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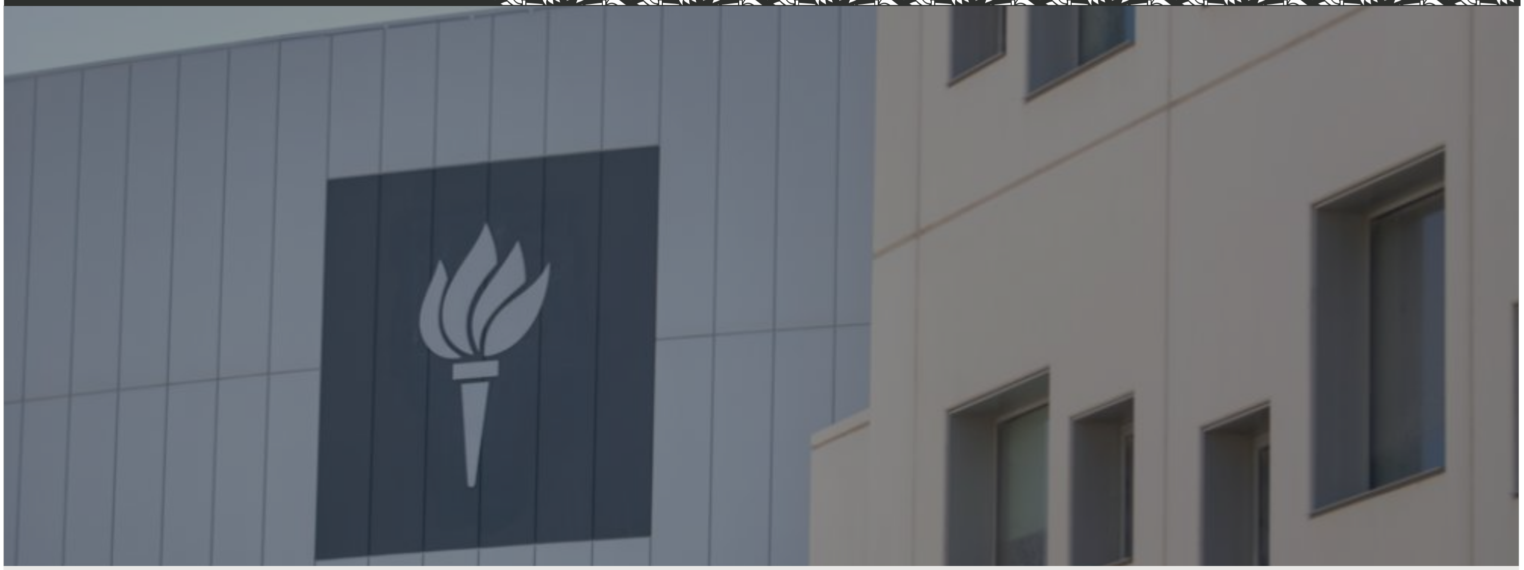

Capitalism: Worries of the 1930s for the 2020s

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Capitalism: Worries of the 1930s for the 2020s[1]

> The decadent international but individualistic capitalism, in the hands of which we found ourselves after the war, is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous; -- and it doesn't deliver the goods. In short, we dislike it and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed (Keynes, 1933, p. 183).

I. Introduction

There is a whiff of the 1930s about the title of this special issue. Then as now, intellectuals denounced the ills produced by capitalism, defended it, pondered how to reform it, worried that it would collapse, or looked forward to the day when it would. Many of the debates of that time echo strongly now, with similar arguments being made on both sides of more than one issue. To what extent do these intellectual debates, and the economic history which produced them, speak to our current predicament?

2. The engines of capitalism

The first question which the authors have been asked to address is: what has gone wrong? But that presupposes that something has gone wrong, which is far from evident. On the contrary, according to many traditional metrics capitalism is behaving exactly the way it is supposed to.

The classical economists, from Smith to Marx, as well as later theorists such as Weber, believed that what defined capitalism above all else was its ceaseless pursuit of accumulation for its own sake. High savings rates were the engine propelling capitalism forward. Readers from Britain (where the gross adjusted savings rate in 2018 was just

[1] This paper has been written for a special issue of the Oxford Review of Economic Policy on "Capitalism: What Has Gone Wrong, What Needs to Change, and How Can It Be Fixed?". I have benefited from the insights and encouragement of Bob Allen, Martin Hellwig, Maury Obstfeld, and Alan Taylor. The usual disclaimer applies more than usually.

