# From Depression to the Welfare State

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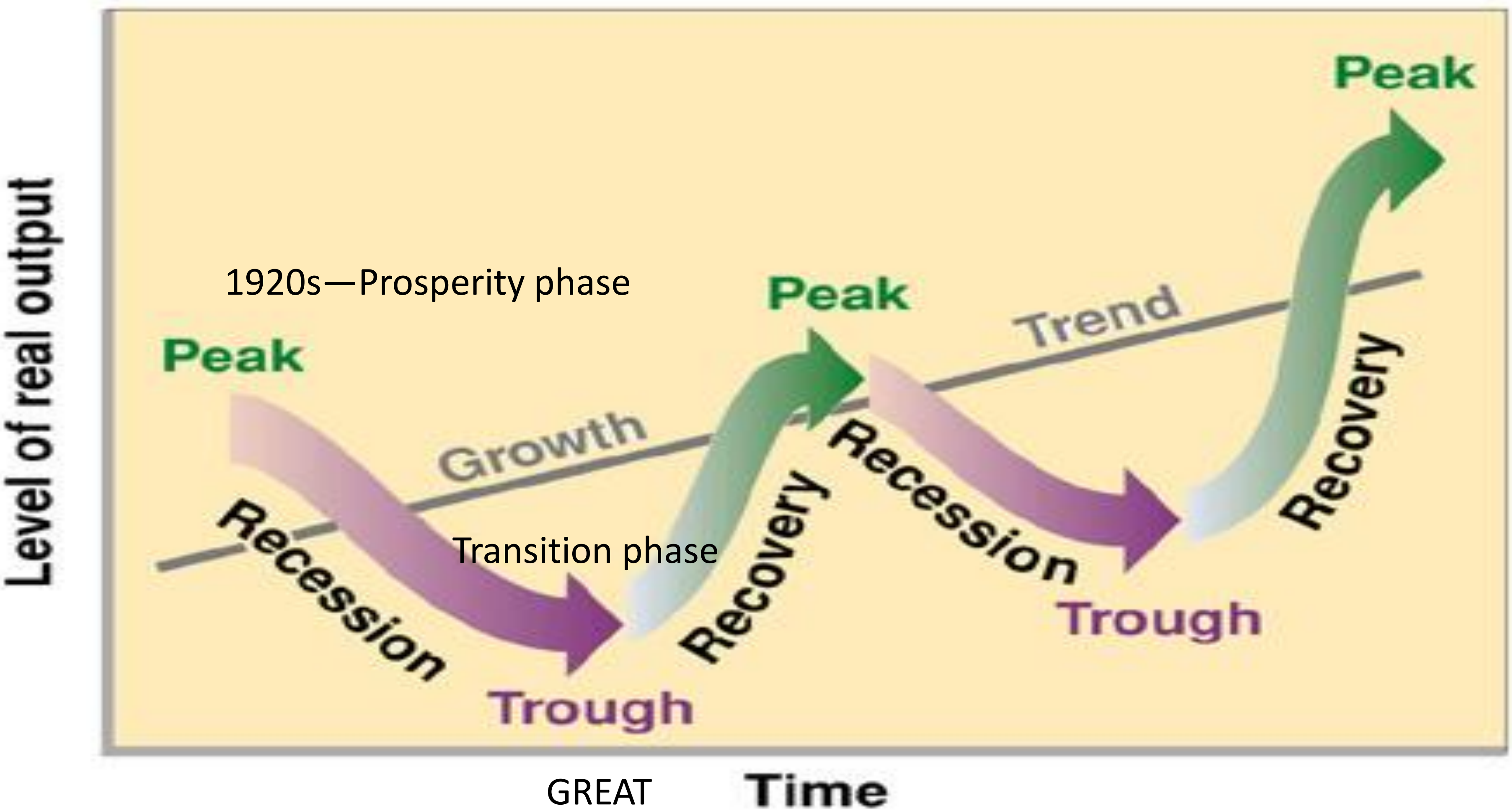



