Solutions to the Global Economic Crisis: Keynesian Myths, Hopes and Illusions

By Prof. Ismael Hossein-Zadeh
Global Research, November 05, 2011
5 November 2011
Theme: Global Economy, History

The Keynesian view that the government can fine tune the economy through "appropriate" fiscal and monetary policies to maintain continuous growth at or near full employment is based on the idea that capitalism can be controlled by the state and managed by professional economists from government departments, that is, capitalism run by "experts" in the interest of all. Economic policy making according to this view is largely a matter of technical expertise or economic know-how, that is, a matter of choice.

The effectiveness of the Keynesian model is, therefore, based largely on a hope, or illusion; since in reality the power or control relation between the state and the market/capitalism is usually the other way around. Economic policy making is more than simply an administrative or technical matter of choice; more importantly, it is a deeply socio-political matter that is organically intertwined with the class nature of the state and the policy making apparatus.

The Keynesian illusion has been nurtured or masked by two major myths. The first myth stems from the perception that attributes the implementation of the New Deal and Social Democratic economic reforms that followed the Great Depression and WW II to the genius of Keynes. This is a myth because those reforms were more a product of the fierce class struggle and overwhelming pressure from the grassroots than that of the brains of experts like Keynes. The harrowing socio-economic turbulence of the 1930s generated momentous social upheavals and extensive working class struggles. The ensuing "threat of revolution," as FDR put it, and the "menacing" pressure from below prompted reform from above—independent of Keynes.

As a relatively well-known academic/economist, however, Keynes provided the theoretical or intellectual rationale for the badly-needed reforms in order to save capitalism by fending off revolution. The auspicious coincidence of the publication of his famous book, The General Theory of Employment, Interest and Money (1936), with the implementation of the New Deal-type economic reforms in the US and Western Europeprovided Keynes with much more credit for those reforms and the subsequent economic recovery than he deserved.

The second myth is based on the view that attributes the long economic expansion of the 1948-1968 period in the US and Europe to the efficacy or success of Keynesian policies of economic management. While it is certainly true that expansionary government policies of the time played a big role in the fantastic economic developments of that period, other factors contributed even more to the success of that expansion. These included the need to invest and rebuild the devastated post-war economies around the world, the need to supply the vast post-war global demand for consumer as well as capital goods, lack of competition for US products and capital in global markets—in short, the fact that there was enormous room for growth and expansion in the immediate post-war period.

Harboring these myths and illusions, many Keynesian economists envisioned a silver-lining in the 2008 financial meltdown and the ensuing economic crisis. For, in the “crisis of Neoliberal economics,” they saw an opportunity for a new dawn of Keynesian economics, or the coming of a second New Deal. Well-known Keynesians such as Paul Krugman, Joseph Stiglitz and Dean Baker wrote (and continue to write) passionately on the need to revive Keynesian policies, to implement extensive stimulus packages, to reinstate the Glass Steagall Act and other regulatory measures that were put in place in response to the Great Depression. The excitement on the part of many Keynesians about the prospects of what they perceived as an almost automatic switching of policy gears from Neoliberal to Keynesian economics led George Mellon of the Wall Street Journal to write (sarcastically)” We’re all Keynesian’s Again.”

More than three years later, it is abundantly clear that Keynesian policy prescriptions are falling on deaf ears, as Neoliberalism continues to keep Keynesianism at bay. Indeed, even the nominally socialist and Social-Democratic economies of Europe have adopted the unbridled austerity policies o Neoliberalism.

Shunned, Keynesian hopes and illusions have turned into disappointment and anger. For example, using his New York Times’ column, Professor Paul Krugman frequently lashes out at the Obama administration for ignoring the Keynesian policies of economic expansion and job creation and, instead, following policies that are not very different from those of Neoliberal Republicans. “The truth is that creating jobs in a depressed economy is something government could and should be doing. . . . Think about it: Where are the big public works projects? Where are the armies of government workers? There are actually half a million fewer government employees now than there were when Mr. Obama took office.”

Let me repeat the essential part of Professor Krugman’s statement: “The truth is that creating jobs in a depressed economy is something government could and should be doing.” This is exactly what I call Keynesian illusion: the belief in the ability of government to control and/or manage capitalism; the perception that government “could and should” invest in job creation but, somehow, does not do it now. Yes, a government could and should invest in job creation; but that would be a different government, a disinterested government independent of special interests, not the Obama administration (or the US government more broadly) that is beholden to the big money for its election/reelection. It is true that a capitalist government may occasionally invest in economic growth and job creation; but those would be occasions when such policies are perceived to be also serving the interests of the ruling class (as in the aftermath of the Great Depression and WWII).