13.5%) or the United States (where it was 18.3%) will be well aware that their countries are not saving as much as they once did, but the Anglosphere is not the world, and the global savings rate has been trending steeply upwards since the 1990s (Figure 1): there is no sign of any crisis on this score.

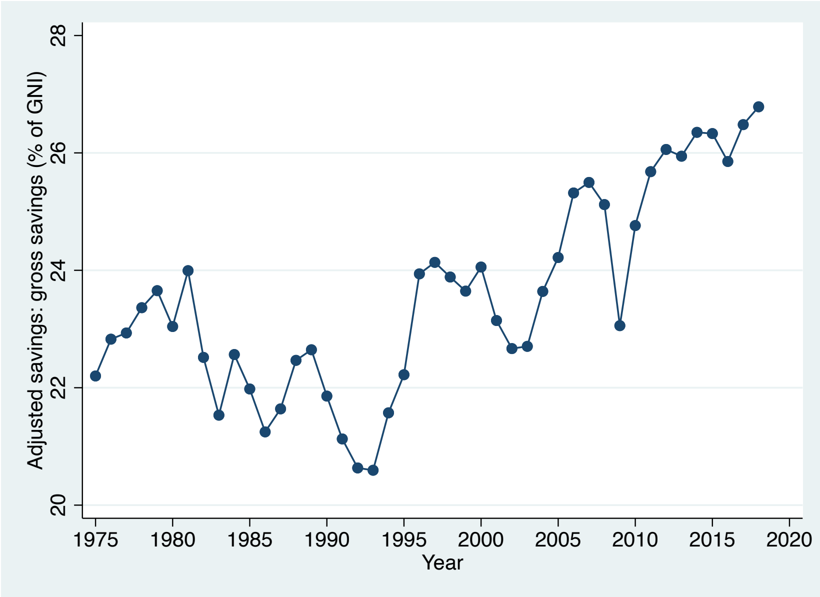

Figure 1. World savings rates, 1975-2018

Source: World Bank.

Writing in 1942, Joseph Schumpeter felt that the classical writers had exaggerated the role of savings and accumulation. For him, the engine of capitalism was driven by “the new consumers’ goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates” (Schumpeter, 2010, pp. 67, 73). New products, globalization, the shift to new forms of producing, retailing, or working: innovation is what defined capitalism in Schumpeter’s view. Despite the economic catastrophe of the 1930s he expressed no great concerns about the ability of capitalism to deliver innovation, and in retrospect he was right: the decade was one of the most technologically progressive on record (Field, 2003).

It is true that US productivity growth fell sharply in the 1970s (Figure 2), and this matters since the US is commonly conceptualized as the world’s technological frontier. But the US is not the world, and Schumpeter included what we would today label “globalization” in his definition of innovation. Even if all that today’s entrepreneurs were doing was deploying existing technology in new environments that would constitute innovation, boosting global TFP and living standards, and so would reconfiguring production chains via outsourcing and other means. Figure 3 shows that prior to the Great Recession TFP was booming: global TFP growth accelerated from 4.3% p.a. in the late 1990s to 6.6% p.a. in 2005-7. When the focus is not on total TFP growth, which includes the more efficient allocation of factors of production within and across countries, but on weighted averages of TFP growth in particular industries in particular countries, TFP growth almost doubled over the same period. The Great Recession led to a sharp decline in global TFP growth, as would be expected, but by 2011 it was recovering. And the past year's innovations in medicine, telecommunications and workplace organization surely suggest that if innovation is the essence of capitalism, then the latter is in good shape.

