

HUEBUNKERS



V. S. CONTREN

Selected Works of Michał Kalecki

Great War, Inflation and Fascism



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Transcriber's note

V. S. Conttren

The works of Michał Kalecki remain *undiscovered* given how extensive his activity throughout the 20th century was. Here we do not intend into producing a biographical note or even a mere 'insight' into his life and work. The intent and the objective are clear: to make *available* a series of articles and studies the Polish political-economist produced on a series of topics.

A selection of his articles, translated into English but nonetheless refrained from being made public—even for historiographic reasons—, with the purpose of continuing a renewal of interest. In the last decades, a refreshing restart into the study and research into Kalecki's theories and analyses became a sparkle in many circles dedicated to Political Economy. One might point towards the confluence of the "return" of the real appearance of an absolute structural crisis which the system of capital—in its totality—has undergone recently, leading to the retaking of a type of 'necessary stepping back' in relation to many non-critical and almost absolutely solidified studies of political economy, made to appear as natural law, even more-so during a period of extended turbulence, in all spheres of bourgeois society.

In these selected texts Kalecki approaches many currents of a period where Political Economy had been conclusively consolidated as the "ideological science" of the 'material world'. His technique, eclectic in appearance, was defined as an engagement with such "science" from within and without—from the standpoint of its own internal logic and from the one that sought to supersede it altogether. The contextual richness of his writings, in a period of extreme declining conditions of bourgeois society as a whole—the Great Depression, the post First War period, the engendering of Fascism and Nazism, culminating in another Great War, more destructive, dreadful and complex—

gives a very clear insight into the “climate” of its contemporary world while at the same time offering decisive critical cuts of this very world in decay.

To say more would be to obscure the topic.

Editor notes (transcribed from the Collected Works themselves) have been marked with “Ed. n.” Some of those, due to their length, have been turned into small addenda sub-chapters.

The articles chosen are present in the Collected Works of Michał Kalecki, volumes I to VII. Transcribed by V. S. Conttren, March 2020. Revised and expanded June 2021.

Remarks on Hitlerism and Business Spheres¹ (1932)*

1. The investment of capital in enterprises is highly risky during a crisis. That is why one can now see widespread hoarding of foreign exchange and gold: for at the expense of forgoing profits one is at least sure of maintaining one's capital. The large enterprise known as the capitalist system is also endangered during a crisis; in exchange for preserving the whole of its substance it is worth offering its 'shareholders' a share in the social income. A friendly democratic state system, however, is not sufficient to prevent its

1 Ed. n.: First appeared as "Uwagi o hitleryzmie i 'sferach gospodarczych'." In: **Przegląd Socjalistyczny**, 2/3 (1932), 5-6.

From 1932 Kalecki consistently pointed out that paramilitary public works and armaments, financed through budget deficits, could turn out to be the two most popular methods of government intervention to overcome the business crisis. He carefully observed Japan's war in Manchuria (see 'Foundations of the Manchurian Conflict' and 'War in the East', this volume); he warned against similar developments in Europe, and against the danger of Hitlerism. In his article 'Inflation and War' he pointed out that 'Hitler is clearly betting on both horses—inflation and war' (p. 178 above), and that a similar tangle of circumstances was pushing Japan along the 'road to glory', as Japan also was betting on these two horses and, with the war in Manchuria not yet over, was already preparing to go to war with the USSR over markets for her industrial goods.

Kalecki dealt with the development of Hitlerism in Germany also in his articles: 'On the Papen Plan' (Collected Works, vol. i), 'On the Margin of German Events', 'The Fate of Experiments', 'Stimulating the Business Upswing in Nazi Germany' (all in this volume; see also 'The Business Cycle and Inflation' and 'The Business Cycles and Armaments', in Collected Works, vol. i).

* **Collected Works of Michał Kalecki**. Vol. VI, pp. 162-163.

excesses. It is inflexible, bureaucratized, and *étatist*. Private initiative is therefore required. An inflow of new, creative, and sober-minded powers is needed. This is costly, even very costly. But that cannot be helped in matters of this kind there is no place for falsely understood frugality.

2. We are hardly claiming that Hitlerism was created by the 'captains of industry'. It came into being almost spontaneously: business spheres only contributed to its support and occasionally gave instructions on good manners.

During an economic crisis a misfortune often befalls some members of the petty bourgeoisie, intelligentsia and half-intelligentsia, or workers who do not think in class terms and are not intellectually capable of understanding the true causes of their fate. In accordance with their primitive psychology, they look for an explanation of its ruins in its manifestations, in national or racial factors, and in fanciful metaphysical ideas. A German shopkeeper first blames his bankruptcy on the moneylender to whom he paid interest until it ruined him, secondly on the Jewish bankers and the payment of reparations, and thirdly on various international mafias the poisoning of the German nation by Jews, Marxism, etc.

Accordingly, the ideology of Hitlerism contains a negation of 'interest slavery' (*Zinsknechtschaft*); it argues that everything will turn right if the payment of reparations is stopped, the Jews are expropriated, and the communists hanged. It professes the German nation's mission in the fight against the international power of Jews and Marxism. However, it is extremely difficult to put this ideology into a system, for its basic feature is obscurity and slipperiness thus making it possible to satisfy the ideological needs of the primitive masses—but diversified in class structure—on which Hitlerism rests.

3. The increase in sympathy of some branches of industry for Hitlerism is not uniform; at the head of the patrons is heavy industry. Its plants are largely concentrated in coal basins. The production of iron and steel, a considerable part of the output of heavy industry, is subject to sharp fluctuations—investments are known to be subject to more severe cyclical oscillations than consumption. For this reason during a crisis coal basins become centres of revolutionary ferment and heavy industry more than other industries is intent on having additional measures of protection.

Is German industry, especially heavy industry, interested in Hitler's coming to power? The answer to this question is not at all simple. If the costs of Hitlerism are already high, they will become even higher when Hitler takes over the machinery of government and in various ways begins to meet the pledges he has made to his supporters. To be sure, heavy industry would then have a privileged position. The part of Hitler's ideology that advocates the abolition of "interest slavery" fits in beautifully with the high indebtedness of this industry; its concentration in syndicate structures in combination with the great influence the industry has with the Hitlerite leadership gives it the role of one of the main decision-making centres. Quite possibly even for heavy industry it would be more convenient and, moreover, cheaper to keep Hitlerism in this way to support the Brüning regime that is moving more and more in the direction of Fascism.

It is another matter that the Hitlerite movement, which blossomed with the support of "business spheres," is now only partially under their control; that is why slight differences in the attitude of big industry towards this movement will hardly decide its future.

The World Financial Crisis¹ (1931)*

1. The period which preceded the present economic crisis abounded in capitalist utopias. American economists in particular excelled in forecasting an everlasting era of prosperity and—what is most astonishing—themselves believed in these horoscopes. The crash on the New York stock exchange at the end of 1929 dealt a fatal blow to these 'theories', which vegetated for a short time (nourished by Hoover's optimism) until they passed into oblivion in 1930.

New apologists of capitalism have been found, however, who without denying the sharp fall in output—assert that the present crisis differs from previous ones in its lack of financial perturbations, which, they claim, is a result of an improvement in the mechanisms of the capitalist economy. Meanwhile, by 1930 the financial crisis had already reached its climax in the raw-materials-producing countries of South America and in Australia: a sharp fall in export prices for their products made it impossible for them to pay both the instalments and the interest on their loans. This checked the inflow of new capital and even caused the outflow of old capital. As a consequence, these countries suspended the convertibility of their currencies into gold.

1 T. N.: Refer to the Addendum by the end of this chapter for the Editor's note.

* Vol. I, pp. 37-40.

These storms on the peripheries of the capitalist world were only faintly felt in its centre. The losses incurred in the raw materials producing countries were offset by gains derived from the cheapness of raw materials, with finished-product prices still hardly reduced. Only when, after some time, the fall in raw-material prices was followed by a fall in finished-product prices did the financial crisis spread to Europe and the USA.

2. Let us imagine a system made up of two countries, *A* and *B*, with *A* indebted to *B*. Let us assume that a sharp fall in prices has occurred in country *A*. Two phenomena will then take place there: (1) production will become less profitable or will bring losses; (2) besides these 'real' losses there will also be 'book' losses, i.e. a fall in the value of stocks. The first phenomenon, i.e. the reduction of current profits, will impede payment both of instalments and of interest on loans incurred in country *B*. Relief could occur if country *B* gave country *A* new credits; but difficulties in serving the former's loans do not encourage the granting of new long-term credits, and, as regards short-term credits, not only will there be no tendency for their inflow but, quite the contrary, their outflow is more likely. For a fall in the value of stocks will reduce the 'liquidity' of short-term credits, which, generally and schematically speaking, are invested mainly in commodity stocks. For example, if the indebtedness of commodity stocks were initially 75% of their value and commodity prices subsequently fell by 25%, then the level of indebtedness of stocks would amount to 100% of their value; and with a further decline in prices the indebtedness would exceed their total value. The sums due to the banks of country *A* would become questionable, thus undermining confidence in those banks on the part

of short-term creditors from country *B*, who as a result would begin to withdraw their capital.

Difficulties in servicing foreign loans, together with the outflow of short-term foreign capital, must cause an increased demand for credits from the bank of issue in country *A*. These credits finance the purchase of foreign exchange or gold necessary to pay both instalments and interest on loans or short-term credits to country *B*. Thereby the reserves of foreign exchange and gold in the assets of the bank of issue of country *A* melt away, while the portfolio of bills increases; the ratio of foreign exchange and gold reserves against total money circulation rapidly declines.

How can this outflow of foreign exchange and gold from country *A* to country *B* be checked? Country *A*'s bank of issue, in order to defend its currency, introduces credit restrictions (deflation), thereby impeding investments and encouraging the running down of stocks. Production and market in country *A* shrink, and so do imports from country *B* to country *A*. Contrariwise, in country *B*, supplied with an inflow of gold and foreign exchange from country *A*, there is an expansion of credit (inflation), output and market increase, and so do imports from country *A*. Hence the foreign trade balance improves in favour of country *A*, the more so as, owing to credit deflation in *A*, prices in that country fall a little, and owing to credit inflation in *B* they rise a little there. As a result, gold and foreign exchange begin to flow back to country *A* from country *B*.

3. The course of the financial crash in Germany² corresponds almost exactly with the above pattern, except for the serious reservation that the adjustment process, i.e., the process of return to normal conditions, shows considerable deviations there. Above all, credit restrictions alone could not check the avalanche of frantically withdrawn short term credits. An agreement had to be signed with a consortium of foreign bankers to leave their deposit in Germany until February 1932. Next, credit restrictions in Germany were not followed by the expansion of credit in those countries to which capital flowed from Germany. Lack of confidence in banks involved in Germany stimulated the withdrawal of deposits from them, thereby forcing them to keep large cash reserves. Consequently, the shrinkage of production in Germany was not accompanied by an increase in production and markets in other countries. Hence the export of German products encountered difficulties, also caused by high tariff barriers, and could increase only as a result of considerable price reductions, exclusively at the expense of exports from other countries.

2 Ed. n.: Germany's economic situation in 1931 was aggravated by currency and finance problems, which manifested themselves in a passive foreign trade balance and currency restrictions, as well as in a tight credit market, especially for short-term loans (despite a declining interest rate). An additional factor impeding improvement in the foreign trade balance was war reparation payments. Heinrich Brüning (1885-1970; in 1930 and 1931 the chancellor of the Reich and a leading figure in the German Catholic Centre party) made many efforts to reduce and defer these payments. In June 1931 he announced a suspension of war reparation payments on account of Germany's economic difficulties. In this situation the Hoover administration (the major creditor of Germany as well as of the European allied countries) temporarily postponed payments of all international obligation to ward off a general financial crisis. Despite this, in July 1931, a few days after the announcement of the Hoover moratorium, one of the largest German banks, the so-called Donatbank (Darmstädter und Nationalbank, after 1931 under government control), suspended payments. Its collapse was followed by the collapse of other German banks and the temporary closing of the stock exchange.

Therefore the adjustment process could not develop properly, and the world economic crisis deepened still further.

In contrast to Germany, England was not a debtor country but an intermediary in the allocation of capital. The outflow of deposits from England occurred mainly in connection with the involvement of English banks in central European and overseas countries. Even more than in Germany, the adjustment process deviated from the theoretical model. The suspension of the gold standard was followed by the devaluation of sterling, which obviously considerably increased the competitive advantage of English exports. They increased entirely at the expense of a reduction of output in other countries, since the inflow of deposits withdrawn from England, like the inflow of deposits withdrawn from Germany, did not expand credit in the creditor countries and hence did not increase their markets. When after a certain time English domestic prices rise, consumption in Great Britain will shrink and the world crisis will deepen. Devaluation in England influences the world economy like deflation in Germany.

After the collapse of sterling the financial crisis spread in ever wider circles. The position of American banks began to give rise to the same doubts as had those of Germany and England. Besides this, after the losses incurred from the fall of sterling many European banks of issue decided to shift gradually from the gold and foreign-exchange standard to the gold standard, and as a result began to convert dollar reserves into gold. Hence a considerable amount of gold began to flow out of the USA. This process was checked by an agreement by which France consented not to withdraw her deposits. However, France demanded a guarantee from American banks that they would pursue a conservative credit

policy, and the US discount rate was raised. Hoarding of money spread world-wide (from fear of keeping deposits in now suspect banks), often turning into hoarding of gold or of goods out of fear that the value of individual currencies might fall.

4. Shortly before the outbreak of financial perturbations in Europe, international capitalism attempted to carry out a co-ordinated operation to relieve the world crisis. This was the aim of the trips of the governor of the Bank of England, Montagu Norman, and Hoover's declaration on debts. The German crash, which occurred soon after the latter, was a signal, so to speak, of a shift from international attempts to co-ordinate and organize capitalism to a policy of bickering imperialisms. In all countries a war cry was heard: to save the 'national economy' from the ruins of the world. While some leaders call for sacrifices in order to maintain the stability of exchange rates, others point to their fall as an instrument for conquering the world.

The development of Hitlerism in Germany in recent months is; unquestionably, closely connected with the financial crisis. The present economic situation there could easily be presented as the work of foreign hands, and the masses have been persuaded to expect salvation through a 'national' revolution. It is possible that when the agreement on the non-withdrawal of short-term deposits expires, in February 1932, the 'Hitlerite folk' will enter the scene and supersede the German capitalists in declaring a moratorium on foreign debts.

France's policy is entirely directed towards not harming her financial capital, which, with the lowered level of prices, means a very considerable increase of her share in world assets. Apprehensive about the integrity of her

investments, France is forcing the USA and, to some extent, the entire world to deflate, though this deepens the world crisis and undermines the foundations of her exports. But what else can be done? For France, it is a question of safety first, then disarmament.

In England, by contrast, the industrialist has triumphed over the banker. While devaluation threatens the role of the City as the banker of the world, industry dreams of conquering the markets of the British Empire and the Far East through a depreciated currency. These dreams will be dissipated when English retail prices start rising and the struggle for wage increases heats up.

We are now living through times which in many respects resemble a great war. They will be no less pregnant with consequences.

Editor's Addendum

This article, published as "*Światowy kryzys finansowy*" under the pseudonym 'Henryk Braun' in the first issue of **Przegląd Socjalistyczny** (PS), 1/1, 1931, pp. 1-3, opens a new phase in Kalecki's scholarly career in which he moves from empirical research to theoretical studies. His theoretical works of this period were influenced by two groups of factors.

The most important in the first group was Kalecki's active collaboration with PS, a revolutionary journal addressed to the intellectual left. The paper was not an organ of the Polish Communist party, but rather followed the programme of the British Independent Labour Party. It was edited by a philosopher and economist, a pupil of Tadeusz Kotarbinski, Antoni Panski, and his brother Jerzy (writing in PS under the pseudonym Jerzy Stefanowski). Artur Salma (now

Stefan Arski) and Stefan Purman were also among its contributors. Oskar Lange, in a speech on the occasion of Kalecki's honorary doctorate at the University of Warsaw, recalled that one of his first meetings with Kalecki occurred during the preparation of an edition of *PS* (see "Prof. Oskar Lange's Conferring Speech," **Zycie Gospodarcze**, 25, 1964 (in Polish).) The first number of *PS* appeared in Dec. 1931; the next 14 numbers appeared in 1932, following which it was suspended by the government commissioners.

The character of *PS* was well reflected in the declaration of its programme in the first issue (in a sense Kalecki's article which immediately followed was a development and substantiation of this programme). It declared among other things:

Whenever the present crisis ends and whatever its final act will be, the terrible object-lesson of capitalism which fate has given humanity must bear its fruits... We see the moral suicide of the system. No matter how long its decay is still to last, people's thoughts will turn ever more unhesitatingly and impatiently toward a system in which society controls its economy in a planned fashion and in which there is no place for the primary motive of today, the entrepreneurial profit—that is, toward socialism.

Our journal will serve the cause of socialism in the way we believe is most effective. We believe that socialism first and foremost requires bold deeds, but it also requires courageous thinking. We believe that it will gather strength, looking squarely at the truth and guided in the analysis of reality more by common sense than by the intellectual constructs of authorities, which are often an impediment rather than a help in understanding the mechanism of the phenomena in question.

We believe our tasks are to examine critically the most important events in the economic and social life of capitalist countries, to

follow the development of the socialists' movement in all its forms, to elucidate the problems it faces, and to record the stages in the building of socialism whenever it has been introduced. As far as we are able, we hope to cover everything which can and should be of interest to the socialist movement.

As people who knew Kalecki in the 1920s later recalled, from the time he left Gdansk Engineering College he held quite radical views and was associated with the political left. He was a Communist sympathizer (though he did not join the party, since—as he said—he wished to retain his independence).

At the beginning of the 1930s, Kalecki was strongly involved in his journalistic career in the fight against capitalism. He was convinced that capitalism must fall, though he was aware that bringing this about would not be easy. In his articles published in *PS*, the formal side of his arguments may occasionally appear to have been subordinated to this conviction.

Kalecki's ideas and activities—like those of Lange and a group of young Polish socialist intellectuals gathered in the Union of Independent Socialist Youth—were also influenced by the continuing crisis, whose effects, especially in 1931, could easily have been taken as symptoms of the impending collapse of capitalism. (Radicalization of views was common then in the political left, not only in Poland, but also in Germany, England, France, etc.—see e.g. the views of the English socialist G. D. H. Cole on the prospects of capitalism, quoted by Kalecki in his paper “Is a ‘Capitalist’ overcoming the Crisis Possible?,” p. 48, in this volume; see also Lange's article of 1933, “From Crisis to Stabilization of Capitalism,” in O. Lange, **Dziela**, vol. I, Warsaw, PWE, 1973, pp. 62-8 (in Polish). On the movement towards some kind of reformist planning ideology, widespread among European social democratic parties at the time—e.g. in

Belgium, Holland, and Norway—and its sources of inspiration in the Soviet industrialization drive of the early 1930s, see Andvig, **Ragnar Frisch and the Great Depression**, pp. 374-5.

