Surrender
Meeropol, Michael Allen

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The Carter administration, the Democratic majority in Congress, and the mainstream majority in the economics profession differed with conservative economists in a fundamental way. They did not believe that the unemployment rate would be reduced merely by improving the incentives of individual workers. They did not believe that letting investors keep a higher percentage of their profits would by itself increase investment. In other words, though incentives were clearly important, by themselves they would not solve the problem of unemployment. More important was increasing the opportunity of people to work by increasing the ability of business to hire people. Incentives existed already. The way to increase the opportunity to work was to raise aggregate demand.

The role of incentives for investors was a bit more complicated. It was mainstream economists, for example, who devised the investment tax credit in 1962. However, investment incentives were just as likely to be stimulated by rising consumption on the part of average citizens as by cuts in the rate of taxation on profits. In fact, most mainstream economists would argue that lower taxes on profits coupled with slower-growing demand would reduce the incentive to invest, while higher taxation of profits coupled with more rapidly growing demand would increase the incentive to invest. Imagine a business contemplating a project to increase its capacity to produce, either by adopting some new technology or by expanding the building space and the number of machines used. If the business expects consumer demand to rise significantly by the time the new investments have increased production, even if the rate of business taxation were to rise, the investment would still be worthwhile if gross profits due to higher volume and/or lower production costs were to rise more. Similarly, if a business expects consumer demand to barely increase, such an investment is unlikely to be undertaken, even if there is a cut in the tax bite on profits.
Because mainstream economists did not emphasize the incentive effects of taxation to the exclusion of other factors, they did not think the stagflation of the 1970s was merely the symptom of a structural crisis. Nor did they think the solutions proposed by supply-siders and monetarists were going to succeed. However, until the late 1970s, and then particularly after Ronald Reagan was elected, they did not systematically examine and respond to the conservative critique.¹

The Carter Administration Analyzes the 1970s

After Mr. Reagan’s election, the outgoing Carter administration had to prepare one final Economic Report of the President. The Council of Economic Advisers was in a position to present a document unfettered by the political need to sell a program to the Congress and the public. Thus, we can be pretty certain that the 1981 report represents the true feelings of the council, perhaps limited only by a desire to put as good a face as possible on the difficult year of 1980. How did the Carter administration analyze the difficulties the United States economy had faced in the 1970s?

The first thing to be noted is that the council did not accept the conservatives’ characterization of the 1970s as an economic disaster for the nation. The apocalyptic language of the Reagan analysis was absent from the Carter report. Instead, it soberly admitted that inflation was high and growth in productivity low, and it recognized that the anti-inflation policies adopted in March 1980 had resulted in a short but significant recession.

In explaining the general problem of stagflation, the Carter administration and economists from the Brookings Institution like Barry Bosworth focused on the rapid increases in oil prices in 1973–74 and 1979 and on increases in food prices in the early 1970s.² Far from abandoning the Phillips curve analysis, as conservative economists had done, these economists stated that there had been a worsening of the trade-off between inflation and unemployment because inflation had occurred as a result of supply shocks.

Supply shocks differ from sustained inflation caused by excess aggregate demand. The latter occurs when the sum total of the desires of business, consumers, governments, and foreigners to purchase goods and services exceeds the economy’s ability to produce sufficient quantities to satisfy those desires. Temporary surges in inflation may
occur when shortages in strategically placed goods, such as food or oil, occur. They may also occur when whole categories of goods, such as imports, experience significant changes in prices. But that was only part of the story. Barry Bosworth of the Brookings Institution stated,

Given the magnitude of the disruptions in world commodity markets during the 1970s, a worsening of inflation was not a surprise; but the persistence of high inflation rates long after the reversal of the initiating factors and in the face of recession and high unemployment was.³