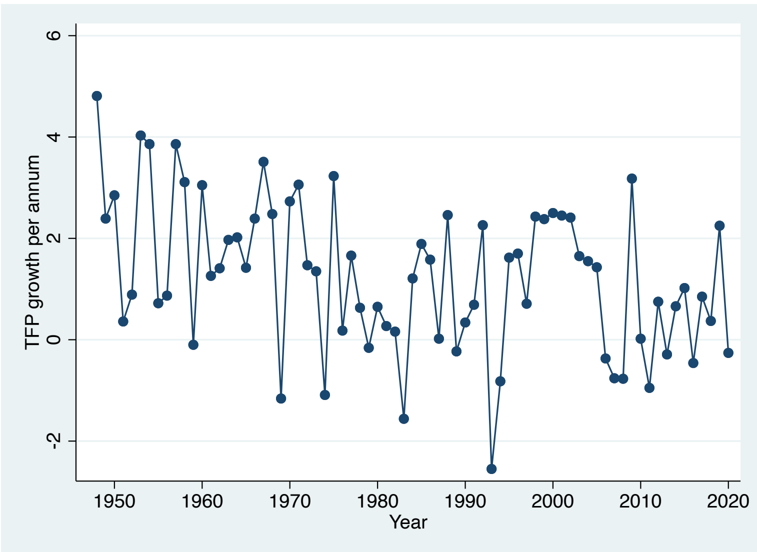

Figure 2. US TFP growth (utilization-adjusted), per cent per annum, 1948-2020

Source: Fernald (2014), updated 2020.

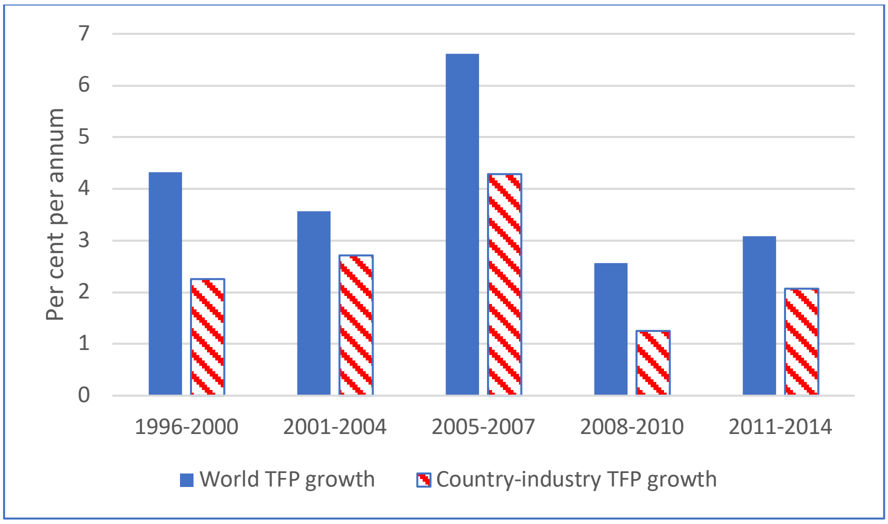

Figure 3. World TFP growth, per cent per annum, 1996-2014

Source: Esfahani et al. (2020).

Schumpeter worried that capitalism would eventually lose its vitality, as ownership became separated from management, and innovation became routinized within bureaucratic corporations. Kodak, which invented the digital camera but was so rigidly run that it was ultimately destroyed by it, might be a case in point (Lucas and Goh, 2009). But new technologies create new corporations, and today's digital giants are headed by larger than life entrepreneurs with as much name recognition as their counterparts in the age of the trusts. Schumpeter would have been reassured. But even so, a more bloodless view of capitalism now largely prevails, in which its main function is to maximize shareholder value. Despite the dramatic fluctuations in share prices which have characterised the past 25 years or so the news here is good as well. The global market value of listed domestic companies has been on a steady upward trend since 1980, even if the rate of increase has declined since the turn of the millennium. As a share of GDP, the value tripled from roughly 30% in 1980 to around 90% in 2018 (Figure 4).

