Subpart-III: The Second Crisis of Capitalism: The Great Economic Depression (1929-30)

- **The Second Crisis of Capitalism:**

- After the First World War, it was the 'Great Economic Depression' which emerged as the biggest threat to the global peace. In a sense, the phenomena of recessions and depressions are inherent in the capitalist economy. In over enthusiasm, the capitalist class destroys its own market for profit. However, if the labour was not given its due share, the consumer market was bound to shrink. This phenomenon is known as 'the phenomenon of under-consumption'. This under-consumption became the most dominating reason behind the Great Economic Depression of 1929-30.
- This worldwide recession of 1929-30 originated in the United States. On October 24, 1929, a sudden downfall occurred in the Stock Exchange of America's Wall Street. This day is known as 'Black Thursday'. It affected almost all countries of the world, whether they were industrial economy or agriculture based. The world economy collapsed. It was characterized by falling prices, declining production, shrinking trade sector and rising unemployment. Only Russia could escape from this cycle of depression, because it was not integrated with the international market at that time. Secondly, the socialist economy of Soviet Russia was not governed by market forces, such as the laws of supply and demand, rather it was operated through economic planning under state control.

- **Causes:**

1. There was an imbalance of trade between western imperialist countries and the colonies, because the mechanization of the agricultural economy in the West led to a decline in demand for the agricultural products of the colonies. It hampered the purchasing power of some of the colonies. Obviously, that made a curtailment in the import of manufactured goods from western developed countries. So, trade cycle between the two was disturbed.
2. There was an imbalance in trade between Europe and USA as well. Although in the course of the WWI, there was expansion of industries in Europe but those were mainly staple industries. On the other hand, USA emerged as the largest economy as well as the largest consumer goods producer. So consumer goods of USA just captured European market, particularly motor industries, but Europe was not in a position to export its products to USA. This created an imbalance in trade.
3. After the WW-I European economy was more or less functioning on American capital. In fact, after the war was over, the economic reconstruction programme was going on in a large number of countries and that was possible only through American credit. So it is crystal clear that if the supply of fund from USA was disrupted] European economy was sure to be dislocated.
4. In the meantime, some American capitalists started to take interest in speculation and they invested a large amount in share market. People were encouraged to buy shares on margin money to increase the sale of shares. Once the cost of a particular share shots up capitalists used to sell the shares and take the profits. But this didn't continue for a long time and on the so called 'Black Thursday', on 24th October 1929, the share market crashed and it could not recover from the shock. It sent a sense of despair among the people all over the world.

- **Methods adopted to tackle the economic depression:**

1. There was a world conference at Lausanne to discuss the issue but there were disagreements regarding the solution. On the basis of Lausanne Conference in 1932 almost 90% of the German loan was waived off.
2. In 1933, a conference was organised at London. It aimed to revive the global trade and to stabilize the exchange rate. But it ended without any concrete outcome.
3. Some countries tried to solve the problem on individual level. They tried to tighten their budget by curtailing their expenditure. But it proved counter-productive measures. It diminished purchasing power of people and it resulted in decrease in demand.
4. The Nazi government of Germany tried to give a better solution to this problem. Nazi government increased government expenditure. To generate employment, it started recruitment of army, construction of roads, arms production. But this led German economy towards war.
5. **Keynesian Economics-** In 1936, John Maynard Keynes published his famous text, *'The theory of employment interest and money'* and in this text, he attacked the gold standard and free market. Keynes prescribed demand management in the economy. For demand management, he talked about two rules, Taxation and Expenditure.
6. Franklin D. Roosevelt introduced an economic package in the form of 'New Deal' Policy in USA. He adopted the policy of public expenditure along with other economic reforms, like subsidies to peasants and unemployed, construction of Tennessee Valley project to generate employment etc. This economic package helped USA to revive from this global economic crisis.

Question: What policy instruments were deployed to contain the Great Economic Depression? (UPSC-2013)

Answer: The state of recession lies in the science of capitalist economy itself. Almost every decade, a cycle of recession comes in the capitalist economy, but the global economic recession of 1929–30 was quite different in its intensity and extent. Naturally, the measures adopted for its solution also proved to be equally complex.