Moreover, Kalecki began writing on economic theory during the great crisis of the 1930s, which therefore disposed him from the outset towards critically assessing existing theories against reality. Thus, he rejected orthodox neo-classical theory; but (as Lange emphasized in the speech mentioned above) Kalecki was also far from dogmatic in following Marxist theory (his debate with Varga is typical; see pp. 50-2 and p. 432, n. [1]).

Kalecki's publications were also influenced by the development in Germany of National Socialism, whose danger he stressed in many articles; see Bibliography in **Collected Works**, vol. VI, and "On the Papen Plan," "Stimulating the World Business Upswing," "The Business Cycle and Welfare," and "The Business Cycle and Armaments," this volume; see also Lange, **Dziela**, vol. II, Warsaw, PWE, 1973, pp. 536-7.

The second group of factors influencing the character of Kalecki's publications in this period is related to the elaboration of his own theory of the business cycle, on which he worked intensively at the Institute for the Study of Business Cycles and Prices. Though the articles in pt. 2 of this volume were merely a by-product of Kalecki's major studies on the business cycle, they nonetheless show how far these studies had advanced and allow us to trace the subsequent development of his theory. They indicate that its basic outline existed as early as the spring of 1932 (see "Is a 'Capitalist' Overcoming of the Crisis Possible?", this volume); that in the summer of that year Kalecki—following J. Tinbergen—had already considered the influence on the business

cycle of the period of constructing capital equipment (see “New’ Industries and the Overcoming of a Crisis,” this volume); that shortly thereafter work on its formulation was essentially completed (see “On the Papen Plan,” this volume). At the end of 1932 Kalecki published the first in a series of papers on the mechanism of stimulating the business upswing and the theory of capitalist reproduction; the argument put forward in these papers rests heavily on the theses of his **Essay on the Business Cycle Theory** (see “The Business Cycle and Inflation,” this volume).

From the spring of 1932 onwards Kalecki clearly points to the possibility of overcoming the crisis through the inflationary financing of public works (see “Is a ‘Capitalist’ Overcoming of the Crisis Possible?,” and “The influence of Cartelization on the Business Cycle,” this volume). The term “inflationary financing of public works” is Kalecki’s. In his later studies in the theory of the business cycle, however, he dropped it, reserving the term “inflation” for processes of expansion accompanied by rising price levels, and showing that with unemployment and idle capital equipment inflation need not arise. This followed from his rejection of the hypothesis of an automatic increase in prices with an expansion of output, i.e. the assumption of free competition (see p. 467 n. [2]).

Reduction of Wages during Crisis¹ (1932)*

1. While the 'doctors' of capitalism, faced with the ever-deepening economic crisis, are losing heart, the 'quacks' continue to prescribe a universal remedy for all the ailments of the sick system—reductions in workers' wages. The counsel of the quacks is gaining ground. Individual leaders of industry are ardently remedying the economic situation in their own businesses by terminating collective agreements and perfecting the art of tacit wage

1 Ed. n.: First published as 'Obniżka płac w czasie kryzysu', under the pseudonym 'Henryk Braun', in *Przegąd Socjalistyczny*, 2/2, 1932, pp. 1-2.

The problem of the effects of wage reductions on the course of the business cycle was very real, since at that time, during the crisis phase of the cycle, wage reductions did take place. In 1931 the major Polish industries demanded drastic reductions in social-security spending and this was granted by parliament. While a frontal attack aimed at industry-wide wage reduction was considered at the time politically unwise, it was particularly favoured by export businesses. Less than two years later, in 1933, the spokesman for the major Polish industries asked parliament to include overall wage reductions in government economic measures to fight the crisis.

Kalecki addressed the problem of wage reduction again in the article "Is a 'Capitalist' Overcoming of the Crisis Possible?," then in the *Essay on the Business Cycle Theory*, both in this volume, and in his paper "Money and Real Wages" (see *Collected Works*, vol. ii). In the *Essay* he investigated more thoroughly the problem touched on here of changes in the relative share of wages in the social income during the cycle. This problem (next to the theory of the distribution of national income) became the main subject of Kalecki's subsequent studies on the distribution of national income.

* Vol. I, pp. 41-44.

reductions. What is the real effect of these measures on economic developments during the crisis?

2. For simplicity's sake we shall consider here a society made up of capitalists and workers only. Let us assume that total social output amounts to 100 units of some goods per month, 60 units of which are the share of consumer goods for workers; 20 units, consumer goods for capitalists; and 20 units, depreciation of capital and investments, i.e., means of production (buildings, machines, etc.). A total of 80 units of consumer articles and 20 units of means of production are produced.

At the same time, let workers' wages amount to 60 and capitalists' profits to 40 money units. Then workers can purchase the 60 units of consumer goods intended for them, and capitalists the remaining 40 units (20 units of consumer goods and 20 of the means of production). Hence the distribution of social output corresponds to the distribution of the money income (or purchasing power) of the population; output and sales are in equilibrium.

We now assume that at a certain moment workers' wages are reduced by 20%. This means that the income (purchasing power) of workers declines by 20%, and that for their work they will now be able to purchase, instead of 60, only 48 units of consumer goods. At the same time, what the workers have lost is gained by the capitalists, who now pay workers less; and hence the income of capitalists will be: $40 + 12 = 52$ money units.

Let us assume, as before, that half of this income, i.e., 26 money units, will be spent by the capitalists on consumer goods and half will be saved. A new equilibrium between the distribution of output and the distribution of income could now be established if the output of consumer goods were $48 + 26 = 74$

units, and the output of means of production were 26 units. For only then will *all* goods, both consumer goods and the means of production, find purchasers: 48 units of consumer goods would be purchased by workers (who now have 48 money units) and 26 units of consumer goods plus 26 units of the means of production would be purchased by capitalists (who now have 52 money units).

We can easily see, however, that such adjustment of output to the new distribution of *income does not occur*. Were it to occur, output of consumer goods would have to be *reduced*, as follows from the above, from 80 to 74 units, and the output of means of production would have to *rise* from 20 to 26 units. But: (i) producers of consumer goods have no reason to reduce their output, since for the time being the profits of each of them—thanks to the reduction in workers' wages—have increased; (ii) during crisis, when plants are working below capacity, even with increased profits from wage reductions capitalists will not immediately increase their demand for new means of production. Thus a disproportion between the distribution of output and the distribution of income, and hence between output and sales, will ensue, which will be followed by an increase in stocks of unsold consumer goods by 6 units, in which part of the capitalists' profits will be tied up.

What happens next? Theoretically, owing to the increase in stocks of consumer goods, their prices decline, and workers for their 48 money units will be able to purchase the entire 54 units of consumer goods intended for them. In this way, with the new prices for workers' consumer goods, equilibrium will be restored between the distribution of output and the distribution of social income.

3. However, if a reduction of wages were to have only such effects, a basic question would obviously suggest itself; in the final analysis, has the reduction of wages really not harmed the workers?² The development of our argument will give us a clear answer to this question.

First, the decline in the prices for workers' consumer goods, owing to the increase in unsold stocks, requires a certain period of time. During this transition period, workers for their new, reduced wages will be able to purchase a smaller part of social output than before the wage reduction. The fact that part of the capitalists' profits will be tied up in an unattractive increase in stocks is hardly any consolation to the workers.

Second, if the capitalists are not strongly opposed by the workers over the reduction of wages, this transition period will change into a permanent condition. An individual entrepreneur, even if growing stocks in his warehouses become a serious problem for him, does not understand that a reduction in prices is the result of the previous reduction in wages, to which he also contributed. He regards the 'market' on which the reduction in prices took place as an external force, independent of him. So from the fall in prices he eagerly draws the conclusion that he should reduce wages still further. Consequently, the stocks of unsold workers' consumer goods increase once again, prices once again fall, etc. An ever greater part of the social income will be tied up in stocks,

2 Ed. n.: Formally speaking, it would follow from the above argument that the consumption of workers would decline from 60 to 54 unites, and this due to the assumption that the increase in capitalist profits would make them expand their consumption by 6 units. Only if we accept Kalecki's assumption in the *Essay* that, in the short run, changes in capitalists' profits have no influence on their consumption will the accumulation of unsold consumer goods increase by 12 units (and not by 6), causing such a fall in their prices that workers for their 48 money units will be able to purchase the entire 60 units of consumer goods. This modification has no effect on Kalecki's further argument, however.

the crisis will continue to deepen, and workers with their shrinking wages will be unable to take advantage of price reductions to restore their previous standard of living.

Third, one should remember that our simplified model does not give a true picture of society, since it identifies only capitalists and workers. Besides these, however, there are intermediate strata, and a reduction of prices in the factory warehouse hardly means reductions in retail prices for the consumer-worker. A fall in prices may be partially exploited by the middle and petty business bourgeoisie, whose income and hence also consumption will increase at the cost of workers' consumption.

Finally, and in passing, one should note that our line of argument that after a reduction of wages there is a return to the previous equilibrium between output and sales through price reductions of workers' consumer goods—can only apply to the period of *crisis* when capital equipment is underemployed. During a phase of economic prosperity, a reduction of wages is followed by an entirely different course of events. With full employment of capital equipment the increase in capitalist profits, caused by a reduction of wages, encourages them to place orders for means of production. The increased activity of the industry manufacturing these means of production in turn raises the total number of employed so that, despite reductions of wages, the total output of consumer goods for workers is wholly purchased by them and there are no further price reductions. During economic prosperity for industry, therefore, even countries with starvation wages can show a sustained development of output, since profits are then reinvested. It is beside the point that this

prosperity, as we know, has its limits. Boom years are inexorably followed by crisis.

4. We can say, therefore, that during a crisis~such as we are now experiencing~a reduction of wages causes a reduction of prices, but the interval between these events does not permit workers to benefit immediately, while further reductions of wages eliminate altogether the possibility of their being able to do so. As a result, the standard of living of the working class and its share in the social income fall, but at the same time the increased share of the capitalists in the social income flows more and more into unsold stocks. This in turn further shrinks output and intensifies the crisis.

Is a 'Capitalist' Overcoming of the Crisis Possible?¹

(1932)*

1. As not only months but years of the world economic crisis pass by, as it continues to deepen and the signs of improvement temporarily appearing here and there quickly fade, erased by new waves of ever deeper depression, the question, When will the crisis end? Increasingly gives way to a different question, whose very formulation in 1930, or even at the beginning of 1931, caused bourgeois economists merely to shrug their shoulders impatiently: Is the overcoming of the present crisis *altogether possible* for the capitalist system?

A few English economists and socialist politicians have responded to this question in a rather general way in the leftist English press. A politically moderate professor of economics of Oxford University, G. D. H. Cole, believes that so far there are no signs of improvement; that in fact the world crisis is intensifying:

It is quite clear that the capitalist system can collapse at any moment and that it is now closer to catastrophe than at any other point in past history, not excluding 1919 ... However, some 'patching up' [of the present system] is possible—and even a

1 T. N.: Refer to the Addendum by the end of this chapter for the Editor's note.

* Vol. I, pp. 48-53.

temporary return to capitalist 'prosperity', which means prosperity for capitalists ... I would not assert with certainty that the capitalists will not apply some measures which will temporarily improve the situation. Everything would seem to indicate, though, that they will be unable to do this in time; this is not out of the question, however ... But I am convinced that the basic causes of the crisis are rooted deeply in the capitalist system, and that with this system no lasting improvement is possible.²

According to another economist, J. A. Hobson, author of a well-known study on imperialism,³ because of the intensity, persistence, and universality of the present crisis, together with the general instability of the monetary system, measures of exceptional scope and boldness are required to overcome it. To prevent a catastrophe in the system, and to extend its life for some time, Hobson believes that internationally co-ordinated credit assistance to debtor countries and world price stability are required.

An extensive analysis of the world economic situation and a discussion of possibilities for overcoming the crisis was recently put forward by the eminent Soviet economist E. S. Varga (*Intern. Presse-Koresp*, of this July.)⁴ His study concerns the last quarter of 1931, but its general conclusions and forecast are still most timely. Here is the summary of Varga's main arguments on the question which interests us, i.e., the 'capitalist' overcoming of the crisis.

First, he describes in detail its past course. He indicates the generality of crisis phenomena and links them with the chronic crisis in agriculture. He points out the depth of the depression (expressed in the volume of the fall in output) and its acuteness (the great—though irregular—fall in prices, and the shrinkage

2 Ed. n.: The source of the quotation has not been identified.

3 J. A. Hobson, **Imperialism: A Study** (New York, James Pott, 1902).

4 **Internazionale Presse Korespondenz**, 13, 15 Feb. 1932, pp. 327-64 (see esp. p. 345).

of entrepreneurial profits). He emphasizes the exceptionally strong set-back to investment activity and the persistent accumulation of stocks, as well as the special role of the financial crisis. He also shows the massive and widespread decline in the working classes' standard of living (affecting not only the unemployed but also, in view of the fall in real wages, the employed), and the contradictions in the capitalist world, which have aggravated the crisis and have led already to the first war in the East. Finally, having shown the importance of social changes in the USSR, Varga moves on to discuss the further prospects for the crisis.

He observes that, as yet, there are no signs of an upturn in the business cycle. The financial crisis is deepening; world output, and in particular investment activity, continue to fall. The depreciation of currencies, which Varga identifies with inflation, does nothing to mitigate the crisis even in individual countries, since depreciation has already spread to such a considerable part of the world that none of those countries which have implemented it has thereby significantly increased its competitive position. Besides this, the few States which have been able to maintain the gold standard are isolating themselves from the others with tariff barriers. Consequently, Varga believes that this year at least—1932—will be a year of crisis for the whole world economy.

At the same time, he vigorously argues against the fatalistic theory which holds that a 'capitalist' overcoming of the crisis is impossible. Here one should distinguish between the *structural crisis of capitalism*, going on for years now, and the present *crisis phase of the business cycle*, whose intensity can be explained by this background, but which—if the social rule of the bourgeois is not toppled—can be overcome within the framework of the capitalist system.

For in the present business crisis-as in previous ones-there are factors operating which both contain the seeds of the system's downfall and prepare the ground for a future business upswing.

The reduction of output deepens the crisis, but at the same time is a factor in overcoming it, since it leads to the liquidation of commodity stocks. The sharp fall in prices causes great losses for capitalist enterprises, but at the same time cheapens elements of fixed capital⁵ and thereby stimulates its utilization, and hence investments. The credit crisis, resulting in numerous bankruptcies, also deepens the economic crisis; but at the same time a process of concentration occurs (a transfer of failing companies into the hands of creditors), combined with large write-offs of the book value of capital, so that the same amount of profit is now obtained from a smaller capital value, thereby increasing the profit rate. Finally, the reduction of workers' wages deepens the crisis by reducing still further the domestic market, while at the same time providing one of the strongest incentives to a renewed employment of capital and hence also to the replacement, investment, and the expansion of capital equipment.

Obviously, during the structural crisis of capitalism, overcoming the crisis phase of the business cycle produces even greater difficulties than before. During the structural crisis, the monopolistic nature of capitalism and the permanent excess of fixed capital counteract tendencies towards the renewal and expansion of fixed capital. The conquest of new markets and the greater penetration of colonial markets meet with difficulties. The aggravation of imperialist contradictions and the constant threat of war check the tendency to

5 Ed. n.: In these early works Kalecki used the term 'constant capital'; in later editions of these works, however, he always replaced it by the term 'fixed capital'. Hence the term 'constant capital' here has also been replaced by 'fixed capital'.

overcome the crisis. Nonetheless, Varga believes that the above-mentioned factors, though in a changed and weakened form, together make up an automatic mechanism which determines the course of capitalist economic developments. Thanks to this mechanism the capitalist system is capable of overcoming the present phase of the business cycle.

It would be wrong to deny this possibility, but it is equally wrong to forget that the overcoming of the crisis by capitalism is inseparably linked to the position taken, and the political actions pursued, by the working class.

2. Varga's arguments, summarized above, concerning the specific factors involved in overcoming the crisis within the framework of the present capitalist system provoke some doubts and questions.

Above all, Varga's identification of depreciation with inflation may lead to serious misunderstandings. Inflation consists in the creation of purchasing power not based on a share in the current social income (e.g., through expansion of credit by the bank of issue or commercial banks). Inflation in a non-isolated economy generally causes devaluation, i.e., depreciation of the currency (a fall in its value in relation to other currencies). However, this depreciation can take place without previous inflation and-as has now happened in Great Britain-can even be combined with restriction of credits, i.e., with deflation. Among the countries which have recently devalued, typically inflationary signs are observed only in Japan, which has financed military operations through credit expansion by the bank of issue.

As regards the effects of devaluation itself, though it does not contribute significantly to a direct mitigation of the economic crisis, it does have a certain balancing influence on the financial perturbations (i.e., the financial crisis) that

intensify it. The countries which have retained the gold standard are mainly the creditor countries. Owing to the fall in the exchange rates of their debtors, imports from the creditor to the debtor countries have declined considerably, which will contribute to a gradual payment of debts. In one of the recent numbers of *Socialist Review* we described in more detail those balancing processes,⁶ which appeared first and foremost in the form of payments of French credits by England. Owing to the increased confidence of France in the English capital market, such processes even caused a return of the earlier withdrawn French capital to England. This tendency has weakened recently as a result of financial perturbations caused by the Kreuger collapse.⁷ The international financial system is already in such a state that as fast as holes begin to be patched up in one place, new holes appear in another. However, if a complete breakdown of international finances does not occur in the mean time, one should expect devaluation to contribute to a certain extent to ending the financial crisis (which obviously still forms no basis for overcoming the economic crisis, but only ameliorates the factors intensifying it).

Next it should be noted that the depletion of stocks due to the shrinkage of output during the crisis is neither the only, nor even the main, reason for the eventual upturn. As Varga himself mentions several times, during a crisis investment activity in particular shrinks, and therefore—in my opinion—it is precisely here that one should seek the starting-point of processes that will bring an upswing of the business cycle. Owing to the fact that during a crisis

6 See 'Mr Keynes's Predictions', this volume (vol. I).

7 See M. Kalecki, 'The Swedish Match Trust', **Przegląd Gospodarczy**, 9/3, 1928, pp. 101-4 (in Polish) (also in **Collected Works**, vol. VI); 'The Match Trust and the Soviets', **Przegląd Gospodarczy**, 9/20, 1928, pp. 1027-8; 'Ivar Kreuger', **Przegląd Socjalistyczny**, 9, 1932, p. 12.

investment activity is on a lower level than that required for simple reproduction (maintenance) of the existing capital equipment, this equipment is also gradually depleted. Unused and outdated machines are sold for scrap, and new ones are not purchased to replace them. Besides, a considerable number of machines- and equipment in general-still kept in factories has not been reconditioned nor maintained properly, and may have become obsolete as well (due to technological progress), and is therefore only partially usable. On the other hand, since in a certain phase of the crisis the output of consumer goods generally starts declining more slowly than the rate of this contraction of capital equipment, there is a real need to employ the existing equipment more fully, which in turn requires investment. There is then a better chance of intensifying investment activity, which is the basic foundation for overcoming the crisis.