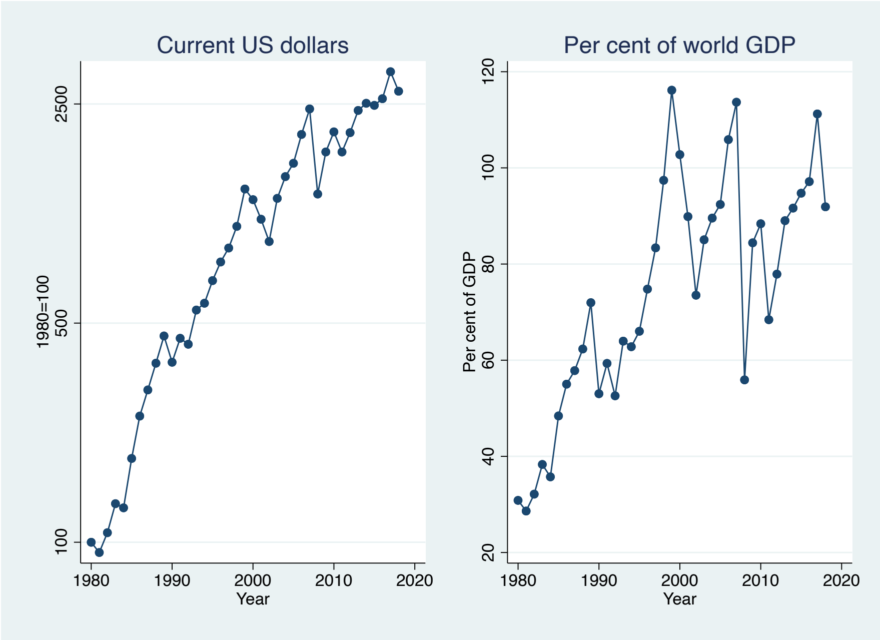

Figure 4. World market capitalization of listed domestic companies (current US$)

Source: World Bank

Ultimately capitalism's claim is that it delivers economic growth. It is true that growth has slowed since the Golden Age of the 1950s and 1960s, but those were exceptional decades. As Figure 5 shows, there has been no downward trend in world GDP growth following the step decline in the 1970s, whether growth is measured in aggregate or per capital terms. Aggregate growth has averaged 2.9% p.a. since 1980; per capita growth has averaged 1.5% p.a.[2] Growth at this rate would suffice to double world income per capita within a half-century.

[2] Based on the World Development Indicators data in 2010 dollars, calculated by regressing the log of the series on a time trend.

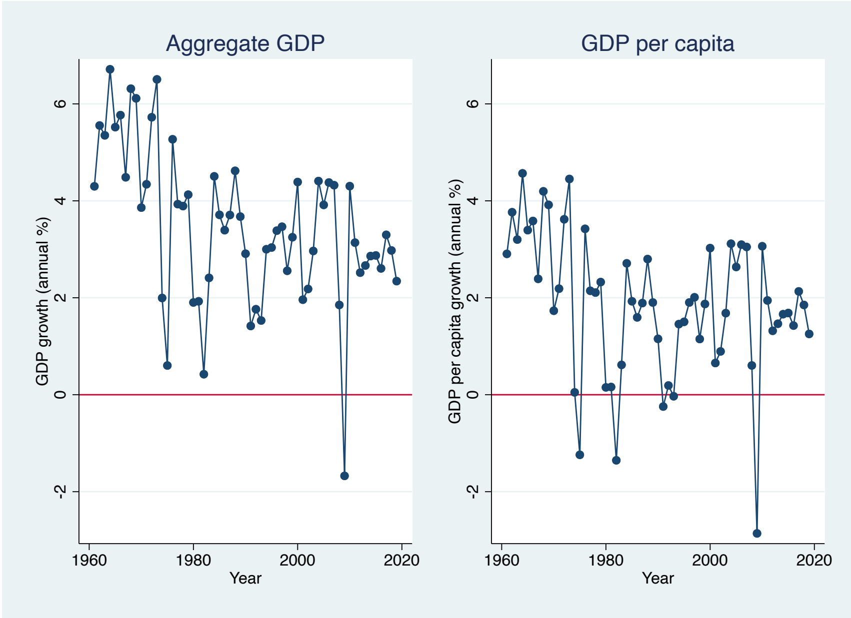

Figure 5. World GDP growth, 1961-2019

Source: World Bank

Figure 6 gives a longer run perspective, based on the most recent Maddison Project data (Bolt and van Zanden, 2020). The exceptional nature of the Golden Age stands out even more clearly from this graph, but what is also clear is that even since 1980, aggregate global GDP growth has far exceeded anything experienced prior to the Second World War. (Growth prior to 1820 was extremely slow by modern standards, whether measured in aggregate or per capita terms.) The 1980s saw relatively slow per capita growth, of just 1.3% p.a.: this was no higher than the growth of the late 19th century, and lower than interwar growth. But global growth has accelerated since then: even the 2010s saw per capita growth higher than anything recorded before 1950.