This was the first experience of capitalist countries to struggle with such a recession. Many steps were taken collectively and individually by these countries. As a collective solution, the Lausanne Conference was organized in 1932 and under this Germany's war compensation amount was waived off. Then in 1933, a conference was organized in London, but this conference could not reach any solution. In the end, various capitalist countries started making individual efforts. Attempts were made by France to cut public expenditure, but instead of solving the problem, it intensified the problem further more. At the same time, Britain adopted the policy of budget control. That also did not work. Then the capitalist countries tried to set up protectionist tax walls against each other to protect their domestic industries. Due to this, a kind of tax war broke out. Similarly, the policy of devaluation of currency for export promotion, compelled the abandoning of gold standard by various countries. This step was coined as *'Beggar thy Neighbor Policy'* by an economist Johnson. These all measures proved to be ineffective.

Further, the Nazi government of Germany emphasized on public works for employment generation. This method worked very well, but it pulled the German economy towards the war. On the other hand, steps were taken by the President of the United States of America, Franklin D. Roosevelt, to increase demand by direct intervention in the American economy through 'New Deal' policy. This step proved to be very effective. But it brought a change in the nature of capitalist economy. Now this capitalism was based on state intervention, not on the principle of free economy.

Thus, different countries had reacted differently to the economic slowdown.

Impact of the Great Depression

Crisis in Capitalism

- Changes in the nature of Capitalism
  - ✍ Development of capitalism based on Keynesian economics.
  - ✍ Increasing the role of government in the operation of economic policy by Roosevelt.
- In order to face the crisis, the power and intervention of the governments increased.
- Socialism benefitted from the crisis in capitalism, especially because only Russia could escape this depression cycle. Hence socialism progressed all over the world.
- Capitalists and landlords were apprehensive about the popularity of socialism, so they encouraged fascism, i.e. the ultra-nationalist ideology.

■ **Impact of the Great Depression:**

1. In order to face the great depression, the nature of capitalism itself changed. Capitalism adopted some of the features of socialist model of economy, e.g. economic planning. The ideological inspiration for this change came from an economist, John Maynard Keynes, who was in favour of government intervention in order to maintain the demand in the economy. Thus the nature of capitalism changed.
2. There was deep impact of the economic downfall on the political sphere. During 1920s, many parliamentary democracies were established in Europe, but in the 1930s, democracy could sustain only in Britain, France, Scandinavian countries, Czechoslovakia and some other countries. Political upheaval was observed even in the countries where a democratic economy was prevalent. In order to face this economic recession, the power and intervention of the European governments increased.
3. It highlighted the weakness of the capitalist economy. Only Russia was able to escape from this depression cycle which resulted in the progress of socialism in the world. So, socialist economic model of Russia attracted the whole world. This posed further challenge to the capitalism.
4. The progress of socialism frightened the capitalists and landlords. Then in order to contain the spread of socialism, Western countries adopted the policy of appeasement and fascist powers were promoted. This was a major reason behind the rise of fascist rule. As a result, it played an important role indirectly in occurring of WW-II.

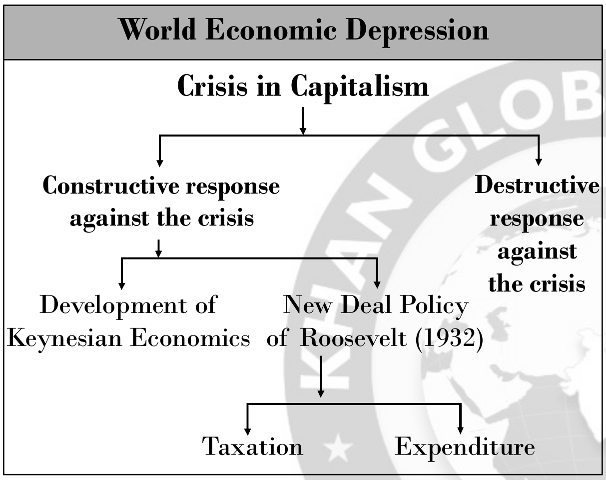
Question:- The world economic depression changed the economy and politics of Europe both. Analyze it.

***(Question Analysis:-** This question is 'Hypothetical' in nature. We have to explain the changes in economy and politics through thoughts and examples.)*

Answer: The world economic depression (1929-30) reflects the crisis in capitalism. It not only brought changes in the nature of capitalist economy, but also brought upheaval in the politics of Europe.