We also have reservations about the other factors of automatic improvement enumerated by Varga. Capital equipment becoming cheaper because of the fall in prices does not, as a rule, occur more rapidly than the average fall in profits. Therefore the hypothetical rate of profit in a new firm would be no higher than in preceding stages of the crisis. Hence, in my opinion, this factor cannot be an independent stimulus to undertaking investments.

As regards the reduction in the book value of capital because of write-offs- while it does indeed increase the nominal rate of profits, this is not a sufficient reason for expanding an existing firm or starting up a new one as long as the crisis lasts. As regards the reduction in workers' wages owing to the domestic market shrinking, which Varga mentions, this either causes a fall in prices or an accumulation of stocks (or both). In other words, profits either do not rise at all,

or are realized in the form of stocks.⁸ In these conditions the cheapening of labour cannot stimulate the establishment of new firms.

In the final analysis, therefore, we believe that, of those components of the mechanism of the capitalist economy which could form a foundation for overcoming the crisis, the contraction of capital equipment caused by the decline of investments (and also by the running down of stocks) should be put in first place.

However, all these factors which affect the course of the crisis do so only after a long time. Former crises as a rule have ended sooner—on account of the intervention of some 'external' factors, such as the conquest of new markets, or a wave of technological innovations. Today—since the colonial countries have also been drawn into the orbit of capitalism—expansion of markets in the geographical sense is almost impossible. The only possibility would be a demand for new goods, which would create new markets. The scope and depth of the present crisis, however, make this way of overcoming it highly unlikely. The same can be said of possible innovations.

Hence today, of the possible 'external' factors which might contribute to overcoming the crisis, the only one left is a 'wartime boom', which, as the war expands, for obvious reasons would greatly undermine the *social viability* of the present system and make the possibility of a capitalist overcoming of the crisis highly doubtful.

Finally, we should mention yet another possibility, namely a certain form of inflation consisting of individual states, or groups of states, starting up major public-investment schemes, such as construction of canals or roads, and

⁸ Ed. n.: See '*Reduction of Wages during Crisis*'.

financing them with government loans floated on the financial market, or with special government credits drawn on their banks of issue. This kind of operation could temporarily increase employment, though on the other hand it would retard automatic 'natural' adjustment processes which might lead to overcoming the crisis. Besides this, if it were to be carried out on a large scale, it would have to be co-ordinated by an international agreement of the individual capitalist governments, which, given today's quarrelling imperialisms, is almost out of the question.

3. There seems to be almost universal agreement that at the present moment there are no signs of the world crisis being overcome. Hence the above arguments are of rather a theoretical nature. They point to ways of overcoming the crisis which are still open to the capitalist system. If and when that system will embark on such measures, and whether they will indeed lead it out of the crisis, is another matter. The decisive factor here is obviously not the economic but the social one the position taken by the working class.

Editor's Addendum

First published as '*Czy możliwe jest „kapitalistyczne” wyjście z kryzysu?*', under the pseudonym 'Henryk Braun', in **Przegląd Socjalistyczny**, 2/10, 1932, pp. 1-3.

G. D. H. Cole was a socialist, J. A. Hobson a liberal reformer, and E. S. Varga a well-known Marxist economist. In analysing the chances of overcoming the crisis, Kalecki and Varga differ from the first two by seeing the attitude of the working class and its political actions during the crisis as of fundamental

importance. More significant from the point of view of the further development of Kalecki's theory, however, are his disagreements with Varga.

In dealing with the business cycle and its crisis phase (leaving aside problems of the 'structural' crisis of capitalism), Marxist economics of that time generally limited itself to a rather mechanical explanation. The main weakness of this approach was inconsistency in rejecting Say's Law. Difference between Varga's views quoted here by Kalecki and his own position can be clearly seen in the evaluation of the effects of wage reductions on overcoming the crisis. Varga takes a position consistent with the theory of under-consumption: a reduction in wages deepens the crisis, since it limits the domestic market. However, underlying his opinion that wage reductions are at the same time one of the most important stimuli to the re-employment, replacement, and expansion of capital equipment is the assumption that what workers do not consume on account of wage reductions will be 'purchased' by capitalists in one form or another, hence the reduction in labour costs will increase profits, which will stimulate the upswing. Indeed, if Varga's argument is taken to its logical conclusion, the problem of realization does not arise here.

Kalecki opposes this by claiming that wage reductions will be accompanied either by a corresponding fall in prices (in which case the entire production will be sold, but neither capitalist profits nor profitability will change, and hence there will be no incentive to increase economic activity) or (with no, or insufficient, price reductions) by an accumulation of unsold stocks, which also will not stimulate the upswing. The gist of the critique of Varga's position is Kalecki's belief that the course of the business cycle is determined by investment activity,

which in turn is affected by factors influencing the expected profitability of investments.

The thesis at the end of the article—that all previous crises ended not so much as a result of the ‘automatic’ mechanism of the business cycle but as a result of some external factors—was more fully developed in Kalecki's *Theory of Economic Dynamics* (1954). In this work he went even further and argued that, leaving out such semi-exogenous factors as technological progress, overcoming the crisis cannot be taken for granted (see *Collected Works*, vol. II). As regards the second ‘external’ factor mentioned by Kalecki (‘wartime boom’), it has been sometimes argued that in the USA ‘the great crisis of the thirties never ended but only melted away in the great mobilization of the forties’ (J. K. Galbraith, **American Capitalism**, Cambridge, Mass., Houghton Mifflin, 1952, p. 69).

The ‘synthetic’ stimulation of the upswing through the inflationary financing of public works (see terminological note on p. 429) was not Kalecki's original idea (see E. Lipinski's introductory article, ‘*On Economic Development*’, in the first number of the bulleting of the ISBCP, **Koniunktura Gospodarcza**, 1/1, 1928, 5 (in Polish); similar views were also expressed at the time by K. Studentowicz and others, though deflationary views were dominant in economic papers). Kalecki's contribution to stress that, with capital equipment lying idle, such an operation leads not only to a rise in prices but also to a rise in production and employment.

'New' Industries and the Overcoming of a Crisis¹ (1932)*

There is no doubt that the appearance during a depression of branches of industry which meet new needs can accelerate the overcoming of the crisis and will also influence the course of the subsequent boom. The overcoming of the crisis in the USA in 1921 was unquestionably accelerated by developing the production of inexpensive cars, radio sets, electrical household equipment, rayon, etc.

How does an 'additional' market for these articles appear? For if incomes remain at the same level, the purchase of 'new' articles must result in reduced consumption of other goods, and thus there would be no change in total output; new branches of industry would arise, but simultaneously old ones would decline.

However, as in business fluctuations in general, a major role played here by the time taken to construct industrial plants. While factories that are to produce new articles are under construction, such articles have not yet appeared on the market, whereas investments have already caused an overall increase in employment and an expansion of the domestic market. Hence, for the moment,

1 First published as *'„Nowe" przemysły a wyjście z kryzysu'*, under the pseudonym 'M. Kai', in **Polska Gospodarcza**, 13/ 31, 1932, pp. 907-8.

* Vol. I, pp. 54-55.

'old' branches of industry gain from the construction of factories for new articles. Obviously, once factories for 'new' branches of industry have been completed and begun to deliver their goods to the market, the situation of 'old' branches will deteriorate; though even then they will still be much better off than during the crisis, since the strong stimulus from investments in new branches of production has in the meantime generated an economic boom. Even so, in the business upswing accelerated in this way, the 'old' branches of industry will not be as prosperous as the 'new' ones. This indeed could be seen during the period of American prosperity which followed the crisis of 1921.

It should be noted, however, that the competition between 'old' and 'new' branches of industry was weakened at that time by the complete destruction of one of the old ones, namely by the introduction of prohibition at the beginning of 1921. During the present presidential election campaign, the 'wets' are once again recommending the lifting of prohibition as a way of overcoming the present crisis, asserting that the reconstruction of the alcohol industry can have the same effects as did the construction, on that industry's ruins in 1921, of factories for cheap auto-mobiles, radio sets, etc.

However, the situation is somewhat different in this case. The point is that many distilleries and breweries which were closed down earlier are still in existence, and hence would not require such great investment as the construction of entirely new branches of industry. Will the production, in this case, of spirits and beer cause a corresponding fall in the consumption of other articles? Probably not. Consumers generally will in fact now spend less on other articles, but this will be offset by demand for those same articles by workers employed in the processing of beer and spirits, and by capitalist deriving profits

from these industries. It is an open question whether those capitalists *will* in fact spend their profits, whether on consumption or on investments, but it seems likely. For even if new distilleries and breweries need not be built, they will in any case require major overhauls, which will absorb the profits of their owners for a long time.

In this way, the production of alcohol will be brought on to the market without reducing the sales of other goods. Hence the market for these goods will not shrink, though neither will it expand, as was the case in 1921 with the construction of factories for new branches of industry. Consequently, not all the symptoms of a boom—such as rising prices and ever-increasing investments—will appear. There will be only a single reduction in unemployment to mitigate the crisis, rather than a continuous upward movement towards a boom. All of this obviously rests on the assumption that the distilleries, long since closed, can be reopened, which surely will not always be the case. There would, therefore, be some construction of new plants and all that that entails; but it would probably be insufficient to accelerate business upswing.

Foundations of the Manchurian Conflict¹ (1932)*

Although as will be seen below, at the centre of the Manchurian conflict is the problem of the Japanese rail ways in Manchuria, the conflict cannot be considered as yet another example of colonial imperialism. The collapse of international trade and attempts of individual countries to become self-sufficient, the intersection of Japanese-American and the Japanese-Soviet antagonisms, the struggle for control over China that is of special importance in the period of the world business crisis—all these factors are clearly reflected in international policies which are interwoven with the Manchurian war.

The economic position of Manchuria. The area of Manchuria is 1 million km² and its population is nearly 27 million. A large part of this population arrived in Manchuria during the last twenty years from the overcrowded province of Southern and Central China. In the past few years, because of civil war in this region, emigration to Manchuria, lying outside the front line has taken the form of a genuine migration of nations. Colonization of Manchuria by the Chinese has continued until the present and the number of migrants is estimated at 1 million per year.

1 Ed. n.: First published as "Podstawy konfliktu mandzurskiego." In: **Przegląd Socjalistyczny**, 2/2 (1932), 6-8, and signed the pseudonym H. Br.

* Vol. VI, pp. 157-161.

Manchuria is at present a purely agricultural country. The main crop is pulse soya but wheat is grown, too. However, Manchuria has natural base for considerable economic development, e.g., forests and mineral deposit especially of coal and iron-ore, that are little exploited now. The main exports of Manchuria are: soya, soya oil, and soya-oil cakes, ores, and pig-iron; among imported goods manufactured goods, especially textile should be mentioned.

The network of the Manchurian railways is rather dense. In the north, the East-Chinese line intersects Manchuria and ends in the Soviet stronghold—Vladivostok. This line is under control of a Soviet-Chinese management. The southern branch of the East-Chinese line leaves Harbin to join in Changchun the South-Manchurian line that leads from Mukden to the sea port of Dairen. This line is owned by Japan, as well as the line from Mukden to Seoul, the capital of Korea. The Chinese lines so far are mainly the branches of these main communication arteries (see Fig. 1).

Japanese interests in Manchuria. Manchuria is the most important area for export of Japanese capital. According to data from the management of the South-Manchurian line, Japanese investments in Manchuria totals \$850 million (of which \$35 million represents investment in the South-Manchurian line itself and \$15 million loans for the Chinese railway development in Manchuria). Apart from Manchurian investments, an important field of operation for the export of Japanese capital is in Central China (mainly in cotton spinning-mills), but the total value of these does not exceed \$250 million.²

2 Ed. n.: In the original paper the figures on Japanese investment in Manchuria and in Central China were mistakenly given as \$85 million and \$25 million respectively. They were corrected in Kalecki's next article on this subject to \$850 million and \$250 million (see p. 167 above).



FIG. 1. Railways in the Far East in 1932

Among investment projects in Manchuria of special interest to the Japanese are those in the development of iron-ore mines and smelting-works (large blast-furnaces) as a supplement to the narrow raw-material base of Japanese heavy industry. Of the Japanese total demand for iron, 60% is met by imports of iron-ore and pig-iron. Half of it comes from Manchuria exports of soya, representing a substantial share in the total food supplies of Japan. In the

first half of 1931 soya supplies from Manchuria represented 11% of all Japanese imports and 60% of Japan's imports from China. Being an important supplier of raw materials for Japan, Manchuria is at the same time a large market for the Japanese industrial goods. Japanese exports to Manchuria in the first half of 1931 represented 7% of her total export and 30% of her exports to China.

According to Japanese plans, capital expansion in Manchuria was to be linked with obtaining there a large settlement for emigrants from Japan. This demographic aspect of the plan was checked by the rather severe climate in Manchuria to which the Japanese (and Japanese women especially) could not adjust. At present of the 27 million population of Manchuria the Japanese represent only 0.2 million and the Koreans 0.8 million.

The 'railway' causes of the conflict. Already Chinese branches of the main lines represent competition against the once monopolistic position of the South-Manchurian line, e.g. the Kirin-Mukden section competes with the Changchun-Mukden one. However, the situation became 'no longer bearable' for the South-Manchurian line when China decided to develop its railways on a larger scale. The most important project in this plan was the construction of the Taoan-Paintala line and the development in the Gulf of Chichili of the Huludao seaport that could play a similar role to that of Dairen. In this way a new line, Qiqihaer-Huludao would be constructed that would have an advantage over the South-Manchurian line in so far as the former would make the distance from the north to the southern seaports shorter and its extension would reach Peking.

If in this case—according to the Japanese—the Chinese constructed 'too much', in another case they constructed 'too little', postponing the extension of the Chanchun-Kirin-Tunhua connection until it meets the coastal Korean line, to

which the Chinese had once committed themselves. Japan was very eager to see this extension completed since she is developing the Korean port of Chōngjin which would then be connected with Kirin and Changchun and thus compete with the Soviet port of Vladivostok. Moreover, for Japan the Changchun-Chōngjin connection would be of the utmost military significance as it would enable troops brought from Japan (by sea) or Korea (by railway) to penetrate lands to the west.

The immediate cause of the Manchurian conflict was, no doubt, the development by the Chinese of a communication artery parallel to the South-Manchurian line and the Chinese reluctance to connect the seaport of Chōngjin to the centre of Manchuria. Both these problems have found their 'solution' in the course of the present, military conflict. Japan now is now constructing intensively the connection between Tunhua and the Korean coastline and advances of Japanese troops southwards clearly aim at taking control over the seaport of Huludao.

The general background of the conflict. Japan's own deposits of raw materials are poor, the density of population is very large, as is her birth-rate. Thus, Japan faces two alternatives: emigration or a very intensive development of processing industries. Emigration is made difficult by the low climatic adaptability of the Japanese (which we mentioned in the context of the attempted settlements in Manchuria), and by limits placed on Japanese immigration to California that has more suitable climatic conditions. Indeed, immigration restrictions, introduced by the USA as early as 1908, are one of the main causes of Japanese-American antagonisms. The development of processing industries that would enable Japan to exchange her manufactured goods in return for food and raw materials

is made difficult by the chaotic nature of the world economy that moves ever closer from an international division of labour to greater self-sufficiency of each country. If in the last few years exports of Japanese industrial goods increased at a high rate, this was due to low wage rates.

However, once the struggle for wages started in Japan, and at the same time the export of industrial capital shifted to countries where the exploitation of labour could be pushed to the limits (*inter alia*, from Japan to Central China), the rate of expansion of Japanese exports had to slow down. *The future of the continued industrialization of Japan within the framework of the capitalist world economy became dependent on the conquest of new lands rich in raw materials and fertile soil that would also make a permanent market for her manufactured goods; this is the broader background to the war in Manchuria.* If it becomes ever more difficult to transport Japanese products to China, Manchuria—to which at the same time constant immigration from other Chinese provinces is taking place—must be taken over and forced to buy these products.

In the political life of Japan an important role is played by a collision of interests grouped around the army and the navy. The first group includes *inter alia* a large industrial concern Mitsui, the other—its competitor, the Mitsubishi concern engaged in the shipyards. The army faction favours a heavy-handed policy in continental Asia which is linked with an anti-Soviet position. In contrast to these plans of conquest of new Asian lands, the navy faction favours the idea of future war with the USA, the result of which would be the lifting of the immigration barriers for Japanese would-be settlers in California and the possible conquest of the Philippine Islands. This faction, aware of the need to secure a benevolent Soviet neutrality in case of a Japanese-American military

conflict—obviously bearing in mind the supplies of oil for the Japanese navy from the Soviet port of Sakhalin—presses for good relations with the Soviets.

The present direction of Japanese policy means that the army faction has got the upper hand over the navy faction. A relatively low-profile position of the USA on the question of the advance of Japanese troops in Manchuria is therefore not surprising, bearing in mind the usually great interest of the USA in China-related problems. Moreover, apart from a mitigation of Japanese-American antagonism, the USA expects, as do West European countries, that the occupation of Manchuria will limit Japan's interests in Central China, and they may consider the Manchurian conflict as the beginning of gaining new spheres of influence in the economically enfeebled (e.g. this year's' flood) Republic of China. The foretaste of such 'advantages' of the Manchurian conflict are increased sales of British products on the Chinese market, related to the boycott of Japanese products.

War in the East¹ (1932)*

1. In the last few weeks 'protection of Japanese interests in China' has been largely 'extended' by Japanese troops entering Northern Manchuria and the Inner Mongolia on the one hand, and by the bombing of Shanghai on the other. If operations in Manchuria and Inner Mongolia represent a consistent advance in the plan to conquer new lands rich in raw materials and fertile land, and located to the north of the Great Wall,² the main objective of the bombing of Shanghai was the desire to stop the boycott of Japanese products in China introduced there from the beginning of hostilities. At the same time, however, the first direction of Japanese expansion turns ever more into aggression against the Soviets, and the second direction means aggravation of the relations between Japan and the USA, and to some extent also Great Britain.

2. Japanese-Soviet relations became tense in the first stage of the Manchurian conflict. Japan then accused Russia of supplying munitions to the Chinese general Ma.³ This was strongly denied by the Soviet authorities. In fact, it was speculated at the time that General Ma received arms shipments from the

1 Ed. n.: First published as: "Wojna na Wschodzie," under the pseudonym Henryk Braun, *In: Przegląd Socjalistyczny*, 2/5 (1932), 1-3.

* Vol. VI, pp. 164-169.

2 See M. Kalecki, "*Foundations of the Manchurian Conflict*," this volume.

3 Ed. n.: In the original, General Maa, but most likely General Chan-shan Ma.

Japanese themselves who wanted to make the conflict more 'intense' and to justify their military advances. At any rate, it is a fact that recently General Ma from being a defender of Manchuria turned into a friend of its invaders. Willing to avoid, at any price, being drawn into war complications, the Soviets then proposed a non-aggression pact but their offer was turned down. Soon Japanese troops entered the areas in Manchuria controlled by the Soviets, invading Harbin and ostentatiously using the East-Chinese railway for military transports. The White Guards, many of whom settled in Manchuria, remained in touch with the Japanese, and their leader, General Horvath⁴ organizes White Guard combat troops.

