The Economic and Labour Relations Review Vol. 23 No. 3, pp. 3–12

Climate Change

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Abstract

The author surveys shifts in macro-economic policy and thought from Keynes and Kalecki to the present, tracking the changing climate of economic opinion. As Kalecki foresaw, the success of Keynesian demand management was undermined when, in an era of full employment, the power of labour threatened industrialists' authority over the economy. From the 1970s, this led governments to introduce pro-capitalist measures. Countering recessions with budget deficits was now seen as irresponsible. The rise of globalisation meant that domestic demand management became less effective, especially in economies highly dependent on imports. Opening up economies meant that their exchange rates and stock markets became more vulnerable to capital flights. As the reach of finance became increasingly global, those private credit rating agencies became the game changers. Today private credit agencies, through their rating of the investment climate and sovereign risk of a country, in effect rate the quality of its government. Capitalist democracies are now dominated by private finance. Management of the investment climate is increasingly done through the virtual rather than the real economy, creating artificial financial asset and housing market bubbles. At the same time, in the neglected real economy, inequality and unemployment have increased, and living standards are falling.

JEL Code: B22

Keywords

Demand management; economic policy; economic role of the state; financial capital; globalisation; Kalecki; Keynes; productivity.

Introduction

Like vegetation that changes with climatic conditions, economic policies too change with another kind of climate, the climate of economic opinion. Although similar to the extent that both are consequences of industrialism, changes in the climate of economic policy impact more directly and immediately on our everyday life. And yet, they are seldom noticed and rarely commented upon critically. The change in the climate of opinion is usually brought about by governments, a sufficiently pliable media beholden to them, and their equally pliable economic experts who enjoy proximity to political power and influence by association. The changes in policy and the economic reforms are then presented to the public as compulsions of the day. The changes can then go largely unopposed under the syndrome of TINA (There Is No Alternative) (Thatcher 1987).

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https://doi.org/10.1177/103530461202300301 Published online by Cambridge University Press

Things are more direct when political power is heavily concentrated. Fascism required state power to be under the control of big business, official communism wanted it under 'the dictatorship of the proletariat' (read the Communist Party). Between these extremes lies the spectrum of liberal democracy which comes in an almost bewildering variety, from social democracy inclined towards economic activism of the state and regulation of markets to the minimalist state inclined towards *laissez faire* and unrestrained freedom for the market.

Nevertheless the various shades of capitalist democracies have one common underlying presumption which has been at the core of the wide-spread legitimacy it enjoys. The state, it is assumed, would maintain a sufficient degree of neutrality to balance conflicting interests of contending classes and groups. The game of liberal democracy cannot be played unless there is a referee. And, the state has to act as the referee to let the fortune of conflicting class interests fluctuate within manageable limits. Like a pendulum it would swing, but the swing will be calibrated, avoiding extremes.

Both market capitalism and political democracy are celebrated as widening the scope of choice. The freedom to choose in an unregulated market is considered a necessary concomitant to the freedom to choose the government. In popular imagination coloured by the media one does not exist without the other. And yet, the logic of the market depends on 'one dollar one vote' which gives the rich disproportionate power; whereas political democracy of 'one adult one vote' depends on the majority. The two coexist in a market democracy without severe tension when the state acts as a relatively neutral referee among contesting classes and groups in the society.

It was on this assumption of relative neutrality of the state that the theory of demand management in capitalist democracies was developed. It is associated with the name of the British economist John Maynard Keynes, although it was formulated independently around the same time by the Polish economist Michael Kalecki. The theory in a sufficiently vulgarised form became conventional wisdom for statecraft ('We are all Keynesians now' remarked former U.S president Richard Nixon). The theory says that a high level of economic activity, output and employment, can be maintained by the government by keeping aggregate demand at a sufficiently high level. And, aggregate demand can be kept high whenever necessary through government spending financed by budget deficit or borrowing. The political implication of the theory is remarkable for capitalism. High output and employment would benefit both the classes — employers and employees, captains of industry as well as workers; even the self-employed would benefit from a buoyant state of the market. Capitalists and managers can look forward to high profit resulting from high capacity utilisation and a larger volume of sales. Workers can expect larger pay packets and easy availability of jobs at high employment. It is the economic recipe for cooperative rather than conflictive capitalism and provides the ideal setting for class harmony in a liberal democracy.

