurated with greater or smaller opposition and without stronger theoretical support.

The country which was the cradle of classical belief, Great Britain, especially surprised the world by promoting a welfare state. Without the signs of great enthusiasm, these changes in the system were accepted, which actually meant a considerable alleviation of its rigidity. Representatives of the classical theory also influenced the softening of the view towards changes (for example A.C. Pigou), whose views supported the redistribution of income, deriving necessarily from the application of measures to increase welfare.[28]

It is evident, then, that rigid frameworks of the classical theory weakened under the pressure of real life, and that changes extended to the economic systems of all industrial countries. Orthodox liberalism experienced defeat, and new ideas broke the former ossified opinions. The Great Depression intensified and speeded up all this. Its forceful attack came after the stock exchange breakdown in October 1929, and its main characteristics were: 1. a vertiginous fall of prices resulting in the financial disaster of industrial and agricultural firms; 2. unemployment; and, 3. misery, especially for the more vulnerable groups of the population.

In such circumstance, from an already heaving sea, John Maynard Keynes emerged and contracted, in his great work *The*

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27 The leading representative of German cameralism, J.H.G. Justi (1717-1771) is considered to be one of the creators of the welfare state, and so it is logical that the idea of the welfare state, and its application, occurred in Germany exactly (cf. Schumpeter, J.A., vol. I, o.c., pp. 142-144).

28 Galbraith, J.K., o.c., pp. 156-157

General Theory of Employment, Interest and Money, published in Great Britain in February 1936, the ideas he had developed since 1929, i.e. the views which were already evident in economic thinking.[29]

This giant of the economic thought of the 20th century, turned thus a new page in the history of economics, filled the void in economic analysis and laid the foundations for a modern macroeconomic theory.

3. THE FEELINGS OF POWERLESSNESS AND A NEW HOPE

Difficult economic circumstances traumatized the economic profession in the 1930-ies. Economic science was neither unanimous nor efficient regarding any measures for improving the state of affairs, and which would be founded on macroeconomic analysis. Therefore, the General Theory came as a new hope and a foundation for the rejection of old models and an evident sense of guilt and powerlessness.[30]

The main task of this gigantic work was directed towards the treatment of "difficult questions of theory", whereas the practical application of this theory was of secondary importance. The general approach, which is the characteristic of the work, had to serve universally and encourage the "critical reappraisal of basic postulations".[31] Keynes was aware in advance that he wrote "the

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29 Robinson, J. and Eatwell, J., o.c., p. 68, note 64.

30 Leijonhufvud, A., *On Keynesian Economics and the Economics of Keynes*, Croatian translation, CEKADE, Zagreb, 1983, p. 30.

31 Keynes, J.M., *The General Theory of Employment, Interest and Money*, o.c., p. 13.

book ... which will change considerably...the way in which the world thinks about economic problems".[32]

Keynes tried to find, in his General Theory, solutions to the economic policy which would remove economic problems by the application of general theoretical principles from which several theoretical discoveries derived.[33]

The strength of Keynes' work becomes prominent especially if it is considered in the context of the devastating action of the Great Depression of the 1930-ies. The destruction of numerous firms, millions of unemployed without hope of finding work, poverty of a great part of the population and the struggle for survival of those most endangered - the unemployed, homeless, old and sick people, and young people with energy and knowledge but with small prospect of using them and proving themselves.

In this darkness, Keynes carried a blazing torch that lighted the way of hope and escape from the existing system, which had to be reorganized by the influence of the state. The formulated theories "point out the crucial importance of establishing a certain central management over the questions that are now left to the enterpreneurship of an individual; there are very broad areas on which it does not have any influence. The government will have to materialize its influence on the inclination to spending, partly through the system of taxation, partly by determining the interest rate and partly, maybe, by some other ways. It seems, further, that the influence which monetary authorities have on the interest rate is not sufficient to establish, itself, an optimal rate of investment. Therefore, I think that socialized investment, will prove, to a considerable degree, to be the only way of providing for full employment, but this does not exclude a series of compromises and ways by which public authorities cooperate with private enterpreneurs."[34]

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32 According to Harrod, R.F., *The Life of John Maynard Keynes*, Harcourt, Brace, New York, 1951 p. 447.