In theory, the rise in particular prices should not even create temporary inflation. Instead, goods and services subject to greater-than-average increases in demand will have price rises, while those goods and services that experience falls in demand will suffer price declines. The problem for the U.S. economy was that prices and wages had become sufficiently rigid in the downward direction that compensating price falls were unlikely, or at least quite slow to develop. Instead of resources automatically flowing out of areas where demand declined into the areas of higher prices and higher rates of return, thereby moderating the price increase, the process of adjustment was slow. Areas of the economy that experienced falls in demand felt the pain of unemployment and business losses, while the incomes of the majority fell as a result of the price shocks in key products such as oil and food. The government was then faced with the unpleasant dilemma of permitting money incomes of the population to rise to compensate for the increased prices of oil and food—in other words, to use expansionary fiscal and monetary policy to defend the real income of the population against the increase in oil and food prices—or accept a long period of high unemployment to keep the price increase confined to oil and food and force other prices and wages down. Generally, the government did a little of both, fighting whichever of the two problems was considered most politically damaging. President Gerald Ford provided a perfect example of that dilemma by reversing himself between October 1974 and January 1975. In October he went on national television asking the country to support him in requesting a tax increase from Congress to fight inflation. In January, he was back on television asking for a tax cut complete with cash rebates to fight the recession.⁴

The policies adopted in 1975 played a major role both in the continued expansion of the role of government and in successfully combattng the recession. Emergency extensions of unemployment compensation together with the tax cut caused a significant rise in the
federal budget deficit. Meanwhile, the Federal Reserve cooperated by pursuing an expansionary monetary policy. In general, the role of the government in the economy continued to grow.

However, President Carter spent his entire presidency obsessed with what his policymakers called a “soft landing” recovery from the recession of 1974–75. He wanted the unemployment rate to fall gradually enough to avoid rekindling the inflation of 1973–74. Unfortunately for his reelection efforts, from 1976 until he left office, the inflation rate rose. Because he was so anxious to restrain this inflation, he did not respond to the 1980 recession as President Ford had responded to the 1975 recession, arguing that

\[\text{twice in the last decade the tendency for government to stimulate the economy somewhat too freely during the recovery from recession probably played a role in retarding the decline of inflation or renewing its acceleration. That is why I was so insistent that a tax cut designed for quick economic stimulus not be enacted last year.}\]

Because of the vigorous antirecession policies of the Ford administration, the federal budget deficit rose to 3.4 percent of GDP in 1975. In 1980, on the other hand, it was only 2.7 percent of GDP, in part because of President Carter’s refusal to recommend a tax cut during 1980, even when a recession occurred in the second quarter. Though not emphasized at the time or since, that nonresponse marked the first time since 1960 that an administration had not responded to a recession with a move toward fiscal stimulus. This represented a major break with the policy that had been followed since the passage of the Employment Act of 1946, and especially since the 1960s. Before 1980, politicians and economists had always assumed that there were significant political limitations on anti-inflation policies. It had always been clear that if the government and the population were willing to accept prolonged periods of high levels of unemployment, any rate of inflation could be reduced, even eliminated altogether. The years of relatively low levels of unemployment and short-lived recessions had created an expectation on the part of the citizenry that the government ought not and would not permit “high” unemployment to last “too long.”

Notice that these terms are imprecise. Congress did respond dramatically to President Ford’s request for a tax cut in 1975, so clearly the recession of 1975 produced unacceptably high levels of unemployment. We have already noted that Congress passed, and President Carter
signed, the Full Employment and Balanced Growth Act of 1978, which specifically identified the old 4 percent rate as the only acceptable level of unemployment. This law was strenuously opposed by many economic and business leaders because they feared serious efforts to implement it would produce inflation.

By 1980, however, the concern about inflation was so great that President Carter felt politically safe in refusing to recommend an emergency tax cut because in his view it was more important to prevent a reacceleration of inflation than to reduce unemployment quickly. In effect, he ignored his own law as the unemployment rate jumped from 5.8 percent in 1979 to 7.1 percent in 1980.\textsuperscript{11} This ended up being an important first step toward demonstrating the willingness on the part of policymakers to risk the political consequences of permitting unemployment to rise \textit{and stay high} in order to fight inflation.

