# Nick Beams answers letters on Keynesianism

**Nick Beams**
**8 January 2009**

*The following letters were sent to the* World Socialist Web Site *in response to the Perspective, "*The crash of 2008 and the prospects for 2009*". Each letter is followed by a reply from Nick Beams.*

In your article "The crash of 2008 and the prospects of 2009," the author states that "the measures enacted by Roosevelt in the New Deal did not bring about a recovery of the American economy. After a brief upturn in the middle years of the decade, the US economy experienced a major downturn in 1937-38 as steep as anything that had gone before."

Several economists have posited that Roosevelt did not effectively apply deficit spending to alleviate the crisis and that his attempt to balance the budget by cutting government spending after his reelection led to the downturn in 1937. Furthermore, Keynes himself told Roosevelt that more government spending was necessary to increase aggregate demand. Paul Krugman has even posted a graph comparing deficit spending as a percentage of GDP during the 1930s on his blog, which shows a steady increase leading to 1937, when government spending is cut and the GDP declines as a result.

How would you interpret this argument from a Marxist standpoint? Does it hold water, and if so, is it sufficient to just say that the New Deal measures didn't work when in actuality they just were not expansive as needed? Wasn't World War II the Keynesian-sized stimulus needed to finally pull the country out of the Great Depression?

Name: RT

Dear RT,

Thank you for your email.

To answer your question it is necessary to go some way into an analysis of the Great Depression. Within the framework of bourgeois economics there are two basic explanations that have been advanced.

For the past 30 years or so, as I pointed out in my recent lecture, the conventional wisdom has been the thesis first advanced by Milton Friedman in 1963 that the Depression occurred because contractionary policies pursued by the Fed turned what would have been no more than a downturn in the business cycle into a collapse.

Prior to that various Keynesian explanations held sway: that the Depression was the result of too little aggregate demand and hence the way to prevent a crisis was to boost government spending when aggegrate demand fell short of the level needed to establish an economic equilibrium at full employment.

Insofar as they have a theory, Fed chairman Ben Bernanke and other US authorities hold to the Friedman explanation and hence have been pumping liquidity into the financial system since the crisis first broke in August 2007. But with the obvious failure of these measures various Keynesian explanations are now resurfacing.

One of the most widely circulated is by historian James Livingston (*Their Depression and Ours*). According to Livingston the underlying cause of the Great Depression was the increase in productivity coupled with a reduction in the share of wages in national income.

"At the very moment that higher private-sector wages and thus increased consumer expenditures became the only available means to enforce the new pattern of economic growth, income shares shifted decisively away from wages towards profits."

The problem with all such underconsumptionist theories, that of Keynes included, is that they seek to ascribe as a cause of the crisis a permanent condition of the capitalist mode of production. In the very nature of the profit system, the aggregate demand from workers spending their wages will never be enough to purchase all the commodities available on the market. How then does the capitalist economy expand? The driving force of economic expansion is investment financed out of the profits of capitalist industry. As long as investment keeps growing at a sufficient rate, the economy can keep growing.

Consider the US economy from this standpoint. In the years of prosperity from 1923 to 1929 average investment was $18.5 billion a year out of an average national income of $77 billion. In the limited recovery of 1933-37 consumption spending, industrial production and national income almost regained the levels of 1929. But investment spending, which had fallen to as low as $5 billion, did not recover, reaching only about $12 billion in 1937.

They key question is why did investment spending fall and why did it fail to recover? The level of investment is determined by profit expectations. Why were profit expectations so low?

The answer to this question cannot be found so long as one's view is restricted to the United States. In short, the Great Depression can only be understood as a global phenomenon.

Falling investment in the US was certainly not a result of the lack of productivity. Quite the contrary, it is doubtful if there has ever been a period of greater productivity growth in American industry than the period from 1921 to 1929. The underconsumptionists of course point to this as the root cause of the Depression. But underconsumptionism—the fact that the value of workers' wages is less than the value of goods they produce—is a permanent condition of the capitalist economy and cannot be invoked to explain a crisis. We must search elsewhere.

And here the focus must shift to the global economy.

The Depression has sometimes been described as a "realisation" crisis. By this is meant that the surplus value extracted from the working class could not be realised in the form of money because of insufficient demand. But the analysis cannot stop there. The question which must be answered is what is the source of this lack of demand?

Marx observed that the creation by capital of surplus value is conditional upon the expansion of the sphere of circulation, that is, the market. "The surplus value created at one point requires the creation of surplus value at another point, for which it may be exchanged" (Marx, *The Grundrisse*, p. 407).

