Nick Beams opening report to SEP summer school

The crash of 2008 and its revolutionary implications

Part 3

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The following is Part 3 of the opening report delivered by Nick Beams, national secretary of the Socialist Equality Party (Australia) and a member of the International Editorial Board of the WSWS, to a summer school held by the SEP in January, 2009 in Sydney. Part 1 *was published on February 4 and* Part 2 *on February 5. The* conclusion *will be published tomorrow.*

I want to emphasise the importance of a global approach, because without it one cannot understand anything about the origins and causes of the Great Depression. And these are not questions of mere historical interest. The Great Depression, in fact, has become something of a hot political issue as the Obama administration prepares its so-called stimulus package, and various Keynesian and "left" economists around the world take the field to argue that if only the measures they proposed were adopted with sufficient vigour, then the crisis now besetting the US and world capitalist economy could be overcome.

John Maynard Keynes was very conscious of his *political* role when he sought to demonstrate that government intervention in the economy, based on increased spending, could overcome the problems of capitalist economy. His political aim was to prevent socialist revolution.

As he explained in his open letter to President Roosevelt at the end of 1933: "You have made yourself the Trustee for those in every country who seek to mend the evils of our condition by reasoned experiment within the framework of the existing social system. If you fail, rational change will be gravely prejudiced throughout the world, leaving orthodoxy and revolution to fight it out."

In a lecture delivered at Colombia University in June 1934, Keynes insisted that the economic problem was no longer how each individual firm could produce more, but how sufficient effective demand could be ensured so that each firm produced what it was capable of producing. If this "new problem" were not solved then "the existing order of society will become so discredited that wild and foolish and destructive changes will become inevitable."

For Keynes, the crisis of capitalism did not stem from inherent processes within it, much less objective laws, but from incorrect ways of understanding it. In the introduction to his *Essays in Persuasion*, published in 1931, he summed up his position as "the profound conviction that the economic problem, as one may call it for short, the problem of want and poverty and the economic struggle between classes and nations, is nothing but a frightful muddle, a transitory and *unnecessary* muddle."

The cause of the crisis, Keynes maintained, lay in intellectual error. The cure, therefore, lay in correct reasoning. This, as his biographer Robert Skidelsky notes, was his answer to Marx. If the leaders of capitalism did not change course and stop screwing down the wages of workers in order to restore profits, then a class war could arise that would vindicate Marx. These issues have lost none of their relevance.

Analyses of the Great Depression have always been profoundly political, because no single economic event—with its horrific consequences, mass unemployment, fascism and war—has demonstrated more clearly the historical bankruptcy of the capitalist mode of production.

Political considerations certainly lay at the heart of the analysis advanced by Milton Friedman in his book *A Monetary History of the United States*, co-authored with Anna Schwartz and published in 1963. Friedman, one of the foremost advocates of the "free market", was eager to demonstrate that there was no inherent problem within the capitalist economy that could have caused such a disaster. Hence he was anxious not only to refute the Marxists, but also the Keynesians, who ascribed the Depression to the lack of effective demand and called for government intervention in the capitalist economy.

According to Friedman, the fundamental cause of the Depression was the contractionary monetary policy pursued by the Federal Reserve, which reduced liquidity, especially in the banking crisis of 1932, and turned what would have been a normal downturn in the business cycle into a catastrophe.

In Friedman's view, an expansion in the money supply could have prevented the collapse and would have been implemented if only different personalities had been in charge at the Fed. Why were they not? Friedman traced the problem back to the death of Benjamin Strong, the governor of the New York Federal Reserve in 1928. His departure altered the balance in the Federal Reserve and left it without effective leadership.

This explanation fails to stand up to even the most preliminary examination. There is no evidence that even with Strong present, the policies of the Fed would have been any different. After all the Fed's approach to the crisis of the 1930s was essentially the same as its response to the severe contraction of 1920-21. Its expectation was that the economy would revive, just as it did in the "roaring twenties".

Despite its intellectual poverty, the Friedman thesis has theoretically guided the US Federal Reserve. The present Fed chairman summed up his view in a speech in 2002, on the occasion of Friedman's 90th birthday. Describing the Friedman and Schwartz analysis as a powerful case, he concluded: "Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again."

In the wake of the stock market crash of 1987, US financial authorities, first under the Fed chairmanship of Greenspan and then of Bernanke, followed the Friedman prescription. Every financial crisis or potential crisis has been met with a lowering of interest rates and an expansion of credit. And for almost 20 years these methods have appeared to work.

Financial crises have erupted, but these have passed relatively quickly following the injection of liquidity into the financial system, which has created the conditions for a new boom.

However, with the emergence of the so-called sub-prime mortgage crisis—itself a result of the financial bubble created in the wake of the share market bubble collapse of 2000-2001—these methods stopped working. The expansion of liquidity failed to halt the crisis, which only deepened as banks and other financial institutions stopped lending to each other.