### General Conclusions from the Mainstream

The general view of the 1970s from the Carter economists was that the economy was in basically good shape. A record number of jobs had been created.\textsuperscript{12} Real income rose as fast as it did in the 1950s, though not as fast as in the 1960s. Investment as a percentage of GDP remained quite high. They disagreed with the view that the problems of the 1970s proved that aggregate-demand management and government intervention in general had failed.\textsuperscript{13}

But the electorate disagreed. They responded to the promise of candidate Ronald Reagan that he would cut taxes in such a way that would fight unemployment and inflation at the same time. They also responded to the short, sharp recession of 1980, caused by both the Federal Reserve’s shift to tight money and the Carter administration’s single-minded pursuit of an anti-inflation budget. The recession, though short, created great resonance for the rhetorical question asked by candidate Reagan on national television, “Are you better off now than you were four years ago?” Given the recession and the “perceived misery” of inflation, enough people answered in the negative that both Reagan and many conservative Republican senators were elected. This gave him outright control of the Senate and an ideological majority in the House with which to put his program into effect.

What is particularly interesting about this occurrence is that the tight monetary policy imposed by the Federal Reserve in late 1979...
under the leadership of its new chairman, Paul Volcker, and the absence of expansionary fiscal policy by the Carter administration were in large part responsible for the affirmative answer candidate Reagan received. The success of the Volcker-Reagan program in reducing inflation and producing a recovery of the economy after the 1982 recession would have been impossible without the electorate’s reaction to the 1980 recession, which itself had been caused by Volcker’s change in policy. The negative reaction to the recession in 1980 proved that the public still expected (and even demanded) that the government do something about high unemployment. Because Carter was perceived as having done nothing, he was voted out of office. When the congressional elections came in 1982, the economy was once again in recession, an even deeper one. The voters took out their frustrations on Republican members of Congress despite strenuous campaigning by President Reagan. Only with the recovery of 1983–84 did the public begin to give President Reagan very high approval ratings and then reelect him in a landslide in 1984.

**Radical Explanations**

If we were to simplify the conservative analysis described in chapter 3, we would locate all economic difficulties in government actions that damage incentives. The mainstream response, by contrast, sees problems in the absence of government intervention, particularly the failure to achieve the economy’s potential because of unemployment and low capacity utilization and periodic interruptions in economic growth. However, a nagging problem is associated with this argument. Mainstream economists have no explanation for the decline in the rate of growth of productivity that is evident from table 1. If the damaged incentives do not explain it, what does? All explanations suggested by mainstream economists appeared, by the end of the 1970s, to have accounted for at best one-third of the slower growth of productivity. To provide an alternative to the conservatives, we need to turn to a group of economists whose focus on conflict attempts to explain the slowdown in economic growth and stagflation.

These economists opposed the Volcker-Reagan program from a radical point of view, a tradition in economics that begins with the work of Karl Marx. While mainstream opponents of the Reagan program stressed that the economy was not in a crisis that required the
solutions proposed by supply-side economists and monetarists, radicals generally agreed that the economy showed serious structural difficulties and that reformist “business as usual” would not correct them. Clearly, they did not support the conservatives’ economic policies or the analysis on which they were built. However, they did accept the premise that the economy was in deep trouble.

Whereas the conservatives identified unacceptable economic performance, especially the slowdown in productivity growth, as stemming from damaged incentives of individuals, particularly investors, radicals began with the entire structure of the economy. That structure can either facilitate rapid improvements in productivity and translate those improvements into economic growth, or it can retard growth in productivity and interfere with growth in the economy as a whole. Which of these results occur depends on the dynamics of the structure of the economy.

From the radical perspective, a powerful element of human solidarity comes out in concepts of “fairness” that are instinctively understood by participants. We noted in chapter 2 that human activity in producing goods and services depends in some measure or other on the voluntary participation of individuals in a group effort. This voluntary participation is influenced by those individuals’ belief in how fairly they were being treated. This treatment certainly includes pay, but it does not relate only to pay. Other issues involved are autonomy, respect, and participation in decision making. Without a sense on the part of people that their participatory activity has some meaning behind it and that they are valued participants, their efforts will fall far short of their capabilities. If this happens to a sizable proportion of the population, the economy’s ability to grow will be harmed, and desires for a rising standard of living will remain unsatisfied.