Is this an omen of an outbreak of a Japanese-Soviet war? It is difficult to answer this question definitely; let us only note that Soviets are reinforcing their defence positions in the Far East. At any rate, it is a fact that Japanese-Soviet relations have become critically tense. Japanese domination over Manchuria is already sealed and a farcical 'independent' State will be established there. Next, Japan will probably attempt to eliminate Russia from the management of the East-Chinese line and then, by means of tariff policy, make the development of Vladivostok—the main Soviet centre on the Pacific coast—difficult, as the connection between this seaport and the Trans-Siberian railway line through the Amour and Usour lines is much longer than that through the East-Chinese line. The Japanese leverage on the Soviets in this and other matters may be the continued 'nursing' of the White Guards who may be used for guerrilla raids (e.g. against the Amour railway line that goes along the border with Manchuria). It appears that the statement of the Japanese representative to the

4 Ed. n.: i.e. General D. L. Horvath, at the time the general manager of the Eastern Chinese Railway.

League of Nations, Mr. Sato,⁵ on the question of the memorandum on the Ukrainians is an attempt to find allies in case of a future Japanese-Soviet conflict.

3. The Chinese have used a boycott of Japanese products several times already; however, it has never been as complete and as consistently executed as in the present conflict. Japanese exports to China, which represents nearly 20% of total Japanese exports and nearly 40% of her exports of industrial goods, have been drastically reduced. In particular, deliveries of Japanese textiles have nearly disappeared from the Chinese market (except for Manchuria) and have been replaced by British products (see Table 36).

In the docks and warehouses of the open Chinese seaports about 800 000 tonnes of Japanese goods have piled up and cannot be unloaded because of the boycott; 700.000 tonnes of these are blocked in Shanghai alone. Moreover, huge stocks of goods destined for the Chinese market accumulate in Japanese warehouses. Next to textiles, products most affected by the boycott are Japanese coal, sugar, and paper products.

Table 36. *Exports to China, September-December 1931*

Month	Total Japanese exports to China (Ym.)	Textile exports from Japan to China (million sq. yds.)	Textile exports from Britain to China (million sq. yds.)
September	23.0	33.2	4.4
October	15.8	9.4	5.8
November	9.0	6.6	6.5
December	5.0 ^a	5.0	11.8

^a Estimated.

5 General Tetsutaro Sato.

The anti-Japan action taken by the Chinese has not been limited to checking the shipments of Japanese products to China, however. First of all, production of Japanese textile factories in China (concentrated mainly in Shanghai) has also been boycotted. Secondly, the Chinese have used their dominant position in the wholesale and retail trade in the nearly all the Far East to stop deliveries of Japanese goods to the Dutch East Indies, Siam, Burma, Malacca, the Philippines, etc. Thirdly, and perhaps more surprisingly, Chinese merchants have stopped not only their purchases from the Japanese but also their sales to them which, of course, does not prevent the Japanese from buying elsewhere, but it disorganizes their routine trade operations and makes them more expensive.

The devaluation of the pound greatly facilitated the boycott of Japanese exports because it reduced the prices of competing British products. To counter this devaluation, Japan, after some hesitation, decided in the middle of December 1931 to suspend the convertibility of the yen into gold, a measure that may somewhat lessen the efficiency of the boycott. Until now the devaluation of the yen has been the same as that of the pound, i.e. 30% of the parity value. It is uncertain, however, if the yen will stabilize at this rate, since war expenditures combined with reduced exports and increasing stocks in factories manufacturing goods for export will cause inflation that to a certain extent has apparently already started. The possibility of a further devaluation of the yen is indicated, *inter alia*, by the very large purchases of cotton in America by Japanese spinning-mills, in spite of a reduction in Japanese sales markets;

clearly, 'patriotic' Japanese industry escapes from the yen and invests in foreign raw materials. This, of course, will accelerate the next fall in the rate of exchange.

We have noted above that the devaluation of the yen could not be considered a radical countermeasure against the Chinese boycott. Thus a punitive expedition to Shanghai—the centre of boycott organization—proved necessary. As usual in such instances, the 'national dignity' of Japan could not bear that some Japanese were beaten there (shortly earlier Japanese marines had beaten the US councillor in Mukden). Thus bombing of the Shapei district in Shanghai, where, incidentally, the offices of the boycott action are housed, was started. To bomb defenceless people who live mainly in wooden houses, aeroplanes were used. As we could see, the applied technique was modern, but the aim is always the same: "With adequate profit, capital is very bold. A certain 10% will ensure its employment anywhere; 20% certain will produce eagerness; 50%, positive audacity; 100% will make it ready to trample on all human laws; 300% and there is no crime at which it will scruple." (Karl Marx, **Capital**).⁶

4. The desire to stifle the Chinese boycott was the immediate reason for the raid on Shanghai but it does not at all imply that the consequences of this raid will be limited to Japanese-Chinese relations. After invading Shanghai—the largest Chinese industrial centre (especially of Japanese industry) and the single most important Chinese seaport—the Japanese will not freely leave it. However, capture by the Japanese of the dominating position in Central China obviously threatens the interests of Great Britain, and especially of the USA, in this region.

⁶ Ed. n.: See MARX, Karl. **Capital**. Vol. I. London: Allen & Unwin, 1946, 786, n. 2; in fact the quotation is after P. J. Dunning, **Trades' Unions and Strikes**. London, 1860: 35.

British capital engagement in China may be estimated at \$700 millions of which, however, only \$150 million represent industrial investments (of which, in turn, \$100 million is invested in an industrial and tobacco company, the British-American Tobacco). The rest is invested in Chinese government bonds, in railways, fleet, commercial companies, banks and concessions for acquiring property rights. British exports to China, consisting mainly of industrial products, was \$60 million in 1930. Japanese capital investment in China (Manchuria excluding) is estimated at \$250 million of which more than \$100 million was invested in industry (mainly the textile industry) and the rest, as in the case of British capital, in government bonds, transport, commerce, and banking.⁷ It will be noted that the share of industrial capital investment in the total invested capital is much higher in the case of Japan than Britain. Moreover, Japanese-owned industry in China continuously develops, and that of the British shrinks. In the textile industry 40% of spindles in cotton-spinning are owned by the Japanese capital (of which three-quarters are located in Shanghai), 4% by the British capital, and 56% by the Chinese. In 1930 the value of Japanese exports to China, which represent—as do British Exports—mainly industrial goods, was \$200 million.

This comparison of the structure of interests explains the zigzag line of British policy on the question of the Japanese expedition. The basic *principle* underlying this expedition, which aims at throwing away the meagre advances of Chinese nationalism and at establishing security of Government bonds, greater favours for Japanese firms, and increased access to Chinese market, is

7 In my paper on the “Foundations of the Manchurian Conflict” the figure of \$25 million was quoted in error; mistaken was also the figure of Japanese interest in Manchuria which is \$250 million, and not \$25 million [see p. 158, this volume, where both figures were corrected].

wholly consistent with British policy targets, except that British rather than other firms should be favoured. Britain is concerned, however, by the role that Japan will play in the restored *ancien régime*. The British are afraid that their capital may be pushed out by the Japanese from the positions it now occupies in marine transport, commerce, and banking, and that British exports that have already shrunk sharply will be altogether eliminated by Japanese competition or by the development of Japanese factories in China.

US interests in China are completely different and hence their position on Japanese expansion in Central China is much stronger. The share of the USA in Chinese government debt is small and total American capital investment is not greater than \$150 million, a large part of it being invested in public utilities (*inter alia*, a power-plant in Shanghai) and in oil-containers. US exports to China, of over \$110 million value in 1930, are almost exclusively raw materials and semi-products. In these circumstances the USA has nothing to lose if an independent China ruled by Kuomintang is established, for it represents at present the interests of the large and middle bourgeoisie. On the contrary, owing to its influences in the Kuomintang Government, the USA may play a significant role in the future development of Chinese industry.

This position of the USA has been achieved, however, not without cost. The Americans have invested more capital in establishing a network of missions, schools, and universities in China than in Chinese industry and commerce. It is thought there that in contrast to European and Japanese imperialists, Uncle Sam is a kind-hearted and non-partial protector of the Chinese. Clearly the huge interests expected on this capital, invested in grand-style self-advertising, will be

lost if Kuomintang is beaten or even only weakened by the Japanese, and if China is enslaved by Japanese imperialism instead of American.

5. In this interplay of economic and political interests there is yet another special factor that deserves attention. It is the existence of the 'red' Chinese provinces located along the south-eastern coast, between Nankeen and Canton, and independent of Kuomintang. The threat which their mere existence presents to Kuomintang is, of course, greater in time of war. From this point of view the persistently repeated rumours that the Nankeen government is eager to put an end to hostilities at any price and, to achieve this end, is ready to accept even the greatest concessions for the Japanese become more understandable. On the other hand, the possibility of a new revolutionary wave developing again in China must be taken into account by both Britain and the USA. The lack of agreement between the positions of these two powers may be partly attributed to the fact that the USA would rather see the Kuomintang government preventing the revolution and Britain would rather see Japan doing the job. From the point of view of the parties most involved in the conflict the situation is extremely complicated. Hence, as yet, these parties steadily reinforce their positions and monitor in silence the war that is waged a few hundred yards from their trenches in the international settlement in Shanghai.

The Business Cycle and Inflation¹ (1932)*

1. No serious theory of the business cycle any longer doubts the fact that fluctuations in investment activity have a decisive influence on the course of the business cycle. During an upswing, an increase in investment has a direct and indirect influence on the rise of employment, while during a crisis, a fall in investment activity considerably below replacement needs leads to the spread of unemployment and under-utilization of capital equipment. If it were not for these sharp fluctuations in investments, there would be no business fluctuations, or in any case they would not be of such scope, nor extend so far to all areas of economic life, as is the case today.

We shall now attempt to prove the following proposition. If the value of investments made at a given moment always equalled the total sum of saved profits including depreciation charges, i.e., if it equalled gross capital accumulation, the investment activity would remain at a constant level and hence there would be no business fluctuation.

In a closed economy, the total profit of capitalists, including depreciation charges, at any given moment equals the value of the personal consumption of

1 T. N.: Refer to the Addendum by the end of this chapter for the Editor's note.

* Vol. I, pp. 147-155.

capitalists and the value of replacement and expansion of capital equipment.² An individual capitalist may earn 'money'; the income of capitalists as a whole, in which mutual debits and credits cancel each other, must equal the value of consumer goods for capitalists and capital goods. From this it follows that the saved income of capitalists as a whole corresponds to the output of capital goods. The sum of profits which flowed to capitalists and were not consumed equals the cost of replacement and expansion of capital equipment. Hence, if at any given moment capitalists undertake investments of the same value as their savings at that moment, then in the next period, when their investment decisions are executed, the output of capital goods will be the same as at the present moment-the investment activity will be constantly maintained at the same level.

Reality differs entirely from the course described above, however. Capitalists as a whole do not undertake investments of exactly the same value as their savings from their profits at a given period. For an increase in the investment activity is not determined by previous profits, but by expectations of the future profitability of enterprises. However, how can capitalists invest more than remains from their current profits after spending part of them for personal consumption? This is made possible by the banking system in various forms of credit inflation. Hence, in accordance with the above proposition, without credit inflation there would be no fluctuations in investment activity, and consequently there would be no major business fluctuations. *Business fluctuations are strictly connected with credit inflation.*

2 For simplicity, throughout this paper we ignore savings of workers and salary earners.

2. What is inflation? *Inflation in the broadest sense of the term is the creation of purchasing power not based on a contribution to current social income.* We shall explain this by a number of examples illustrating various forms of inflation.

Let us imagine that someone has a chest of gold and at a certain moment begins to spend it for the construction of some factory. The increased demand for various goods generated by this contributes to the increase of total output and a rise in prices to levels at which the profits of capitalists increases by a sum equal to the sum spent on the construction of that factory. (The construction of every new factory increases profits by an amount equal to the costs of its construction.) Gold passes from the hands of the original owner—who obviously earns nothing on the construction of the factory and will begin to earn money only after putting it into operation—to the hands of other capitalists. It would obviously be wrong to assume that all of this gold will remain in their strong-boxes as money in circulation. The demand for money will certainly increase on account of an increase in output and prices, but not necessarily by as much as the sum spent. Usually only part of this sum serves to increase money in circulation, i.e. cash in hand, while part of it will be deposited in banks, which will correspondingly reduce those other capitalists' rediscount in the central bank by paying the gold received into this institution.

The question arises here of what this new factory was really built from, as the gold passed from hand to hand, along the way, however, stimulating the production necessary to build it. Obviously the production of capital goods increased above all. This results in additional demand-by newly employed workers—for consumer goods. The prices of the latter rise, and output expands. Hence there is an increase in total output with a simultaneous fall in real wages,

which leads to an increase in profits equal to the cost of the newly built factory.³ The factory comes into existence in part on account of the general increase in output, in part at the cost of limiting the consumption of the previously employed workers. If capital equipment producing consumer goods was fully utilized before the construction of the factory was begun, then the prices of such goods will rise sharply, since the same volume of consumer goods will have to suffice for a considerably increased number of workers. The workers' 'forced savings' will then play a greater role than when capital equipment producing consumer goods is under-utilized, and when a rise in prices is accompanied by increased output of consumer goods.

One might suppose that when the stock of gold has been exhausted and the construction of the factory financed by this gold completed, the temporary upswing caused by this operation will subside and everything will return to its previous state. This is not the case, however, since during this temporary upswing the profitability of existing plants has increased, which stimulated further investments. Hence the upswing will last longer than the direct influence of the original cause, i.e. longer than the construction of the factory financed by the chest of gold.

We have discussed this simplest example of inflation in some detail in order to point out the basic elements of its course. The pattern of this course is as follows: A certain sum is additionally spent, i.e. on top of the sums obtained from current social income. The profit of capitalists increases by precisely this sum, in part on account of the rise in total output, in part at the cost of limiting

3 Ed. n.: In later works Kalecki no longer assumed free competition and automatic changes in the prices for manufactured goods (and hence in real wage rates) with business fluctuations (seep. 467 above).

the consumption of previously employed workers. Part of these profits remains on hand owing to the greater demand for money, part of it can be used freely, e.g. deposited in the bank. The upswing caused by expenditure of the 'additional' sum lasts longer than the process of its expenditure.

Exactly the same effects as of the gold inflation described above will come from spending hoarded banknotes or funds received from a foreign loan. A similar type of inflation is the financing of investments from bank deposits, a process usually not classified as inflation but one which perhaps has the greatest importance in the inflationary financing of investments during an upswing in the business cycle. Let us imagine that someone has a bank deposit. Let this be a time deposit, hence not a demand deposit serving to meet daily withdrawals. Let us further assume that someone who wishes to build a factory borrows the money from the owner of the deposit, giving him securities (stocks or bonds) instead. It would appear (and many economists so believe) that a rise in investment activity cannot be financed in this way. For, losing its deposits, the bank begins to restrict credit accordingly, and other investments are thereby reduced in favour of ones financed from bank deposits. This is not the case, however, or in any event is only partially true. For, as we have already seen, as the construction of the new factory proceeds, profits will increase equal to the costs of this construction. The greater part of these profits will return to banks either as time or as demand deposits. Only a relatively small part will remain in circulation,⁴ and banks will have to reduce credits or increase their rediscount in the central bank by only this amount. Hence a certain credit expansion of the

4 This increase in circulation contains, *inter alia*, an increase in the cash reserves of banks in connection with the shift of certain sums from time to demand deposits (see above), which also takes place on account of an increase in turnover.

latter will be unavoidable if the new investment is not to affect other investments.

In this way we come to the role of the central bank in credit inflation. As we see, in financing investments from deposits this role is supplementary. However, one can also imagine an inflationary operation of which the central bank is also the starting-point-which indeed often happens in reality. Let us assume that the central bank grants someone credit, giving him banknotes which it prints. The borrower builds, let us say, an industrial plant. Other capitalists thereby earn profits equal to the cost of construction. The greater part of these profits returns as deposits to banks, which correspondingly reduce their rediscount in the central bank. One may doubt whether investments can be financed from short-term credit which the central bank gives in the form of discounting bills of exchange. We should not forget, however, that entrepreneurs to a greater extent than before can then finance their liquid assets, e.g., inventories, by credits from the central bank and thereby disengage their own funds, which they again allocate for financing investments.

'Credit creation' may be affected not only by the central bank but also by private banks. This form of credit inflation appears often, especially in Anglo-Saxon countries. A private bank opens credit and debit accounts for its client at the same time. Now the client can draw cheques on the bank and use them to make payments. An individual bank cannot carry out such operations without restraint, but must moderate the rate of its credit inflation in line with the rate of this inflation in other banks, for otherwise its settlements with other banks, to which its cheques go, will be unfavourable for it, and balancing processes will set in. Its rate of credit inflation will be checked, and that of other banks will be

raised. The effects of credit inflation of private banks are exactly the same as the inflationary effects of the central bank.

3. We have thus far discussed a mechanism by which investments can be made above the volume of saved profits. Besides the existence of this mechanism, a condition for undertaking investments was obviously the willingness of the entrepreneur to make use of this mechanism. The entrepreneur spent his gold, made use of a foreign loan, borrowed bank deposits from their owner, raised credits in the central bank or in a private bank. The question arises here whether the inflationary mechanism-concerning the creation of credits by the central bank or a private bank-can be more than a passive instrument in the hands of the entrepreneur, and can become an active factor encouraging him to make use of its services. The answer to this question is affirmative, though with some serious reservations.

To be sure, banks can increase the demand for credit by lowering the rate of interest. Its reduction encourages investments, since it increases the profitability of future enterprises by a reduction in charges for interest payments. The rise in investment activity is financed from bank credits, and by lowering the rate of interest banks can thereby grant more credits than before. Indeed, this is the typical method of intervention of the banking system aimed at improving business conditions.

However, to a large extent this influence is illusory. The rate of interest is not a decisive factor in undertaking investments. More important is the expected gross profitability of the enterprise, estimated on the basis of profitability of existing enterprises. During crisis, when this profitability falls considerably below its average level, with very slack employment of existing plants, a reduction in

the rate of interest has only a weak influence on the desire to invest and, in any case, takes a long time to produce perceptible effects. This method of intervention is deceptive because it acts through the entrepreneur, only attempting to exert a certain influence on his will. Reliable measures of intervention are those which afford certainty that the scope of investments will in fact be increased. We have in mind investments undertaken by the government and aimed at mitigating the crisis or accelerating a business upswing.

The government can obviously make use of all methods of credit inflation available for private entrepreneurs: it can contract foreign debts, it can issue its obligations at home, which will be bought by owners of bank deposits, and finally it can raise credits at the central bank. In all of these cases the business upswing will have much wider effects than those directly resulting from government investments in public works.