The world economic depression gave a serious jolt to the policy of free economy based on classical economics. This resulted in the development of Keynesian economics, which emphasised the role of the state in demand management. With Keynesian economics, the concept of fiscal policy came into existence, as well as capitalism adopted some elements of socialism. It proved to be a constructive response to the crisis.

On the other hand, the destructive reaction against the crisis in capitalism manifested in the form of fascism and gave a different direction to the politics of Europe. In fact, due to the crisis in capitalism, socialism progressed in Europe. Being apprehensive, the capitalists supported fascism which was based on ultra-nationalism, so that people's attention would be diverted from internal struggle to external struggle. This resulted into the emergence of fascist leaders like Hitler and Mussolini which culminated into the Second World War.



- **Response against the second crisis in capitalism**
- **Constructive Response:**

1. **Keynesian Economics and New Version of Capitalism–** Capitalism never experienced such a disastrous crisis in the past as it faced in 1930 in the form of 'Great Depression'. It seemed that capitalism was going to an end. Classical economics faced a serious question mark. Classical economics talks about invisible hand and natural equilibrium in the economy, which was based on demand and supply. Economists from Adam Smith to J.B. Say contributed in its evolution. It was assumed that supply itself creates demand and aggregate income is equal to aggregate production/expense. There was no scope for unemployment. But during the Great Depression, a huge fall in demand was recorded and the rate of unemployment increased up to 25%. Classical economists took it as normal recession which would be passed itself after a short span. Trade unions and industrial workers created upheaval because they did not let fall in wages.

- In 1936, John Maynard Keynes published his famous text, ***'The Theory of Employment, Interest and Money'*** and in this text, he attacked the gold standard and the free market. Keynes prescribed demand management in the economy. For demand management, he talked about two rules - (i) Taxation (ii) Expenditure
- Keynes assumed that the inflation would increase the employment, and it is necessary to decrease unemployment. So he recommended that whenever there is a slump in the market, the government should reduce taxes and increase the expenditure. So demand would increase, and this increased demand would create price-rise which would lead to an increase in the production and the employment. This cycle would continue till employment reaches up to nearly 100%. In that situation, there would be an inflationary pressure on the economy due to the excessive demand. Then government should increase the taxes and reduce the expenditure. This method was known as 'fiscal stimulus' and J.M. Keynes is characterized as the father of this policy. Thus developed the so-called macro-economics. Still, Keynesian model was different from socialist model in the sense that, whereas in socialist model, the economy is under total control of the state, in Keynesian model it is not under total state control. Keynes believed that, as the state had a lot of other important work to do, the economy should be run under the private sector. The government should intervene only for demand management.

2. **New Deal Policy of Franklin D Roosevelt:**

- The American president introduced the policy of **'New Deal'** to counter world economic depression. In order to create demand in the economy, Roosevelt's government took several measures, such as giving subsidies to peasants and unemployed, encouraging construction works in order to generate employment like the construction of Tennessee valley project, which gave employment to nearly 20,000 people, reforms in banking laws etc. So American economy started to recover slowly, which led to the recovery of world economy as well. But here the point to be noted is that the 'New Deal' policy changed the very nature of capitalist economy itself. New Deal no more accepted the principle of free economy, rather it prescribed government intervention in the economy for the purpose of demand management. So sometimes the question is raised, did capitalism borrow something from socialism and partly followed the model of socialism? We can't deny the fact that capitalism strengthened itself by borrowing some features from socialism. It was visible in 'New Deal policy' as well as Keynesian economics. Similarly, Lenin had borrowed some capitalist features in his 'New Economic Policy'.

New version of Capitalism

↓

Impact of Keynesian Economics and New Deal Policy of Roosevelt

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- Capitalism strengthened itself by adopting some features of socialism.
  ↓
  Capitalist Model
- It also successfully counter socialism by emphasizing government expenditure and public welfare works.
- Change in the nature of government
  - ✍ Emphasis on the concept of a maximal state while the emphasis of classical economics or liberal economic policy was on a minimal state.