**Two Aspects of the Growth in Productivity**

To analyze whether the structure of an economy is helping or hindering economic growth requires an important distinction. There are two ways output per unit of labor can be increased. The first, which is a real increase in productivity, is to enhance the ability of workers to produce using the same effort. An example is providing workers with better machines, say substituting a scanner for a cash register at the supermarket checkout counter. Another example is using the same machines
in a less wasteful way—such as substituting contour plowing for straight-line plowing, which cuts down soil erosion. Another example is providing workers with a better understanding of what their tasks so they are in a better position to anticipate problems in production and reduce downtime. Consider someone who runs a copy machine but knows nothing about how it works. This person runs the copier until it stops—because it has run out of paper, or because it has broken down—and then calls for help. Now compare someone who understands the working of the machine—not enough to repair it, but enough to open the machine and clear paper jams. Perhaps the knowledgeable operator can call for routine maintenance before the machine breaks, avoiding any downtime whatsoever.

All three of these examples are true increases in the productivity of labor. However, as mentioned in chapter 2, there is another way to increase productivity, one that looks the same in government statistics even though it is very different: increasing the intensity with which people work. This can occur by increasing the speed with which they work. Our copy machine operator, for example, can feed the machine the instant it is ready or wait several minutes before inserting the next item to be copied. As mentioned above, there is a tremendous gap between the maximum amount of work that can actually be done in the time one is on the job and the minimum (which would involve doing nothing the whole time!). Those who work in the radical tradition have always stressed the conflict between owners of businesses, who would like the physical maximum out of their employees, and the workers, who would like to finish the workday with enough physical and psychological energy to enjoy their leisure hours.

**The Significance of Conflict**

The conflict over the intensity with which work is done is one part of a general conflict between labor and capital that is at the heart of the radical tradition in economics. These groups (called *classes* by classical political economists and Marx) represent a division of the human factor of production in the economy. The division is based on the difference between those who own sufficient wealth-producing property (*means of production*, in Marx’s language) to survive on the income from that property alone, and those who do not own sufficient prop-
erty and thus must work for someone else. The “someone else” who owns sufficient property is known as the capitalist; the property is referred to as capital. Those who do not own enough capital to be independent must work for some capitalist or starve. In its most abstract form this is the simple model of a market economy that is the starting point of radical economic analysis.

Note that unlike mainstream economists, for whom the distribution of income and wealth is unimportant in explaining how the economy functions, the distribution of wealth and power is crucial to the radicals’ explanation. Because wealth is distributed more unequally than income, the size of the class of capitalists is quite small, at least relative to the size of the class of workers. The difference in wealth leads to a significant imbalance of power between capitalists and workers when they meet in the workplace. Instead of workers selling their labor in a competitive market, with thousands of workers competing for jobs while hundreds of businesses compete to hire them, the radical tradition sees a rigged market with a chronic surplus of labor and a relatively small group of capitalists.

Capital makes profit only by utilizing the labor of others and paying that labor less than the total that is produced. (In Marx’s language, capital exploits labor by paying labor less than the value of the product it produces.) Every rise in wages means a reduction in profit unless productivity rises faster. Sometimes, the rate of profit can be reduced even if wages do not rise. The rate of profit is the ratio of profits to capital invested, and if the amount of capital invested rises but total profits don’t rise as much, then the rate of profit is lower. If I make $30,000 one year with a $100,000 investment, my 30 percent rate of return is excellent. If next year, I expand my investment to $500,000 and make $40,000, my rate of return is less than 10 percent, and the expanded investment will have been a failure.

According to this tradition in economic analysis, the continuous danger of falling profitability is a source of the chief successes of market economies, internally generated economic growth. The threat of reduced profitability leads owners of capital to constantly search for newer and cheaper ways of producing goods and services. Though this pattern seems commonplace today, the appearance of this behavior during the industrial revolution was an unprecedented change for humanity. Previous to the industrial revolution, human economic existence had been subject to rises and falls. Technological change was
usually of the nature of a once-and-for-all adjustment, such as the
development of irrigation systems. The economic systems that existed
prior to the rise of capitalism did not generate pressure for constant
discovery and introduction of new technology. Thus, the pace of tech-
nological change was quite slow until the rise of capitalism, the rise of
market economies.

But let us recall what we have mentioned above, that growth in
productivity can occur as a result of increased intensity of effort, as
well as from improvements in technology. Much increased intensity is
the result of a structure in which cooperation among workers and cap-
italists occurs. One of the key arguments of economists working in the
radical tradition is that what appeared to be an unexplainable decline
in productivity growth in the 1970s resulted in part from reductions in
intensity of effort. To understand this process, one needs to focus on
the distribution of income, wealth, and power and whether that distrib-
ution meets a popularly perceived standard of justice.

