How much is enough?

Alan Freeman

University of Manitoba

8. February 2009
How much is enough?
By Alan Freeman, University of Manitoba

Abstract
This article assesses the extent and nature of the stimulus that will be required to end the economic crisis that opened in 2008. It compares the present economic situation to that which opened in 1929 and studies the relation between state spending, investment, and employment.

Keywords: Credit Crunch, Investment, Liquidity Preference, Rate of Profit, State, Welfare State, War
How much is enough?

By Alan Freeman, University of Manitoba

How much is needed to get us out of the crisis? From the historical evidence, a lot more than we’ve seen so far. Obama’s stimulus, at five per cent of GDP, outstrips all others in the Western world—which on its own sheds doubt on them. Yet even this may not be enough.

All but the wilfully stupid now know this is no ‘ordinary’ recession. Downturns like 1974 pale into insignificance beside it. Only two crises in modern history – 1929 and 1893 – compare with it. With few exceptions, economists in Bush’s inimitable words ‘misunderestimated’ this from day one.

It is driven, like those of ’29 and’93, by a failure of investment, in turn caused by a system-wide crisis of profitability. When the return on capital sinks to present levels, investors simply retreat from productive investment into ever more irrational speculation.

This occurs rarely, but when it does, the conventional belief that ‘the market always works’ is worse than useless. One must be guided not by doctrine but the facts. It is an open secret that Obama has expressed more interest in the 1933 US ‘New Deal’ than in the views of his closest economic advisors. So let’s take a look at it.

Who blessed America?

By 1933, US unemployment reached the unprecedented level of 25%. It’s not hard to see why: capital stopped investing. By 1932, private investment of all types had fallen to the all-time low of 2.2 per cent of GDP, from 15.9 per cent only three years earlier.

An investment failure goes beyond lack of demand. You can cut taxes and interest rates as far as you like, but unless investors put their money where their large mouths are, the economy goes nowhere fast. The state has to step in directly. In words used by Keynes but conveniently ignored by his recent converts, it must ‘socialise investment’. But on what scale? Like Obama – but two years too late – the New Deal hiked state spending by five per cent of GDP, cutting unemployment to 16 per cent until the mini-recession of 1937-38.

Cool – but not a recovery. The ‘golden age’ boom of 1942-1968 finally saw the back of the depression. It dates not from the New Deal, but the War. Between 1938 and 1944, government spending trebled, approaching half of GDP – compared with a miserable three per cent from private investors. And when the war was over, state investment stayed at double its prewar level despite repeated foolish attempts to cut it back. This was what it took, economically, to ‘solve’ the crisis.

It’s common to speak as if the war was ‘economically abnormal’. Well, so is the present situation. So here’s an ‘uncomfortable truth’: before the US economy saw a meaningful recovery, the state took over half its economy, supplanting private investment for three years, and following that, retained both investments and spending which were double their prewar levels.
And it happened in wartime, when private investors accepted measures they would not tolerate in peacetime. That’s food for thought. It means the way out of the crisis involves something never seen before – wartime state involvement on a peacetime basis.

In simultaneous polls in the USA and Canada, two-thirds of those interviewed said that they wanted direct state spending instead of tax cuts – a historic shift of opinion. North American economists haven’t caught up and, according to the Wall Street Journal, are still arguing for tax cuts – which just means they want the poor to pay. This is so last Millenium. As France and Iceland show, it won’t play in Peoria.

Maybe it’s time the politicians stopped listening to their economic ill-advisors, and started listening to their own people – and the lessons of history. Capital, move over. Public, move in.