1920s—Prosperity phase

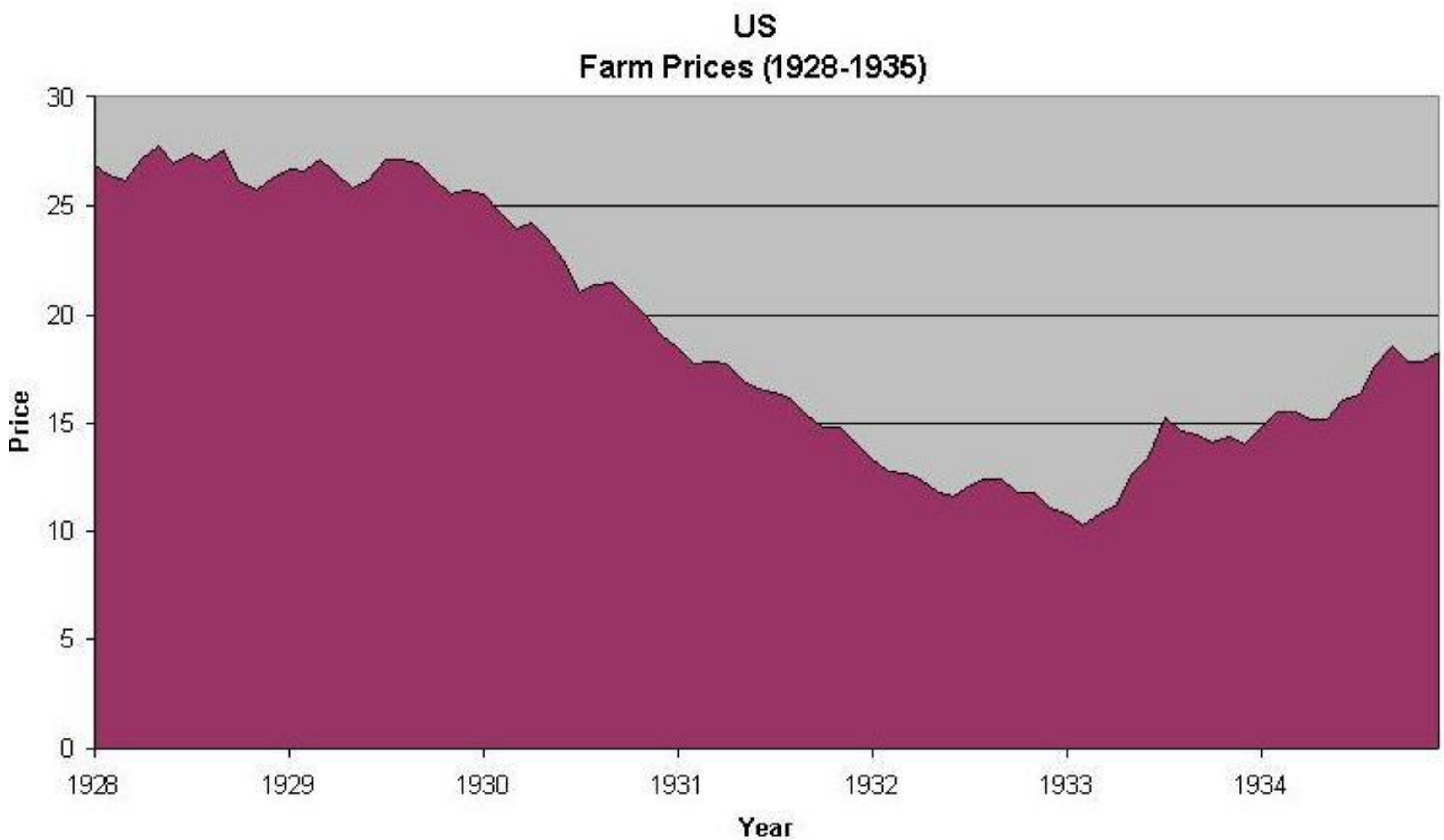
Transition phase

GREAT DEPRESSION

# And there were hidden problems in the U.S.. . . .

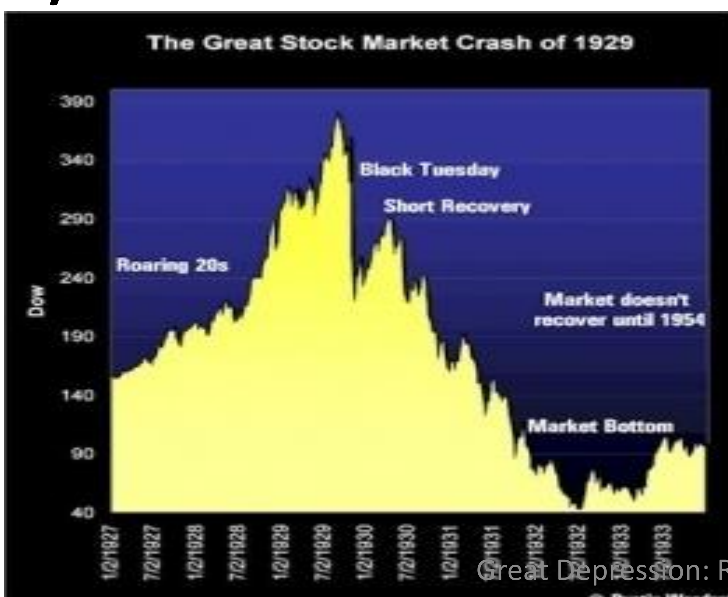
- Wages lagged behind profits
- Fewer purchases
- Farmers used new technology to expand production but Commodity prices fell
- Farmers couldn’t pay debts
- And couldn’t purchase goods
- Manufacturing began to lose jobs and profits…

# Agricultural Decline and Depression

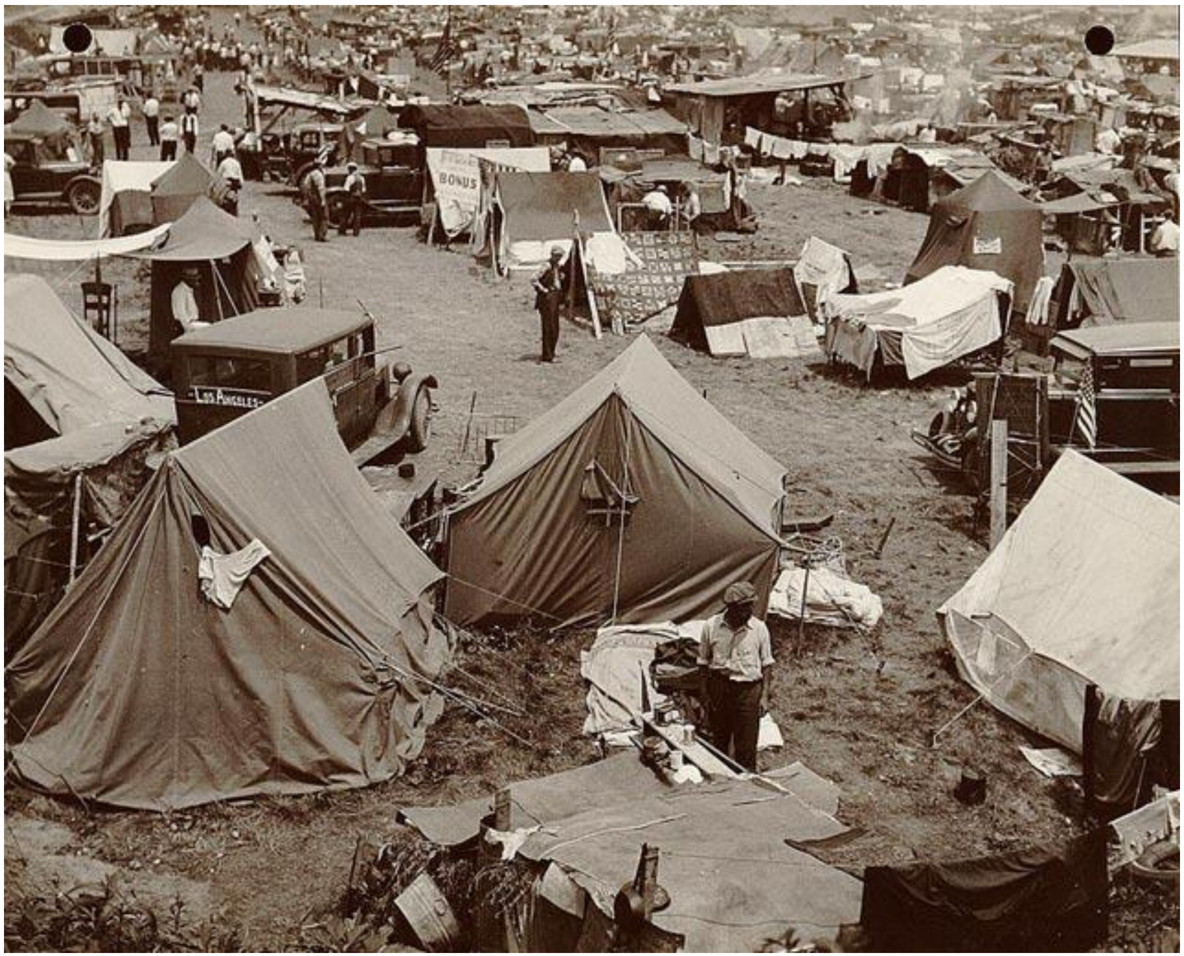


# The crash of 1929 and the spread of economic crisis

- World prices plunge
- World Trade falls
- Unemployment skyrockets




# Unemployment and Protest



# clinging to the gold standard made things worse


*The Silliest Show on Earth*

# How? Let's review the Gold standard?


The Silliest Show on Earth

# What happens when you are in a balance of payments deficit and you are tied to the gold standard?

- What if a country's economy was declining and it began to import more than it exported. (balance of payments deficit)

- They would have to either 1)figure out how to expand exports, 2) slow down imports, or 3) figure out how to keep paying for the excess imports by borrowing