The Unequal Distribution of Income,
Wealth, and Power

Assessing the impact of the distribution of income, wealth and power
on the well-being of society as a whole has been controversial. First we
should distinguish income from wealth. Income measures the flow of
purchasing power to an individual or an institution in a given period of
time, usually a year. Differences in the yearly flow of income play a
major role in the ability to satisfy basic needs and discretionary wants
or to accumulate assets. Many believe that differences in income flows
play an important role in rewarding hard work, unique contributions,
risk-taking investment—in sum, success. These rewards, coupled with
the punishment of low income for slackers or for poorly skilled, unint-
telligent, or risk-averse individuals, are said to be the incentives neces-
sary to make a market economy grow and prosper.

On the other hand, there are many who believe on purely ethical
grounds that a more equal distribution of income is fairer than an
unequal one. Alan Blinder summarized the position this way:

That all men and women are not created equally equipped to play the
economic game is clear. . . . [My] attitude holds that we ought to
soften the blows for those who play the economic game and lose, or
who cannot play it at all.15
He goes on to argue that most transfers of income from the relatively well off to the relatively bad off raise the total level of satisfaction in society because the intensity of the gain felt by the relatively poor individual is greater than the intensity of the loss felt by the well-off individual. Blinder acknowledges that these transfers cannot be pushed so far that incentives are damaged. What he does not consider is whether a distribution perceived as unjust will also damage incentives.

One of the effects of inequality in the distribution of income is that only those whose incomes are large can afford to save large amounts of current income to acquire assets. These assets—a house, jewelry, stocks, bonds, life insurance policies, a business, and so on—constitute wealth. Wealth has the potential to produce its own future income. Wealth, again, is more unequally distributed than income. Such inequality, usually based on previous inequality of income, is often seen as the reward for success.

Power is a very difficult concept to introduce into this analysis. On an elementary level, power consists of the ability of an individual or institution to compel behavior on the part of another individual or institution. For most economists, the institution that exercises power in an economy is the government. If government were relegated to a somewhat minimal role, power would be disbursed so widely as not to be a factor interfering with the functioning of the market system. The majority of economists believe that there is no significant market-determined distribution of power.

The radical response is that the power identified by mainstream economists as emanating from the government is exercised on behalf of those with sufficient wealth to influence government decisions. Those with the most economic clout are in a position to make sure that when government exercises its power to alter the economy, it almost always does so in order to enhance the profitability of certain crucial businesses or to enhance the long-run viability of a business-dominated system. Thus, the Republican desire to shrink government as expressed in the *Contract with America* does not extend to the defense establishment. From aerospace to high-speed computers to the Internet to the automobile industry, it was government production, government research and development—in short, government money—that made these industries the profit centers they are today.16 True, sometimes the “business community” is forced to accept some limitations on its “freedom,” as with the passage of the National Labor Relations Act during the depression or the development of environmental regulation in the...
1970s. But by and large, the richest, most powerful individuals and institutions, far from being victimized and limited by government intervention in the economy, are for the most part subsidized and aided by such intervention. This point of view is rarely heard when policy is debated either in the media or in Congress, but scores of historical case studies support it, going all the way back to the development of numerically controlled machine tools in the early years of this century. We will have occasion to mention departures from the theoretical idea of free-market economics during the Reagan years to remind ourselves that this point of view should not be dismissed out of hand.

**The Significance of Income Distribution for Economic Growth**

In addition to believing that power is exercised only by government, not by private concerns based on an imbalance of wealth, the mainstream of the economics profession generally ignores the distribution of income when analyzing growth. It was not always so. Beginning with the classical political economy of David Ricardo, the distribution of income among landlords (rent), capitalists (profit), and workers (wages) was considered the key to understanding economic growth. Marx rejected the three-class model of society presented by Ricardo in favor of a two-class model, capitalists (who receive profits) and workers (who receive wages).