33 Leijonhufvud, A., o.c., p. 23.

34 Keynes, J.M., *The General Theory of...*, o.c., p. 213.

The views exposed in his earlier works,[35] or speeches show that the ideas expressed in the General Theory are the result of Keynes's conviction and commitment. To be explicit, ten years before, in 1926, when the post-war conjuncture of affairs was at its peak, he pointed out "great inequalities in richness" in one of his lectures in Germany under the title "The End of Laissez-faire" and proposed the remedy that "lies outside the reach of the individual and we could say that it is to the benefit of the individual to stir up that illness. I believe that the remedy for these questions is in the thoughtful supervision over money and credit by the central institutions... . That measure would oblige society to take over the central and spiritual guidance by means of an appropriate institution, and that private incentive and entrepreneurship remain undisturbed."[36]

The basic idea of J.M. Keynes was the escape of classical fallacies in order to remove the contradictions and "the drawbacks of our economic society".[37] He claimed that the market economy did not necessarily find a balance at the point of full employment, i.e. that it could be caught in the trap of balance at incomplete employment,[38] That it is such a balance of aggregate supply and aggregate demand (in which production is quite smaller than the potential), when, logically, a great number of the unwillingly unemployed appears. He specially emphasized that a lack of demand was possible, which meant the rejection of Say's law. Therefore, the government has the task of encouraging that lacking demand, intervening with measures that are "closest" to it. Because a fiscal policy preferring the indebtedness of state (government) and spending for public purposes can counter, in the most efficient way, the imbalance of incomplete employment. A deliberate budget deficit

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35 For example in "Essays of Persuasion" - London, 1933, he points out the need to reconcile "utility and generosity" (according to J.M. Keynes Izabrana djela, Privredni vjesnik i Matica hrvatska, Zagreb, 1994, p.26)

36 J.M. Keynes - *Izabrana djela*, o.c., p. 89.

37 Keynes, J.M., *The General Theory of Employment, Interest and Money*, o.c., p. 210.

38 Tobin, J., *Asset Accumulation and Economic Activity*, Croatian translation, CEKADE, Zagreb, 1983, p.19.

is an efficient instrument in the overcoming of the state of affairs (the balance of incomplete employment), which is subpotential and harmful from the point of view of employment.[39]

If fiscal policy is used also "as a thoughtful means of obtaining an even distribution of income" then its contribution to "increasing the inclination to consumption, is, of course, even greater."[40] That is to say, in crisis conditions when: 1. it is not possible to wait these self-correcting powers to correct imbalance (to obtain the balance at full employment)[41] ; 2. it is not reasonable to expect that wages decrease unemployment[42] ; 3. it is illusory to expect that lower interest rates will influence the rise of investment spending[43] , then the only solution remains - the intervention of government for the rise of aggregate demand. At a time of imbalance between aggregate supply and aggregate demand, the rules of coordinated financing of public spending must loosen, of necessity, to advance demand in order to reduce unemployment.[44]

The essentials of Keynes's revolution in economic theory and economic policy are the balance of incomplete unemployment,

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39 Keynes applied the new approach (deficitarian) only when he entered the Treasury in the 1940-ies, and that was an "intellectual revolution", as they called it then (cf. Kahn, R., *Selected Essays on Employment and Growth*, Cambridge University Press, London, 1972, p. 107).

40 Keynes, J.M., *The General Theory of...*, o.c., p. 69.

41 Balance at incomplete employment can be stable and of long duration

42 If wages were decreased at a time of unemployment, the effective aggregate demand (buying power) would decrease, which would then influence the rise of unemployment.

43 Very low interest rates prevailing in the then crisis circumstances did not advance investments owing to already existing but unused capacities and a low rate of return. Lower interest rates could only strengthen the inclination to liquidity

44 In this interpretation, the quotations from Galbraith are used from his book *Economics in Perspective,...* . o.c., pp. 164, 171-174, and from J. Tobin from the book Asset Accumulation and... , o.c., pp. 19-22.

rejection of Say's law and advocacy of deficitarian public spending in order to obtain effective demand.[45]

That is Keynes's famous blazing torch, speaking metaphorically, which came from the depths of powerlessness to enlighten the ways of hope. Because John Maynard Keynes believed deeply that full employment is a *condicio sine qua non* of a civilized society.[46]

4. IN THE FOLLOWING SIXTY YEARS

Keynes's theory made its way with difficulty. Economic circumstances, i.e. the problems in industrial countries helped it, but the classical orthodoxy, despite all this, was stubborn in its belief that a way out was possible in the framework of its ideology.

The Second World War mostly confirmed Keynes's teaching and pushed aside classical thinking,[47] because it was a time of unavoidable government intervention. Younger economists, who accepted Keynes at the level of economic theory and economic policy,[48] gained influential positions in the government so that a way was open to the Keynes's basic ideas. One of the essential fact derived from the war, in an economic sense, was a completely new view of the role of government and the possible effects of its intervention.[49]

As far as the 1970-ies, i.e. for 25 years after the war, there was no greater power in the economy of the industrial countries that would necessarily move economic science to declare itself regarding the new challenges of life.