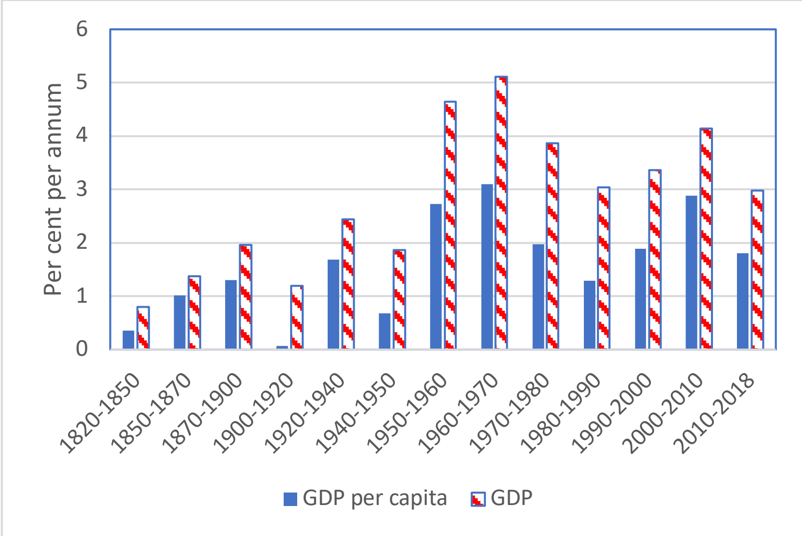

Figure 6. World GDP growth, 1820-2018

Source: Bolt and van Zanden (2020)

Not only has capitalism been performing well according to the standard metrics; it has become the dominant economic form worldwide. In so doing it has shown itself to be institutionally adaptable, a considerable advantage for any social institution. China is now one of the most successful capitalist economies in the world, and what Branko Milanović calls "political capitalism", as opposed to the liberal democratic capitalism that we are more familiar with in the West, is now flourishing in several jurisdictions. There is no historical reason to think that this dependence on undemocratic regimes will damage the vitality of capitalism: the breakthrough to modern economic growth of the late 17th to early 19th centuries occurred in countries that were highly corrupt and undemocratic, if not downright autocratic. Consider Schumpeter's (2010, p. 121) description of life under Louis XIV:

On principle, the monarchy managed everything, from consciences to the patterns of the silk fabrics of Lyons, and financially it aimed at a maximum of revenue. Though the king was never really absolute, public authority was all-comprehensive… The king, the court, the army, the church and the bureaucracy lived to an increasing extent on revenue created by the capitalist process, even purely feudal sources of income being swelled in consequence of contemporaneous capitalist developments. To an increasing extent also, domestic and foreign policies and institutional changes were shaped to suit and propel that. development… The steel frame of that structure still consisted of the human material of feudal society and this material still behaved according to precapitalist patterns. It filled the offices of state, officered the army, devised policies—it functioned as a *classe dirigente* and, though taking account of bourgeois interests, it took care to distance itself from the bourgeoisie. The centerpiece, the king, was king by the grace of God, and the root of his position was feudal, not only in the historical but also in the sociological sense, however much he availed himself of the economic possibilities offered by capitalism.

Was there ever a better description of today's Communist China? Nor should we allow the new Whig tendency in recent economic history to blind us to the corrupt, undemocratic, and bellicose nature of 18th century Britain. Schumpeter believed that this mutual dependence between extra-capitalist elites and capitalists provided protection for the latter, who were in any case unsuited to government, unheroic and rational as they were.

So one answer to the question posed to the authors is that there is nothing wrong with capitalism: on the contrary, the patient is alive and well, and delivering the goods on a planetary scale. So what, if anything, is the problem?

3. Secular stagnation? [3]

To each of the traditional engines of capitalism, there corresponds a corresponding worry about the long run viability of the institution. As we have seen, Schumpeter worried that entrepreneurship would be drained of its vitality. To classical economists focussed on savings and accumulation, the danger was diminishing returns, as a greater capital stock pressed against fixed land supplies. Profits would eventually fall to the point where accumulation came to a standstill. The stationary state was not necessarily something to be feared: while Smith believed that wages could only be kept above subsistence when the capital stock was growing, later writers argued that moral restraint in a Malthusian world could potentially maintain living standards at a respectable level. And Say's Law ensured that everything that was produced would be sold.

But economists' worries about the future of capitalism follow a long swing, being predictably related to the underlying state of the economy around them. The immediate aftermath of the Napoleonic Wars saw British per capita GDP falling by 11% between 1815 and 1819; unemployment in industry and transport reached 17% in 1816 (Broadberry et al., 2015; Feinstein, 1998, pp. 646-7). Slow growth, stagnant wages, and political unrest

[3] This section draws in part on O'Rourke (2016).

remained the order of the day until mid-century. In this context, theorists such as Malthus, Chalmers, Lauderdale, and Wakefield worried that excessive accumulation would lead to gluts of unused capital and unsold commodities. Their arguments were still classical, in the sense that they assumed that excessive savings would be channelled into excessive investment. (While a modern economist might object that this hardly seems rational, Weber would reply that an irrational propensity to accumulate is what capitalism is all about.)