The significance of income distribution between wages and profits remains an important element in the radical tradition descended from Marx as well as in the post-Keynesian economic tradition. Much of the analysis emphasizes the share of profit in society as a crucial determinant of the level of investment activity. In this respect, a trend in the distribution of income that favors profits will have a positive impact on investment. Similarly, a trend favoring wages will have a negative impact.

However, the opposite effect is also possible. If income becomes too unequally distributed, the size of the market for goods and services may not grow sufficiently to justify more investment. In other words, a trend in the distribution of income that favors profits *too much* may actually have a *negative* impact on investment. In this situation, increasing wages relative to profits has a positive impact. Which of these alternative tendencies prevails will depend on many factors and
cannot be simplistically captured by some notion of incentives as developed by supply-side economists.

Since radicals agree with conservatives that the economy was in deep trouble by the late 1970s, it is important to understand why they reject the mainstream view that better application of aggregate-demand management combined with policies to keep inflation from ratcheting upward was all that was necessary.

They don’t accept the view of the anti-Keynesians (the new classicals, the monetarists, the supply-siders) that getting government out of the way of private sector incentives will permit the self-correcting mechanism in the system to cure business cycle downturns before they become disasters. However, they do not believe that Keynesian style aggregate-demand management is sufficient. They deny the possibility of permanent counteraction to the business cycle, but they do acknowledge that between World War II and the early 1970s, aggregate-demand management combined with a number of other factors to create a structure within which productivity growth was rapid and sustained and recessions were short and shallow.

**Explaining Post–World War II Prosperity**

There are two major radical schools of thought on this period of success, one we will call the stagnation school, the other the long-swing school. The differences between the two schools need not concern us here. They both agree that the period from 1945 to approximately 1973 was one of extraordinary and unsustainably high growth. Among the elements that contributed to this extended period of prosperity were the following: (1) a capital-labor truce, (2) a social safety net, (3) U.S. military and economic hegemony in the world economy, (4) cheap raw materials, and (5) a government committed to preventing depressions.

1. Conflict between workers and management had become quite serious during the depression and immediately following World War II. Business interests had fought bitterly against the National Labor Relations Act, which had created a legal framework under which the government could force businesses to officially recognize the union chosen by a majority of their workers. Previous to the passage of that act, businesses could recognize and bargain with unions or attempt to ignore them. If workers wanted a union to represent them and the
business did not wish to bargain, then workers would have to strike *just to be recognized*. In fact, the necessity of striking merely for recognition was held up by some members of Congress as a reason the National Labor Relations Act was necessary to *reduce* the amount of strike activity.

After a big increase in strike activity and wages right after World War II, Congress amended the National Labor Relations Act so the law would not tilt so clearly in favor of organized labor. The amendments also led to the purging of Communists from the union movement, which, while welcomed by most union leaders, reduced the potential for radical demands. By the early 1950s, many businesses had determined that they could get along with labor unions. In collective bargaining, wages and working conditions could be negotiated, but unions would explicitly ignore pricing policy and recognize “management prerogatives” that might alter the work process in order to raise productivity. Business realized that union-driven wage increases need not cause reductions in profit if productivity increased at least as much as wages. Under this accord, wages rose, the number of strikes declined, and productivity grew faster than wages for the entire period from 1945 to 1966.²

2. The key piece of legislation in the construction of the social safety net was the Social Security Act. Social legislation like this came late to the United States, but it was a crucial element in maintaining aggregate demand during the brief business-cycle downturns that occurred after World War II. Not only did this law create the pensions that have come to be called Social Security, but it also enacted unemployment compensation, which whenever the economy slips into a recession automatically increases the ability of laid-off workers to continue consuming at close to their previous level. If the recession is short enough, the short-term subsidies to the consumption spending of unemployed workers will keep the recession from spiraling downward as a result of rising bankruptcies by businesses dependent on workers’ consumption for their survival.

In addition to cushioning the fall in aggregate demand that occurs when the economy slips into a recession, the existence of programs like Social Security creates political legitimacy for the system. In other words, those who might be losing out will be steered away from support for drastic radical proposals to restructure society if they feel that despite their personal difficulties, in general the society is dealing fairly with them and seeing to their needs. Given that capitalist societies were
severely shaken by the events of the 1930s, with many countries succumbing to fascism, while in others the left-wing minority became quite strong, such political legitimacy is not to be taken lightly.