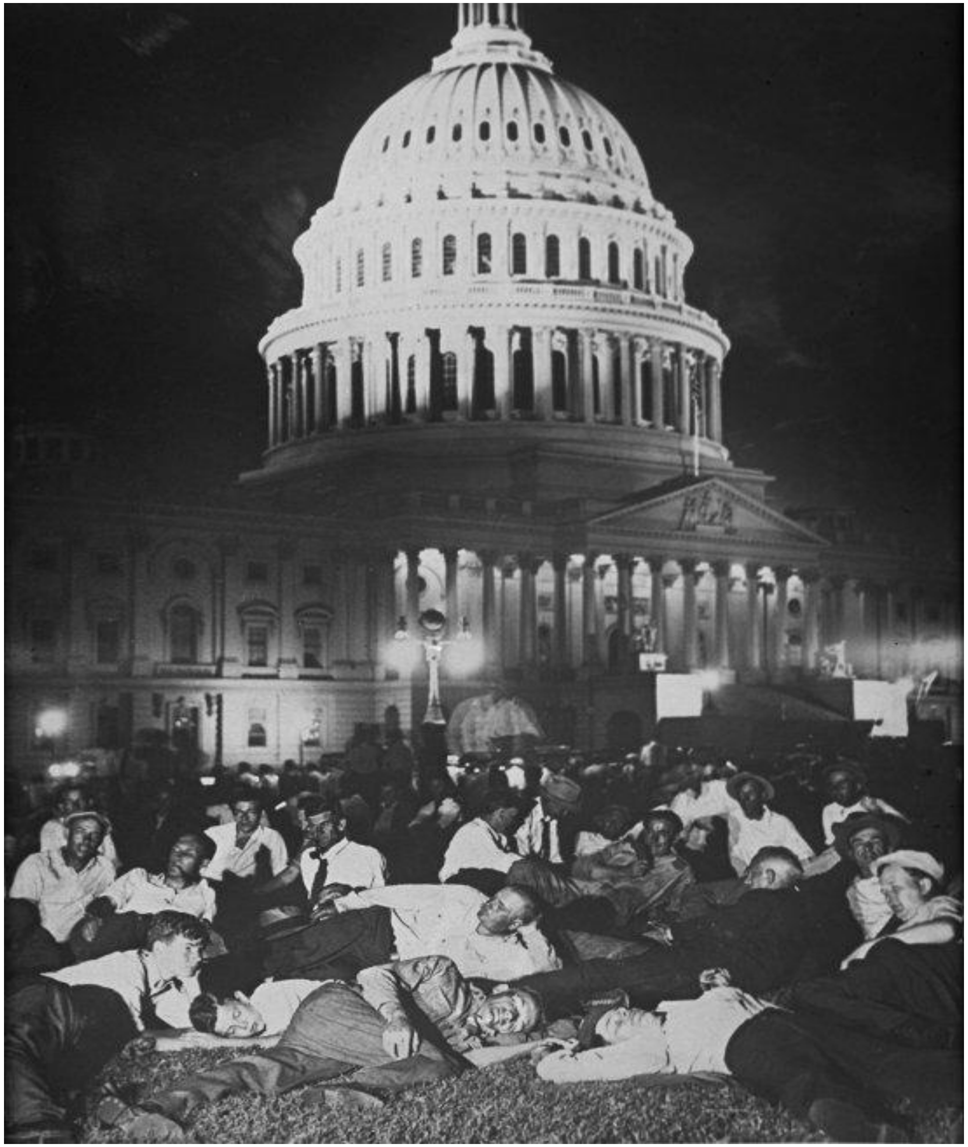
# 1) Try to expand your exports (sell more so you can buy more)

- HOW? DECREASE YOUR CURRENCY VALUE BY LOWERING INTEREST RATES…….
- ↓ interest rates → ↓ demand for currency↓ currency value → ↓ price of goods sold abroad → ↑ exports →↑ production +↑ jobs → ↑ Y → ability to pay for imports → ↑ currency value
- But NO…..they couldn't do that. Why? **The currency value was fixed to the price of gold.**

# 2) Raise interest rates and deflate the economy even further…..

- Raise interest rates so that speculators wouldn't convert investments into gold.
- ↑interest rates → ↑increase cost of borrowing → ↓ access to credit → ↓ production → ↓ jobs → Y → ↓ demand for goods → more ↓ production → ↓ jobs
- **This won't do either!  Can lead to social unrest which can topple governments!**

# Protest



# The Gold Standard left governments immobilized……unless……

- The Gold Standard created a “self regulating market,” immobilizing Governments.

- **Governments were immobilized because they were pulled in opposite directions: falling production required forceful action to ease credit and lower interest rates; but easing too much risked a flight of capital that would deplete their gold stocks.**

- **The gold standard relegated government to the largely passive economic role of safeguarding a nation's gold stocks**.

# 3) They were given credit to pay for imports

- Much of production was financed by credit---by promises of repayment in the future.
- Consumers went into debt "The 1920s were definitely the beginning of modern consumer finance," In the 1920s, installment lending -- loans secured by a car or appliance --
- The United States private banking sector grew and began to make loans/provide capital to the rest of the world—also bought foreign securities

- **Britain as the world's creditor**
- Where did the credit come from? The Market wasn't self regulating: Britain as the world's creditor
- 
- Throughout the 19th century, Britain played the role of the world's creditor, in order to keep free trade alive--, Britain maintained a relatively open marked for the exports of countries in balance of payments difficulties, 2) provided contracyclical foreign long-term lending, and 3) acted as a lender of last resort in times of exchange crisis**.**

# Depression took away Britain’s ability to be the world’s creditor

- As production declined, England could not pay for imports and the gold reserve supporting the pound declined,
- and people who had pounds converted their pounds into gold because value of gold was stable.
- **Then there were too many British pounds on the market and the value dropped**. So Britain went off the gold standard in 1931 in order to devalue the pound.
- Then 20-odd other countries went off the gold standard in order to protect their industries and their exports

# Without credit, governments would be toppled if they clung to the gold standard

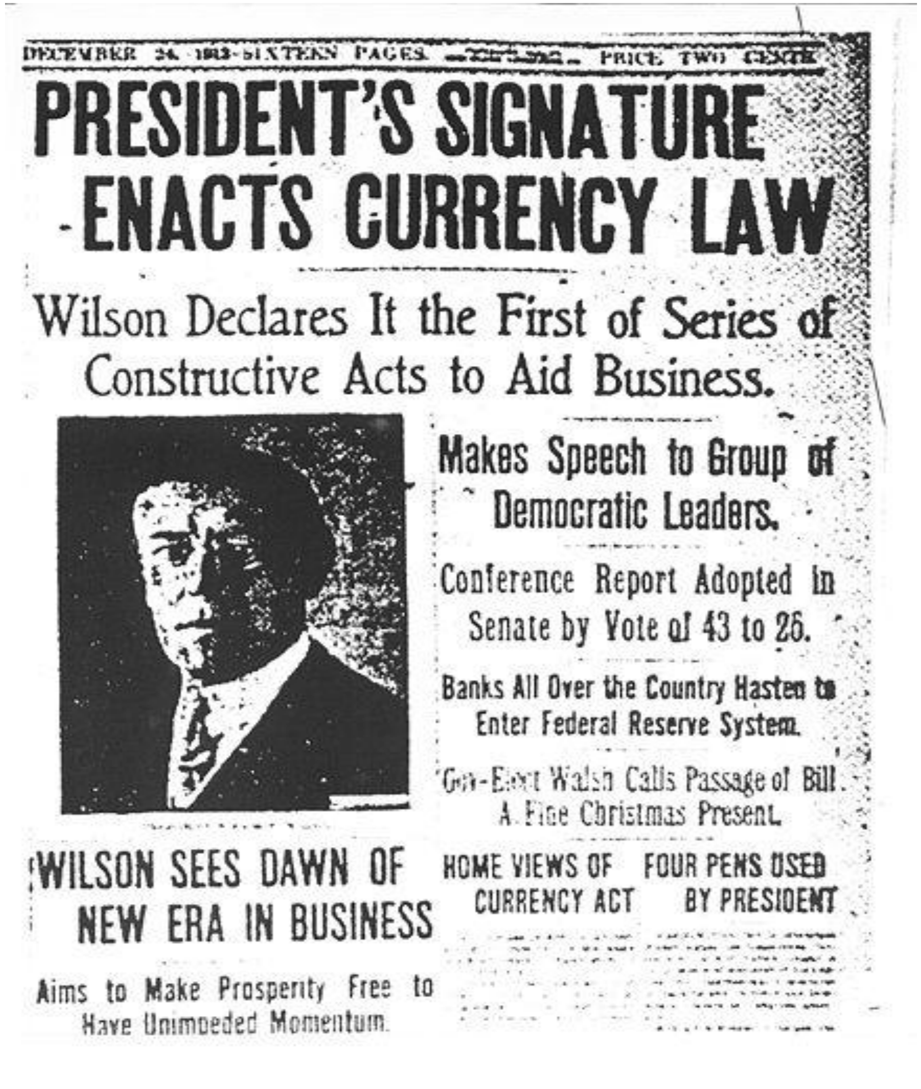
- Their only choice was to deflate their economies and deflation was unacceptable….
- So they abandoned gold