The Great Depression years saw the theoretical foundations of this worry being developed in two key ways. First, the Keynesian theory of effective demand implied that it was investment that drove savings, rather than vice versa, and that as a result unemployment could be an equilibrium outcome. Second, the Keynesian argument was embedded in a dynamic framework in which insufficient investment demand could arise in the long run, even though technological change and population growth were constantly offsetting the impact of diminishing returns on the return to capital. The 1930s was a time of fears about slowing population growth: in 1937 Keynes argued that if the sum of population growth and technological progress were too low, relative to the savings rate, then investment demand would be insufficient to absorb those savings (Keynes, 1937).[4] Those fears were developed in a series of publications by Hansen, who is generally associated with what became known as the theory of secular stagnation (e.g. Hansen 1938, 1941). In contrast to the classical economists, and perhaps to the Hansen we think we know, Hansen did not predict that the world would fall into secular stagnation for ever: for him it was a (long run) cyclical problem. When technical change accelerated this would call forth increased investment demand and savings; when it decelerated, however, savings rates would not fall as easily as they had previously increased. At such points in the cycle government needed to step in to boost demand (Hansen, 1938, pp. 301-12). The 1930s were such a period, in his view, due not only to falling population growth, but to the closing of the new world frontier on which he had grown up, and to the decreasingly capital-using nature of technological change.

[4] Key stepping stones on the way to the theory of secular stagnation were the reviews of the General Theory by Hicks (1936) and Hansen (1936).

It is not surprising that fears of secular stagnation should have been resurrected in 2013 by Larry Summers, at a time when the world economy was still recovering from the Great Recession and Europe was in deep crisis. Thanks to a robust and historically-informed policy response in 2009, the Great Recession was much shorter-lived than the Depression, but recovery was slower also, as the Eurozone embraced a brutal and premature contractionary fiscal policy (Figure 7). And the world seemed to be entering a prolonged phase of historically unprecedented low real interest rates, indicating that there might indeed be a structural imbalance between savings and investment demand.

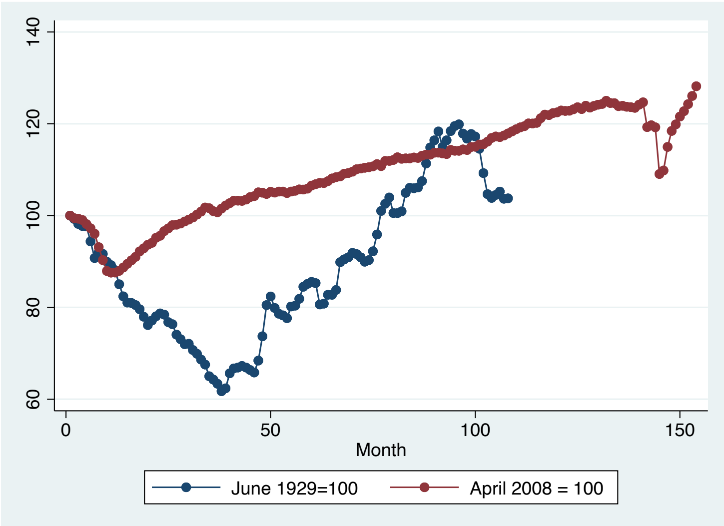

Figure 7. World industrial output during two global crises

Source: Eichengreen and O'Rourke (2009), updated using https://www.cpb.nl/wereldhandelsmonitor-januari-2021, accessed 8 April 2021.

Schumpeter devoted an entire chapter of *Capitalism, Socialism, and Democracy* to arguing that secular stagnation was nothing to worry about, since the innovative spirit would always find an outlet for its creativity. The argument comes across as essentially faith-based, but as it happened technological progress remained healthy in the US after the war, while the baby boom more than doubled the population growth rate. It may well be that the world has been undergoing a difficult period of structurally deficient demand since the turn of the millennium, but what about the future? World population growth is falling rapidly, and the United Nations projects that this will continue for the foreseeable future until growth comes to a halt altogether. On the other hand: world TFP growth remains strong; as we have seen over the past year innovation can still happen remarkably quickly; there is huge potential for catch-up in sub-Saharan Africa, where population is still growing rapidly; and the energy transition will require massive investment in new energy production, storage, and transmission infrastructures. So maybe a lack of investment demand will not be a problem going forward after all.