However, the two economists who had formulated independently the same theory of demand management differed radically, not about its logic but about its future political prospects. Keynes with the privilege of being in the limelight

https://doi.org/10.1177/103530461202300301 Published online by Cambridge University Press

at Cambridge University, the intellectual centre of the world of economic theory at that time, had a wide audience. He had come to save capitalism with his theory, not to bury it. Kalecki, a Polish Jew and a refugee escaping from the lengthening shadow of Nazi Germany over Europe, was acutely aware of the monstrosities capitalism was capable of producing in the service of capital — Imperialism, Fascism and Nazism. With little illusion about capitalism, Kalecki foresaw the political fragility of the assumption of a neutral state pursuing even-handed economic policies to nurture class cooperation. As early as in 1943, he claimed that the theory of demand management would falter, not on its logic but on its politics (Kalecki 1943[1971]).

The novelty of the theory of demand management lay in breaking the analogy between an individual and the society. For an individual over-spending in relation to his or her fixed income is unsustainable over time due to rising debt. For the economy as a whole, argues the theory of demand management, this analogy does not hold especially in times of serious unemployment and underutilisation of productive capacity because the income of the nation is not fixed. If a government overspends, say through budget deficit, it raises demand in the market which magnifies further the level of demand as the initial spending by the government becomes income for workers and profit for capitalists and this process goes on in many rounds multiplying several times the initial increase in demand from government spending. Since this increase in demand makes producing more and employing more workers profitable for private business by utilising the unutilised potentials of an economy in depression, economic activity and aggregate income increases. Therefore, unlike for an individual the total income of a society is not given for the macro-economy; in depression it increases with demand.

The novelty of the theory went against the 'commonsense' based analogy between the economy and an individual household. So politicians as men and women who pride themselves with 'commonsense' in abundance were slow to learn. Historically, Nazi Germany was about the only country that followed peace-time Keynesian demand management policies starting with a massive motor way ('autobahn') construction programme, not because of the theory but as a prelude to setting up its war machinery. Nevertheless it did provide high employment and popular support to Hitler. In comparison Roosevelt's much publicized New Deal in the U.S.A remained a feeble attempt (the deficit hardly exceeded 5 per cent of GDP between 1934–38 returning to fiscal retrenchment by 1938); other capitalist democracies were even slower to learn. The opposition to government spending financed by deficit faded under the threat of war, and war time Keynesianism maintained full employment, but only at an enormous cost of shifting resources from civilian to military production. It was indeed far more dangerous than 'digging holes in the ground to fill them up' as a way of creating demand.

In the absence of controlled experiments of physical sciences, the experience of war economies came closest to confirming the validity of the proposition that intelligent demand management by the government can sustain full employment over time. If actual war was needed to establish the theory, the cold war years

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saw Keynesian theory gradually gaining wider acceptance in official circles. Politics rather than economics was probably the more compelling reason. The cold war meant a competition between the two systems of market capitalism and centrally controlled Soviet socialism. Despite its many weaknesses, the latter had warded off successfully the great depression of the 1930s and maintained full employment throughout. Its attraction was strong enough for working people in capitalist democracies for the state to look for remedial actions. And this competition between the two systems about the welfare of their ordinary citizens contributed to the wide political acceptance of the welfare state with Keynesian demand management as its rationale.

For some quarter century after the second world war (until about the first oil price shock of 1973), long years of capitalist prosperity followed. It was a period of almost uninterrupted high employment and growth, accompanied by an unprecedented rising living standard of working people. Scandinavian social democracies had already set the standard. As the Swedish economist Ohlin had pointed out, the objective of social democracies was the socialisation of consumption, not of production. This is wage-led growth, with wage defined in the broader sense to include the social wage of health, education, old age insurance etc offered by the welfare state. Nevertheless, maintaining high employment and social consumption required state intervention in production on a larger scale with budget deficit and the nationalisation of several industries, especially public utilities like basic health and education services. For ordinary citizens this was the golden age of capitalism; but not so for the captains of industry. Their authority over the economy was gradually eroding, as workers' 'indiscipline' in the form of higher wage claims was rising in a tight labour market. The fear of job loss was less serious and, 'giving the sack' lost its potency.

The rising power of labour plus the ability of the state to maintain continuous full employment independently of the capitalist class are the ingredients of transformative politics that can reduce drastically the role of capitalists. This is when the sham politics of electoral democracy has to give way to the real politics of class power. In the real politics of class power, high profit accompanied by high employment is unworkable over a longer period of time because, continuous full employment would shift power unacceptably in favour of the working class. The captains of industry must oppose policies that erode their power even if their profit remains high. Democracy of the majority will take precedence over the economic power of capital if the popular imagination is persuaded that the government can continuously maintain a high level of economic activity without the support of the capitalist class. The power of the government to follow policies on its own without depending on capitalists has to be curbed if capitalist democracies are to remain capitalist first and democracy only in the second place.

