

Redistribution and stability: beyond the Keynesian / neo-liberal impasse

As the financial crisis that erupted in 2007 unfolds in an economic cataclysm which, it is now clear, is unprecedented in the history of capitalism, world leaders without exception reveal themselves as politically and ideologically bankrupt in their efforts to bring it under control. This is most obviously demonstrated by their insistence on the need for individuals and enterprises to boost their levels of consumption and fixed investment – with the aid of new loans from the financial sector – even though it is obvious that the immediate cause of the crisis has been the creation of excessive credit leading people (and businesses) to spend well beyond their means.

The implication of this manifestly perverse official response to the crisis is that the world economic system has become fatally dependent on the need endlessly to expand production (of goods and services) at the fastest possible rate without regard to the ability of the market to absorb them. It is the compulsion to feed this addiction to rapid growth – in the face of long-term decline in the rate of global GDP increase since the 1970s – which has driven the credit bubble (or, as we should rather say, series of bubbles) that has now finally burst with such devastating effect.

The logic of this strategy of trying to revive the level of consumption and investment (total final expenditure) at all costs is that it is necessary in order to overcome the shortfall in demand relative to productive capacity (of capital and labour), thereby increasing the rate of capacity utilisation. Clearly, however, the same objective could in principle be achieved by allowing productive capacity to shrink – through the natural process of capital destruction brought about through the classic business cycle. But equally clearly, since this would also mean putting tens of millions of surplus workers into unemployment as well as the obliteration of scores of trillions in market value of financial assets, allowing the cycle to run its course in this way would impose unacceptable economic and social disruption on a global scale.

The evidence of the last 30 years points unambiguously to the conclusion that it is not possible to avert such a disaster by artificially boosting demand to fill the “output gap”. For we have known at least since the 1970s that “Keynesian” policies cannot indefinitely stave off or reverse such downturns – and also risk inducing unacceptable levels of inflation - while the three subsequent decades of neo-liberalism have equally failed to stop global growth rates from continuing to slow – despite a massive boost to indebtedness in an increasingly desperate attempt to keep people spending.

Now that this strategy has inevitably collapsed in a morass of unpayable debt it is striking that the entire global leadership have nothing to propose but a rerun of the failed Keynesian agenda of yesteryear. Yet they must be aware that the danger of this approach is that levels of public debt (as a proportion of GDP) are already at least twice as high as 30 years ago, limiting the scope for further borrowing or money printing without risking Weimar / Mugabe-style currency collapse. Furthermore such an attempt to revive demand for both capital and labour will be rendered even more futile than in the past by a shift in a) the pattern of demand away from manufactures towards services (which are less capital-intensive) and b) technological change (so that less capital and labour are now needed per unit of output). At the same time other factors (health consciousness, environmental constraints) are tending to limit or even

reverse consumption growth. Despite these constraints all governments – and most economists – are seemingly committed to this strategy which is bound to fail.

Given this unanimity it seems inevitable for the moment (as of January 2009) that such a strategy will continue to be pursued until it is shown to be unworkable (perhaps by an outbreak of hyperinflation). It is important to prepare for this eventuality and face the reality that we are long past the stage where it is possible to avoid a calamitous contraction in global production by artificial stimulation of demand. At that point it should also become inescapably self-evident that such a contraction is the only way that the crisis of overproduction can be resolved under the capitalist system. Yet since this would be intolerable it follows that

- a) drastic measures must be taken by the authorities (including where necessary the expropriation of private sector assets) to minimise economic disruption and social distress;
- b) the system itself must be fundamentally reformed so that it can no longer inflict such harm on the community in future.

It likewise follows from the preceding analysis of the weaknesses of the existing capitalist model that maximising GDP growth is no longer tenable as the supreme public good of economic policy makers – as it has been at least since World War II. By the same token an economic system that is dependent on high growth – based largely on profit-maximising shareholder companies – must be seen as outmoded. In trying to develop a more functional and sustainable economic model we shall need to return to first principles.

Back to first principles

It must be recognised that the essentially Ricardian theoretical basis of conventional economics, which has predominated since the Industrial Revolution, is fundamentally flawed and designed primarily to serve the interests of owners of capital in that

- It prioritises targeting the level of production so as to bring it in line with the available or potential capacity of productive factors rather than adjusting capacity to the actual or potential level of need / effective demand;
- It assumes that under conditions of more or less free competition markets will always tend to equilibrium at levels consistent with the full employment of productive factors.

Little attention has been given to the fact that Ricardo's own contemporary Malthus exposed the central theoretical weakness in this model in that it ultimately rests on the very primitive Say's Law – "supply creates its own demand" – which underpins Ricardo's Labour Theory of Value. The fact that the latter was uncritically adopted by Marx and his followers is perhaps ascribable to their close identification with another producer interest – labour – whose leaders may have seen it as conveniently aligned with their own narrow objective of maximising the numbers employed (potential union members / political supporters). Although Keynes and his followers recognised the importance of Malthus' critique and insight that overproduction was not only possible but chronically inevitable, they were and are overwhelmingly supporters of the same producer (capitalist) interests favoured by Ricardo.