The increase in the extraction of surplus value in the United States—arising from the development of new methods of production in the 1920s—was not matched in the rest of the world. The constrictions of the European nation-state system meant that the vastly more productive methods of American capitalism could not be developed on the European continent. Rather than the long production runs of American industry, the European economy was characterised by cartels and restrictive agreements. This meant that the surplus value extracted at one point, the United States, was not matched by a sufficient extraction of surplus value at another, Europe.

The US had established itself as the pre-eminent capitalist power. But it was dependent on the European and world market. That was the significance of its entry into World War I. In the 1920s, the US was the chief source of loan funds which sustained the German and European economy in the brief period of expansion in the mid-1920s. But the provision of loans to Europe was not a viable long-term solution.

You cite the experience of the war as evidence that a Keynesian stimulus, if sufficiently large, can provide a solution.

There is no question that war expenditure provided a boost to the American economy. But it could not provide a permanent solution. Here an analogy with medicine suggests itself. A shot of adrenalin can work wonders if the underlying health of the patient is good. But it cannot overcome a chronic condition.

During the war discussion in US economic and government circles centred on the question of what would happen when the war was over? There was a recognition that unless some of the fundamental structural problems of the world economy were resolved then the US would be rapidly plunged back into the conditions of the 1930s—with potentially explosive political consequences.

In order to understand the basic causes of the Great Depression it helps to consider how it was overcome. The reconstruction of Europe—the Bretton Woods Agreement of 1944 and above all the Marshall Plan of 1947—opened the way for the economic expansion of Europe based on the development of American production methods and American investment. But this was only achieved through a war in which hundreds of millions died.

Keynesian measures, including war expenditures, provided an adrenalin-like stimulus, but they did not bring a solution to the crisis of the 1930s. In the present situation they may again provide a limited stimulus. But they cannot overcome the breakdown of the capitalist economy now taking place.

Regards,
Nick Beams

To Nick Beams,

How specifically did Keynesian policy create stagflation in the 1970s, and why can it not help capitalism recover from debt deflation or prevent future stagflation?

Name: Bob

Dear Bob,

Thanks for your email.

The crisis of the 1970s was the outcome of a fall in the rate of profit from the mid to late 1960s. This was not merely a cyclical downturn but signified the exhaustion of the assembly-line (Fordist) system of production that had been developed in the United States in the first two decades of the twentieth century and then extended to the rest of major industrial economies in the period after World War II.

Assembly line methods provided a significant boost to the capitalist economy in the post-war period because they vastly increased the productivity of labour expanding the mass of surplus value extracted from the working class and thereby increasing the rate of profit.

But by the middle of the 1960s this regime of accumulation was exhausted. No longer was it possible to increase labour productivity and profits through this system. In fact, attempts to do so produced a rebellion—the eruption of militant strike action by workers at the Lordstown GM plant in Ohio in 1972 was the most graphic example.

Keynesian measures were unable to resolve this crisis because increased government spending did nothing to resolve the underlying problem of profitability. The injection of additional demand into the economy did not bring about increased production and demand for labour. Rather, firms continued to cut back on labour leading to further unemployment while raising prices in a bid to restore profits. Hence the phenomenon of stagflation—rising prices and increased unemployment—which according to the Keynesian schema should not have taken place.

However, rising prices, the means by which industrial capital sought to maintain profitability, eroded the profits of finance capital—at one point in the late 1970s real interest rates were negative.

The turn came in October 1979 with the appointment of Paul Volcker as chairman of the Fed and the initiation of monetarist policies based on high interest rates. This led to the closure of vast sections of American industry, the development of outsourcing, the introduction of new computer-based technologies and the financialisation of the American economy. Some thirty years on, as I went over in my recent lecture, these processes have now led to a new crisis.

Keynesian measures cannot restore the health of the capitalist economy because they fail to tackle the essential problem: that is the overaccumulation of capital in relation to the surplus value extracted from the working class. Capital seeks to resolve this crisis by intensifying the exploitation of the working class and by the elimination of whole sections of capital through recession, trade war and ultimately military conflict. In short, through a return of the conditions of the Great Depression of the 1930s.

If it were possible to resolve this crisis by the injection of more money into the economy, it would have already taken place. The financial authorities responded to the crisis, which began to emerge back in August 2007, through the expansion of liquidity in the hope that this would bring about a revival as it had in the 1990s and at the beginning of this decade. On this occasion, however, these measures failed and the crisis worsened.

I hope this answers your question.

Regards,
Nick Beams