Capitalist Model
Free Market

Law of Demand ↓↑ Supply ↓ Emphasis on profit making

↓

- **Negative Aspects** ↓ The domestic market shrinks, causing recession
- **Positive Aspects** ↓ Emphasis on profit making encourages production

Socialist Model
State controlled Economy

Production & Distribution under State control

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- **Positive Aspects** ↓ Benefits of growth to all and arrangement of some fundamental services like free education, health, transportation etc. Due to this rapid expansion of the economy in the beginning.
- **Negative Aspects**
  - No motive of profit-making hence decline in growth in long run
  - Governing the economy through bureaucracy
    ↓
    - Red-tapism
    - Corruption

- **Impact of Keynesian Economics and New Deal Policy of Franklin D Roosevelt:**

- We have discussed above that a new economic model had been developed to overcome the crisis in the capitalist economy and in this sequence of events, Keynesian Economics and New Deal Policy of Franklin D Roosevelt came into existence. Although it was an economic outcome, its impact was also underlined in other areas also like constitution and governance.
- Classical economics talks about free economy and leaves economic activities in the discretion of market. It says that the role of state is limited to ensuring law and order. As a result, the concept of 'Minimal State' was put forward. But Keynesian economics and Roosevelt's New Deal greatly increased the role of state in economy. Now state started playing its role in demand management. In this direction, public welfare programmes were launched. Now state obviously increased tax rate and then, concept of 'Maximal State' came into light.
- This whole changed scenario gave a new direction to the constitution and government. It was very natural that increasing role of central government in economic field made it strong position. But it reduced the power of the provincial government. In addition to that, as we know that the government had three branches- legislative, executive and judiciary, among these three branches, executive had attained a strong position. In USA, Roosevelt's policy of new deal made centre more powerful in the centre-state relations. Now, the federal government started putting stress on the operational aspect of economic issues and the policy of social security. In this order, President Roosevelt faced a power struggle with federal court and federal court also considered this change in the balance of power in these changed circumstances.

Capitalist Model

Capitalist model was not a uniform model. It has different face in different countries due to condition and circumstances of concerned country. Its general characteristics are mentioned below:-

1. Economy has been put under the ownership of private sector, not in state control.
2. Private investment, private entrepreneurship and private profit are promoted.
3. Economic activities are governed by market forces (law of demand and supply) because it is considered that market takes better decisions as compared to any state authority.
4. Capitalism focuses on growth and it assumes that the fruit of this growth finally reach to all.

Positive aspect:

- Promotion to private investment and private entrepreneurship enhance production and bring growth also.

Negative aspect:

- More emphasis on profit making and private entrepreneurship widen economic gap. Some people are benefited, but most are deprived. There is no scope for social justice. This economic inequality shrinks market for capitalist itself. It creates production related problems and further economic recession becomes an important characteristic of this economy.

Socialist Model

Socialist model of economy was formulated by Marxism, but Karl Marx personally did not present any economic model. Later, Lenin and Stalin adopted an economic model after lots of experiments and this model was called socialist model of economy. Its characteristics are mentioned below-

1. State has direct interference in the market forces. State gives direction to it according to its convenience.
2. State enjoys full control over economy. State has land ownership and industries remains under direct control of state.
3. Market forces have been replaced by economic planning. In other words, production of goods is determined by market demand in the capitalist economy, but in the socialist economy it has been decided by the state.

Positive aspects:

1. Exploitation of resources on a large scale has become possible due to the state's interference. Through collectivisation of land, inequality has been removed from agriculture sector. It promotes increases in production and per capita income. Finally, it enhances demand.
2. Heavy industries and infrastructural based development have been given priority.
3. State has arranged some fundamental services like free education, health, transportation etc.

Through this model, Soviet Russia achieved 40% growth rate in its GDP.

Negative aspects:

- Profit is the main catalyst for production and labour force. Since this profit has been curbed, therefore economy has lost that motivating force in long run.
- Market forces enhance goods quality and reduce their prices due to market competition. But it is difficult to promote competition and maintain high quality of goods in the socialist economy.
- Since, production and distribution of resources remain under state's control, so it is state's responsibility for equal and fair allocation of resources. But on the one hand, it increases the size of bureaucracy and on the other hand, tendency of red-tapism and corruption become the part of system.

Inter-Disciplinary Approach

As we have seen earlier that we underline the elements of change in the study of world history. These elements of change have made impacts on contemporary polity, economy, society, constitution, culture etc.