Just as other capitalists make money on the construction of a factory by some entrepreneur, so capitalists as a whole, after the completion of a number of public works, make a profit equal to the cost of those works. For example, if the government issues its bonds and they are purchased by owners of bank deposits, as these borrowed sums are spent they will return to the hands of capitalists, who will thus get back all of the borrowed money and will still own the bonds issued by the government, and thus their profit will increase by the costs of the public works. This, however, will in turn make their enterprises more profitable and thereby encourage them to increase their investments. If public works are conceived on a sufficiently large scale, therefore, they will stimulate a business upswing that will also continue after completion of the public works

which activated this improvement. Moreover, it seems possible that through suitable administering of public works during crisis, i.e. through proper control of their volume and timing, one can achieve relative stabilization of the business cycle: passing from the bottom of the business cycle not to its top but to a straight line, from which there would be only minor deviations.⁵

5 Ed. n.: J. M. Keynes advocated public works as a remedy for unemployment as early as 1924 (see his article "Does Unemployment Need a Drastic Remedy," *In: The Nation*, May 1924). When, in 1929, Lloyd George put forward a large public works project in order to reduce unemployment, Keynes supported it with the rather ambiguous argument that an increase in investment would generate a rise in saving, and that therefore no credit squeeze would affect the financing of private investments (see J. M. Keynes and H. D. Henderson, **Can Lloyd George Do It?**, London, 1929). In late 1929 Keynes was appointed a member of the Macmillan committee on finance and industry under the second Labour government. During sessions of that committee Keynes developed the argument he put forward in support of Lloyd George. Keynes also advanced similar ideas at the economic advisory council which advised the prime minister and the Cabinet on economic questions. In June 1931, at the University of Chicago, he gave three lectures on "An Economic Analysis of Unemployment," where a shift of emphasis towards changes in output and some hints of his later concept of equilibrium at less than full employment may be noted (see **The Collected Writings of John Maynard Keynes**, vol. XIII, London, Macmillan, 1973, pp. 343-67). Nevertheless, all these pronouncements were couched in terms of the neo-classical assumptions of his *Treatise on Money*, and a consistent theoretical foundation for his support for public work was still lacking.

Public works were also considered at that time in other European countries as well as in the USA, and in fact in Germany they were soon undertaken.

"In the United States economists such as Professor Paul Douglas, Henry Simon, and even Jacob Viner, all of whom were at the University of Chicago, advocated what would now be called expansionary fiscal policies well before *The General Theory* appeared. Before Herbert Hoover was President of the United States he was Secretary of Commerce. As such he sponsored Commissions and Reports which advocated a budget that was balanced over the business cycle rather than annually, i.e. under his auspices contra-cyclical fiscal policies were advocated. However, these economists and politicians did not have and hold a theory of the behaviour of capitalist economies which gave credence to their policies: their policy advice was divorced from their theory." (H. P. Minsky, "The Financial Instability Hypotheses: A Restatement." *In: Thames Papers in Political Economy*, autumn 1978, p. 8).

However, this assertion does not seem to apply to Kalecki's argument put forward at the time.

In our argument so far we have assumed a closed economic system. Thus we did not speak of the influence of inflation on foreign trade, on the currency position, etc., while it is precisely these factors which will prevent the successful intervention described above in non-isolated systems such as individual states. Whichever way an increase in output were to be achieved by inflationary measures, a worsening of the currency position would always follow, since the amount of money in circulation would increase along with the shrinkage of stocks of gold or foreign exchange. Indeed, an increase in output and prices must cause an increase in demand for money, which would have to be met by the central bank, unless it wished to choke the operation to stimulate a boom by applying credit restrictions.

Moreover, the increase in prices reduces the competitive position of domestic industry by comparison with overseas, and thus there is a fall in exports and an increase in imports. Even if we leave aside this rise in prices, however, which on account of the very slack employment of plants during crisis must take place very slowly at first—especially if we imagine tariff barriers as a protection against increased imports and the dumping of cartels as a preventive measure against a fall in exports—the trade balance all the same must worsen. Why? Because increased output will require an increase in the import of a whole range of inputs not produced at home, especially foreign raw-materials.

Thus, for one reason or another, there will be an outflow of gold or foreign exchange in connection with a worsening of the trade balance, and, as we have said, their reserves will shrink with a simultaneous rise of money in circulation. With a development of these tendencies the currency will collapse—unless even before this a currency panic, against the background of a declining ratio of

currency in circulation to gold reserves, does not cause a run on the central bank. Continued inflation after the collapse of the currency must lead to a further decline in its exchange rate, and after a certain time inflation will turn into hyper-inflation, which happened in Poland and Germany in the early 1930s. Thus, as we see, intervention to improve business conditions in a given country can be carried out without concern for the position of the currency only to a very limited extent. This extent is determined by the reserves of gold or foreign exchange in the possession of a given country.⁶

4. If in an open system inflationary intervention is made difficult for currency reasons, on the other hand its advantage over the closed system is usually that a crisis there is automatically mitigated by an improvement in the trade balance. For if a crisis takes place only in this one country, or in any case does not extend to a large part of the world, then a reduction of prices in the country suffering an economic depression increases its export capacity, while the reduced demand for foreign raw materials simultaneously restrains imports. In this way there is an inflow of gold to this country, or it pays its foreign debts, or increases its foreign investments. As a result the fall in the profitability of enterprises will be slowed, since profits will rise by the amount of improvement in the trade balance.

6 Ed. n.: Kalecki took up the problem of the worsening of a country's balance of trade with an increase in output and employment as early as 1929, and again in 1931 (see "On Activating the Balance of Trade" and "Consequences of Dumping," both in this volume). Comparing Keynes's theory with Kalecki's, Joan Robinson wrote: "Keynes's *General Theory* was worked out in terms of a closed system. It was left to me to sketch its extension into the theory of foreign trade in slump conditions. Here also Kalecki's work claims priority." ("Introduction" to M. Kalecki, **Studies in the Theory of Business Cycles 1933-1939**, p. XI; Robinson implicitly refers here to her "Beggars'-my-Neighbour Remedies for Unemployment," from her **Essay in the Theory of Employment**, London, Macmillan, 1937).

The close analogy with public works is obvious. While capitalists earned there the same amount as the cost of public works, here they earn the amount by which the surplus of exports over imports increases.⁷ Instead of the government running public works, here we have foreign countries purchasing goods; instead of government bonds remaining in the hands of capitalists after the completion of public works, we have gold, foreign exchange, or foreign stocks and bonds which have flowed in from overseas in exchange for the achieved surplus of exports over imports.

5. During the present crisis this mechanism for easing the depression in a given country does not function. The crisis has extended to all countries at the same time. This synchronism results in a shrinkage of imports with a simultaneous decline in imports in all countries. Improvement in the trade balance does not take place, and hence economic activity is not stimulated from this side.

The world economy, however, though afflicted by the crisis in its entirety, has hardly transformed into a closed system. Individual central banks continue their struggle to maintain their gold standards, and for the most part this makes impossible any inflationary measures which could lead to an improvement in business conditions. Public works, as we have seen above, would cause an increase of money in circulation and a shrinkage in the stocks of gold or foreign exchange, to which the central bank would have to respond by tightening the deflationary screw, thus aborting the business upswing stimulated by undertaking public works.

⁷ Ed. n.: For a more detailed analysis of this question, see *"On Foreign Trade and 'Domestic Exports,'"* this volume.

In these conditions the only possible way to accelerate the overcoming of the crisis on a wider scale would be an international inflationary operation based on a central bank of issue. The creation of such a bank must be regarded as utopian, however, for the same reason that international disarmament cannot be achieved. The analogy is not a loose one, for these problems are very closely connected.⁸

Consequently, it appears that the present world crisis will only be overcome slowly, mainly through automatic mechanisms of a purely internal nature, and especially by the gradual decay of non-renovated plants in whose place, with the present almost complete suspension of investments, new ones are not being built. The only country in which inflationary measures undertaken on a rather wide scale may accelerate the overcoming of the crisis is the USA, which has a considerable supply of precious metals along with a rather small foreign trade turnover in relation to total output. Because of this, the fear of currency perturbations in connection with inflation is less intense there. But precisely because of the fact that the US economy is relatively 'closed', the influence of an eventual improvement in business conditions there on business conditions in other countries via foreign trade will be relatively slight. The effect we may expect here will be a rise in optimism on European stock exchanges, which will result in the return of hoarded capital, perhaps becoming the basis for undertaking an inflationary operation without concern for the position of the currency.

Editor's Addendum

8 Ed. n.: See *"The Business Cycle and Armaments,"* this volume.

First published as "Koniunktura a inflacja." In: **Polska Gospodarcza**, 13/48, 1932, pp. 1411-15.

While working on his *Essay on the Business Cycle Theory*, Kalecki published a number of articles which roughly fall into two categories: (i) empirical studies of the successive stages of the 1929-33 crisis (see "Comments on Hitlerism and 'Economic Spheres'," and "On German Events," both in **Collected Works**, vol. VI; "Sources of the Manchurian Conflict" (pseud. H. Br.), **Przegląd Socjalistyczny**, 2/2, 1932, pp. 6-8 (in Polish); "War in the East" (pseud. Henryk Braun), **Przegląd Socjalistyczny**, 2/5, 1932, pp. 1-2 (in Polish); "Inflation and War" (pseud. Henryk Braun), **Przegląd Socjalistyczny**, 2/13, 1932, pp. 1-2 (in Polish); (see also p. 429 above); and (ii) papers on various aspects of the business upswing (see pt. 2 of this volume). From the end of 1932, having probably already finished work on the *Essay*, Kalecki concentrated on developing the mechanism of the business upswing and a theory of employment and capacity utilization, which were both implied by and sketched out in the *Essay*. The articles in pt. 4 of the present volume (with one exception) are devoted to this subject of research.

The main feature of these papers (with two exceptions) is their inseparable link with empirical enquiry: Kalecki attempts here to explain the actual course of the business cycle on the basis of his trade cycle theory, and at the same time to test the latter against the observed facts. Consequently, along with these papers he published further empirical studies on the business cycle (e.g. "The Fate of Experiments" and "The German Experiment," both in **Collected Works**, vol. VI; and "The Present Phase of the World Crisis," **Polska Gospodarcza**, 14/1, 1933, pp. 9-11 (in Polish).)

Together with Kalecki's studies of business conditions in individual commodity markets, his publications on the methodology of business cycle research, and his (and Landau's) estimates of the social income in Poland (see **Collected Works**, vol. VI), such works were quickly bringing him to a more general theory of employment and business fluctuations. In order to write it up, Kalecki decided to take advantage of a Rockefeller Foundation grant which he received in 1935. In Feb. 1936 the Kaleckis set out for Sweden, a country which in the eyes of many seemed likely to be the first to break out of the strait-jacket of economic orthodoxy.

Part 4 of the present volume ends with a paper, "Three Systems," which attempts to define the relation of Kalecki's own approach to the problem of capitalist reproduction to approaches based on Say's Law (as Kalecki puts it, to models where "the principle of preservation of purchasing power is pushed to the extreme"), and a model in which, though the possibility of 'creating' and 'losing' purchasing power exist, no unemployment is allowed for. Hence this paper sets out Kalecki's early ideas in comparison with some fundamental concepts of contemporary academic economics.

On the Papen Plan¹ (1932)*

1. The assertion often made by 'economic spheres' that a reduction in tax burdens is the best means for overcoming the crisis does not withstand careful economic analysis. A reduction of direct taxes must be combined either with a reduction of government expenditure or with an increase of taxes on the working classes. In both cases the demand for industrial goods will shrink, and hence their prices will begin to fall. What 'economic spheres' gain by 'loosening the tax screw' they soon lose as a result of a fall in prices. Only a certain

1 Ed. n.: First published as "Na marginesie planu Papena." *In: Polska Gospodarcza*, 12 / 39, 1932, pp. 1157-8.

Franz von Papen was the chancellor of Germany from May 1931 to Nov. 1932 and the vice-chancellor in 1933 and 1934 during the first period of Hitler's chancellorship . Von Papen was well known as a representative of the Junker right, financiers, and industrial capital.

The Papen plan was put forward on 4 Sept. 1932, against the background of a particularly severe crisis in Germany. Industrial production in 1932 reached only 54% of the 1928 level; the production of steel, 39%; employment in heavy processing industries, 64% (5 million unemployed were recorded in Germany in 1932); nominal wages in industry, 83%; wholesale prices, 67%; and the stock market index, 19%. The crisis was deepened by the obligation to repay war reparations: see pp. 429-30 n. [2].

For some later discussions of the Papen plan see C. W. Guillebaud, **The Economic Recovery of Germany**. London: Macmillan, 1939; and K. E. Poole, "German Financial Policies 1932-1939." *In: Harvard Economic Studies*, 66, 1939. The plan was reprinted in G. Bombach *et al.* (eds.), **Der Keynesianismus II**, Berlin: Springer, 1976, pp. 152-9. For a discussion of the relation between the Papen plan and Ragnar Frisch's treasury bills scheme, see Andvig, **Ragnar Frisch and the Great Depression**, pp. 362-4.

* Vol. I. pp. 60-62.

redistribution of profits will follow; their total volume will remain about the same. An improvement in profitability, which was supposed to be the starting point for a business upswing, will not occur.

The first part of the Papen plan² concerns the effects of granting privileges to industry. The gift from present taxes would be, as we see, minimal. The idea of the plan is to remit future taxes. With the payment of current taxes, tax remission certificates would be issued for a certain part of those payments which can be used to pay taxes for the years 1934-9. Though every industrialist unquestionably prefers to be relieved of taxes now and not in the future, for industry as a whole the main advantage of relief—paradoxically—is that it is not effective. Certificates of exemption from taxes in future years will be entered in the books by industrialists as profit, but there will be no fall in prices caused by a reduction of government expenditure or by greater tax burdens on the working classes. Profitability will thereby be increased—or rather it will appear that it has been increased. A real increase in total profitability will occur only when total output and the share of profit in it increase. But this increase of profitability on paper is quite *real* for every entrepreneur, and hence will be an incentive to establish new firms or to expand, or at least to renovate, existing plants. These processes form the basis for a natural transition to a business upswing.

Discussions of the Papen plan have often stressed the importance of funds for investment gained by industrialists in the form of tax remission certificates, since these certificates can be pledged, sold in the money market, etc. However,

2 We discuss here only the first part of the Papen plan concerning tax allowances. This is the most important, most original, and most matter-of-fact idea of the plan. The awarding of bonuses for employment also contained in the plan may be regarded rather as a distortion of this idea.

this advantage is of rather a secondary nature. The basic factors necessary for undertaking investments are the will of businessmen to do so and an adequate capacity in the capital market. If this market is sufficiently receptive, inexpensive credit may be obtained, holding the tax remission certificates in reserve. However, with all the facilities for trading in these certificates, credit inflation is unavoidable; among other things, an increase in credits from the bank of issue and of money in circulation will follow.

We come here to the currency problem. The Papen plan, like every other plan for stimulating the business upswing, must jeopardize the currency position, unless there is a simultaneous inflow of capital from abroad. For, on the one hand, with the increase of output-which is the aim of the plan-there is an increase of money in circulation and, on the other, there is an outflow of gold or foreign exchange on account of a 'worsening' of the trade balance. The latter will occur even if prices, with an improvement in the economic situation, rise only slightly, thus leaving *export capacity* unchanged. For with an expansion of output, imports of a number of raw materials and semi-finished products that are indispensable to production and not produced domestically must increase.

2. The Papen plan differs considerably from the Nazi economic programme, which included the financing of large public works by the issuing of money, i.e. it planned the stimulation of the business upswing by means of a certain type of monetary inflation. The fight between Papen and Hitler is largely a clash between these two ideas for overcoming the crisis. It will be interesting to compare both programmes, the more so as such a comparison will clearly show what the Papen plan is and what it is not.

What processes take place with the financing of public works through monetary inflation? Let us assume that the government is constructing public works, financing them by raising loans from the bank of issue. Prices, output, and hence profits increase with the overall growth in demand. The increase in profits will be equivalent to the accumulation of capital tied up in the completed public works. In what form do the profits reach the hands of the industrialists? They will reach them either in the form of an increased number of banknotes in their possession or in the form of repayments of their obligations to the bank of issue. This process is reflected in the latter's balance sheet in an increase in the portfolio of treasury bills, an increase of money in circulation, and a decrease in the portfolio of private bills. Yet another shift in the balance sheet takes place. Since the increase in output is accompanied by increased imports of foreign raw materials and semi-finished products, part of the money put into circulation will be exchanged for gold or foreign currency to pay for this increase.

In turn, the increased profits of industrialists will encourage the latter to undertake investments; private investments will begin to grow around public investments and the business upswing will be stimulated. The main difference between the Papen plan and the programme of inflationary financing of public works is that the core of the former plan, around which industrial investments are concentrated, is the 'tax gift', and that of the latter, profits made by industrialists from undertaking public works. These profits are associated with increased employment, which also increases later on account of private investments. This initial increase of employment is absent from the Papen plan: there is *only* secondary growth, resulting from more intensified investment activity by industrialists on account of increased profitability. The outflow of gold

or foreign exchange starts with the Papen plan only when the investment activity of industrialists rises; with the programme of inflationary financing of public works it starts immediately after they are initiated. For these reasons, and also because the inflationary elements of the Papen plan are more latent, it will give rise to less fear about devaluation than will the inflationary financing of public works. The latter could easily cause a flight from domestic currency and soon result in a real devaluation.

In fact, Papen's and Hitler's programmes are different only in their nuances . The slogan of Papen's plan, 'Through profitability to employment', corresponds to Hitler's slogan, 'Through employment to profitability'. The transposition of phrasing comes from the fact that Papen and Hitler each have different followings.

Inflation and War¹ (1932)*

1. Inflation and war are the two cards on which the system that goes bankrupt, and that fearfully listens to its creditors walking up the steps, may still bet. The wave of inflationary outbursts that has recently swept across the world was accompanied by pistol-shots of assassins that announce cannon shots to follow. Will the bankrupt decide to bet on the cards still in his hands? On which one will he bet? Will he bet on both? Has he got any chances to win back?

2. Inflation is the single 'surgery-type' means of mitigating the crisis of the capitalist system,² however, this instrument is of a merely theoretical significance now, since its use in the concrete conditions of contemporary capitalism encounters insurmountable difficulties. For, as we have often emphasized, credit inflation, i.e. a more liberal supply of credit by the central bank, may be of minor significance only when the business crisis is as deep as at present. Entrepreneurs will not, as a rule, invest the newly received credits because easier terms of credit

1 Ed. n.: First published under the pseudonym Henryk Braun as "Inflacja a wojna." *In: Przegląd Socjalistyczny*, 2/13 (1932), 2-3. See also **Collected Works of Michał Kalecki**, vol. I, pts. 2 and 4 and the corresponding editor's notes (esp. pp. 485-91).

* Vol. VI, pp. 175-179.

