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FAILED AND SUCCESSFUL CAPITALISMS: LESSONS FROM THE TWENTIETH CENTURY.

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Bard College
A talk prepared for the Jerome Levy Economics Institute
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Introduction

Outline

1. THE ELECTION RESULTS HAS LED ME TO CHANGE MY TALK

The emphasis is still on the century as a whole

My main points are

1. The experience of the twentieth century provides material supporting the proposition that the big government interventionist capitalism that was developed as a reaction to the great depression was a more successful economic system than the largely laissez faire capitalism that ruled for the first third of the century.

It is not true that government which does the least is best.

However Capitalism, and especially big government capitalism comes in many forms:

There are as many possible forms of capitalism as Heinz has of pickles

It is necessary to distinguish among big governments which are military states, which rely upon transfer payments and those that emphasize resource development.

One problem with big government capitalism is of course corruption both of the overt kind and the covert kind in which the jobs that government undertakes are done poorly because of a lack of worker performance.

Over the 20th century big government capitalisms have in general been more successful than small government capitalisms, but that the form which big government capitalism takes has an effect in determining the overall performance of the economy.

My theme is simple. My reading of history is that the 20th Century can be divided in three parts. The first third ended in 1933 with Capitalism in the United States and Western Europe a colossal failure.

The second third which ran from 1933 until around 1968 or 1970 spanned an era that has been characterized by some as a Golden Age of Capitalism.

The third third will end in 2000: so far this third period has been characterized by comparative failure: the American Economy is neither the disaster that it was in 1933 nor the great success of the 1950's and 1960's. The period from say 1968 to date is an unsatisfactory performance only when measured against the performance of 1933-1968, it is not as yet a failed economy as failure was revealed in 1933.

However, in this last third of the century, ominous signs of financial instability occurred.

PROFITS

The profit equation and the failure of capitalism
Gross profits equals = investment + government deficit + surplus on international trade - savings out of wage incomes + consumption financed by income from capital. (i.e. financed by dividends, interest payments etc)

But business gross profits are committed to the fulfillment of debt contracts even as investment in excess of internal funds needs to be financed by some combination of debts and external equity investments.

My explanation for the progression of the 20th century: absolute failure - success - comparative failure centers around the role of government in sustaining profits when "investment", the "normal" sustaining device for "profits" in a "capitalist" economy, breaks down.

In a small government minimum international trade involvement the equation for profits reduces to
profits = investment + consumption financed by capital income - savings out of wages.

Stylized Facts:

In 1929 gdp = \$ 100 billions
Government spending = \$ 3 billions
At most a no tax government could run a deficit that is 3% of prior peek gdp. This was not enough to offset the

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collapse of investment which took place between 1929 and 1933: (in fact the government ran a surplus in 1929)
Now (1990) GDP 5,546 billions
government spending 1,252 billions > 20% of GDP
In 1990 the government deficit was 221.4 billions or 4% of GDP

There are side effects of any policy that the big government uses to stabilize profits, and there is a necessity to contemplate forms of big government capitalism which can be alternatives to the welfare state which became the dominant form of capitalism as the combined cold war-welfare state was ended

Understanding the scope of possible forms of capitalisms is of greater importance today than it was a short time now that world for the foreseeable future will be capitalist. Even as the countries of the former Soviet bloc are in the process of creating capitalisms the rich capitalist countries, such as the United States and Western Europe, are in the process of reforming their big government capitalism.

I believe that it was the Pope who said that the proposition "**Capitalism is a success**" does not follow from the proposition "Communism was a failure". Ideology is supposed to be dead. But as we saw in recent elections Ideology is very much alive. Commentators have reported a mean streak of resentment running through the United States and the other rich capitalist economies. Simplistic and

often foolish solutions for what troubles the country, such as the balanced budget amendment, take the center stage of the public discourse.