3. With the end of World War II, the United States enjoyed a twenty-five-year period of economic and military hegemony. One aspect involved the role of the U.S. dollar as the crucial international currency. All other nations defined the value of their currency in terms of dollars. Since the United States emerged from World War II with a very large percentage of the world’s monetary gold as well as owning the debt instruments of its allies, all nations wishing to engage in international economic activity needed dollars. This meant that United States businesses wishing to invest abroad merely had to use dollars to acquire these assets. Thus, the government found many willing borrowers for government assistance loans. The government also found willing sellers in countries where military facilities were deemed necessary. The role of the United States dollar as the only truly acceptable international currency meant that businesses could acquire assets abroad and the government could pursue military and political objectives abroad with United States dollars. If the rest of the world had not been not so starved for these dollars, the only way the United States economy could have pursued these goals would have been to sacrifice some domestic consumption by sending goods overseas to earn the foreign currency that would finance these activities.

However, quite early in the postwar period, dollars flowing overseas began to exceed foreign currencies flowing to the United States. Foreigners were using those dollars to build up their own international reserves and to stabilize their own currencies. The stability of this system depended on the security of the dollar’s value in terms of gold and the ability of the United States military to keep the world safe for free flows of capital. This role should not be underestimated. The military hegemony of the United States helped define the “rules” for international economic behavior, especially in the world of newly independent or “Third World” nations.20

With the dollar underpinning international trade and the military enforcing the “rules of the game,” trade barriers were reduced significantly beginning in 1949, international capital flows expanded dramatically, and the international economy as a whole experienced continuous and rapid growth.

4. The availability of cheap petroleum is particularly important in the light of the role played by oil prices in the 1970s and 1980s. The
discovery of cheap oil in the Middle East in the late 1930s coupled with the lesson taught would-be nationalists by the overthrow of the Iranian government in 1953 guaranteed that oil prices would remain low throughout the immediate postwar period. This availability contributed to the spread of the automobile culture not only in the United States but in Europe and Japan as well. In addition to automobiles, the use of oil to heat homes and as an input into the petrochemical industry played a major role in supporting economic growth. Cheap raw materials in general help raise productivity and profits while permitting wages to rise as well.

In addition to cheap oil, the qualitatively significant surge in consumption and investment represented by the spread of the automobile culture was induced by government spending on roads and the subsidizing of mortgages. Creating and maintaining a giant “peacetime” military and using it to fight two wars (Korea and Vietnam) was the other major governmental prop to aggregate demand, providing significant jolts in the early 1950s, early 1960s, and post-1965 period.

5. Finally, the commitment by governments in all of the capitalist countries to refuse to permit a rerun of the 1930s led to the use of aggregate-demand management. Contrary to the Reagan administration critiques, radicals believe that for over twenty-five years aggregate-demand management was quite successful. The most important part of that success was the increase in the absolute and relative size of government spending as a percentage of GDP. Both schools in the radical tradition agree on the crucial role of military spending in the success of the U.S. economy after 1945.

Explaining the Slowdown of the 1970s

To explain the difficulties of the United States economy in the 1970s, those who believe that the structure described above had been the basis of the 1945–73 prosperity argue that the very nature of the success had within it the seeds of failure. In other words, granted that this institutional structure sustained the economy in very dramatic, if uneven, growth, it was still capitalism. Capitalism has a dynamic that is constantly in danger of interruption as profitability is eroded. Every one of the successes of the 1945–72 period set in motion certain tendencies that by the late 1960s and early 1970s had produced extraordinary difficulties that ultimately led to the end of this phase of capitalism. In
the United States that breakdown led to the ascendancy of conservative economics.

The capital-labor accord produced a wage-bargaining process that some economists believe contributed to the persistence of inflation even during short-term business-cycle downturns. The accord also produced resentment on the part of minorities and women left out of the capital-labor truce. These groups demanded similar increases in income and status and access to the advantages of the organized labor movement. This increased the demands on capital, since business was a major source of taxes to pay for such programs. To the extent that taxes on wages were used, that increased the pressure of organized labor on business to come up with higher wages to help pay these higher taxes.