# And unmasked the unsustainability of the gold standard

- Just like the commodification of labor, Polanyi argued that the gold standard wouldn’t work.

- Global Market Place Without Global Government!

# Leaving the Gold Standard Standard



DECEMBER 24, 1913—SIXTEEN PAGES. PRICE TWO CENTS

# PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

## Wilson Declares It the First of Series of Constructive Acts to Aid Business.

### Makes Speech to Group of Democratic Leaders.

Conference Report Adopted in Senate by Vote of 43 to 25.

Banks All Over the Country Hasten to Enter Federal Reserve System.

Gov-Elect Walsh Calls Passage of Bill A Fine Christmas Present.

## WILSON SEES DAWN OF NEW ERA IN BUSINESS

Aims to Make Prosperity Free to Have Unimpeded Momentum.

### HOME VIEWS OF CURRENCY ACT

### FOUR PENS USED BY PRESIDENT

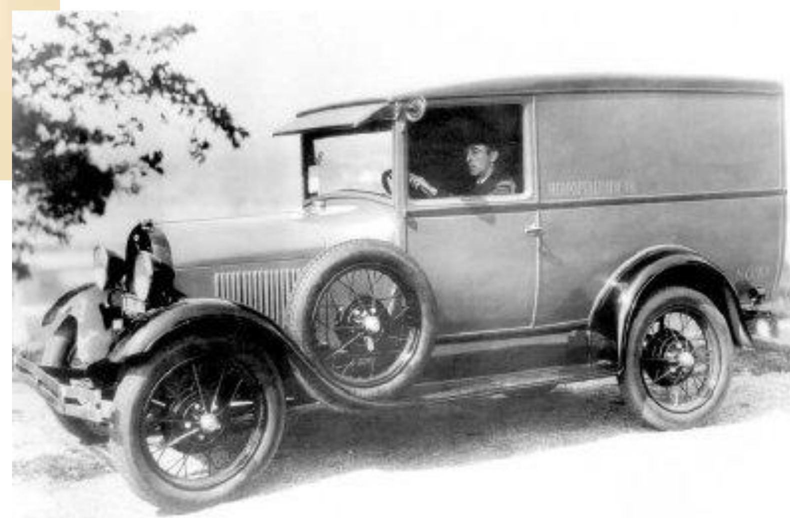
# Currency values plunged…..

- And countries engaged in competitive devaluations to make their exports cheaper
- Forcing the closure of plants in importing countries
- Leading to more and more joblessness which then led to

# Protectionism: Tariffs, quotas, and other trade barriers enacted

# The world responds with economic nationalism

# Trade stops, US economy declines even more

# More economic nationalism around the world

- Tariffs and qualitative restrictions
- The world disintegrates into fiercely competing national economic systems
- Every state for itself!

# The Tendency toward Economic Nationalism

- The Logic of Protectionism
- **Contradictions between  needs of the domestic political economy and the International economy**
- **Markets require national economies to be open for free trade to flourish**
- **But markets fluctuate and can have negative effects on society**

# The imperatives of the market vs. needs of the national community

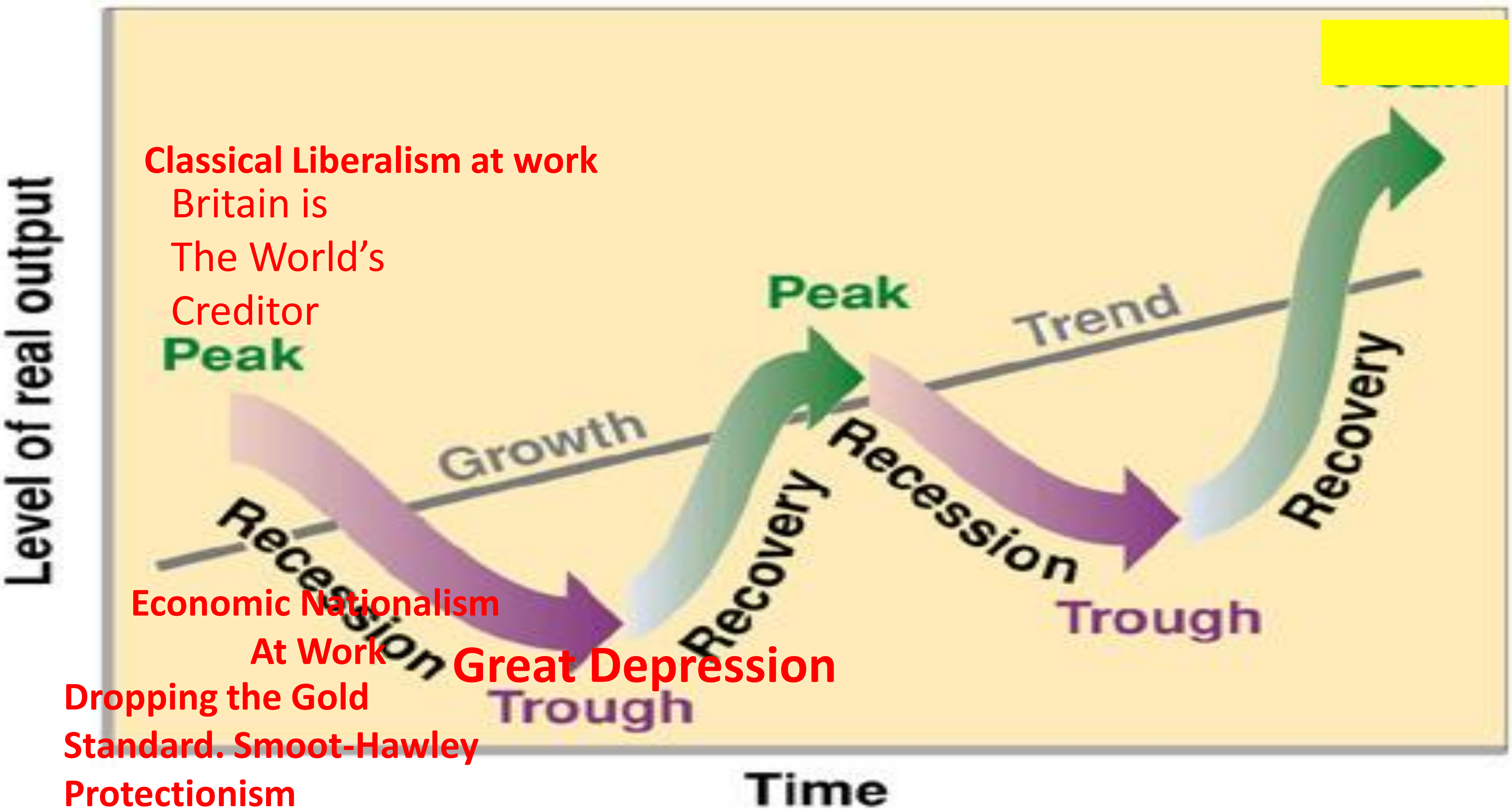
- Market imperatives
  - The business cycle
  - Free Trade creates losers and requires "adjustment"
    - Losers are free to fail
- Political Imperatives
  - Nations and states need political and social stability—losers are must have a safety net because they are citizens of the "nation"
  - The political need for stability and the requirements of the market are contradictory under the above conditions
- Governments must intervene in markets
  - to protect the "nation"
  - They can topple when society is unstable