It is necessary to raise the level of the public discourse, to make an economics which embodies a sense of history and institutions the framework around which the analysis of "what is to be done" revolves. One necessary step to the achievement of a policy relevant economics is to take a critical look at today's "American Capitalism"

Now that the whole world will be capitalist we have to recognize that there are different forms of capitalism.

There are as many varieties of Capitalism as Heinz has of pickles. This may account for the relative success of capitalism: it is like a bacterium which confronts a new antibiotic. For a time the new antibiotic is effective but the bacterium mutates and the virus loses its effectiveness. Capitalism is a surviving economic system to the extent that its institutions are allowed to change. When institutions are frozen, capitalism doesn't perform well: the citation may well be the land tenure systems in Latin America.

There is an aside to the above which may account for the failure of the Lenin - Stalin Communism: it became frozen institutionally and could not adapt to the decentralizing force that came with modern communication and engineering. The freezing of a 1920's style of industrial plant, the style of Chaplin's modern times, was a characteristic of Lenin Stalin Communism: this is a style of plant which is no longer contemplated in the capitalist world.

There is a message in the Soviet failure which we should heed. Those who talk or write of a "true" capitalism, as some non-interventionist form that is consistent with a particular reading of a sacred text, such as Adam Smith's Wealth of Nations or Hayek's The Road to Serfdom, and from this premise draw the conclusion that the

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observed failures of a real world capitalism are due to its deviation from a "true" model do not appreciate that market economies need a great deal of institutional infrastructure to work and this infrastructure evolves in response to gain seeking by the agents who make up the economy.

In thinking about the various forms of capitalism it is desirable to distinguish between small government laissez faire forms, in which government intervention is minimal, and big government - interventionist capitalisms. Among big government interventionist capitalisms I want to differentiate between those that are mainly populist and equalitarian and those that are repressive and defenders of an inherited political and social hierarchy. We need to recall that the Fascist, Nazi and colonial regimes were capitalist as were the Scandinavian countries of the post war era.

As the twentieth century draws to a close we need to extract lessons from this century in which progress was inexorably intertwined with horrors and disasters. An exercise which aims at extracting lessons from history could deal with big questions such as the meaning of success and of failure, of progress and decline and whether a common morality exists and, if it exists, its significance. I am not going to try to extract lessons about big philosophical and moral questions.

I wish to limit the discourse or concentrate our vision on a narrower set of questions all dealing with the success

or failure of economic structures. This grim century has seen the rise and collapse of the Soviet model of Socialism, which was an economic order based upon an extreme rejection of the use of markets to determine economic outcomes.

But earlier in this century, in the winter of 1932-33, the advanced economies based upon the use of markets were abject failures. One evaluating economies from the perspective of the mid 1930's would start from the observation that market economies "break down" and therefore conclude that there is a need to alter if not to abandon the market way of organizing economies.

However after the collapse that culminated in 1933, as well as during the first twenty five years after the end of World War II, a mighty recovery and expansion occurred in the United States and in the capitalist economies of Western Europe. However this recovery and expansion was of a model of capitalism which differed radically from the model of capitalism that collapsed in 1932-33. The welfare state capitalisms of the postwar period were more successful economy than the largely laissez faire pre-war economy.

Need to talk not of the welfare state but of the military spending welfare State.

Beginning about 1968 to 1970 the success of the military - welfare state began to slacken, to run down. Some impute the decline to the oil shocks of the 1970's which led to a large transfer of wealth from the advanced and emerging economies to the oil producing states. Others,

and I am one of the others, put relatively more weight on the growing fragility of the financial structures of the capitalist economies. What was true was that the 1970's was a period in which the real growth of the principal capitalist economies slowed down and a decade of price level inflation began. The constraints of the Bretton Woods monetary system on the United States led to an abandonment of the United States of its core position in maintaining essentially fixed exchange rates. The "cure" for the inflation which followed upon the abandonment of the quasi gold standard and the multiplication of the price of oil was a regime of extraordinary high interest rates at the end 1970's and into the 1980's. This led to a set of serious recessions and a breakdown of the financial institutions that were based upon a pattern of interest rate stability which made long term debt financing a backbone of the housing system of the United States.