It is obvious that the Keynesians’ disgust with the Neoliberal policies of the government of big business is misplaced. At the heart of their frustration is the unrealistic perception that economic strategies and policies are largely intellectual products, and that policy making is primarily a matter of technical expertise and personal preferences: economists and/or policy makers who are far-sighted, good-hearted, or better equipped with “smart” ideas would opt for “good” or Keynesian-type capitalism; while those lacking such admirable qualities would foolishly or misguidedly or heartlessly choose “bad” or “Neoliberal capitalism” [1].

As I have pointed out in an earlier critique of Keynesian economics, it is not a matter of “bad” vs. “good” policy; it is a matter of class policy. Keynesians are angry because they tend to be oblivious or shy away from the politics of class, that is, the politics of policy making. Instead, they seem to think that economic policy making results mainly from a battle of ideas and theories, and they are disappointed because they are losing that battle.

Professor Krugman passionately writes, “Where are the big public works projects? Where are the armies of government workers?” What he fails to mention is that those “armies of government workers” were put to work not courtesy of FDR, or because of Keynes’ brilliant ideas (in fact, when the FDR administration initially embarked on the implementation of the extensive public works projects it did not even know Keynes was alive), but because much larger armies of workers and other grassroots threatened the capitalist system by persistently marching in the streets and demanding jobs. It is interesting that many Keynesian economists admirably fight (of course, in the realm of ideas) for the rights of workers but shy away from calling on them to rise up to demand their rights.

It is not enough to have a good heart or a compassionate soul; it is equally important not to lose sight of how public policy is made under capitalism. It is not enough to repeatedly bash Ronald Reagan as a wicked king and praise FDR as a wise king. The more important task is to explain why the ruling class ousted the wise king and ushered in the wicked one. Government policy makers are certainly not stupid. Why, then, did they switch from the policies of Keynes and New Deal economics to those of Reagan and Neoliberal economics?

The US capitalist class pursued the Keynesian-type policies in the immediate post-war period as long as political forces and economic conditions, both nationally and internationally, rendered those policies effective. Top among those conditions, as mentioned earlier, were nearly unlimited demand for US manufactures, both at home and abroad, and the lack of competition for both US capital and labor, which allowed US workers to demand decent wages and benefits while at the same time enjoying higher rate of employment.

By the late 1960s and early 1970s, however, both US capital and labor were no longer unrivaled in global markets. Furthermore, during the long cycle of the immediate post-war expansion US manufacturers had invested so much in fixed capital, or capacity building, that by the late 1960s their profit rates had begun to decline as the capital-labor ratio of their operations had become too high. In other words, the enormous amounts of the so-called “sunk costs,” mainly in the form of fixed capital, or plant and equipment, had significantly eroded their profit rates [2].

More than anything else, it was these important changes in the actual conditions of production and the realignment of global markets that precipitated the gradual abandoning of Keynesian economics. Contrary to the repeated claims of the liberal/Keynesian partisans, it was not Ronald Reagan’s ideas or schemes that lay behind the plans of dismantling the New Deal reforms in fact, steps to hammer away at those reforms had been taken long before Reagan arrived in the White House). Rather, it was the globalization, first, of capital and, then, of labor that rendered Keynesian or New Deal-type economic policies no longer attractive to capitalist profitability, and brought forth Ronald Reagan and Neoliberal austerity economics [3].

Karl Marx argued long ago that dreams of an egalitarian socialist society to supplant capitalism could not be realized unless (a) conscious political actions are taken toward that end (i.e., there is not such a thing as automatic collapse of capitalism), and (b) such actions are carried out on a global level. In light of the relentless Neoliberal austerity race to the bottom that globalization has unleashed in recent years and decades, it is obvious that Marx's provisos for meaningful social change applies not only to radical socialist ideals but also to reformist capitalist programs a la Keynes.

References:

[1] Many progressive/Keynesian economists call the protracted crisis that started in 2008 the crisis of "Neoliberal capitalism," not of capitalism per se—see, for example, David M. Kotz, "The Financial and Economic Crisis of 2008: A Systemic Crisis of Neoliberal Capitalism," Review of Radical Political Economics, Vol. 41, No. 3 (2009), pp. 305-317.

[2] For a relatively thorough discussion of this issue see Anwar Shaikh's "The Falling Rate of Profit and the Economic Crisis in the U.S.";in The Imperiled Economy, Book I, Union for Radical Political Economy, Robert Cherry, et al. (1987).

[3] For an informative analysis of this transition see Harry Shutt's The Trouble with Capitalism: An Enquiry into the Causes of Global Economic Failure, Zed Books (1998).

Ismael Hossein-zadeh is Professor Emeritus of Economics, Drake University, Des Moines, Iowa. He is the author of The Political Economy of U.S. Militarism (Palgrave-Macmillan 2007) and the Soviet Non-capitalist Development: The Case of Nasser's Egypt (Praeger Publishers 1989).