By the mid-1960s, organized labor began to feel it had sacrificed too much for the accord. Productivity increases permitted business to raise profits dramatically, while wages increased only modestly. Thus, when the late 1960s ushered in an era of very low rates of unemployment, labor was anxious to play catch-up. This conflict was not solely played out over the issue of wages. One particularly dramatic episode in the conflict over the intensity with which people work was illustrated in the struggle at the General Motors Vega plant in Lordstown, Ohio in 1972. This was a fully automated, brand-new plant, and the General Motors Assembly Division attempted to speed up the line. The workers balked, and there was a strike. The president of the local union told journalist Studs Terkel,

> In some parts of the plant, cars pass a guy at 120 an hour. The mainline goes at 101.6. They got the most modern dip system in paint. They got all the technological improvements. They got unimates. But one thing went wrong . . . They didn’t have the human factor. We’ve been telling them since we’ve been here: we have a say in how hard we’re going to work. They didn’t believe us. Young people didn’t vocalize themselves before. We’re putting human before property value and profits.

> We’re still making 101 cars an hour, but now we have the people back GMAD laid off. They tried to create a speed-up by using less people. We stopped ’em.

The unwillingness of workers to accept the continuous increase in the intensity with which they work and more aggressive efforts to raise wages combined to create a squeeze on profits. When business began to find its profits squeezed, labor was unwilling to moderate wage
demands until forced by recessions in the mid-1970s and especially by the recessions of 1980 and 1981–82. The capital-labor accord proved unsustainable in the wake of the squeeze on profits. By the end of the 1970s, there was no more capital-labor truce, and the best evidence of this is the dramatic rise in the rate of inflation coupled with the decline in real wages.

The social safety net was initially quite modest. It did not apply to all workers, and initially the ratio of workers to beneficiaries was quite high. In the 1960s, the social safety net expanded dramatically, and the reason for that spread is not hard to understand. Once the link between work for a capitalist and income is broken in principle, there is no reason why every citizen should not be entitled to access to such programs. If securing the political legitimacy of the system requires a “citizen wage” to supplement the private-sector wage that is paid for contributing to a capitalist’s profit, then all groups in society with a potential complaint about the system (discriminated-against minorities and women, the poor in general) need to be co-opted according to the already existing formulas. This is what happened in the 1960s with the spread of the safety net.

For much of the 1960s and 1970s, the spread of the safety net actually succeeded in significantly reducing poverty. Unfortunately, this also reduced the leverage of capital on the working class. In effect, it reduced the power of capital to get workers to work harder even though there was less promise of increased income. This showed up in the statistics as a decline in productivity growth, but even before that, there was a decline in the rate of profit. With the fall in productivity growth in the 1970s, the safety net became too expensive, and capital began to fight back. By the end of the 1970s, the means-tested entitlement programs had ceased growing (in fact, inflation was reducing some real benefit levels). However, Social Security had been made inflation-proof and rose quite rapidly through the end of the decade. From the perspective of this analysis, the system that had been so successful between 1945 and 1972 was now too expensive. The ascendancy of conservative economics marks a very strong effort to escape from that difficulty by changing the rules. The push to balance the budget can here be seen as a way of making sure those rules are permanently changed. Budget balance, especially by constitutional amendment, would make it virtually impossible for the majority of the population to push through spending programs because it would require tax increases to fund them.
Note that the radical interpretation has a lot in common with the conservative analysis. Both groups agreed that there were fundamental problems with the economy as it existed at the end of the 1970s. In this they were united against the more sanguine views of the mainstream group of economists, who saw problems but didn’t believe such radical solutions were necessary. On the other hand, the radicals disagreed with both the conservative and the mainstream economists because the latter two groups focused on altering the role of government in a basically private-enterprise economy. The radicals believed that the nature of hierarchy and power and inequality in a private-enterprise economy was at the root of America’s problems. They believed further that neither the liberal reformism of the mainstream economists nor the radical conservatism of the Reagan administration would solve the economy’s problems. Today, with the debate focusing on how to balance the budget and shrink government, we see the same dichotomy in the responses of liberals and radicals to those proposals. The liberals say the Republican proposals go too far, while the radicals assert that the proposals have nothing to do with solutions to our economic problems but everything to do with diverting the attention of the population from what is really wrong.