The attack on a pro-active state for maintaining full employment starts in the name of 'sound finance'. 'The social function of the doctrine of sound finance' as Kalecki wrote in 1943, 'is to make the level of employment dependent on the "state of confidence"' (Kalecki 1943[1971]: 139). This calls for a paradigm shift in policy from wage-led to private profit-led growth. Instead of assigning

https://doi.org/10.1177/103530461202300301 Published online by Cambridge University Press

independent economic power to a relatively neutral state, the focus of policy shifts to strengthening the state of confidence of private capital through pro-capitalist measures.

It is considered irresponsible fiscal behavior to have recourse to budget deficit even in times of recession. Stretching the false analogy between the individual and the society, it is seen as leading necessarily to unsustainable debt burden on the future generations. The fact that providing productive employment to the unemployed would expand the real income of the society to finance at least part of the deficit without inflation, or that the state can continue to service its debt through issuing new bonds and refinancing partly its outstanding bonds debt is conveniently overlooked. It is at best policies with concern for the future without concern for the present, reminding one of Keynes's famous quip, 'in the long run we are all dead'. And one might add that market democracies might become dead democracies, if unemployment continues to be exceptionally high.

Even more remarkable is the notion of distributive justice practised in the name of democratic politics for improving the investment climate for private capital. Normally, aggregate demand increases through redistribution in favour of the poor who consume more out of income. Nevertheless, in this scheme redistribution in favour of the poor is opposed. Measures to expand social consumption and subsidies for the poor financed by progressive tax rates on income and wealth are reduced to create profitable investment opportunities by reducing the economic presence of the state. A typical justification offered is the alleged inefficiency of the state in delivering services to the poor. It is conveniently overlooked that replacing the state by the market mechanism loaded in favour of the rich prices out the poor from getting these services. The failure of the state to deliver services is not faced as a political problem; instead it is pretended to have an economic solution through the 'magic of the market place'.

Abandoning redistribution in favour of the poor, exactly the opposite route is taken in the name of demand management. Holding the traditional theory of demand management hostage to the interest of the capitalist class, it suggests that the rich should have even more through the generosity of the fiscal and monetary policies of the state, so that they have stronger incentives to invest. This means cutting taxes for the high income brackets, reducing wealth and corporate tax, and, whenever possible, generating artificially asset market and real estate booms.[1] In a favourable investment climate, the rich would invest their excess funds in financial assets to make more capital gains and keep the asset market boom going. As the rich become wealthier, they borrow more against their increasing wealth, and spend more to increase aggregate demand. The aggressive assault of this private profit-led growth hopes to compensate for the reduction in aggregate demand from redistribution against the poorer classes (who have higher consumption propensity) by higher private investment from the rich who are made richer through state policy to improve the climate for investment.

Globalisation adds new dimensions by increasing the relative importance of the external in relation to the domestic market. Opening up economies means domestic demand management would be less effective, especially in those economies which are highly import dependent because a significant part of the demand

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generated would leak out in the form of import demand. This places economies with lower international competitiveness at a double disadvantage. On the one hand they are less able to manage effectively the level of demand at home; on the other, they are able to sustain openness in trade by accumulating deficit as growing foreign debt. This provides greater scope for international capital flows to make exchange rate and stock markets more vulnerable to capital flights. Unrestricted economic openness for an internationally less competitive country becomes a recipe of growing indebtedness and shrinking domestic demand. So the policy prescription follows: countries should enhance their international competitiveness with the objective of achieving export led growth.

Paradoxically, it is a policy supposed to be relevant in a globalising setting and yet, it is fallacious precisely in that setting. Not all countries can achieve export surplus at the same time: for every gainer from such a strategy there must be losers who continue to accumulate sovereign debt. However, this expands the market not for goods and services, but for global finance. At the same time, obsession with international competitiveness requires giving large corporations a free hand as they are best placed to take advantage of the international market through their production and distribution network. Competiveness in the international market usually has two aspects — having a technological edge or niche and being cost competitive. Cost competitiveness, measured by unit cost, requires higher labour productivity and lower wages. Higher labour productivity without a corresponding increase in wages has the potential of increasing the profit margin per unit of sale without necessarily enhancing price competitiveness. Although the link between wage and productivity increase (or an incomes policy) was institutionalised as a further aspect of cooperative capitalism in some European countries (e.g in 'social partnership' in Austria, 'social market economy' in Germany) they face increasing strains like outsourcing under the pressure of maintaining international competitiveness. While foot-loose multinational corporations restrain wages by out-sourcing or shifting locations to lower wage, lower tax countries, they increase labour productivity through shedding labour by mechanisation and robotics. Neither employment nor wages grows adequately even in countries that succeed in being in export surplus, while countries are compelled to join a 'race to the bottom' in terms of concessions in tax policies and labour laws to nurture a more favourable climate for corporate investments.