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45 Galbraith, J.K., o.c. , p. 164

46 Thirwall, T., "*The Return of Citizen Keynes*", *Sunday Observer*, April 23rd 1996.

47 Robinson, J. and Eatwell, J., *An Introduction...* , o.c., p. 72

48 Modigliani, F., *The Debate Over Stabilization Policy*, Croatian translation, CEKADE, Zagreb, 1991, p. 15.

49 Galbraith, J.K., o.c., pp. 179-180.

For a quarter of a century the economy was in a state of "balanced growth" and not, as the classicists expected in a "stationary state". Those gloomy expectations of the classical economists have not materialized, because governments followed Keynes' approach and managed, by the influence of governmental measures to reduce those earlier excessive rises and falls to moderate oscillations around a rising trend of production and prices. Employment also maintained even growth, but in a somewhat slower tempo regarding production per capita. [50]

That was at a time when strength was being mostly exhausted by the removal of the consequences of the war, but also at the time when the modern theory of growth was founded (R. Harrod and E. Domar), whose approach leaned directly on Keynes's ideas.[51]

At least two economic novelties are characteristic of that period: intersector analysis (W. Leontief) and econometrical models (J. Tinbergen).[52]

We can, then, conclude that in that relatively peaceful period economic science, without too much stress, was in the ascendent, giving answers to the questions and problems derived from ever more complex relationships in the economy.

One economic problem - which before then, was already present from time to time, but did not attract great attention - appeared at the end of the 1960-ies and at the beginning of the 1970-ies. That was a new type of inflation - the inflation of expense, which meant a sudden rise in wages and prices.[53]

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50 Napoleoni, C., *Economic Thought of the Twentieth Century*, o.c., p.10.

51 ibid., p. 110

52 Galbraith, J.K., o.c., pp. 192-193.

53 The Oil shock from 1973 encouraged inflation a great deal in the industrial countries, when the members of OPEC increased the price of oil several times; from under U.S. $ 3 a barrel in 1973 to almost 11 in 1974 and above 30 in 1982 (cf. Wonnacott, P. and Wonnacott, R., *Economics*, o.c., p. 589.

The Keynesian economy did not have a "right" answer ready as it did not paid appropriate attention to that problem; it was neither preoccupied with economic nor with political repercussions of inflation. The problem of inflation was "left over" to the microeconomics and classical market ideology.[54]

In these circumstances, monetarism (M. Friedman) appeared which forced the Keynesian paradigm into defence and retreat. The basic idea of monetaristic theory was that all macroeconomic problems derived from abadly run monetary policy,[55] from which one could conclude that the solution might only be sought in the monetary sphere, i.e. that money was essential, and only money.

Monetary policy was really based on the classical model - the model of the classical competitive market and disbelief in the authority of government. However, it was also connected with Keynesianism in the belief, that, at least in principle, monetary and fiscal policies affect money and real income.[56] But, monetarists were stubborn and claimed that "only money was important", and the keynesians had a broader outlook and emphasized that "Money was important, but the fiscal policy was also important".[57]

As inflation was progressing in the 1970-ies, and the solution could not be found in higher taxes, lower public expenses or in the control of wages and prices, the politicians in the USA (J. Carter) and in G. Britain (M. Thatcher) had recourse to the measures of monetary policy, by which the Keynesian approach bowed down before monetarism.[58]

Several years were needed to stabilize prices; this was finally obtained in the 1980-ies, but with great sacrifices: the decline of small firms, the inflow of foreign capital which influenced the rise

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54 Galbraith, J.K., o.c., pp. 197-198.

55 Modigliani, F., *The Debate over...* , o.c., p. 16.

56 Ibid., pp. 16-17.

57 Samuelson, P.A. and Nordhaus, W.D., *Economics*, 15th ed., o.c., p. 609.

58 Other countries had a similar approach, for example France (cf. Hayward, J., *The State and the Market Economy - Industrial Patriotism and Economic Intervention in France*, New York University Press, New York, 1986, p. 220.

in value of the American dollar and by that the fall of American exports and the rise of imports, the deficit of the trade balance and balance of payments, the slowing down of economic growth, rise of unemployment.[59]

Real movements showed, then, that the claim of the monetarists that monetary policy was a cheap anti-inflation strategy proved to be unconvincing.

Supply - side economics (A. Laffer and others) made a great step forward as a stimulus to a tired American economy in the 1980-ies, i.e. during R. Reagan's Presidency. There were various ideas in that concept, but two characteristics were essential: 1. emphasis on motivation and supply, unlike Keynesian emphasis on demand, and 2. a considerable decrease in taxation.