The collapse of the entire "free market" order has given a new lease of life to the Keynesians. They maintain that the crisis can only be resolved with a return to government intervention and stimulus packages.

When one points out that the New Deal measures failed to end the Great Depression, they reply that the problem was that they were not pursued with sufficient vigour. To the argument that the nine-month decline from September 1937 to June 1938 was, in the words of one historian of these events, "without parallel in American economic history" and "the sharpest decline in any period for which there are statistical data" (Kenneth D. Roose "The Recession of 1937-38," *The Journal of Political Economy*, June 1948) they insist that the downturn following the recovery of 1933-37 resulted from Roosevelt following bad advice when he lifted tax rates.

Furthermore, the Keynesians maintain that the economic recovery that took place in the wake of government war spending proves their case. Government spending, they argue, will work provided it is sufficiently large. Capitalism can, indeed, be regulated to meet social needs. The present crisis is not, as the Marxists maintain, a product of the irreconcilable contradictions of the capitalist order, but stems from the abandonment of the wisdoms of the Keynesian program in favour of the nostrums of the "free market" agenda over the past 30 years.

I shall deal with these issues by firstly examining them theoretically and then historically, with a review of the origins and resolution of the Great Depression.

The basic theoretical fallacies of Keynesianism are rooted in its incorrect assessment of the nature of the capitalist economy. The driving force of the capitalist mode of production is not the production of use values or consumption, but the accumulation of capital through the extraction of surplus value. Thus the key question is: what impact do Keynesian measures—based on increased government spending—have on this process? What is their impact on profits?

For the Keynesians the key problem is the lack of effective demand. If there is a lack of demand then the goods that have been produced cannot be sold. If the firms that have made them cannot sell them, they must cut production. This will lead to a reduction in demand for the goods that the firms themselves purchase, creating a further reduction of effective demand, and so on. The key issue, then, is to restore the level of effective demand so that the economy begins to expand again.

Let us look at this more closely. What is effective demand? It consists of two components: the demand of workers for consumption goods and the demand of capitalist firms for production goods. Workers' demand for consumption goods—a demand based on their wages—can never provide a sufficient market for capital to realise its profit, because the price of consumptions includes the profits going to capital. In other words, underconsumption by the working class *always* occurs. This flows from the nature of capitalist production itself. The value of labour power—the wage the worker receives—is *always* less than the value that worker adds in the production process. The difference is the source of surplus value and profit.

The source of the crisis cannot, then, be the underconsumption of the workers, because this is a permanent condition of the capitalist mode of production. The level of effective demand must be determined by the other component, the demand of capitalist firms for production goods. And the level of this demand will be determined by the rate of profit. If profits are expanding, then investment spending will grow. If investment spending grows then more workers will be employed in the industries producing these goods. If more workers are employed then consumption spending will grow and the economy as a whole will expand.

Keynes emphasised the decisive role of investment. He saw its decline as the outcome of pessimistic conclusions being drawn from the state of the market. But if the psychology of capitalist businessmen and their propensity to invest is determined by the state of the market, we are back to the same question: what determines the state of the market?

There is no question that a crisis or depression takes the form, in the market, of a lack of effective demand. But that lack of demand is the appearance-form of a process that has its origins not in the market, but in the sphere of production.

Let us look at this more closely. Every capitalist firm is confronted with the dictates of the market. It is through the market that each capitalist firm realises—turns back into money—the surplus value it has extracted from the working class, or, to put it more accurately, participates in the appropriation of the total surplus value that has been extracted from the working class as a whole.

In order that the profitability of any particular section of capital can increase, the market as a whole must expand. This expansion occurs through the increased extraction of surplus value by other sections of capital.

As Marx put it, the creation by capital of surplus value is "conditional upon an expansion, specifically a constant expansion, of the sphere of circulation. 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).

What effect does increased consumption spending—whether directly by the government or indirectly through tax concessions—have on the accumulation of surplus value? It does not increase it. In fact, insofar as additional government spending has to be financed by the creation of debt, it may worsen the problem in the long run by increasing bond holders' interest claims.

Increased government spending may lead to economic expansion, that is, to a rise in national income, for a period. But it will not, of itself, bring about an increase in the accumulation of surplus value and the rate of profit.

Let us take an analogy from the sphere of medicine. If a young person receives an electric shock that stops their heart, then a shot of adrenalin that starts the heart beating again will save that person's life. The adrenalin works because this is the heart of a healthy young person. But if the heart is seriously defective, then no amount of adrenalin will resolve the underlying problem.

In the capitalist economy, if the production regime is healthy—if it continues to pump out sufficient surplus value—then a shot of economic adrenalin in the form of increased government spending can work wonders. But not if the economic pumping mechanism is defective or worn out, not if the arteries through which surplus value flows have become sclerotic.