If we take a look on long lasting impact, then we find the changes which are mentioned below-

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Keynes assumed that the inflation would increase the employment, and it is necessary to decrease unemployment. So he recommended that whenever there is a slump in the market, government should reduce taxes and increase the expenditure. So demand would increase and this increased demand would lead to an increase in the production and the employment. This cycle would continue till employment reaches up to nearly 100%. In that situation there would be an inflationary pressure on the economy due to the excessive demand. Then government should increase the taxes and reduce the expenditure. This method was known as 'fiscal stimulus' and J.M. Keynes is characterized as the father of this policy. Still Keynesian model was different from socialist model in the sense that where as in socialist model, the economy is under total control of the state, in Keynesian model it is not under total state control. Keynes believed that as the state had a lot of other important work to do, the economy should be run under the private sector. The government should interfere only for demand management.

New Deal Policy of Franklin D Roosevelt

The American president introduced the policy of 'New Deal' to counter world economic depression. He declared that 'in order to save USA and the world, I declare a new deal to fight depression'. Here the approach of Roosevelt seems to be different from Barack Obama. At the time of the 1st economic depression (1929) USA tried to make a compromise between its own economy and the world economy but at the time of 2nd depression (2007) Obama's government showed a self–centered approach when it decided to put a check over outsourcing to India. So he failed to show the leadership quality which had earlier been shown by Roosevelt. Taper tantrum on account of the ultra-cheap liquidity policy of American central bank is another example. In order to create demand in the economy, Roosevelt's government took several measures such as giving subsidies to peasants and unemployed, encouraging construction works in order to generate employment like the construction of Tennessee valley project which gave employment to nearly 20,000 people, reforms in banking laws etc. So American economy started to recover slowly which led to the recovery of world economy as well. But here the point to be noted is that the 'New Deal' policy changed the very nature of capitalist economy itself. New Deal no more accepted the principle of free economy, rather it prescribed government intervention in the economy for the purpose of demand management. So sometimes the question is raised that did capitalism borrow something from socialism and partly followed the model of socialism. We can't deny the fact that capitalism strengthened itself by borrowing some features from socialism. It was visible in 'New Deal policy' as well as Keynesian economics. Similarly, Lenin had borrowed some capitalist features in his 'New Economic Policy'.

Constitution and Governance

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Classical economics talks about free economy and leaves economic activities in the discretion of market. It tells that the role of state is limited to ensure law and order. In result, concept of 'Minimal State' was put forward. But Keynesian economics and Roosevelt's New Deal increased greatly role of state in the economy. Now state started playing its role in demand management. In this direction, public welfare programmes were launched. Now state obviously increased tax rate and then, concept of 'Maximal State' came into light. As we have seen earlier that middle class was not in favour of such wider role of the state, but crisis in capitalism and fear of communism were in front of this class. So, middle class had to accept this change.

This whole changed scenario gave a new direction to the constitution and government. It was very natural that increasing role of central government in economic field made it strong position. But it reduced the power of provincial government. In addition to that, as we know that government had three branches- legislative, executive and judiciary, among these three branches, executive had attained a solid position. In USA, Roosevelt's policy of new deal made centre more powerful in the centre-state relations. Now, federal government started giving stress also on operational aspect of economic issues and policy of social security. In this order, President Roosevelt faced power struggle with federal court and federal court also considered this change in balance of power in these changed circumstances.

Capitalism vs Socialism

As we have seen that Russian Revolution had established first socialist government of the world. Further, it had developed a new economic model which was not based on market forces, but it was a planned economy. This model proved successful and it provided high growth rate to the Russian economy. At the same time, capitalist economy faced unprecedented slowdown, 'Great Depression'. It posed a big question mark on credibility on the capitalist model of economy. Simultaneously, socialist ideology progressed immensely on global level. In this scenario, Keynesian economics and New deal presented a practical solution in this crisis period and it introduced a new model as a middle way between capitalism and socialism. It had provided a human face to capitalism and enabled capitalism to fight against socialism. Soviet Russia's revolution attempted to attract labours and workers. On the other side, Keynesian model tried to face socialist propaganda through welfare programmes for labours. Therefore, capitalism received constant stimulation from Keynesian economics throughout cold war. Yes, it is true that socialist model got dismantled in later period, but it forced capitalism to adopt some socialist ideas.

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