Making sure that capitalists remain in command in democracies is a game as old as universal suffrage. The game is played in different circumstances, but the outcome is ensured that capitalist democracies remain capitalist first and democracies only in the second place. However, a mutation in the evolution of global capitalism has appeared, paradoxically also through globalisation, because globalisation has increasingly been less about free trade involving free movement of goods and services and more about free movement of financial capital. From the mid-seventies, the deregulation of capital markets of major industrialised nations (OECD) — a process roughly completed by early 1980s — unleashed massive private funds moving across national boundaries. The total foreign exchange required for trade and foreign investment accounts for hardly 4 per

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cent of the massive daily volume of turnover in the foreign exchange market, the rest goes in various paper assets.

As globalisation became more a matter of global free movement of finance than of free trade in goods and services, the centre of gravity of power began to shift. Acquiring a commanding position in the real economy lies increasingly through finance. This has changed the investment climate in at least two ways. Since a currency or stock market can be set on a downward spiral with devastating consequences for the investment climate of a country, finance capital wields power as never before. Manufacturing industries have a subservient position in this scheme because, achieving export or industrial competitiveness operates on a considerably longer time scale compared to the ability of finance to change the exchange rate or the international payments situation through short term capital flows. Its immediate victim is demand management by any individual country in isolation as capital can fly out in protest against expansionist policies to destroy almost overnight the investment climate of that country. However, against the global background of the 'race to the bottom' to attract capital flows, whether policies of a national government are sufficiently hospitable to finance capital is decided by a few leading financial institutions. In developing countries it used to be the World Back and the IMF; in developed capitalist countries private credit rating agencies rated the securities and credits of corporations. As the reach of finance became increasingly global, those private credit rating agencies became the game changers. Today it is private credit agencies like Standard and Poor's or Moody which through their rating of the investment climate and sovereign risk of a country rate in effect the quality of its government, its democracy.

Capitalist democracies have come the full circle through the dominance of private finance. Management of the investment climate is increasingly done through the virtual rather than the real economy, e.g. creating artificial financial asset and housing market bubbles. At the same time, in the real economy inequality increased through fiscal and monetary concessions to the rich, the withdrawal of welfare measures from the poor, and the slow growth of employment and wages as a consequence of a dangerous obsession with international competitiveness. The interests of the real and the virtual economy are reconciled through artificial bubbles, as the negative impact of growing inequality on aggregate demand in the real economy is alleviated by asset price boom in the virtual economy. It continues for a while driven by a mechanism of positive feedback between rising asset prices creating an even higher demand for assets, a self sustaining process of mutual reinforcement so long as it lasts. And yet, when the bubble of rising asset prices bursts, it throws up an old question, the question of how to reconcile a growing tension between Industry and Finance. After Britain returned hurriedly to the Gold Standard in 1925, Winston Churchill observed:

> … the Governor (of the Bank of England) shows himself perfectly happy in the spectacle of Britain possessing the finest credit rating in the world simultaneously with a million and a quarter unemployed … I would rather see Finance less proud and Industry more content. (Churchill 1925)

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As a sequel to this, Josef Steindl, one of Kalecki's most distinguished colleagues reminds us:

> Kalecki used to interpret the events in Britain around 1931–32 in terms of a shift of power from the City (Finance) to Industry. The interest of the City was overruled by abandoning the Gold Standard … With this tarnishing of the international image of the City, the centre of gravity of economic policy shifted to the home front in favour of domestic industries. This provided the necessary sociopolitical base for the acceptance of Keynesian policies. (Bhaduri and Steindl 1985: 57–58)

To paraphrase Marx, history repeats itself, the first time as a tragedy, the second time, if not as a farce, then as a deeper tragedy. The tragedy is the engulfing depression with rising unemployment and erosion of living conditions of ordinary citizens in capitalist democracies. With the massive bail-out of financial institutions in various forms, first the U.S government and now (2012) Germany try to save Finance in the Euro-zone from a crisis, but without corresponding measures to save Industry and employment in the real economy. So long as the supremacy of Finance remains the over-riding objective of economic policy, intelligent demand management policies along Keynesian lines would have no place in the political scheme. And yet, in the final analysis Finance produces intangible 'fictitious commodities' in the form of claims on real commodities among various economic agents. The real economy that produces tangible goods and services is the foundational base on which elaborate financial structures are built. Elevating Finance to a commanding height by neglecting the underlying base of the real economy opens up new fault lines in capitalist democracies. Unless a course correction takes place, soon a more devastating earthquake will engulf the system in a deeper tragedy.

Notes

1. *Development and Change* (2011) Forum 2010/2011. For a convenient recent summary with analysis, see Saith 2011.

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