This cursory summery of economic developments over this grim century indicates that history has much to teach us about the varieties of capitalism that existed and how they behaved. The early part of this century was a largely though not a completely laissez faire system. The middle part was in the United States a big government capitalism. The third part of the century was a period in which the success of the 2nd third was attenuated but which did not fall into anything like the disastrous performance of the

1st third. We need to extract from history ideas about what makes a capitalist economy a successful economy.

We can also extract from a reading of history some of lessons how about how the success of an economic system is linked to social and political developments. In order to do this I will emphasize developments in the United States with some asides upon developments in what are now the rich market economies. I will not deal with the abject economic failures of the African nations, both North and South of the Sahara, the chronic stop go progress of the Latin American economies, nor with the recent success of the Asian Tigers.

For the remainder of this century and the first part of the next the countries of Central and Eastern Europe will be occupied with creating capitalism. The rich Capitalist countries of Western Europe, the United States, Japan and some of the former British Dominions, will be occupied with trying to capture once again the glories of the period during which capitalism was a great success. This will involve reforming the current structure and in an effort to make Capitalism work once again as well as it did in the aftermath of the great depression. Now that the whole world is setting out to be Capitalist, the problems of the era we are entering will be to create capitalism, reform capitalism and make capitalism succeed.

Thus like Gaul for Caesar, the performance of the United States United State's economy during the 20th century is divided in three parts. The first part ran from the

beginning of the century to the collapse of Capitalism in the winter of 1932-33. The second part runs from 1933 until about 1968 and the third part runs from 1968 until now. Similarly the political history of the United States falls into three parts.

The first third from 1900 until the election of 1932 had eight presidential administrations of which 6 were Republican and only two, the Wilson years, were Democratic. The second third running from 1932 until 1968 had nine administrations seven of which were Democratic. Only the two Eisenhower administrations were Republican. The third part of the century will have eight administrations of which we know seven: the split to date is five Republican and two Democratic terms.

Capitalism was a abject failure in the winter of 1933, not only in the United States but also in the then developed economies. Although there were runs of good times during the first thirty three years of the century - the boom after the first world war in the United States being one of these runs - a serious depression took place in 1907 and around 1922. That of 1907 led first to the setting up of the National Monetary Commission and this in turn led to the establishment of the Federal Reserve System. The great contraction, which ushered in the crisis of 1933 that marked the virtual collapse of capitalism, took place between October 1929, when the stock market crashed, and March of 1933 when the banking system was shut down.

Even aside from the great contraction the overall performance of the economy during this first third of the century was mediocre: what prosperity there was poorly distributed and a succession of depressions racked the land. However the failure over the 1929-1933 period was well nigh unique in that all sectors of the economy suffered.

In many ways the literature about the Great depression catches the flavor of the collapse better than a mere recital of the statistics. We all know *The Grapes of Wrath*, in the film version if not in the novel. However the *Oakies* of the 1930's collapse were but the victims of just another farm crisis: *A Grapes of Wrath* could have been written of the era that led to *Coxey's Army* in 1894. The landmark William Jennings Bryan "Cross of Gold" speech of 1896 was a reflection of a chronic crisis in agriculture.