That is not to suggest that the market on its own will suffice to spend our savings, but since capitalism is not “the market”, being rooted in particular national, regional, and global institutional frameworks, that is not a problem for capitalism *per se*. Investment will not flow to sub-Saharan Africa in an institutional vacuum, and given the network nature of many of the new energy technologies we will need there will surely be a role for government involvement there as well. If the Biden stimulus plan is a sign that the political pendulum is shifting, this may be exactly what capitalism needs today. In the 1930s Hansen thought that the stock market was increasingly unsuited to the role of mediating between savers and investors, and that government would have to take on this role: “The government is becoming an investment banker” (Hansen, 1938, p. 318). Schumpeter, it’s worth noting, was entirely sanguine about the prospect. Investment might indeed be increasingly funded by government, either because it was unsuited to “cost-profit calculation, such as expenditure on the beautification of cities, on public health and so on”, or because the industries concerned were “increasingly amenable to public administration”, such as “means of communication, docks, power production, insurance and so on”. “National and municipal investment could thus be expected to expand, absolutely and relatively, even in a thoroughly capitalist society, just as other forms of public planning would. But that is all” (Schumpeter, 2010, pp. 105-6).

The experience of the past year, when capitalism has delivered new vaccines astonishingly quickly in cooperation with governments, suggests that the Hansen vision of government as investment banker may become increasingly relevant in the years ahead. If this helps capitalism deliver the goods, boosting investment demand in the process, that will strengthen capitalism, not weaken it.

4. Globalization, rules, and discretion

Maybe the problem isn't capitalism, therefore. Maybe it's us, or to be more specific, the West. No-one ever claimed that creative destruction was going to be pretty, but on the Schumpeterian view it's what makes capitalism so successful in the long run. But perhaps it is one thing when the bones of Bengali weavers are bleaching in the plains of India; quite another when it is our rust belts that are laid waste. It should come as no surprise that there has been a political backlash: as Schumpeter said, expecting the have-nots to reward capitalism for its long-run benefits "would require an almost impossible moral feat…In order to accept his lot, the leveler or the chartist of old would have had to comfort himself with hopes for his great-grandchildren" (Schumpeter 2010, p. 130).

Piketty (2013) and a host of writers since have provided ample empirical evidence that capitalism can generate rising inequality, just as Marx thought, and just as has been happening for a while in the UK, US, and elsewhere. In conjunction with the bruising experience of the Great Recession, when insufficiently fettered financial capitalism wreaked havoc with private and public balance sheets, with terrible consequences for the real economy, you might have expected left wing critics of capitalism to have received a boost. By and large, however, that is not what happened: Syriza in Greece, Podemos in Spain, and Sinn Féin in Ireland are the European exceptions that prove the rule.

Because the innovations that are doing the (creative) damage today largely involve foreign competition, it is natural for those who are harmed to blame "globalization" rather than "capitalism". Globalization has a long history of undermining itself politically via its distributive effects (O'Rourke and Williamson, 1999; O'Rourke, 2019). In our own day economists and political scientists have been accumulating abundant evidence of the links between import competition and economic dislocation, that has in turn fuelled an anti-globalization vote typically favouring right-wing populist politicians (Autor et al., 2013; Autor et al., 2020; Colantone and Stanig, 2020). This is highly reminiscent of the 1930s, which saw a widespread increase in the vote for extremist parties favouring the overthrow of the democratic system. Again, you would have thought that left-wing parties would have been best positioned to take advantage of the era's radicalism, and in some countries, like Bulgaria and France, they did indeed profit from anti-system sentiment. But it was far more common for the extreme right to benefit (de Bromhead et al., 2013). Liberal internationalists, by contrast, were electorally hamstrung by their continuing advocacy of failed policies and refusal to think outside the gold standard box.

A key text from the 1930s is Keynes' Finlay lecture delivered in April 1933 in University College Dublin (Keynes, 1933; see also Obstfeld, 2021). In it he argued eloquently in favour of national policy experimentation, that would suit "different national temperaments and historical environments". A greater degree of national self-sufficiency was desirable, "not as an ideal in itself, but as directed to the creation of an environment in which other ideals can be safely and conveniently pursued". Keynes singled out international capital mobility as one dimension of globalization that particularly threatened desirable domestic policy flexibility (Keynes, 1933, pp. 184-5). Keynes' argument linking globalization and policy autonomy prefigures the Rodrik and Mundell-Fleming trilemmas (or perhaps, in the latter case, dilemma) (Rodrik, 2000; Rey, 2015), while his attack on capital mobility resonates strongly in the light of the Eurozone crisis – which, like the Great Depression in Europe, can be understood in terms of a sudden stop of capital flows (Obstfeld 2013; Accominotti and Eichengreen, 2016).