2 When we speak of a 'surgery-type' instrument we neglect the possibilities of overcoming the crisis—that are far away at the moment—through the 'automatic mechanism of the crisis itself (see M. Kalecki, "Is a 'Capitalist' Overcoming of the Crisis Possible?". *In: Collected Works of Michał Kalecki*, vol. I. Oxford: Clarendon Press, 1990.)

will not induce any investor to build a factory that will have no chance of finding a market for its products. New credits will be used rather to pay back the old ones and the surprised creditors will bring their repaid credits back to banks thus happily closing the circle.

What indeed could change the situation is fiscal inflation on large scale, for instance, by the government obtaining large credits from the central bank and spending them on massive public works of one sort or another. In this case the money no doubt would be spent and this would result in increased employment (combined with an overall reduction in wage rates). However, even such an intervention could be effective only if it were undertaken in a closed economy, e.g. in the capitalist system as a whole, embracing the whole world, where there is one exchange only and no tariff barriers. If fiscal inflation is carried out on a broader scale in one country alone it must cause disturbances in the rate of exchange. A rise in local output requires increased supplies of foreign raw materials and imports as well. At the same time, together with employment domestic prices rise which restricts exports. Consequently, the balance of payments deteriorates, an outflow of gold and foreign exchange follows, and the exchange rate falls.

In general, these processes will end earlier because in expectation of their development foreign capital will withdraw and local capitalists will purchase foreign exchange thus accelerating devaluation. This, in turn, will distort the fiscal inflation process because of rise in prices of foreign raw materials will add to a general price rise until the symptoms of hyperinflation, already known from our experience, appear. Therefore, a necessary condition for fiscal inflation to be effective is an international agreement of the capitalist powers, which is, of

course, totally utopian. Thus, imperialism, which is an unavoidable phase in the development of capitalism, makes the 'inflationary' way of mitigating the crisis unavailable.

War and inflation have many points in common: war also involves 'public works' on a massive scale; it is always financed through inflation although the latter does not necessarily turn into hyperinflation because the country at war may be aided by foreign capital supporting it, or it may meet its demand for foreign raw materials by plundering the invaded lands.

3. The purchasing power of the dollar should be returned to its average value in 1921-9 (in terms of the wholesale price index) and maintained at this level through regulation of the volume of credit and money supply—this is the essence of Goldsborough's bill³ that was adopted by the US Congress and sent shock-waves to the rate of exchange of the dollar throughout the world. This achievement cultivated in the capitalist hothouse is not very impressive however; ordering a 50% price rise through a more intensive supply of credit will be no more effective than ordering an immediate stop to economic crisis. However, this nonsense of primitive bourgeois economics, wholly discarded by the capitalist decision-makers, is accompanied by ever more vocal pronouncements of various splinter factions of large capital. Approximately at the same time as the Goldsborough bill was passed, Hoover was approached by a delegation of industrialists, led by Owen Young (the author of the Young Plan), requesting that public works be started and budget deficits of individual states and cities, equal \$2 billions, be paid by the Federal government, which means that eventually they

3 Ed. n.: This probably refers to Thomas Alen Goldsborough's bill on stabilizing the purchasing power of money put forward in the House of Representatives on 9 Dec. 1931 and 15 Jan. 1932.

would have to be paid by the Federal Reserve System. In the USA the road from inflation to hyperinflation would be very long. Even if the dollar were devalued, chiefly because of outflow of foreign capital, the share of imports in total US demand is so small that increased costs of raw materials following devaluations would be of hardly any significance. Nevertheless, the financial tycoons of Wall Street opposed and will continue to oppose broad inflation that could follow a large devaluation because it would depreciate the value of their capital invested abroad. Thus, the contradictory interests of various groups of large capital dash the efforts to deal with the crisis.

4. In a speech made in the German Reichstag on 6 May 1932, one of the Hitlerite leaders, Georg Strasser, put forward the position of his party on the question of the struggle against unemployment as follows:

The large wave of anti-capitalist demonstrations that has recently swept through the whole of Germany cannot be accommodated within the requests of the Social Democrats who on 1 May had no more to offer to the masses than the shortening of the working week, international peace and class hatred. Earlier the Social Democrats, next to shortening the working week, at least fought for higher wages. However, the shortening of the working week considered by them as a panacea, if the wage rates are not increased, is equivalent to a 16 per cent reduction in incomes. The Social Democratic trade unions have taken a more sensible position on this question than their own party. We are ready to co-operate in the implementation of the programme of combating unemployment that was put forward by the Social Democratic trade unions, and we share many ideas that were outlined by Herr Woytinsky in their trade union bulletin about the financing of this programme. We reject the government project of a national loan with premium. This attempt to solve our problem... is unacceptable for our independent workers' party (interruption by [Ernst] Torgler, a communist MP.: 'But you do depend on Thyssen'⁴

4 [F.] Thyssen is a leading figure in German heavy industry.

and on Prince Wilhelm')... Our party puts forward a better programme of fighting unemployment—the programme based on the everlasting values of our natural resources and labour, instead of gold... we want public works to be financed by the Bank for National Economy, especially designed for this purpose.⁵

What a moving scene for our Herr Gross;⁶ a Hitlerite who with his one hand smashes the capitalist system... by means of inflation, and in a friendly way extends his other hand to the Social Democratic trade unions!

It appears that once Hitler takes over power in Germany, or even starts to control it, inflation will no doubt follow. Perhaps the theoreticians of Hitlerism, such as Godfried Feder, are not aware that in German conditions inflation must directly lead to hyperinflation. Aware of this, however, are the bosses of those theoreticians—the barons of heavy industry and the large landowners who all desire cancellation of their huge debts. The Social Democratic trade unions march to meet the Hitlerite heralds of inflation. The already-mentioned theoretician of the Social Democratic unions, Woytinsky (who, incidentally, in contrast to Gross, did not pretend to advance socialist ideas) in his book *Internationale Hebung der Preise*⁷ sought a capitalist way out of crisis in world-wide inflation combined with international financial co-operation of the capitalist powers—a truly fanciful idea! However, when this failed to appear, Woytinsky abandoned his hope and turned to demonstrating the possibility of 'internal'

5 Ed. n.: See **Verhandlungen des Reichstags**, vol. 446. Berlin: Reichsdrukerei, 1932, 2513.

6 Ed. n.: Probably Mr. Daniel Gross, a senator, author of **Post-war Reconstruction and Economic Transformation of Poland** (Kraków, Prawo I Lud, 1929) (in Polish), where he argued for large government intervention and greater equality in income distribution.

7 Ed. n.: See W. S. Woytinsky, **Internationale Hebung der Preise als Ausweg der Krise**, Leipzig, Buske, 1931.

financing of public works in Germany without exposing the German economy to inflation; for this he was leniently scolded by bourgeois economists.

We thus see that Hitler is clearly betting on both horses—inflation and war: his offers to lead a ‘Teutonic Knights’ crusade against the ‘fortress of Marxism’ are well known, not to mention his bellicose plans against Poland. It is here where Hitler receives the friendly support of the Reichwehr’s Generals Schleicher and Hammerstein who came out of the shade of the ‘grey-headed Marshall’⁸ and who in present day Germany together with Hitler openly strive for power. Are these ‘brave soldiers’ the heralds of a military way out of the crisis in Germany? Are they to succeed in preventing inflation from turning into hyperinflation?

5. Like Germany, a chain of events is also pushing Japan along the ‘road to glory’, and for more than a year now it has bet on both horses—inflation and war. The balance-sheet of this policy is rather discouraging, however: pacification of Manchuria takes much more time than expected which in turn makes economic penetration very difficult. At least until present, the latter certainly has not compensated for the losses due to the closure of the Chinese market. Consequently, ‘the motherland still needs to be saved’ and this task is now being taken over by the military party that is supported by various fascist groups. Heavily loaded with anti-capitalist phraseology and coloured with concern about the future of farmers and small salesmen, this party is at present gaining a decisive influence on the Japanese government and ever more clearly urges that the war against the Soviets be started. The conviction that, next to the overthrow of the Soviet system, this war will also bring an upswing in world

8 Ed. n.: i.e. Generals Kurt von Schleicher and Kurt von Hammerstein.

business, becomes increasingly popular among the capitalist decision-makers. That these plans altogether neglect factors that may completely wreck them is a quite different question, however.

On the Margin of Events in Germany¹ (1932)*

1. A performance of *Faust* is being staged in Germany on the centenary of Goethe's death: the Wilhelmite triumvirate of feudals, generals, and heavy industry leaders is conjuring up the Hitlerite devil, who is supposed to infuse new life into it. For the time being—as in Goethe's drama—Faust is moving about the stage in the company of his devilish servant; to be sure, he has not yet been transformed into a man in his prime: under the make-up wrinkles are visible and the aged body gives off a cadaverous odour that offends the sense of smell even of contemporary Europe. Soon the old man will probably retire, tired out by his new incarnation, and the real Hitlerite devil will appear on the stage, dancing to the melody of the capitalist Faust.

2. If in the immediate future there are no decisive moves on the part of the German working class, the attainment by Hitler of official and decisive influence over the government of the Reich after the July elections seems certain. For although it is not likely that in the elections—even together with the bourgeois Right supporting them—the Hitlerites will gain an absolute majority in parliament, more or less the same constellation is probably in the Reich as now

1 Ed. n.: The article first appeared as "Na marginesie wydarzen niemieckich," under the cryptonym H. Br., *In: Przegląd Socjalistyczny*, 2/15 (1932), 4-5.

* Vol. VI, pp. 180-182.

exists in the Prussian Parliament that is incapable of forming any kind of parliamentary government. In one form or another a coalition of Hitler with the present government will then be most likely. In this situation the Hitlerites will have the decisive voice and thereafter—with the support of the Reichswehr and General Schleicher—will be able to maintain themselves in power by force.

It is unlikely that when in power, the Hitlerites will turn out to be very revolutionary in foreign policy; in particular, they are unlikely to decide on a war with Poland just now. However, with all the greater force will they unquestionably start fulfilling their true goal in domestic policy, i.e. to completely control and crush the German workers' movement. Inflation certainly will play a crucial role in this policy.

3. In the Hitlerite programmes of inflation is called "stimulation of the economy" through spending domestic currency in which the Reichsbank will give the government interest-free loans. This obviously does not change the essence of the inflationary process. That is why the stock exchange reacted to the fall of the Brüning government with a rise in share prices and a fall in prices of fixed-interest securities, i.e. anticipating price inflation.

Inflation would probably be indispensable for Hitler in this very first steps. First, it would supply funds for maintaining the storm battalions and the Hitlerite vanguard as a whole. Secondly, in its early phase, before hyperinflation sets in, through an increase in employment this policy would temporarily fulfil the hopes of the masses standing behind Hitler and would also reduce resistance in the opportunistic ranks of Hitler's opponents—the political centre and the Social Democratic trade unions—which Hitlerism will surely try to draw into 'concrete work'. It should be added here that the period before hyperinflation sets in may

be relatively long in present conditions because of the considerable underemployment of capital equipment: the increase in demand caused by inflation will be easy to meet due to an increase in output, and hence at the beginning the increase in prices will not be too large. Only a fall in the rate of exchange, which unquestionably will occur and will cause a rise in prices of foreign goods, will accelerate the upward movement of prices; however, this process will not start right away.

In this way Hitler would have a rather long breathing spell, filled with efforts to split and corrupt the Social Democratic trade unions and with acts of ruthless terror against the communists. For this reason during the transition from inflation to hyperinflation the government apparatus already might be so completely under Hitler's control that the inevitable desertion of him by the masses will no longer be fatal to him. There are all too many good examples of groups that came to power initially on the shoulders of mass social movements and then stayed in power for years despite the complete loss of their initial popularity even the clearly revolutionary attitude of their disappointed supporters.

Breaking the resistance of the German working class is not easy, however, and for this reason the situation of Germany today really has no precedents in post-war history. Nonetheless, it seems certain that if before or right after Hitler takes power, the working masses do not take decisive action in the broadest sense, Hitlerism will surely succeed in consolidating its power for a long time. That is why the often-repeated statement that 'if Hitler comes to power he will soon compromise himself and be overthrown by a revolution' seems a very careless prediction.

4. Implementation of the inflationary programme will mean two things for the capitalists: "social peace" will be established and at the same time profits will be made from inflation. In particular, large landowners and heavy industry with big debts will benefit from the depreciation of their obligations. Obviously, with hyperinflation a stabilization crisis must occur, but today who would think so far ahead! Today the salvation and strengthening of capitalist for several or a dozen or more years is a matter of primary importance.

The Present Phase of the World Crisis¹ (1933)*

1. The autumn of 1932 brought some easing of the economic depression, mainly due to a gradual dampening of the financial crisis that culminated in the middle of 1931. The recovering in world money and capital markets may be attributed to several factors that operated from the beginning of 1932. The devaluation of the pound was followed by an unexpected inflow of gold from India's strong-rooms, but more importantly, it allowed the British Empire relatively to improve its balance of payments position and, what follows, facilitated the repayment of outstanding credits to its lenders: the USA and France. This in turn, together with the *Stillhalteabkommen* concluded between Germany and its lenders,² and the definite solution of the question of German reparations, contributed to mitigating the 'confidence crisis'. This relative consolidation of the world financial position led to earlier hoarded capital being put to use.

1 Ed. n.: First published as "Obecna faza kryzysu swiatowego." In: **Polska Gospodarcza**, 14/1 (1933), 9-11.

* Vol. VI, pp. 183-187.

2 Ed. n.: This is implied reference to the second Lausanne Conference, of 9 July 1932 which practically relieved Germany from reparations payments (they were reduced to about 8.5% of their original value, the annual payments cut down from about RM3 billion to RM230 million).

Credit inflation in the USA worked in the same direction, although in an economic crisis as deep as the present one it could not immediately improve investment activity. Credits that in the final resort were granted by the banks of issue, were largely used for repayments of outstanding liabilities and returned to banks in the form of deposits, thus improving liquidity in the financial markets. In these conditions, liquidity quickly increased and consequently the rate of discount in the important money markets was reduced to less than 1%. High profitability of stocks and bonds in view of their low rates made them attractive. The demand for them in the stock exchange increased and their rates grew swiftly causing a fall in their profitability; following short-term credit long-term credit also became cheaper.

The second phase in this course of the business cycle was a rise in commodity prices. The bull market in the stock exchange gave rise to rather exaggerated optimism on the part of investors regarding imminent economic recovery, and to speculative purchases of raw materials, stocks of which could be held much easier because of the low rate of interest. Moreover, a rise in prices of raw materials was followed by speculative purchases of good manufactured from them. Their stocks also started to increase quickly which again was facilitated by cheap credit. This in turn added to the bull market for commodities and, what is more important, generated a rise in employment in factories processing raw materials, mainly in the textile industry and above all in the cotton industry.

2. It is known that a rise in employment in one industry must to some extent find reflection in all other industries. Increased employment in the processing industries that were subject to speculative purchases was not,

however, the only cause of the general rise in output observe in September and October 1932. Other factors, of a more stable nature, operated, too. One of them was a reduction of output capacity during the two preceding years when investment activity was below the depreciation of capital stock (which improved the profitability of the still-operating factories and led to greater investment activity). The other factor was cheap credit, especially long-term credit. The operation of these two factors together with increased employment—due to the expanded output of the processing industries that were subject to speculative purchases—contributed to a rise in investments that in turn increased overall output still more.

What changes in total world output can we expect in the near future? First of all, the recovery in the textile industry and in other processing industries that were subject last autumn to a speculative boom must end. After the new commercial orders had been filled and stocks replenished, the volume of stocks increased significantly. Sales cannot be expected to rise in the same proportion, however. The growth in total output until now is insufficient to generate such a rise in sales, the more so as, for instance, consumption of textile goods does not change in step with total output; while their consumption by workers may change in the same proportion as total output, that of the middle classes is relatively inelastic.

The end of recovery in those industries is apparently already reflected in the reduction of commodity prices that was observed in the past two months. Of course, this was also caused to some extent by the unfavourable general political situation and by the unregulated question of mutual debts among allies. However, these latter phenomena, which must also influence the rates

quoted in the stock exchange, were unable to reduce these rates by as much as the reduction in prices of raw materials.

Thus, we may soon expect total output to decline but its volume to be somewhat higher than in the middle of 1932 because the already started investment projects will be continued and new investment orders will rather tend to rise. Indeed, they are still below the volume of depreciation even at the present level of increased investment, and production capacity continues to shrink. Moreover, in the absence of large political disturbances in the near future one may expect that hoarded capital will continue to be invested and this will be accompanied by a further decline in the cost of long-term credit. On the other hand, one must not forget that investment activity will be relatively insensitive to these stimulants: the present long-lasting crisis during which a large part of production capacity stood idle, not earning enough to cover even its cost of depreciation, in the next few years will undoubtedly affect the psychology of entrepreneurs. Discouragement towards mechanization, the tendency to rent already existing equipment instead of building the new equipment—all these factors are likely to slow down investment, at least in the near future. Clearly a rise in prices of raw materials, which may well accompany a future bull market in the stock exchange, will more than once contribute to a rise in total output, as was the case in the autumn of 1932. However, this mechanism will be of a permanent nature only if the boom in commodity markets is combined with the already quickly advancing recovery in the whole economy—something that depends in turn on investment activity.

3. In conclusion, it may be argued that we are probably now entering the second half of the depression during which world output, though slowly and

with the numerous disturbances, will nevertheless rise. This is valid, of course, only in the case of an 'automatic' mechanism of the business cycle. However, the improvement may arrive more quickly if individual governments pursue a policy of economic intervention through inflationary financing of public works.' Public works undertaken on a large scale would contribute to the better employment of production capacity, improve profitability, and thereby after a time (possibly not all that soon) would encourage larger investments, and this would generate business recovery. Such an inflationary financing of public works could be implemented at present without great difficulty only provided that it was done throughout whole world. For in any single country such 'stimulation' of the business upswing leads to increased demand for foreign raw materials, brings about an unfavourable balance of trade and exposes the rate of exchange. However, if the steady inflow of hoarded capital continues, deposits of gold and foreign exchange in the banks of issue will further increase, the necessary cash reserves of the banking system will be reduced and hence the danger of currency shocks involved in the inflationary financing of public works will be diminished.

Indeed, in some countries such inflationary measures can already be undertaken. For instance, the dependence of the USA on foreign raw materials is relatively small and their gold reserves are large; hence public works could be started there without the danger of devaluation. In the middle of 1932 a specific programme of public works to the value of \$3 billion was prepared. However not much has been heard of it recently and it is uncertain whether it will be included in Roosevelt's economic programme. Incidentally, it must not be overlooked that economic programmes are decided not I by the readiness to stimulate the

business upswing alone but also by the contradictory interests of the opposed parties.

The second country that can afford public works is France with the largest reserves of gold in the world in relation to her economy. The recent project of a national loan to finance investments in various areas will consist precisely in such an inflationary financing of public works, because with an extremely large financial liquidity a large loan will not significantly drain the money market that might in turn restrict private investments. However, even if that happened, the bank of issue could easily extend its credit supply without much concern about the rate of exchange if the balance of trade somewhat deteriorated.

