

A Keynesian view on the management of fiscal and budgetary instruments

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Abstract:

The purpose of this paper is to emphasize the main features of budgetary and fiscal policies in the Keynesian framework. Thus, we analyzed the defining elements captured by J.M. Keynes in his main work, that discuss about the financial government instruments involving in the economy, showing their true qualities. This analysis captures including the future developments of the Keynesian theory.

Keywords: fiscal policy; budgetary policy; Keynesians

JEL Classification: E12, E21, E24, E62

1 Introduction

Neoclassic made a microeconomic analysis by excellence, giving their main attention to studying the interdependence of economic processes at the company, producer and consumer level. This approach started from the belief that the market economy on the macroeconomic level is set for itself, and the balance between supply and demand is established automatically. Keynes rejects this view and argues that although the market economy is better than other forms of organizing economic life, she has a whole series of shortcomings, such as imbalances, unemployment, inequalities of wealth and income, etc. All these deficiencies can be explained and even exceeded, but only through macroeconomic approach.

2. The message of the General Theory

Keynesianism is one of the most important economic doctrine that has caused substantial changes in financial policy issues in general and in the fiscal and budgetary policies in particular regarding the role the latter has in the economic and social recovery and development, in the context of market forces began to no longer meet the challenges and to generate economic and social system breaks.

Thus, in 1936, Keynes produced a new approach to fiscal policy measures, introducing the public budget mechanism in the economic circuits. Keynes argued that the classical theory of employment depended on two postulates: wage rate was equal to the marginal productivity of labor and the utility remuneration for the worker equalizing the marginal utility loss of employment. Keynes accepted the

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first postulate, but denied the other, because the last implies the impossibility of the existence of involuntary unemployment, which also was evident everywhere at that time.

The central message of the General Theory was that the economy was not driven by supply and Say's law no longer proven useful, so that an equilibrium level of income and of the output should not meet a situation of full employment. Keynes has justified his theory by several assumptions: consumption is primarily a function of income, not one of interest rate; autonomous injections in aggregate demand will be increased by a multiplier higher than one, which was marginal propensity for mutual savings; this multiplier will be applied equally to public and private investment spending, rate / interest elasticity coefficient is very low, rate / coefficient of elasticity of demand for money is very high and even infinite at certain minimum rates of interest and the position of investments is volatile.

In this context, monetary policy seems to be unable to grow the savings "committed" in serious recession through interest rate mechanism in the absence of fiscal stimulus. Keynes also argues that the multiplier may still lose power just when the situation of full employment was reached and that civil engineering works are best related to severe unemployment.

An implicit assumption of the neoclassical approach is that the economy operates with a full employment level. Under a level lower than full employment, Keynesian approach argues that budget deficits will not lead to crowding (Cretu, et.al., 2011). Given fixed wages and prices, changes in aggregate demand induced by changes in the level of public expenditure and taxation affects the production factors in the economy, increasing domestic output. An expansionary fiscal policy, according to a Keynesian approach, will leading to economic growth.

Keynesian theory brings into question the potential of budgetary and fiscal policies to solve macroeconomic problems. The principle is simple: use fiscal stimulus budget to eliminate unemployment and fiscal restrictions to keep inflation under control (Dragomir, et.al., 2011). Evolution of Keynesianism began, in fact, immediately after the appearance of Keynes' theory and continued even during war time when in United Kingdom, William Beveridge, in 1944 drafted a report on full employment, "Full Employment in a Free Society", in which, based on Keynes's theory emphasizes that the task of national economic recovery and reducing the loss of purchasing power was for the state, which was called to stimulate global demand and make investments capable of increasing production to global demand level. Beveridge believes that this objective could be achieved by increasing public expenditure (investment and the granting benefits to those with low incomes) and lower revenues (reduced demand leading to increasing solvent taxes population and the ability of entrepreneurs to invest). Budget deficit, thus appeared, will need to be covered by the state loans, this route being attracted to the economic cycle and the un-invested savings (Chirila, 2011).

3. The functional finance

Although General theory explicitly supports public works programs and the expansion of public investment, does not pay attention directly to the implications on the budget. Thus, the author changed the traditional doctrine of fiscal austerity. This change is noticeable at his disciples, in largest proportion of Abba P. Lerner especially (1943) and Paul Samuelson (1948) who promoted the doctrine of functional finance. The central idea is that government fiscal policy, its expenditure and taxes, loans and the repayments of debt, money supply problem and withdrawal of money from circulation should be addressed by follow up of these actions on the economy and not by reference to what traditional doctrine establishes as healthy or unhealthy (Nuta, 2011). Principle of judging how economy works in terms of budget and fiscal measures we can call functions in functional finance. (Lerner, 1943).

Lerner has established three law of functional finance that should determine monetary and fiscal policies of any government. First, the government should adjust their expenditure and taxes in order to maintain aggregate demand at a level that will buy, in current prices, the result of full employment. In these circumstances the budget balance or imbalance becomes irrelevant (Pripoaie&Pripoaie, 2011). Second, the government must borrow money or repay debts just by interest rate changes. Government should not ever borrow to finance its budget deficit, a goal better served by issuing currency. A third law, derived from the first two, the government should give money or should remove from use the volume that serves the objectives of functional finance.