By and large voters in the 1930s voted to maintain private property: they were unwilling to abandon capitalism for Soviet-style socialism. But that didn't mean that they were prepared to accept governments that were unable or unwilling to intervene in the economy to make their lives better. Where governments in Europe experimented they reaped the rewards, whether they were Irish nationalists or Swedish Social Democrats. But where there were no democratic parties offering the changes that voters wanted, such as in Germany, where constitutional politicians of all descriptions eschewed the policy interventions that were necessary due to a variety of ideological constraints, it was right-wing extremism, recognizing no constraints of any kind, that benefitted (Berman, 2006).

It has been commonplace since the 1990s to argue that social safety nets should be used to compensate those hurt by foreign competition. The argument appeals, since it offers the hope of intervening to help people without interfering with markets, but it fails to recognize that what voters want is not so much welfare benefits as the dignity that goes with decently paid work. Will the market on its own guarantee that, especially given the strong regional dimension to the adjustment problems facing the West? While teleworking may offer the prospect of regional rebalancing, the logic of agglomeration will always work in the opposite direction. Regional policies providing the infrastructure needed to level regions up, and in some cases providing jobs directly, seem required.

If those policies affect trade flows indirectly, so be it: not every policy intervention influencing trade should be regarded as protectionist. The interwar period teaches us that excessive policy rigidity is ultimately self-defeating. Countries that stuck the longest to the gold standard, whose constraints symbolized "responsible" and internationalist economic policy-making at the time, ended up being the most protectionist: in a situation requiring policy adaptation, rigidity along one policy dimension caused over-compensation along others (Eichengreen and Irwin, 2010).

Not everyone agreed with Keynes in the 1930s. Nor does everyone agree today with the view that domestic policy experimentation should not be overly constrained by globalization. What Quinn Slobodian terms "the Geneva School" worried in the 1930s (and subsequently) about the impact of democracy on the international economy: by empowering a host of interest groups it weakened the state, contributing to the rise of economic nationalism and the disintegration of the world economy. Ultimately the solution was to legally constrain what democratic states could and could not do (Slobodian, 2018). Some would argue that today's multilateral economic treaties achieve precisely that, particularly in Europe, and many economists view that as a good thing. But the 1930s also reminds us that experts can get it badly wrong, which is a big problem when it is they who incarnate the opposition to mutually destructive nationalism. Davos man and woman cheered financial deregulation, praised excessive austerity in Europe after 2010, and denounced dissenting voices as "populist". A little humility might now be prudent. If voters are once again inclined to ditch yesterday's dogma, and reward policy experimentation, then it would surely be better if democrats, rather than autocratic nationalists, supplied that demand.

And that is the central dilemma we face today: for on climate change, security, health, and a range of other issues – including the economy – we obviously need robust multilateral institutions that can help countries achieve cooperative solutions in the interests of everyone. When it comes to climate change the consequences of not succeeding are terrifying; when it comes to security we would be foolish to assume that international capitalism, on its own, can guarantee peace. Keynes spent much of his Finlay lecture debunking the argument that it would, and by now most of us have presumably abandoned the naïve hopes of the 1990s along those lines. What the scope of such institutions should be, how they should be governed in an increasingly multipolar world, and how they can be reconciled with democracy, are some of the trickiest, but also most important, questions facing us. It will probably be politically easier to resolve them if those advocating multilateralism break the links that have recently been forged in the popular mind between multilateralism, unfettered international markets, and a reduced role for the state domestically.

5. Conclusion

Capitalism is as healthy as it has ever been, although whether you view that as a good thing or not will depend on your perspective. Its capacity to innovate seems undiminished, and correctly channelled that can help us solve many of our most pressing problems, including the most important one of all, namely climate change. But capitalism does not operate in an institutional vacuum: like a liquid it will shape itself according to the social structures that surround it. As a force that is both creative and destructive, it is constantly eroding these structures: the more elastic they are the more likely they are to survive. Whether or not we find the right institutional balance between flexibility and commitment, at the national, regional, and global levels, will determine how well we cope with the many shocks and strains that the 21st century will subject us to.

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