Inflationary financing of public works in the USA or France would affect the business cycle in other countries. The direct impact through increased purchases of foreign goods in the USA or France—would be relatively small. As we noted above, the American economy is so big that it is largely self-sufficient. Of much greater significance, however, would be the mutual links between all stock exchanges in the world. For instance, a business recovery generated by public works in the USA will quickly raise rates quoted in American stock exchanges. This would be followed-precisely because of the mutual connection of the stock exchanges-by improved quotations of European securities that in turn would encourage investment in them of the capital hoarded so far, and thereby would strengthen the foundations of financing public works in individual countries.

The Fate of Experiments¹ (1934)*

1. When in September 1933 we examined the course and effects of a stimulation of the business cycle in the large economic centres of the world,² we arrived at the following appraisal of the situation:

(i) The business upswing in the USA caused by the devaluation of the dollar seems temporary because it is based on speculative demand that occurred in anticipation of price rises. After a certain time this demand must end and the running down of previously accumulated stocks may, even take place. If during the upswing generated by devaluation, investment activity does not rise to a volume that will replace speculative demand, a downswing is inevitable.

(ii) The effort to increase the purchasing power of the masses by rising wages within NIRA regulations³ cannot prevent this downswing. If wage rates

1 Ed. n.: First published as "Losy eksperymentów," *In: Polska Gospodarcza*, 15/50 (1934), 1531-4; for more on the mechanism of the business upswing, see **Collected Works**, vol. I, pt. 4.

* Vol. VI, pp. 188-195.

2 Ed. n.: See "Stimulating the World Business Upswing," **Collected Works of Michał Kalecki**, vol. I.

3 Ed. n.: National Industrial Recovery Act, passed in the USA in 1933, in its first part defined the principles of "honest" competition and measures to counter-act monopolistic tendencies, and in the second part it created the basis for the fight against inflation and economic stagnation (*inter alia*, through public works), and for collective labour agreements. The purpose of the law was to help the American economy to overcome the

are not raised, prices in relation to wage rates would fall with the end of speculative demand. With an increase in wage rates, they will rise in relation to prices. Thus independently of the NIRA operation, the profit margin will shrink which will be followed by a reduction in the employment of capital equipment.

(iii) The only way out of this situation will be the payment of unemployment benefits or the starting up of public works, provided that the funds for this purpose are obtained not from additional taxes but by creating additional purchasing power one way or another.

(iv) Germany, which from the outset stimulated the business upswing through the inflationary: financing of public works, is not threatened with a domestic recession as in the USA where the upswing was generated by devaluation. However, the weak point of Germany's intervention is the trade balance that will unavoidably worsen because of the ever-increasing demand for foreign raw materials with the rise of output. If Germany does not succeed in increasing her exports, she will find it impossible to acquire adequate supplies of foreign raw materials for her economic expansion.

These forecasts turned out to be generally correct. In what follows, we shall examine these processes and trends in some detail.

2. The upswing generated by devaluation, which in the USA lasted until the autumn of 1933, caused-as one can infer from subsequently published statistics-a considerable expansion of investment activity, mainly in renewal of capital equipment; the construction of new plants as well as housing construction remained at the previously low volume. In any case, the general volume of

1929-33 crisis. NIRA's regulations were terminated two years later as violating the Constitution of the USA.

investment activity was not high enough to replace speculative demand. Stimulation of the latter by means of another devaluation of the dollar also produced no effect. Experience taught speculators that prices do not rise as fast as rates of exchange fall in relation to gold, and consequently a further fall in the dollar did not generate the speculative fever that followed the first devaluation.

The result was a sharp decline in output. The production index for November 1933 was already nearly 30% lower than its maximum value in the first half of the year and only 10% higher than at the beginning of 1933.

At that stage, in November 1933, various public works were started on a large scale. By the end of February 1934 more than \$1 billion was spent on them, thereby achieving an increase in output of more than 12%. The funds were obtained through loans negotiated in the free market. Obviously, this does not end creation of additional purchasing power. Sums previously held in private banks were spent by the government. This does not force these banks to restrict credit, however, for the money spent by the government in the final analysis falls into hands of capitalists as profits and in this form returns to the banks.

Theories on this subject are often advanced to the effect that these funds become tied up in the production process, or in consumption. These theories make sense only if they are supposed to argue that the quantity of money in circulation is thereby increased. In general, this factor plays a relatively small role, however, and in the present economic situation in the USA its significance is out of question: already before November 1933 the quantity of money in circulation was exceptionally high because of the necessity to maintain large emergency funds due to the crisis; that is why, despite large increases in prices

and output, the quantity of money in circulation is at present smaller and not greater than a year ago.

Public works were financed not only through the use of deposits, whose owners invested in government securities, but also through the direct purchase of obligations by banks. Namely, banks invested a considerable part of their cash reserves in these obligations which, however, not remaining in circulation, returned to the banks and enabled them to purchase new obligations. Thus, the final financial outcome and the cost of public works was an increase in the government debt.

Here the question is often asked: with what will the debt contracted by the government for these investments—the future profits of which are more than doubtful—be paid back? Such a question, however, only shows lack of understanding of the essence of stimulation of the business upswing. The objective of the inflationary financing of public works is to enhance-through artificial stimulation of the business upswing-private investment activity. When this occurs, public works can be discontinued. Increased economic activity will then provide greater revenues for the Treasury thereby enabling amortization of the debt and the payment of interest. Even from a purely fiscal point of view, profitability of stimulation of the business cycle cannot be identified with the profitability of investment projects completed under public works, but will depend on the overall effects of intervention. These rather complicated problems are explained below with the help of an example taken from the actual development of the private sector of the economy.

A certain economic region was heavily dependent on a huge steel-mill located there. The coal for this mill as well as for the entire industry of the region

was supplied by a mining company. As a result of an unfortunate accident, the mill blew up. Its owners received the insurance premium, but since business was slack in the steel market and profits were not enough even to balance on-going interest on capital, the owners decided not to rebuild the mill. The result of this was the suspension of production by plants directly connected with the mill, a big increase in unemployment, and collapse of the industry that produced consumer articles for workers—in short, the region was affected by a sharp economic crisis. Also, the coal sales of the mining company shrank to a minimum, and it was faced with bankruptcy. It then negotiated a loan and rebuilt the mill. With slack demand in the steel market the mill was still losing, but the mining company offset these losses with the recovery of its coal sales, not only to the mill but to all the industrial plants of the region.

3. The question arises, however, whether stimulation of the business upswing really achieves its objective, i.e. whether artificial stimulation brought about by public works turns into natural stimulation, or, to put it more precisely, whether the increased profitability of industry in connection with public works is soon followed by a strong increase in private investments. As far as the present situation is concerned, investments in the engineering industry have reached a normal relation to increased output: both indices roughly correspond to their respective volumes in 1931. At the same time, private construction activity is still extremely low. One may expect, however, that if artificial stimulation of the business upswing continues, investment activity will pick up in this area as well. In estimating the possibility of increased investment activity one must not forget the influence of natural factors—namely wear and tear of capital equipment which is caused by the suspension of investments during the crisis, and which at

the same time is the starting point in the automatic transition to the business upswing.

We now come to the question of the influence of stimulation of the business upswing on consumption. If we compare workers' wages today with those a year ago it turns out that they have not changed much: the increase in wage rates approximately corresponds to the increase in the cost of living. However, the salaries of white-collar workers have not kept up with manual workers' wages and hence real salaries have declined. The average real wage rate unquestionably has fallen, which happens during every business upswing. This decline, however, was much smaller than the rise in employment. Consequently, the purchasing power of the population has increased, though so far this does not exceed 5-10%. A more significant increase in consumption can only take place in a later phase of the upswing.

As it was mentioned earlier, another devaluation of the dollar no longer stimulated speculative demand and did not cause another round of price increases; hence prices calculated in gold declined. This obviously had to have an impact on foreign trade. Despite the increased demand for foreign raw materials due to increased output, with the improved competitiveness of American goods in foreign and domestic markets, imports calculated in gold even declined somewhat, while exports rose. As a result, the positive balance of trade grew larger and therefore the American upswing was unable to affect other countries through increased demand for foreign goods. Only if the USA had a large negative balance of trade, would this enable other countries to repay their obligations to the USA in goods that would at the same time create additional demand in these debtor countries.

4. The main difference between the situation in the USA and in Germany is that the USA has to collect debts and has devalued the dollar, whereas Germany has to pay debts and has not devalued the Reichmark. The depreciation of the dollar to some extent is an unnecessary addition to the present system of stimulating the business upswing in the USA, but its stimulation in Germany has been greatly impaired by the developments in foreign trade.

Under the influence of the stimulation of the business upswing, the growth of output in Germany generated a greater demand for foreign raw materials, but without devaluation of the mark there were no incentives that would pave the way for a strong expansion of German exports. This accounts for the continual worsening of the German balance of trade and for the outflow of foreign currency which only for a limited time could be stopped by the partial suspension of the transfer of obligations and interest payments. With a further expansion of output and a following increase in imports this measure turned out to be unsatisfactory and Germany was faced with the question of how to continue stimulation of the business upswing without being able to acquire adequate amounts of raw materials for this purpose. A few alternative solutions exist here, although the German government has not yet definitely decided in favour of any of them.

The first is completely to stop stimulation of the business upswing. For the present German authorities this seems out of the question, for large public works are the only point of their social programme they have fulfilled, and as such it is of great political importance to them.

Also highly unlikely is the devaluation of the mark for psychological and prestige reasons; a more probable measure is the use of some general export

premium. The funds for its payment can be raised in the same way as those for public works, that is, through inflationary financing. But the effect of taking this path, as well as the path of devaluation, is still doubtful since a considerable part of German exports goes to countries which in this case can undertake special measures against sales of German goods. Unquestionably, though, something could be gained in this way.

Finally, Germany can suspend capital transfers completely, which would make it possible for her to make ends meet even at a somewhat higher volume of imports than at present. In this case the negative balance of trade would be offset by a positive balance of services (such as transport by German ships) and the repayment of Soviet credits raised in Germany. The conference on suspended German transfers has not produced any results, however. It is an open question therefore, whether Germany will decide on a complete break with foreign capital. Here one should also bear in mind a special aspect of this matter, namely about Germany's positive balance of trade with England which is threatening to confiscate this balance on behalf of English creditors.

For the time being Germany solved the problem of foreign raw materials provisionally by, simply limiting their import, hoping to continue production in the few months following with existing stocks. At the same time, a complicated system of regulations has been constructed to prevent increases in prices of these articles.

If account is taken of the fact that possible future increases in international trade promise rather meagre benefits for Germany since-as always happens during an upswing in the business cycle the prices of raw materials imported by Germany will rise faster than the prices of finished goods exported by her, then

it is highly probable that Germany will follow the path of autarky (as she has already done in agricultural products), which is a path close to the spirit of Hitlerism. Obviously, one should not expect Germany to cut herself off from international trade entirely. What is most likely is that imports of foreign raw materials will be kept at the present volume with only the increased demand being covered by local raw materials. Germany's advanced engineering and chemical industries provide an exceptionally promising field here for substitutes and savings in the use of raw materials.

Obviously, like every autarky, this will mean a reduction in living standards of the population. On the other hand, it will not harm the upswing in the business cycle; on the contrary, it will create a field for many new investments. There is nothing strange about this. Only under very special conditions does a business upswing coincide with an increase in the well-being of the masses. Essentially, a boom means the full employment of capital equipment. Ultimately, such employment is determined by the profitability of plants. As it will be seen from the example of Japan, the profitability of plants can even increase with a decline in the overall consumption of the masses. It is another matter that with alternative solutions—i.e. maintaining the present level of unemployment in Germany, or full employment of productive factors under partial autarky—the latter will imply a certain increase in the overall consumption of the masses. However, the real wages of the employed will inevitably fall sharply, since wage rates fall to some extent during every business upswing and in this case they would be further suppressed by autarky.

So far we have discussed the external difficulties of stimulating a business upswing by Germany. Regarding domestic developments, inflationary financing

of public works has had no effects similar to those that are generally considered as inflation. As in the USA, despite an increase in prices and output, the quantity of money in circulation has even declined slightly. As in the USA again a clear sign of inflationary financing in Germany was indebtedness of the central and local governments; in 1933 it increased by RM3 billion.

The problems that arise in such cases have already been discussed in detail in our analysis of the situation in the USA. Now we should point out that-as in the USA-the stimulation of the (business upswing in Germany has also influenced the expansion of private investment activity. The inflow of new orders for machines is twice as high at present as a year ago. Orders have also considerably increased from these industries that are not directly involved in public works. Industrial construction has also expanded considerably.

Real wages unquestionably have fallen, though this decline was smaller than the increase in employment. The rise in consumption was very modest, not exceeding 5%. With continued stimulation of the business upswing, there will be a tendency for consumption to rise faster, although this may be checked by further autarkization caused by difficulties in dealing with the unfavourable balance of trade.

5. Simulation of the business upswing in Japan, the third largest industrial centre of the world, has had a somewhat different nature from that in the USA and Germany. Japan has taken the path of inflationary financing of armaments not to fight the crisis but because of her overall foreign policy in the Far East and the conflict in which she has become involved there.

The industrial crisis was rather mild in Japan. Industrial output fell by only a few per cent in comparison with 1929. Considerable unemployment was more of

a structural nature and resulted from the rapid modernization of capital equipment combined with a high birth-rate and no reduction in the working-day. When inflationary financing of armaments began, capital equipment was already nearly fully employed; therefore, in this case the expansion of output was coupled with a sharp decline in real wages. As a result, despite the increase in employment, the purchasing power of the masses has not risen and may even have fallen.

This must always happen when additional demand—resulting from inflationary financing of government investments, or simply from a government deficit—happens in conditions of almost full employment of capital equipment. A large increase in prices in relation to wage rates is then required to employ this equipment even more fully by using its less economically producing parts or by rapidly expanding it. A condition is then created which in certain respects is similar to the period of inflation we experienced after the war: a boom manifesting itself in the full employment of capital equipment accompanied by an extremely low level of mass consumption.

Yet another factor has brought about the reduction in living standards of the Japanese masses. This was the sharp devaluation of the yen. Contrary to what is commonly stated, this factor did not stimulate a business upswing in Japan. All the time, Japan's balance of trade was almost in equilibrium. Hence no additional purchasing power from abroad was flowing in to Japan, which would have been the case if the trade balance had been strongly positive. Japan is only exchanging a greater volume of her products for foreign ones, thereby acquiring a greater amount of raw materials required to increase her output. And she is acquiring them at the cost of the extremely unfavourable relation in

which she exchanges her goods for those of other countries. Precisely here—besides the stimulation of the business upswing under near full employment of capital equipment—lies the source of the lowering of living standards of the Japanese masses during the greatest boom that Japan has ever experienced.

The Business Cycle and Armaments¹ (1935)*

The close link between stimulation of the business upswing in recent years and armaments is unquestionable. The sharp increase in industrial production since 1932 in Japan has been caused by the inflationary financing of armaments and the Manchurian expedition. Armaments here were a goal in themselves, while the business upswing in large part was only a secondary, unintended side-effect.

The situation is quite different in Germany. Here stimulation of the upswing, with the aim of a general improvement of the economic situation, was the only social promise kept by Hitlerism, and undeniably was and still is the foundation on which Hitler's government rests. This is hardly contradicted by the long shadow cast by armaments in the present German business upswing.

With stimulation of a business upswing by the inflationary financing of public investments, the nature of these investments is—from the standpoint of their immediate economic effect—largely a matter of indifference. What is important is that the additional purchasing power created by banks be used by the government to purchase investment goods of one kind or another, which

¹ Ed. n.: First published as "Koniunktura a zbrojenia," **Polska Gospodarcza**, 16/22, 1935, pp. 701-3.

* Vol. I. pp. 182-187.

increases employment in the plants involved and hence also increases demand for consumer goods. Stimulation of the upswing by public investments is like an 'essay on a subject of choice', and in Germany this subject was determined in agreement with the Reichswehr.

Everyone today says that the public works conducted for past two years in Germany are, directly or indirectly (e.g. the network of strategically important highways), military in nature; it is even surmised that Germany cannot stop arming herself, lest the boom collapse. In this way armaments are surrounded by an air of economic mysticism: allegedly only they can stimulate the business upswing.

This is obviously one of many myths frequenting economic journalism. Armaments do not stimulate industrial activity because they are armaments, but only if they are financed by inflation; the creation of additional purchasing power intended for any other purposes would have, as we emphasized above, the same short-run economic effect. From the point of view of this effect, it does not matter whether or not one day military transports or buses move along the roads now being built; and it also makes no difference whether steel is used to make cannons or for sheet metal to cover a hospital building.

But let us return to German armaments. They are not financed only by the creation of additional purchasing power which, flowing through them, stimulates a general business upswing; they also feed on the effects of this upswing. Increased employment caused a fall in total payments of unemployment benefits. These savings were not used to increase benefits for the remaining unemployed or to reduce insurance premiums; they were used to put more of the unemployed to work on public investments similar to those by which the

upswing was stimulated. This is one of the reasons for the relatively slight increase in consumption by the broad mass of the population with the rise in employment. For the purchasing power of this population increases, not by the total amount of wages received by newly employed workers, but by the difference between this sum and their previous unemployment benefits.

Further, a general business upswing causes an increase in tax revenues. This increase also can be allocated to armaments. Thus, as we have said before, armaments absorb not only a considerable part of the sums stimulating the upswing, but also a considerable part of the increase in social income indirectly generated by this stimulation.

Stimulation of the business upswing had yet another negative effect on the German economy, connected in a special way with the increase in Germany's combat readiness. We have in mind here the question of raw materials. The expansion of production obviously increases the demand for foreign goods, especially raw materials. There is no mechanism, however, which would make the increase in production go hand in hand with an increase in exports. On the contrary, prices rise during a business upswing, which obviously reduces the competitive position of German products on foreign markets.

Thus with no inflow of foreign capital Germany experienced typical difficulties in her balance of payments, which were a symptom of the inability to acquire adequate supplies of foreign raw materials. Obviously these difficulties were not eased by forced purchases overseas, especially for military purposes. The only radical way out of this situation could be partial autarkization—forcing the exploitation of domestic natural resources and production of synthetic raw materials (mainly as admixtures to natural resources). Naturally, there is no talk

here of the complete suspension of raw-material imports, but only of adjusting them to the volume of exports.

The Germans, understandably, did not take this path voluntarily, but necessity quickly became a virtue, at least from the military point of view. For could the Reichswehr ever have dreamed of experiments in self-sufficiency on such a wide scale in the event of war? And the matter does not end with experiments, since Germany's capital equipment is already now being expanded in the direction of manufacturing substitutes, thereby saving investments during an eventual war; hence this expansion of the output of synthetic raw materials entirely resembles that generated by armaments in the strict sense.