# Tendency toward economic nationalism: explaining protectionism as a PD Game

| | Cooperate (free trade) | Defect (protectionism) |
|---|---|---|
| cooperate | 5, 5<br>Comparative advantage<br>Growth for all, I keep my market open even with BOP deficits because I know things will get better | 0,3<br>I keep my market open but you close yours; I lose so eventually I will retaliate |
| Defect (protectionism) | 3,0<br>You keep your market open, I close mine, I win, you lose and eventually you retaliate | 1,1<br>We both close our markets; you close yours, I retaliate, you retaliate, and so on…..no more free trade |

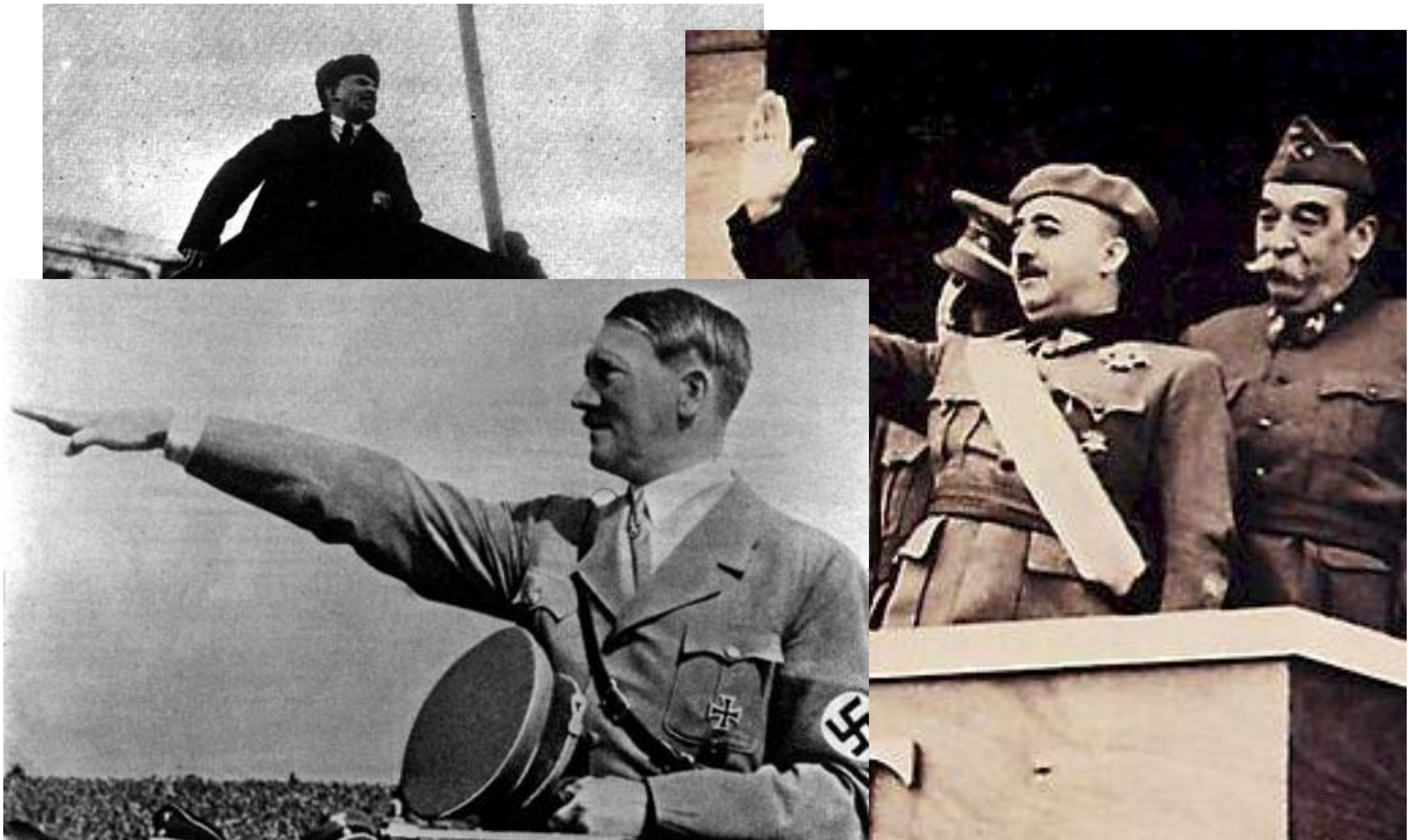
**Contradictions between needs of the domestic political economy and the International economy**

# Sure enough…..the world moved from Liberalism to Economic Nationalism



# Capitalism in Crisis: The Great Depression and backlash against liberalism

# The Great Depression showed that the classical liberal response was too risky for governments



# Deutschland erwacht!

**In allen Gauen der deutschen Nation ruft Adolf Hitler das erwachende Volk zum Befreiungskampfe auf.**

Hitler auf seinem Deutschlandflug bei der Zwischenlandung in Danzig


Hitler beim Verlassen einer neuerrichteten nationalsozialist. Geschäftsstelle.