4. The new economics

When Paul Samuelson (who consider debt financing budget deficits unless the growth rate of debt is lower than economic growth), embraced the doctrine of functional finance in his first edition of *Economics: An Introductory Analysis*, in 1948, the economic statements during the postwar Western economies have moved decisively behind this doctrine. Keynesians have focused attention on the behavior of equilibrium economies suffering under labor underutilization. For this reason the Keynesian model developed by John Hicks (1937) and extended by Alvin Hansen (1953) explained in real terms, without reference, the potential of inflation problems. Keynesian economic policy was changed gradually in nature, not without some degree of internal disputes on Keynesians themselves, making a compromise between classical and Keynesian model, known as "neoclassical synthesis". This compromise combined Keynesian theory of aggregate demand with classical aggregate supply theory and with the theory of "Phillips curve" regarding the way in which prices are adjusted when aggregate demand exceeds the aggregate supply to provide a macroeconomic model able to incorporate the real inflationary effects of budgetary and monetary fiscal policies.

Among American Keynesians economists manifested in the six-seven decades of the last century were noted: A.H. Hansen, P.A. Samuelson, R. Solow, R.L. Klein, J. Tobin, W. Heller, F. Modigliani, etc. The ensemble inspired by Keynesian ideas have been called "new economics".

Alvin H. Hansen, has realized the Americanization of Keynes. His book, *A Guide to Keynes*, published in 1953, it is a guide for reading mathematized formula, but also very accessible to the *General Theory*. In this book he presents, from a sketch made by John Hicks, the IS-LM model, "after gradual systematization, will constitute in the 50's and 60's under the main development of Keynesian macroeconomics, the neoclassical synthesis version" (Beaud M., Dostaler G., 2000).

In this respect, Hansen attaches a special importance to investments and state expenditures in general, as a means to combat crisis. Thus, according to him, public spending and private autonomous investment are the most important factors of growth and decline of the national income. In the fight against crisis and unemployment, he proposes to use, among others, state budget expenditures, including military, taxes, loans and other financial leverages. Hansen's conception on taxes is that they are an effective means of fulfilling crisis prevention and control of labor use, mentioning for this purpose three types of programs. The first program, flexible mechanism, parts of which were taxes, public spending and social security, aims to adapt these components to the concrete conditions in which economic activity is found, allowing recovery in times of crisis and provides a balance over an economic cycle. Second, the compensation program, has as main components taxes and public spending and directly address the action of cyclical fluctuations (Ariton, 2006). Last program, called stabilizers system, involve semi intervention depending on the level of certain economic indicators, for example, unemployment index. This provided automatic modification on tax rates and spending when the unemployment index size increases or falls below a previously established level.

American Professor Paul Samuelson believes that the existing economic system in western countries

is a mixed regime. "Mixed-economy shows that are based primarily on price to organize the economic system, but uses a variety of state interventions to deal with macroeconomic instability and market imperfections"(Samuelson, Nordhaus, 1989). Furthermore, Samuelson believes in the early '70s, in all countries of the western world, governments and central banks have shown that they can win the fight against depressions where people press them to intervene. These two allies have fiscal policy levers [fiscal policy, n n], (such as public expenditure and taxation) and monetary policy (under public market operations, discount rate mutations, mandatory manipulations in coverage share) to move curves that determine the number of jobs and national income "(Samuleson, 1977).

In this respect, state intervention in the economy makes a series of costs (consumption or investment). How public expenditure are borne mainly from taxes, the character of state intervention becomes a means of redistributing income, increasing or reducing the consumption or investments demand of household.

American economist reveals the existence of "stabilizers incorporated system", of levers acting automatically to mitigate business cycles. Within these, distinguishes the role played in the overall budgetary policy and fiscal policy in particular. It is considered that the tax revenues registered the same trend as national income, increase with this growth and collapse with its decrease. To temper the boom - Samuelson says - it is desirable to create a budget surplus. Or, to create a surplus there are two processes which consist either compressing public expenditure or increase the tax revenues. Also there are two methods to act against a recession, namely increasing public spending or reducing tax rates. We must therefore congratulate ourselves for the automatic flexibility inherent to a certain extent, of our current fiscal system, whose earnings tend to rise during periods of inflation and decrease in times of depression, because it is a strong stabilizing general economic and business cycle phase equalization "(Samuleson, 1977).

In addition, a similar role plays the unemployment benefits and other social transfers. In good times of the cycle, when the degree of use of labor is high, unemployment fund excess withdrawals payments made it, which has the effect of exercise a stabilizing influence on the excess costs. In bad times of the cycle, when unemployment increases, payments from this fund exceed withdrawals, contributing to increasing solvent demand.

Then agriculture support programs act as stabilizers incorporated. In bad times of the cycle, when consumer demand falls and prices collapse capitalization of agricultural products, there is the intervention of the State to take some of the harvest keeping prices at an appropriate level. Later, when there is growth the state liquidated the stocks product, thus removing some of the amounts on the road and maintaining price levels. Paul Samuelson considered however inadequate the action of stabilizing only with automatic action being necessary the usage of other measures alongside these.

5. Conclusion

The outline of the specific Keynesian framework, who provided the theoretical basis for fiscal policy decisions, not only in countries and periods when it turned to scientific theories born on this land has allowed economists to characterize the implementation period as the "Thirty Glorious Years "in the fight against unemployment and economic instability, but they involved some phenomenon with negative impact on the economy, as inflation, which led to the exercise of other minds, equally valuable

5. References

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