It follows from the above that a more rational, sustainable and politically acceptable economic model needs to shift the emphasis away from prioritising the interests of producers (owners of capital and labour) – including the insatiable demand to devote an ever greater share of value added to maintaining the rate of return on accumulated capital – to giving primacy to the interests of the far greater number of consumers and taxpayers. By moving in this direction we should give ourselves the chance better to respond to what should surely be the basic purpose of a rational economic system: to provide people with what they need and want to the maximum extent possible with the available resources. (This might be seen as consistent with the old Utilitarian ideal of “the greatest good of the greatest number”). Advocates of market capitalism have long claimed that it meets this criterion by forcing enterprises to adopt the principle that “the customer is king”. In reality we know – on the authority of Adam Smith himself as well as from our own experience – that entrepreneurs are naturally motivated by a desire to maximise profits above all other concerns¹, and that meeting the demands of consumers – not to mention workers and taxpayers – has to be subordinated to that priority.

Alternative vision for the future

Key principles and features of this would be:

- Downgrade / abandon the growth objective. This would inevitably mean placing more emphasis on income redistribution both within and between nations (recognising that “trickle down” is a myth).
- Give priority to stability and security (economic and social) consistent with equity and maximum economic efficiency (long-term lowest economic cost²).
- Subject the corporate sector to proper public accountability. Since the self-regulated profits system has proved unable to deliver general economic prosperity – rather the opposite – it is no longer tolerable that it should enjoy the privileges and protection conferred by the state (including limited liability) without the attachment of stringent conditions – e.g. effective public veto over key decisions (investment, pricing etc.). This would obviously tend to restrict returns on capital (ROC) and lead over time to the public (at national or local level) owning as well as controlling most key enterprises as private investors sold out because of inadequate rewards relative to risk.³
- Explicitly jettison the ever more meaningless goal of “full employment” – often used to justify support for maximising growth (albeit long tacitly abandoned by governments) in favour of a radically different system of income distribution. This would be based on a) universal entitlement to a citizen's income (at a flat basic “survival” level) regardless of means or employment status and b) more regulated labour (and product) markets

¹ Indeed company law effectively requires them to make this their overriding purpose in the interests of their shareholders

² This means taking account of all “externalities” not normally accounted for in commercial cost / benefit calculations (e.g. environmental damage, loss of amenity to the public / consumers)

³ In the case of financial institutions their collective failure (central to the present crisis) – and their inability to meet the public need in terms of sustaining the productive sector now threatened with collapse – means that they should be brought under full public control without delay.

designed to prevent any groups or individuals gaining an unfair share of national or global value added in a world of more limited growth.

- Abandon “free” trade in favour of explicitly managed trade. Scrap the WTO system in favour of regulated multilateral structures – and severely restrict the free movement of capital. A key principle here would be that - in a world of more limited scope for growth - investment, production and trade must be organised so that value added is redistributed in favour of the most disadvantaged (particularly in the Third World). (It should also be noted in this connection that another Ricardian shibboleth cherished by mainstream economists which needs to be jettisoned is the idea that maximising the growth of world trade is a public good – all the more so now that this objective is seen to conflict with that of minimising carbon emissions. This would clearly imply that the full economic costs of transporting goods should be taken into account, thus favouring more emphasis on local sourcing of goods, other things being equal).
- Initiate international action to stabilise commodity markets and limit price fluctuations - in place of the present *laissez faire* régime (which benefits only rent-seeking speculators). This applies most obviously to foodstuffs, where we must now re-learn the once familiar lessons of the destructiveness of uncontrolled commodity markets and the disastrous effect of crop price cycles on consumers and small farmers alike; but also notably to energy, where the recent grotesque gyrations of oil and gas prices have a) wrought economic havoc in both exporting and importing countries and b) undermined the confidence of potential investors in both conventional and renewable production.

Crucially any alternative system must be geared to determining economic priorities and allocating resources based on criteria other than the highest rate of ROC (profit maximisation) as determined by the market. This must imply reaching such decisions based on politically determined selection – derived in turn from democratic processes defining greatest (social) need. Once the requirement to maximise returns to shareholders is removed – along with the bias in favour of the most capital-intensive forms of fixed investment – it will become apparent that a huge share of economic value added that is at present wastefully diverted to serving the priorities of the owners of capital⁴ can be more usefully devoted to serving the needs of the wider public as briefly outlined above.

It is self-evident that the transition to such a collectivist, more humane economic model cannot occur overnight. Thus in order to avert the most dire consequences of the ongoing collapse of the existing model it will be necessary to maintain and extend the kind of emergency state intervention and support already being provided by governments since 2007 (although it would be quite feasible to adopt measures such as the reintroduction of exchange controls without delay). What is important, however – if recurrent disaster is to be averted – is to set a course now to a more sustainable model for the future, and to discredit the widely held fantasy that we shall be able to return to “business as usual” once the crisis is over.

⁴ Such as the British government's profoundly perverse recent decisions to support investment in uneconomic and anti-environmental projects such as the massive expansion of nuclear power generation and the construction of a third runway at Heathrow Airport.

Harry Shutt - January 2009