On the basis of these theoretical considerations, let us return to the historical development of the Great Depression.

Writing in 1933, the British economist Lionel Robbins noted: "We live, not in the fourth, but in the nineteenth year of the world crisis." He meant that the crisis began, not in 1929 but in 1914. Taking this approach enables us to gain a correct understanding of the causes of the Great Depression.

The eruption of the world crisis in the form of World War I came, as we have already noted, at a turning point in the curve of capitalist development. After a stormy period of growth from the mid 1890s, profit rates began to turn down. This was not simply a fluctuation in the business cycle but, as the subsequent failure of the European economy to recover in the post-war period demonstrated, a new phase of economic development.

In the 1920s, many observers were able to see how capitalism could advance: the European economy would have to be reconstructed on American lines, utilising the vastly more productive American methods in order to expand. But this was impossible. The war itself had arisen out of the conflict between the expansion of the productive forces and the constrictions of the nation-state system. Far from alleviating this conflict, the war's outcome—the Treaty of Versailles—only worsened it.

European industry's expansion, the introduction of long run methods of production, was hemmed in by tariff walls, cartels, agreements to restrict production, and national borders.

At the same time, the United States was undergoing rapid growth. But it was no longer self-sufficient. For American economic expansion to continue required an expansion of the European economy. The extraction of surplus value from the working class through the vastly more productive methods of American capitalism required the extraction of increased surplus value in Europe. That could not take place, and the result was the collapse of the American economy in 1929. In other words, while the Depression took the form of a collapse in effective demand, its cause was not underconsumption, but the under-production of surplus value, above all in Europe.

The Great Depression was not a crisis that started in one country and then spread to the rest of the world. It was a global crisis, which found its most dramatic expression in the world's two most productive economies, the US and Germany.

If the collapse was so marked in the United States, it was because the European economies had never really emerged from the depressed state into which they had entered after the war. And if it was so sharp in Germany, it was because no economy was so constricted by the European nation-state system—a restriction the German bourgeoisie sought to throw off when it backed Hitler, in the hope that he would prove capable of establishing *Lebensraum* through military conquest in the East.

Rather than Roosevelt's New Deal providing a way forward for American capitalism, it was precisely its failure that convinced US ruling circles that only a complete reconstruction of the entire world order could resolve the historic impasse that had led to the Great Depression. The way had to be cleared for the more productive methods of American industry. As Trotsky explained in November 1933: "Sooner or later American capitalism must open up ways for itself through the length and breadth of our entire planet." That task would be carried out, he wrote, by every means available, including war.

Clearing the way for American capitalism meant that German plans for an empire on the European continent had to be thwarted. Likewise, Japanese plans for an empire in the East, the so-called Co-Prosperity Sphere. It also meant, as Churchill discovered when he met Roosevelt in 1941 to discuss the Atlantic Charter, that American visions for the post-war world did not include the British Empire, with its closed doors and imperial preference agreements on trade and finance.

The post-war restructuring, expressed in the Bretton Woods Agreement of 1944 and the Marshall Plan of 1947, provided the economic foundations for a new period of capitalist expansion. These measures opened the way for the extension of American industrial methods, with their higher productivity of labour and greater extraction of surplus value, and the expansion of American investment, to the rest of the world.

Within a period of less than three decades, however, all the fundamental contradictions of the capitalist mode of production were to re-emerge. The story of the collapse of the Bretton Woods monetary system in 1971-73 can be told in terms of the excess of dollars circulating throughout the world compared to the gold stored in the US that was supposed to back them. But this was only the expression of a more fundamental process: the contradiction between the growth of the world economy, which the post-war monetary system had itself made possible, and the grounding of that monetary system on the currency of a single nation-state—even the most powerful—the US. In other words the contradiction between world economy and the nation-state system had resurfaced. In the wake of the collapse of Bretton Woods, every proposal aimed at devising some kind of stable international unit of account foundered on the conflicting national interests of the major capitalist powers, just as had Keynes's earlier proposal for an international currency.

The other contradiction to which we have pointed also re-emerged. The world recession of 1974-75 resulted not simply from an escalation in oil prices, These were only a trigger. It stemmed from a downturn in the rate of profit that started to emerge from the end of the 1960s. The curve of capitalist development had entered a downswing.

I traced the ensuing developments in my lecture The World Economic Crisis: A Marxist Analysis in December, so I will not repeat the points I made there, except to emphasise the central issue. The breakdown into which world capitalism entered in 2008 was not the outcome of bad policies, or a flawed understanding on the part of bourgeois policy-makers that can now, somehow, be corrected. It resulted from processes that had themselves been set in motion by the crisis of the early 1970s and which were lodged in the economic and historical logic of the capitalist mode of production itself.

To be continued