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A TEST OF TWO OPEN-ECONOMY THEORIES: OIL PRICE RISE AND JAPAN

Abstract:

Two major open-economy theories are the Keynesian and Monetarist theories. The goal of the study is to empirically discriminate between the two theories. Keynesian and monetarist views about the homeostatic mechanism are fundamentally different and provide a basis for constructing discriminatory empirical tests. The Keynesian theory holds that there is no, or only a very weak, homeostatic mechanism and, in the absence of government intervention, real income tends to remain below the level of full employment. In the monetary interpretation, the homeostatic mechanism is strong, and real income can be treated as though it were exogenous. This study examines the response of Japan to the sharp increase in oil prices in late 1973. The experience of Japan, as an oil-importing country, supports the Keynesian view.

Keywords:

Open-Economy, Competing Theories, Oil Price Rise, Oil Shock, Japan

JEL Classification: F41