Arthur Miller's play, "*The Price*", captures the special property of the Great Contraction of 1929-33 in that its theme is how the Great collapse impacted the well to do along with workers and farmers who were the usual payers of *The Price* that depressions extracted. The singular impact of the great contraction was not in the fall of output prices by about 1/3 or in the estimated 25% unemployment rate: the extraordinary impact was upon the price level of assets. One representation of the price level of assets is the Dow Jones index of stock prices. By 1933 the Dow Jones was some 15% of its peak value: it had fallen by 85%. This fall in stock exchange prices was associated with a massive

decline in urban real estate values, in the price of agricultural land, the bankruptcy of "blue chip" railroads and utilities, and a rash of bank failures. Not only did stock prices fall but "safe" assets such as savings deposits and bonds lost value relative to the decline in prices. These developments in asset prices meant that an unprecedented impoverishment of the well to do took place. For them, who had been the main beneficiaries of the good times of the 1920's, capitalism suddenly failed.

This first third which ended in the spring of 1933 was followed by some thirty five years which led to the United States being a roaring success, albeit that the political and economic hubris that this success bred led to the United States sashaying into intervening and defeat in Viet Nam. The last third of the century, starting from 1968 is still incomplete, but the indications for the performance of the economy is that nothing as severe as the debacle of 1929-33 is likely to happen, but the performance is not up to the standard set in the middle third of the century.

We do not want to make too much of this division, but Democratic Administrations are associated with the transformation of failure into success and Republican administrations are associated with outright debacles as well as the deteriorating behavior which transforms successes into relative failure.

Through much of the 20th century there is a difference between the two parties views of the economy. Republicans

tended to reflect a faith in letting the markets determine outcomes whereas the Democrats reflect a wariness towards accepting the claims made for the market way of organizing economies. There is a difference in their views of how well the market economy functions if left to its own measures.

Full Employment in a Free Economy

This was the title given by Lord Beveridge to the book which contained his prescription for Economic Policy after World War: His definition of full employment was not stated as a measured rate of unemployment, at which point the analyst assumes that a further decrease in measured unemployment will lead to an unacceptable rate of inflation. Beveridges' definition of full employment was a market condition: At the ruling money wage the number of job vacancies had to exceed the number of unemployed. To Beveridge the aim of policy is to keep labor markets "tight".

The problem which the Beveridge conception of full employment leaves open is whether such tight labor markets would put so much upward pressures on money wage rates, and thus on the money costs of production, that unacceptable and accelerating rates of inflation result. To present day economists the question of full employment becomes a question of the trade off between inflation and employment.

Employment policy during the first New Deal (1933-1936) era in the United States reflected two "ethical principles":

1. no one will starve in the United States, and in the normal course of events
2. income from work sufficient to achieve the no starving state will be available to all.

From 1 and 2 WPA, NYA, and CCC follows as principle devices to assure employment.

A POLICY AGENDA

This highly stylized disaster, practical best or well nigh golden age, and deteriorating performance reading of the economic performance of the United States - and the other principal capitalist economies - during the 20th century can be interpreted fatalistically as the playing out off a long wave in economic life, which is usually labeled as a Kondratiev cycle. However as the major driving forces of a capitalist economy profits earned by owners of capital assets and investments made by profit seeking enterprises exploiting perceived profit opportunities are supplemented by government spending, in the form of transfer payments and the purchase of goods and services, and a favorable balance of trade. These complicating factors in the determination of profits mean that the way the century unfolded was not the inevitable outcome of economic forces. What happened was the result of the particular twist given to the economic outcome by the manner in which the self seeking behavior of households, businesses

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rough guess adds 2 million to labor force

Propose raising it over 10 years, Increase age of eligibility for both full and reduced coverage every six months. 100,000 every six months.

some 200,000 per year added to labor force.

Begin with an older adult job corps that has 200,000 positions. Not means tested

while in job corps social security taxes withheld and paid by government. Medicare coverage begins at 65 whether employed by job corps or by private employer.

at \$ 9,000 per year 1st year this equals 1.8 billion,

in addition some 200,000 in a CCC type affair which the military uses and which is housed in barracks on active military bases to do supplementary non armed work on the bases. Add 1.8 to military budget for this activity.

The older adult job corps which may do supplementary teaching in schools etc can increase at the rate of 33,000 per month until it settles down to say