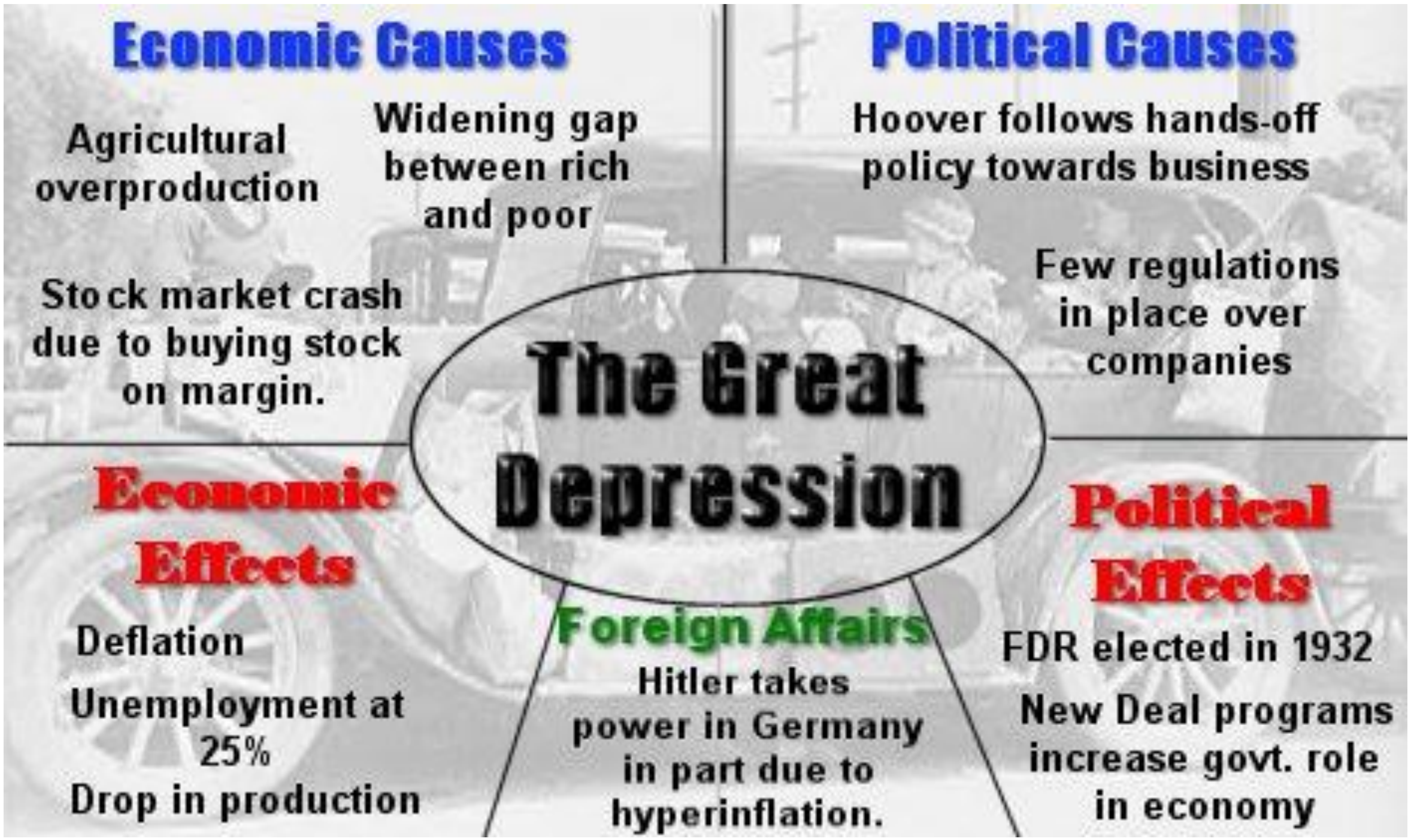
Oben:
**Hitler schreitet die Front der S.A. ab.**

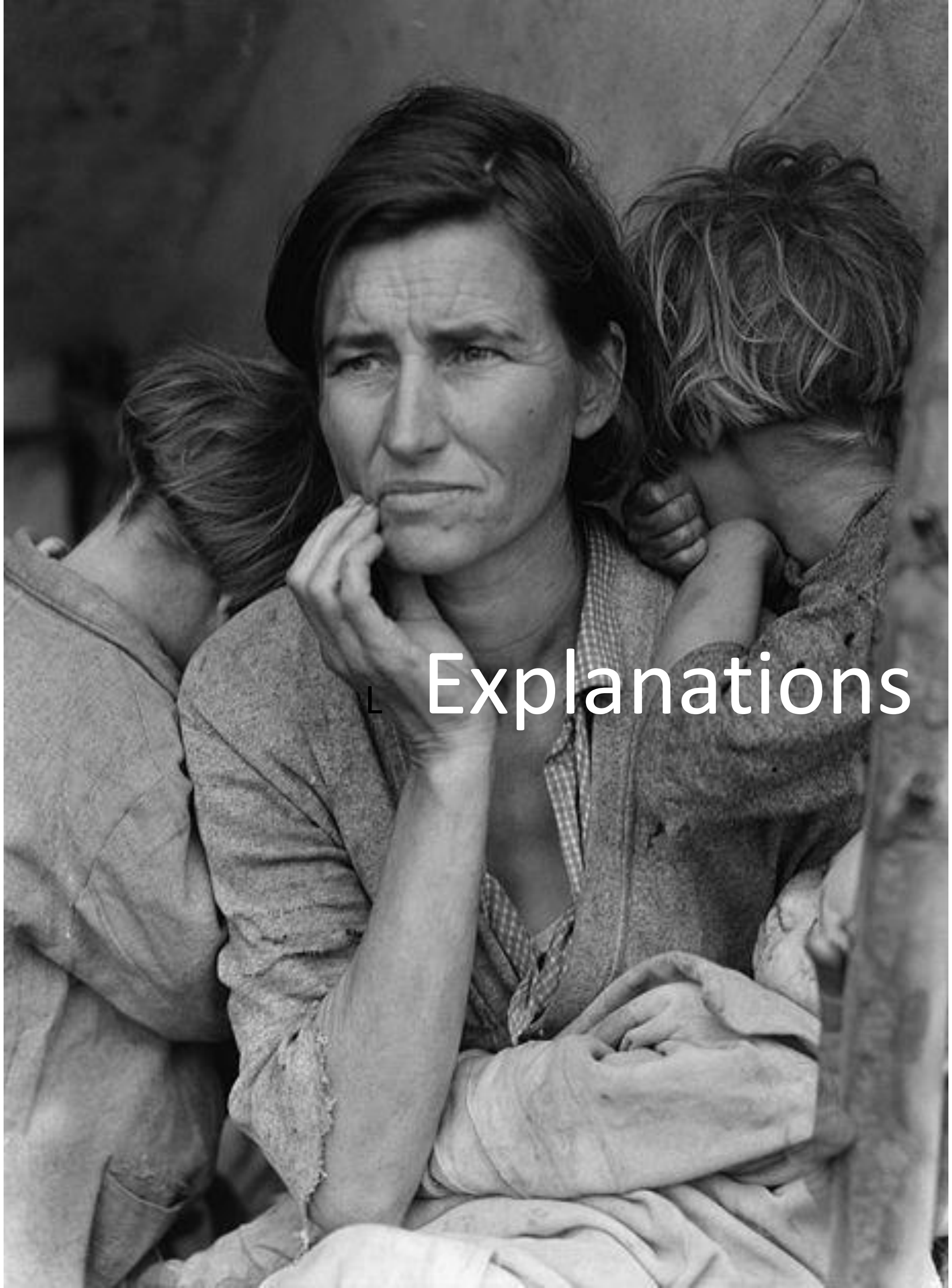
Nebenstehend:
**Die Jugend begrüßt den Führer des kommenden Deutschlands.**

