

# Aggregate demand, income distribution and unemployment

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# Outline

- The importance and nature of aggregate demand in post Keynesian economics
- Investment
- Saving
- Implications
- Some remarks on the supply-side
- Political and social constraints on full employment

# Demand and credit creation

- Demand to become effective has to be financed
- Demand is embedded in a monetary production economy
- Endogenous money and bank credit creation

# Investment

- Investment as a key component of the level of demand and as additions to supply potential
- The interdependence of demand and supply

# Investment

- What influences the level of investment?
- Capacity utilisation
- Profits and profitability
- Credit availability
- 'Animal spirits'
- Technological opportunities

# Saving-investment

- The causal relationship runs from investment to savings
- In a similar vein, for banks causation runs from loans to deposits

# Saving behaviour

- Saving and the distribution of income
- Saving out of wages
- Saving out of profits
- Why are there differences?

# Simple model

- Saving equation

$$\frac{S}{K} = \frac{sP}{K} = s \frac{P}{Y} \frac{Y}{Y^c} \frac{Y^c}{K} = \frac{smu}{v}$$

- (S saving, K capital stock, m profit:income ratio, Y output, Yc capacity output, u capacity utilisation)



# Simple model

- Investment equation

$$\frac{I}{K} = \alpha u + \beta m + \mu$$

- Putting them together yields:

$$u = \frac{(\beta m + \mu)v}{sm - \alpha v}$$

- Significance of this result

# Simple model

- Kaleckian proposition

$$\frac{smu^*}{v} > \alpha u^* + \beta m + \mu$$

- Where  $u^*$  is full capacity
- Note roles of  $s$  and  $m$  in this inequality

# Simple model

- Introducing budget deficit ( $d$ ) and net exports ( $x$ ) gives:

$$u = \frac{(\beta m + \mu + d + x)v}{sm - \alpha v}$$

## Simple model

- In this approach note:
- The role of investment
- The role of income distribution
- The role of budget deficit

## Capacity utilisation and employment

- This is cast in terms of capacity utilisation: employment can be 'read off' from capacity utilisation but no presumption that there would be full employment even at full capacity utilisation.
- The (likely) need for a long-term budget deficit (and hence the stupidity of the 'fiscal compact')

## A couple of asides

- Financialisation: profits and inequality; effects on investment
- Ecological concerns: lower growth --lower investment

# Supply considerations

- Conflict theory approach to inflation based on competing claims on income which are kept in check through the level of economic activity