This model also, which nevertheless cast a shade over Keynes's approach, was founded on classical principles, but it did not last long, as it was dropped after the departure of its advocate, R. Reagan.

Speaking about the economy of supply one can conclude that opinions are diverse regarding its efficiency and theoretical foundation.However, the practice did prove, that exactly at that time: 1. the budget deficit was increased; 2. inflation decreased, but at a great price - recession, unemployment; 3. national savings reached a low level; and 4. the fall of production was noted. This was all contrary to what which the advocates of that idea were forecasting.[60]

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59 An interesting historical aspect of the development of world economy and of the economy of more important countries, (and in this framework of the problems discussed above) is given in the book, Holtfrerich, C.L. (ed.), *Interaction in the World Economy - Perspectives from International Economic History*, New York University Press, New York, 1989.

60 Thurow, L.C., *Dangerous Currents in the State of Economics*, Croatian translation, CEKADE, Zagreb, 1987, pp. 93-104; Samuelson, P.A. and Nordhaus, W., *Economics*, 14th ed., o.c., pp. 559-563.

Although it derived its roots even from the 1960-ies (J.F. Muth) and the seed could be found in Keynes's General Theory,[61] the rational - expectations theory or the new classical economy has developed during the last twenty years (R. Lucas and others), and it has been based also on the classical approach and suppositions that individuals link their expectations with the best available information, and that prices and wages are flexible, i.e. that they adapt very quickly to the balance of supply and demand.[62] The advocates of that theory oppose the division of microeconomics and macroeconomics, and consider that a great part of unemployment is voluntary.

One can conclude, from these designations of the main postulates of the model of rational expectations, that it is also in opposition to Keynesian teaching, which means that it is another obstacle in the path of J.M. Keynes.

60 years have passed since economic science has been additionally and permanently enriched by the great Keynes' work - the General Theory. What to say at the end of this paper, and what answer to give to the question put in the title of this work?

The scheme over its 60-year development and the present state of economic thought is very complex. Numerous ideas, opinions, theories have arisen and arise now. They all intertwine among themselves, are more or less in accord, or exclude each other.

A new classical macroeconomics, neokeynesianism, neoclassical synthesis are new shoots grafted on to the old branches, already dried up, which try to feed, with their sap, the tree that bears them. But life goes on, bringing small or great changes, which is necessarily reflected in economic theory, because economic thought cannot, by any means, be separated from the economic context. On the contrary, J.M. Keynes was convinced that ideas should conform

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61 Keynes, J.M., *The General Theory*..., o.c., pp. 45-47, 96-105.
62 Thurow, L.C., o.c., pp. 106-124.

to the practice,[63] so that the ideas of this great man of economic thought would today probably be somewhat different.[64]

However, despite, we might say, an intellectual confusion among the economists,[65] and despite, metaphorically speaking, numerous stronger or weaker lights which enlighten the ways of economics, the lighl of J.M. Keynes can easily be seen.

Time is the "culprit" in that its intensity has somewhat weakened, butnevertheless, Keynes's light still shows direction; there would be more wanderings and failures without it.

The modern market economy, the economy of the developing countries,[66] of the countries in transition,[67] of the developed countries, leaves enough room for the application and linking of various models, including Keynes's. For Keynes, economics was a moral science;[68] and is not that the way towards the aims to which humanity aspires?

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63 Kahn, R., *Selected Essays....* o.c., p. 103

64 Cairncross, A., "*Keynes the Man*", *The Economist*, vol. 339, no.7962, April 20th, 1996, pp. 85-86.

65 Thurow, L.C., o.c., pp. 7-11

66 Robinson, J. and Eatwell, J., o.c., pp. 342-345.

67 Cf. Aslund, A. (ed.), *The Post-Soviet Economy - Soviet and Western Perspectives*, Pinter Publishers, London, 1992, pp. 39-60; Aslund, A. (ed.), *Economic Transformation in Russia*, Pinter Publishers, London, 1994, pp. 59-76, 174-181.

68 Thirlwall, T., o.c.

CONCLUSION

The history of economic thought shows that economic ideas have always been the product of a specific time and space. They reflect the problems of contemporary life, and they should be considered in such a context. Keynes's theory is also the result of specific circumstances; it was encouraged by extremely complex economic and social conditions, and by the inefficiency of the existing patterns.

Relationships have changed with the flow of time, of course, and new ideas appear attempting to explain the reality of life. They lean, more or less, on previous ones, but they also put them in the shade.Great ideas, however, have a privilege. They are of long duration and they serve as the support for new thinking and practice. Such is Keynes's theory. Its practicality cannot be questioned even today.

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