Unten:
**Hitler spricht mit mecklenburgischen Landarbeitern.**

# War and Genocide

# Overview: Cause and Effects



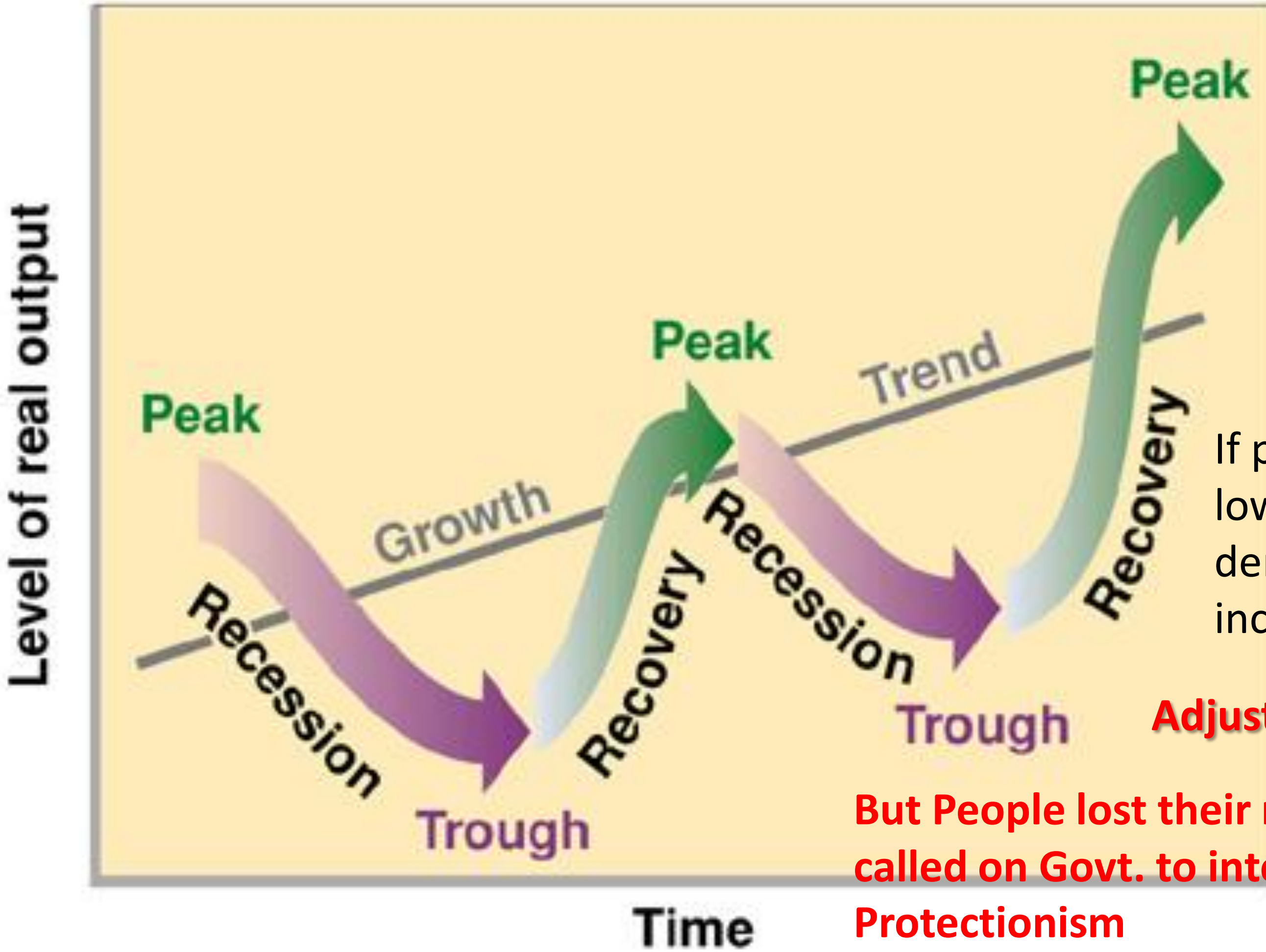


# Explanations

# Marxist explanations

- Exploit others
- Grow or Die
- Overproduction
- Underconsumption

# Liberal Explanations: Depression as low point in the Business Cycle




If prices are low enough, demand will increase

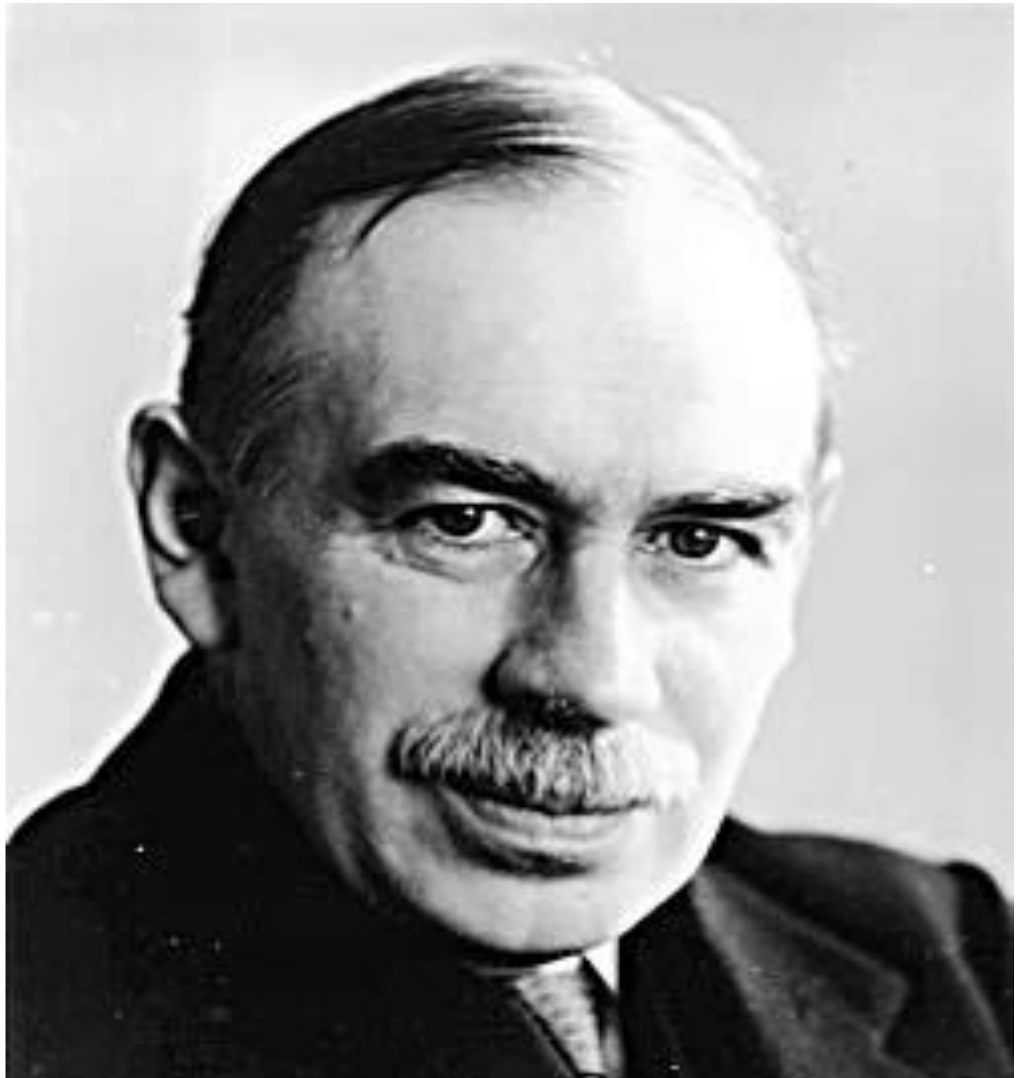
**Adjustment Required**

**But People lost their nerve and called on Govt. to intervene→ Protectionism**

# Market solution: “purge rottenness out of the system”

- After the 1929 crash, Treasury Secretary Andrew Mellon advised the government to cut spending to balance the budget, and leave desperate banks, businesses, and families to fend for themselves because the market alone would "purge the rottenness out of the system."