# Supply considerations

- Simple pricing equation

$$p = w \left( 1 + n \left( \frac{Q}{Q^*} \right) \right) \cdot L(Q)$$

- Wage determination

$$\frac{w}{p} = \vartheta_0 + \frac{\vartheta_1 L(Q)}{L^*}$$

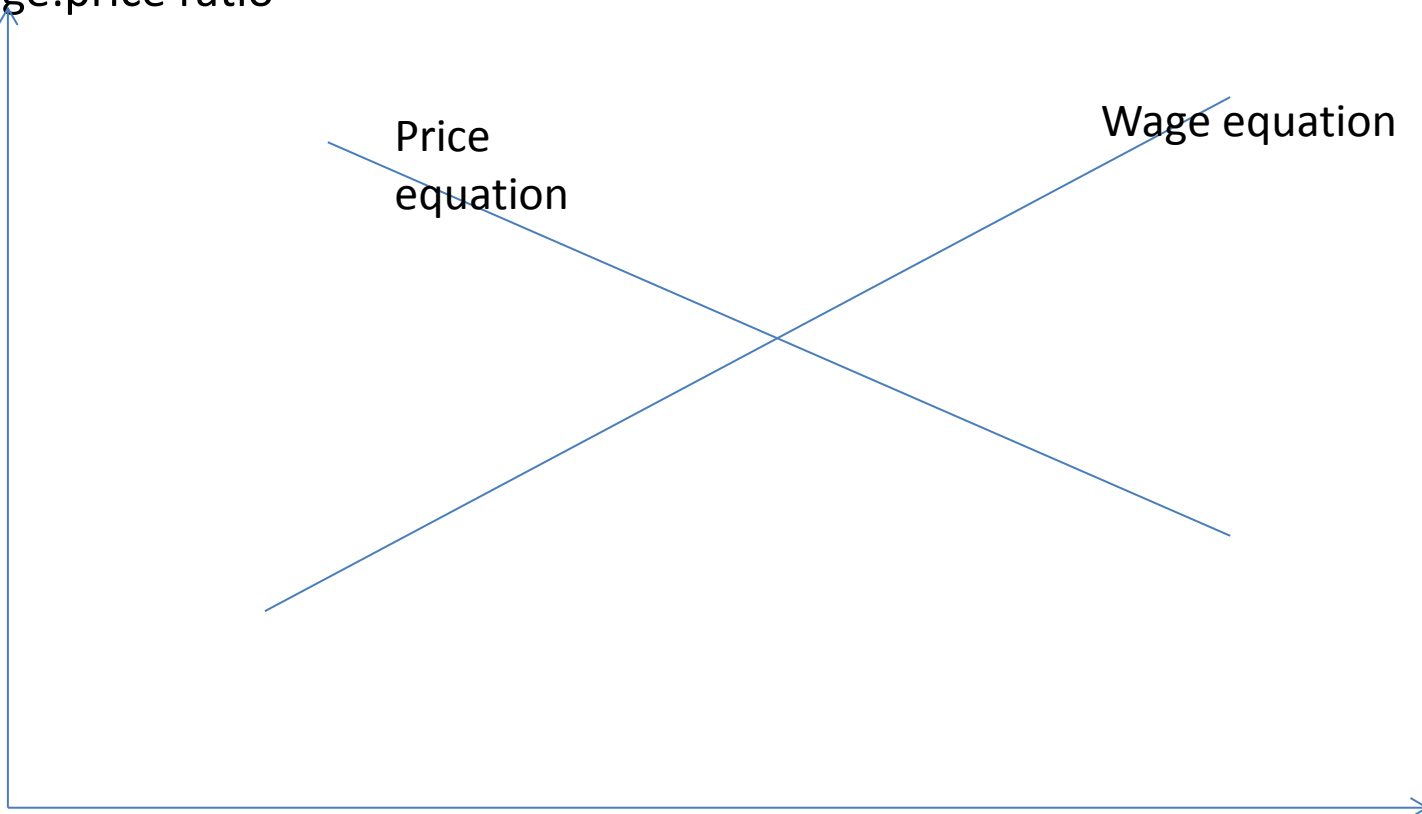


Wage:price ratio

Price  
equation

Wage equation

Output



## Inflation barrier

- The intersection provides a level of output and distribution of income at which inflation would be constant
- This should not be seen as an 'attractor'

## Inflation barrier

- The price equation would shift with  $Q^*$  (capacity output): more capacity, more output, more employment
- Inflation barrier should not be seen as related to labour market

## An aside

- Mainstream economics portrays the capitalist economy as stable and full employment as the norm, and deviations from full employment to be explained by shocks, imperfections and policy mistakes
- Post Keynesian economics portrays the capitalist economy as liable to fluctuations and crisis and unemployment as the norm, and full employment to be explained by ‘special circumstances’

# Political and social constraints on full employment

- Creating sufficient demand and the need for budget deficits
- Creating sufficient productive capacity in the right quantity and quality
- Changes in the balance of economic power

## Concluding remarks

The importance of demand for the level of unemployment; and within demand the significance of investment and of income distribution;

Productive capacity of the right quantity and location required for full employment;

The political constraints on the achievement of full employment

## Some reading

- E. Hein and E. Stockhammer (eds.) A Modern Guide to Keynesian Macroeconomics and Economic Policies
- P. Arestis and M. Sawyer, 'Aggregate demand, conflict and capacity in the inflationary process', *Cambridge Journal of Economics*, vol. 29, no. 6, pp. 959-974