A MANIFESTO FOR SOCIALIST SENSE

More than four years after the financial crisis began, the world’s major advanced economies remain deeply depressed, in a scene all too reminiscent of the 1930s. And the reason is simple: the capitalist mode of production has failed yet again, just as it did in the 1930s. We are relying on the same ideas that governed policy in the 1930s. They are relying on vulgar ideas, long since disproved, that involve profound errors untruths both about the causes of the crisis, its nature, and the appropriate response.

These errors have taken deep root in public consciousness and provide the public support for the excessive austerity of current fiscal policies in many countries. So the time is ripe for a Manifesto in which mainstream concerned economists offer the public a more evidence-based socialist analysis of our problems.

- **The causes.** Many policy makers insist that the crisis was caused by irresponsible public borrowing. With very few exceptions — other than Greece — This is false. Instead, the conditions for crisis were created by a system of production that goes on strike whenever there are insufficient profits. This was covered up for a while through excessive private sector borrowing and lending, including by over-leveraged banks. But eventually, profits from credit-fuelled speculation in the stock market and in property, using financial instrument of mass destruction, were no longer realised. The collapse of this bubble led to massive falls in output and thus in tax revenue. So the large government deficits we see today are a consequence of the crisis, not its cause.

- **The nature of the crisis.** When real estate bubbles on both sides of the Atlantic burst, many parts of the capitalist corporations and banks private sector slashed spending in an attempt to pay down past debts. This was a rational response on their part of individuals, but — just like the similar response of debtors the capitalist sector in the 1930s — it has proved collectively self-defeating, because one person’s spending is another person’s income. Profits fell, and the capitalist sector stopped investing. The result of the investment spending collapse has been an economic depression that has worsened the public debt.

- **The appropriate response.** At a time when the capitalist private sector is engaged in a collective effort to spend less, public policy that preserves this sector cannot and should not act as a stabilizing force, by bailing them out attempting to sustain spending. At the very least we should not be making things worse by big cuts in government spending or big increases in tax rates on ordinary people to pay for the bailout of the banks. Unfortunately, that’s exactly what many governments are now doing.

- **The big mistake.** After responding to save the banks that caused the economic crisis when it broke, just as they did in the 1930s, well in the first, acute phase of the economic crisis, conventional policy wisdom deliberately took a wrong turn — focusing on government deficits, which are mainly the result of a crisis-induced plunge in revenue, to and arguing that the public sector should attempt to reduce its debts in tandem with the private sector. As a result, instead of playing a stabilizing role, fiscal policy has ended up reinforcing the dampening effects of capitalist private sector spending cuts. In the face of a less severe shock, monetary policy cannot solve the problem. It’s not just because...
slack. But with interest rates are already close to zero, monetary policy – while it should do all it can – cannot do it, when the problem is the profitability of the capitalist sector, not the lack of credit the whole job. Only when the banks are brought into democratic public ownership can credit be directed towards helping investment, jobs and growth and away from speculative gambling that they are currently engaged in.

It is not the right policy to propose There must of course be a medium-term plan for reducing the government deficit based on cuts and tax rises. That is not just because But if this it is too front-loaded and will it can easily be be self-defeating by aborting the recovery. A key priority now is to reduce unemployment, before it becomes endemic and that means more investment and growth. Reducing the government deficit is irrelevant, making recovery and future deficit reduction even more difficult.

How do those who support present policies answer the argument we have just made? They use two quite different arguments in support of their case.

- **The confidence argument.** Their first argument is that government deficits will raise interest rates and thus prevent recovery. By contrast, they argue, austerity will increase confidence and thus encourage recovery. But there is no evidence at all in favour of this argument. First, despite exceptionally high deficits, interest rates today are unprecedentedly low in all major countries because inflation is low and we are close to deflation, where there is a normally functioning central bank. This explains is true even in why Japan where the government debt now exceeds 200% of annual GDP; and despite past downgrades by the rating agencies has very low here have had no effect on Japanese interest rates. Interest rates are only high in some Euro countries, because debt is rising and economies are in depression and capitalist lenders fear they will not get their money back, because the ECB is not allowed to act as lender of last resort to the government. Elsewhere the central bank can always, if needed, fund the deficits and debt, but that still leaves the burden on capitalist profit down the road, leaving the bond market unaffected.

Moreover Past experience includes no relevant case where budget cuts have actually generated increased economic activity. The IMF has studied 173 cases of budget cuts in individual countries and found that the consistent result is economic contraction. In the handful of cases in which fiscal consolidation was followed by growth, the main channels were a currency depreciation against a strong world market, not a current possibility. The lesson of the IMF’s study is clear – budget cuts retard recovery. And that is what is happening now – the countries with the biggest budget cuts have experienced the biggest falls in output. On the other hand, devaluing the currency will also hit average living standards and eventually growth because costs of production will rise and profitability in domestic industry will fall, particularly in small capitalist economies who have small market share.

For the truth is, as we can now see, that budget cuts do not inspire business confidence. Companies will only invest when they can foresee enough customers with enough income to spend. Austerity discourages investment. But companies won’t invest either if their profitability is restrained by increased taxation in order to fund rising government spending and deficits. As long as the capitalist sector is dominant and profit rules, increasing government spending through more taxes
and/or more borrowing will restrain capitalist investment. The real answer is to replace the capitalist system with a plan based on socialised production.

So there is massive evidence against the confidence argument; all the alleged evidence in favor of the doctrine has evaporated on closer examination.

- The structural argument. A second argument against opposing austerity expanding demand is that output is in fact constrained on the supply side – by structural imbalances. If this theory were right, however, at least some parts of our economies ought to be at full stretch, and so should some occupations. But in most countries that is just not the case. Every major sector of our economies is struggling, and every occupation has higher unemployment than usual. So the problem must be a general lack of spending and demand. And what causes that lack of demand is the lack of investment and what causes that is a strike by the capitalists sector due to a lack of sufficient profit.

This supply constraint is a product of the failure of capitalist production. Providing more government spending at a cost to profitability will not do the trick. Government action should be to replace capitalist investment with public investment. There is plenty of potential supply but no investment to start it. In the 1930s the same structural argument was used against proactive spending policies in the U.S. But as spending rose between 1940 and 1942, output rose by 20%. So the problem in the 1930s, as now, was a shortage of demand not of supply.

As a result of their vested interest in profit mistaken ideas, many Western policy-makers are inflicting massive suffering on their peoples. But the ideas they espouse about how to handle recessions are still conventional wisdom among most economists and were rejected by nearly all economists, despite after the disasters of the 1930s, accepted the continuance of the capitalist system, especially during and for the following forty years or so when the West enjoyed an unparalleled period of economic stability and low unemployment.

It is tragic that in recent years the pro-capitalist old ideas have again taken remain rooted. But we should can no longer accept a situation where the interests of capitalism mistaken fears of higher interest rates weigh more highly with policy-makers than the horrors of mass unemployment.

Better policies will differ between countries and need detailed debate. But they must be based on a correct analysis of the problem. We therefore urge all economists and others who agree with the broad thrust of this amended Manifesto to register their agreement at www.thenextrecession.wordpress.com manifestoforeconomicsense.org, and to publically argue the case for a socialist approach.

The whole world suffers when men and women are silent about what they know is wrong.