# The Domestic Solution was a Keynesian Solution: Embedded Liberalism



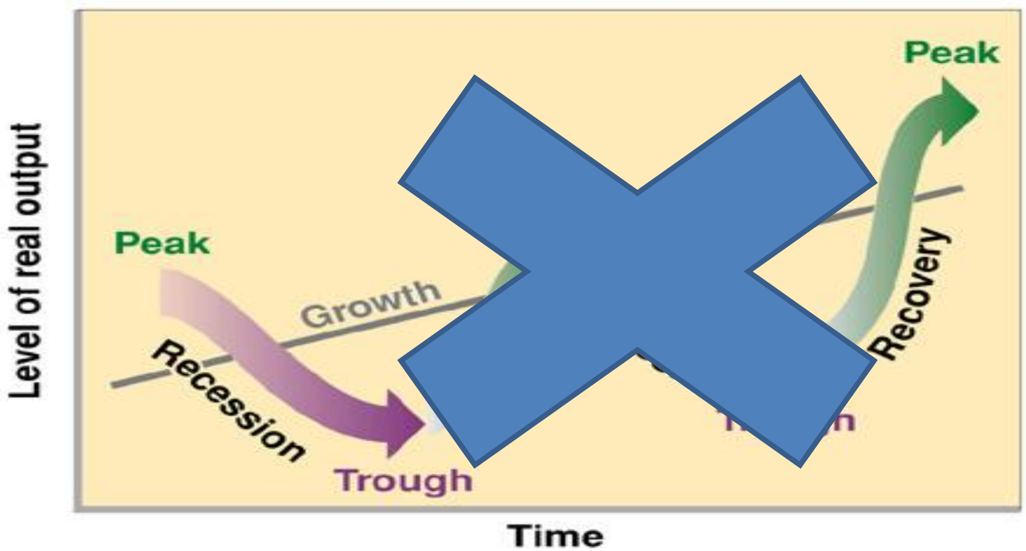
# Keynes repair of classical liberalism

- Theory of macroeconomics grew out of the Great Depression
  - Classical liberal models built on assumptions of individual behavior (rationality)
  - This might work for individuals but not for whole economies
- Economic stability is not assured through market forces
- Political stability requires state intervention to achieve economic stability

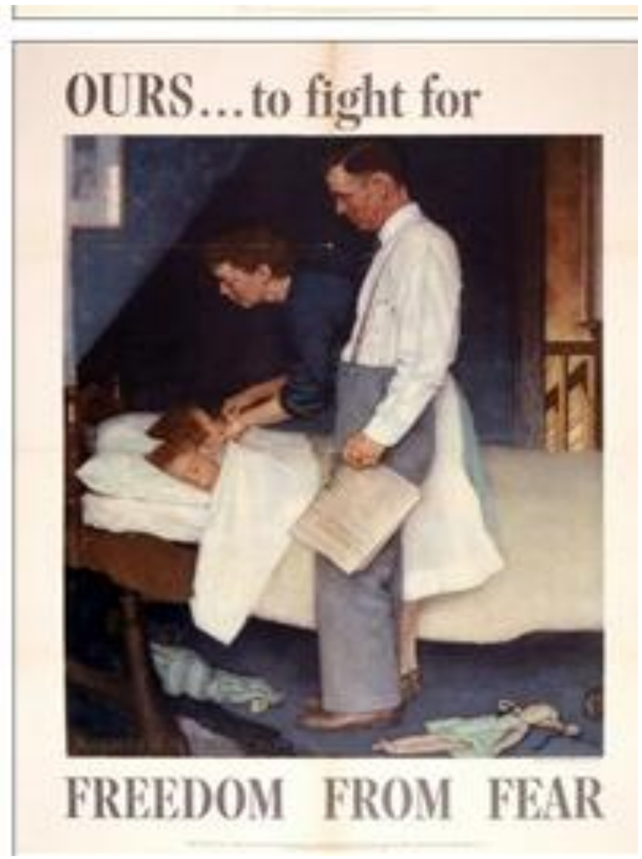
# Keynes and the Limits of the Market

- ↓ employment -> ↓ Demand -→ No Market correction and spiral downward
- ↓ employment -> ↓ Demand -→ **Govt. intervention** → ↑ Employment

Liberal Business Cycle Model is Wrong!



# Keynes' views bolstered by Expansion of Political Liberalism: Four Freedoms

# First Modification:The welfare state and aggregate demand

- Social insurance:  permits those not working to create demand in the economy
- Governments provide bank guarantees to encourage savings and investment
- The government itself creates demand
- Adds up to this: Government intervenes in the “trough” of the business cycle to take over financial institutions and even industry

# The New Deal in the United States: Domestic Embedded Liberalism + regulation

- WPA
- Social Security
- Minimum Wage
- Banking regulations
- FDIC, Glass-Steegal Act
- SEC

# WPA employed Artists!

# The Welfare State

- **Social insurance:** Insures against inability to work, whether from unemployment, disability or old age
- **Health insurance:** Universal health insurance or access to health care
- **Education:** Free primary, secondary and university education or access to training and continuing education
- **Child care:** Child care before primary school to support labor market entry
- But there are three kinds of welfare states:

# The Liberal World of Welfare

- **Low benefits:** Relatively meager unemployment and retirement benefits
- **Unequal benefits:** Poor rely on (low) public benefits, middle-class rely on (higher) private benefits
- **Private sector priority:** Pension, health care supplied by employer, requires participation in the market

# The Social Democratic World of Welfare

- **High benefits:** Generous unemployment insurance, retirement pensions
- **Equal benefits:** Both lower and middle classes rely on the same social policies
- **Public sector administration:** Many benefits (child care, health care) are administered by the state

# The Consequences of the Social Democratic Welfare State

- **A source of solidarity:** Workers (and the middle class) rely on the same welfare state
- **Labor power resources:** The welfare state creates jobs (health care, child care) and a solid voting bloc
- **Contesting corporate control?:** Pension funds as significant actors in Scandinavian financial markets

# The Dark Side of the Socialist Welfare State

# The Conservative (Communitarian) World of Welfare

- **High benefits:** Generous unemployment insurance, retirement pensions
- **Unequal benefits:** Unequally distributed depending on occupation and contributions
- **Corporatist administration:** Delegated to new or traditional social organizations (trade unions, industry associations)

# The Consequences of the Conservative (Communitarian) Welfare State

- **Reinforces traditional gender roles:** Emphasis on contribution history punishes labor market exit
- **Reinforces occupational distinctions:** More generous benefits for some occupations, civil servants

# The End

# But Free Trade tends to undermine these new roles for the state

- Free trade and comparative advantage demand that inefficient industries should fail and employment should be left to the market
- Employment will fluctuate with supply and demand for labor
- For Liberals, too much state intervention to create demand does not allow the free market to work properly: "tax and spend" reduce money available for investment—governments should "reduce taxes" to create aggregate demand