One should not think, though, that stimulation of the upswing brought the Germans nothing but benefits from the military point of view. The foreign-currency difficulties (a symptom of short supplies of raw materials) which the Reich is experiencing in connection with stimulating the upswing can be overcome by autarkization only in the long term. For the present, the demand for foreign raw materials had to be covered at the cost of total outflow of gold and foreign exchange reserves, and also by the no less complete suspension of transfer payments of debts and interest on them. Germany thereby completely stripped herself of the possibility of making purchases overseas except in barter exchange for her own goods; not only does she have no gold or foreign currency, but she cannot make use of foreign credit, having totally lost the confidence of international capital owing to her insolvency. And since complete autarkization is out of the question even during wartime—because some imports are indispensable, even on a large scale, while exports are impeded both by the full employment of factors of production for the war effort and by

possible disruptions in transport capacity to handle world trade—the impossibility of acquiring foreign goods for gold or foreign exchange during wartime, or of raising foreign credits, is a very serious weakness in Germany's military complex.

Besides this, however, difficulties in supplies of raw materials threaten German armaments from another angle, namely, the possibility of their further expansion. Will Germany be able to arm in the next few years at an even faster rate than now? It seems not, and in the final analysis this is connected with the raw-materials situation.

By stimulating a business upswing, Germany expanded her domestic market and overcame the crisis in sales. But she soon faced another crisis—the raw-materials supply crisis, which can be overcome by partial autarkization only in the longer term. Expansion in the home market has thereby become limited for the present. This explains the fact that the German production index, following a sharp increase from the middle of 1933 to the middle of 1934, for nearly a year now has remained on more or less the same level. No significant increase in the German social income can be expected in the immediate future; an increase in the rate of armaments would therefore take place at the expense of two other items of this income, consumption or investments, and a reduction of either of these is very unlikely.

The increase in consumption in Germany during the present upswing is insignificant by comparison with the rise in employment. The reason for this, as mentioned before, is that unemployment benefits saved by the increase in employment were again allocated to public works; and, moreover, production on the whole became more expensive on account of partial autarkization. If

attempts are made to gain funds for investment at the cost of consumption, reducing the latter below its present relatively low level by the imposition of new taxes, reducing civil servants' salaries, unemployment benefits, etc., all the social advantages of stimulating the business upswing would then vanish, and the masses, already disappointed by the failure to implement the entire social programme of the National Socialists, will become completely disheartened.

Neither can armaments be increased at the expense of investments; the opposite is rather the case. Profitability and private investments have increased owing to stimulation of the business upswing, as was intended; for the synthetic upswing is supposed to change into a natural one, with public investments 'relieved' by private ones. So now, when this private investment activity-the construction of new industrial plants and the renovation of old ones-has finally got under way, is it to be stopped (e.g. by raising the rate of interest) and are public investments to be continued instead, causing ever greater indebtedness of the treasury? This is obviously out of the question, the more so as a considerable part of private investment is going in the direction mentioned earlier, to create new industries producing substitutes for raw materials, which again is an important part of the economic and armaments plan as a whole.

We have examined the essence of the impossibility of a further intensification of German armaments. We shall now see how this looks from the financial side. With increasing private investments, which also have a stimulating effect on the upswing, the sums allocated to stimulating public investments have to be reduced, for otherwise total production would have to increase further, which would cause difficulties in supplying particular industries with raw-materials and would lead to a breakdown of the entire system. Moreover, since

production cannot increase, neither can one count on an increase in tax revenues or on new savings in unemployment benefits, unless taxes are raised, or It social services or civil servants' salaries reduced, which—as we have said earlier—seems improbable.

It obviously does not follow from the above that the stocks of armaments of the Reich will not continue to increase; it only means that the annual increase in these stocks in the next few years will probably not be greater, and may even be smaller, than at present. Besides, all of this applies to the relatively near future. In the longer run, efforts to produce synthetic raw materials may make it possible to increase social income, and the eventually more favourable position of Germany in international markets may also contribute to this. But one may expect only a rather slow improvement of the situation.

Disclosure of the tremendous armaments amassed by Germany in the last two years will unquestionably encourage other powers, especially France and England, to increase their defence effort. If these countries wished to stimulate business upswing in this way, they would not encounter the same difficulties as Germany now has. To be sure, in Germany capital equipment and the labour force are not yet fully employed, but the absence of the complementary factor of foreign raw materials makes further expansion of output impossible. France, on the other hand, has tremendous reserves of gold and hence could afford to increase imports for a long time without increasing exports. England's position in this respect is even better on account of close ties with her dominions, which have adequate supplies of almost all raw materials.

As we see, an increase in English and French armaments by inflationary financing, which would simultaneously stimulate a general business upswing in

those countries, is possible without serious difficulties. Will events in fact go in this direction? It is difficult to answer this question; however, since an increase in armaments would swell budgets, and it is rather doubtful whether taxes would be increased, the sums required would come from loans. Moreover, it is unlikely that France and England would permit a contraction of the private capital market; rather, in one form or another, additional purchasing power would be created by banks. So perhaps we are approaching a moment when it will turn out that Germany has stimulated, not only her own business upswing, but also—on a labyrinthine path, via the arms race—a world business upswing.

Economic Aspects of West German Rearmament¹ (1962)*

1. After the Second World War the Federal Republic of Germany (FRG) went through the same three stages as did the German Republic following the First World War: (i) a period of economic chaos; (ii) a period of economic stabilization and reconstruction associated with an increased politico-economic significance in the world capitalist system; (iii) a period of militarization coupled with expansionist slogans.

The last phase, which we are witnessing today, shows, however, an important difference from the corresponding period of the 1930s. Hitlerism came to power during a deep economic crisis. Armaments and related government investment, such as road-building, were designed to stimulate production—it was the fascist way out of the crisis. But the Adenauer regime started the process of remilitarization of West Germany during a period of a high level of economic activity, and, as will be seen, its continued favourable course has by no means depended directly on the armament programme. Hence the question arises as to the relation between militarization and the basis

1 T. N.:

* Vol. II, pp. 402-408.

for the economic development of the FRG. This article discusses this question and the correspondence between West Germany's economic policy and its military strategy.

Unlike Hitler's, the Adenauer regime bases its military strategy on close collaboration with the whole capitalist camp. The key to the economic role of militarization of the FRG must be also sought in its indirect impact on the economic situation of that entire camp, which in turn influences the economic situation of the FRG.

Table 58. *National Income in the FRG, 1956–1960 (DM billion, at 1954 prices)*

Components of the national income	1956	1960	1960 (1956 = 100)
<i>I. Private accumulation</i>			
1. Non-productive investment ^a	16.5	55.5	132
2. Productive investment ^a	25.6		
3. Increase of inventories	4.1	5.7	—
4. Foreign balance ^b	6.5	2.6	—
5. Taxes on corporate profits	4.7	6.7	—
6. Current budget deficit ^c	– 17.2	– 22.4	130
<i>Total</i>	40.2	48.1	—
<i>II. Surplus of government income over administrative outlays and social transfers</i>			
	26.1	35.7	—
<i>III. Consumption of goods and services</i>			
National income (from consumption services ^a)	176.8	223.3	126
Of which government expenditure on goods = (5 + 6 + II)	13.6	20.0	147

^a Before deducting depreciation.

^b No allowance is made in imports for government foreign transfers.

^c Excluding government foreign transfers.

2. Let us begin with an analysis of the FRG national income and its components in the remilitarization period 1956-60 for the purpose of

establishing the source of its continued economic upswing. It will be seen that the driving force of this upswing has not been armaments, but non-productive investment. The relevant data, calculated on the basis of official statistics, are presented in Table 58.

This table is constructed along the same lines as Tables 55 and 56, used for the study of the economic situation in the USA (see pp. 388 and 394), with some minor modifications. Since government investment is included in the items of unproductive and productive investment, the budget deficit relates only to the current budget. The minus sign before the budget deficit figures means that a budget surplus was in existence throughout the period (in the sense defined above).

As we see, from 1956, when the essential stepping-up of the militarization of the FRG began, to 1960, the national income grew by 26%, or at an approximate rate of 6% p.a. Consumption increased in the same proportion. Government expenditure on goods between these years grew by 47%, which reflects the expansion of the arms programme. But as a result of increased taxation the budget surplus not only failed to decline but even increased more rapidly than the national income (by 30%).

Even if the increase in the budget surplus is considered exclusive of taxes on corporate profits (which, used to finance government outlays, have a stimulating effect on the economic activity)² it appears that its growth is parallel to that of the national income from 12.5 billion DM in 1956 to 15.7 billion in 1960, i.e., by 26%. Since the real foreign balance declined, the increase of private accumulation representing the 'dynamic components' of national income,

2 Ed. n.: See p. 389 above.

resulted from the expansion of non-productive and productive investment, and these were the driving force of the economic boom in the period considered. (The higher increase in inventories was of less significance here.)

It is therefore difficult to speak of a direct influence of armament on the economic activity here. This becomes even clearer if we consider that a large part of the increase in armaments was effected by means of imports. For, on analysis of the sources of internal demand, it would be convenient to deduct this part, which obviously does not generate demand, from both government outlays and imports. (Unfortunately, we do not possess accurate data on the subject.) The national income and private accumulation figures would remain unchanged, but the 1960 foreign balance would rise appreciably, and would differ little from the 1956 level; whereas the budget surplus in 1960 would be *pro tanto* greater, and would thus show an even faster growth in relation to 1956.

Before proceeding to analyse the indirect but essential role of militarization in shaping the economic situation of the FRG, it is useful to add a few words on the reasons for the increase in investment. Non-productive investment consists primarily of residential building followed by local and central government investment. Since central and local government policies decisively affect the housing construction programmes, the increase of non-productive investment is a reflection of government investment policies. As concerns productive investments, their increase partly results from the continuous growth of the national income and partly from the modernization wave which has swept over the capitalist countries in recent years (for instance, large-scale automation). An additional incentive to modernization and mechanization in the FRG in the period considered was the shortage of manpower in many branches of industry.

3. Despite the rapid growth, by capitalist standards, of national income, the FRG has had no difficulty in covering its simultaneously increasing imports with expanded exports. On the contrary, if we ignore armament imports, the FRG has maintained its real export surplus at a nearly constant level in the period examined,³ while as a result of an appreciable improvement in its terms of trade in this period, the money value of export surplus showed an important increase. Even after deducting from this surplus imports of armaments and government foreign transfers, particularly to West Berlin, its balance of payments still remains favourable, thus making the FRG an international financial power. Indeed, the USA itself recently begged West Germany's help in its currency difficulties (besides arms orders).

It would be wrong to assume that the favourable foreign-trade position enjoyed by the FRG in the given period is due to the growth of its exports to the newly established Common Market. Actually, the balance of trade between the FRG and its Common Market partners has grown worse as a result of its increased arms imports. But even if these imports are disregarded, the increase in the export surplus with those countries would be small, and could not constitute the essential factor in shaping West Germany's balance of payments.

Actually, the expansion of West German exports, which has continued for a number of years, rests on the following factors:

- i. A rather high level of economic activity has prevailed in the capitalist world, one of the most important pillars of which has been the armaments programme of NATO, in particular that of the USA.

³ By real export surplus is understood the difference between exports and imports calculated in prices of the base year, which in this case is 1954.

- ii. As a result of this lasting prosperity and of the realization of the development programmes of the underdeveloped countries, the demand for machinery as well as chemicals, West Germany's basic export products, showed a high and rising level.
- iii. The export efforts of West Germany's main competitors on the world machinery market were weakened by the absorption of a large part of the respective productive capacities by their armaments.
- iv. In addition, the FRG has a strong competitive position owing to its relatively low production costs, which are a result of high productivity and fairly cheap labour.

In other words, its production structure and costs have facilitated the expansion of West Germany's exports on the world market. And the situation in the latter has been favourable in great measure as a result of the armaments programmes of the capitalist camp. Armaments stimulated the economic activity of the capitalist world on one hand, and they checked to some extent the trade expansion of the main exporters of machinery on the other.

The indirect relation between the militarization of West Germany and its economic development becomes evident here. The increase in the national income requires growing imports. For an economy so much lacking self-sufficiency as that of the FRG, this is of great importance, in particular since the concept of the Common Market, promoted by West Germany, excludes import restrictions. Increasing imports must be covered by the expansion of exports. But the pattern of West German exports is to a great extent dependent on armaments of other capitalist countries. Hence the economic interest of the FRG in maintaining international tension. And one of the most essential elements of

the Cold War is the militarization of West Germany, which has played such an important role in the conceptions and strategic preparations of the Atlantic alliance. It is easy to see that the relaxation of tension in international relations, leading to disarmament, would deal a heavy blow to the expansion of FRG exports. World capitalist economic activity would then undergo at least a certain weakening, and the 'disarmed' producers of machinery would intensify their export drive. It may be claimed that the decline in armaments production would be compensated for by allocating the corresponding funds to underdeveloped countries for the purchase of machinery, the production of which would utilize the capacity freed from arms production. But even if such a conversion of armament production were fully effected, the underdeveloped countries would then receive machinery from the former arms producers in such quantities that West German exports could not but be seriously hurt. However that may be, one thing is certain: the *surest* basis for West German export expansion has been the Cold War.

Some may say: granted that militarization of West Germany stimulates the Cold War. The Cold War maintains the arms race. Armaments create a favourable position for FRG exports. But since West Germany must in turn arm itself, its export efforts will suffer as well. However, the following must be taken into consideration. (i) The FRG has a much greater heavy-industry production capacity in relation to its national income than is the case in the other capitalist countries, and thus a given percentage of the national income allocated to armaments burdens this capacity to a correspondingly smaller degree. (ii) As already indicated, the FRG covers its growing demand to a considerable extent

by foreign-produced arms, for which it assigns part of its foreign-trade surplus achieved through the expansion of its exports.

This kind of coverage of part of its armaments programme burdens the balance of payments, but, as we have seen above, this by no means creates any special difficulties. On the contrary, if West Germany refrained from the import of armaments while maintaining its exports and other imports, this would lead to balance of payments difficulties for its allies and in consequence to economic and political frictions. On the other hand, the imports of arms have the advantage over their production, accompanied by a simultaneous shrinking of exports, in that armaments orders abroad help the FRG to acquire important political and economic influence among the exporters, which in turn facilitates the further expansion of militarization.

The British harboured the cynical dream that the armaments of West Germany would paralyse its exports of machinery, thus enabling them to take over some of the FRG's markets. But, as often happens, this hope proved to be short-lived. The Germans outsmarted the British. True, they improved somewhat Britain's balance of payments; they did so, however, not by slowing down the expansion of their exports and surrendering their markets, but by directing arms orders to Great Britain, obtaining important political concessions in return.

Under these circumstances, there is nothing strange in the fact that even poor old Krupp got tired—though probably for a limited time—of being a world blackguard, and that he now produces ploughs rather than swords.

4. We referred above to the effect of West German militarization on the maintenance of international tension, which is, moreover, the clear goal of its entire foreign policy. It is in this manner that the FRG has also sustained the

armaments programmes of the capitalist camp as a whole, which has in turn reacted favourably on its export expansion. We have also pointed out that another important factor of this expansion has been the competitive position of West German exports which rests on relatively cheap labour. Now, militarization is also indirectly instrumental in maintaining this labour cheapness. For the militarization of the FRG is closely linked to its growing chauvinist-revanchist attitude. The Adenauer regime has in this manner achieved a political miracle which is more astonishing than its much-advertised 'economic miracle' by creating in a short time a virtual one-party system. For it is difficult to find today any significant difference between the leading parties in the FRG, particularly between the ruling party and the social democrats. The complete assimilation of the latter most likely has resulted in weakening the militancy of the trade unions. This is of course very helpful in maintaining the relatively low production costs, despite the manpower shortage in many branches of industry, which facilitates pressure for an increase in money wages exceeding the increase in labour productivity. Table 59 shows that in fact the latter did not occur in the FRG.

Thus, as a result of the identical rise of money hourly earnings and of man-hour productivity, labour costs in 1956-60 (just as in 1952-6) remained at a constant level. This, moreover, occurred under conditions of a decline in unemployment to a very low level, and of a certain increase in the cost of living.

Table 59. *Wages, Productivity, Labour Costs, Unemployment, and Cost of Living in the FRG, 1956–1960*

	1952	1956	1960
Money hourly earnings in industry ^a (1952 = 100)	100	124	166
Man-hour productivity in industry ^a (1952 = 100)	100	124	165
Average unit labour costs (ratio of the preceding 2 items)	100	100	101
Unemployment as % of hired manpower	8.4	4.2	1.2
Cost of living (1952 = 100)	100	102	110

^a Including construction.

To sum up: militarization is the corner-stone of the FRG policy of inciting international tension abroad and of stifling the class struggle at home. And these two basic political effects, by their economic repercussions-maintaining high armament levels in the other countries of the capitalist camp and facilitating stabilization of production costs at home-clear the way for the expansion of West Germany's exports, which is an integral element of its conception of economic growth.

Editor's Addendum

First published in *Ekonomista*, 6, 1961, pp. 1245-50. A revised version of this article was subsequently included in Kalecki's *Sketches on the Functioning of Modern Capitalism*, pp. 43-52. This version has had several translations: the French, 'Les Aspects économiques de la remilitarisation de l'Allemagne Occidentale', appeared in *Annuaire Polonais des Affaires Internationales*, 1962, pp. 73-82; the English, 'Economic Aspects of West German Rearmament', was published in *Economic Weekly* (India), 12 May 1962, pp. 775-80; the Italian, 'Aspetti economici della millitarizzazione nella Germania occidentale', appeared

in Kalecki's *Sul capitalismo contemporaneo*, pp. 81-9; the Spanish, 'Aspectos económicos de la militarización en la Alemania occidental', was published in Kalecki's *Sobre el capitalismo contemporáneo*, pp. 81-92. According to a private communication of A. Szeworski to the editor of Kalecki's *Collected Works*, a German translation of this article probably also appeared in the FRG. Kalecki asked Szeworski to translate it into German and sent a typescript to one of the German trade union organizers with a request to publish it; neither the addressee nor the journal in which the article might have appeared have been established, however.

The permission of *Economic Weekly* to reproduce the English translation of this article is gratefully acknowledged.

In the Preface to the *Sketches* Kalecki wrote:

The subject-matter of the next study, on 'Economic Aspects of West German Rearmament' ... is already somewhat different, owing to the specific position of the FRG in the capitalist camp. We try to answer the question of what economic interest West Germany has in a rapid increase of armaments which does not serve, at least directly, the stimulation of the business upswing. (p. 8).

The Fascism of Our Times¹ (1964)*

1. In the last few years we have noticed fervent activity among strong fascist groups in the developed capitalist countries. The most important of them are the OAS in France, the neo-Nazi elements in West Germany, and the Goldwaterites in the USA. All these groups have the following characteristics in common:

- a. In contrast to the Nazism of the period of the Great Depression of the 1930s, they do not resort to social demagogy. Goldwaterism even

1 Ed. n.: First published as "Faszyzm naszych czasów" in **Polityka**, 8/46 (1964), repr. in M. Kalecki, **Z ostatniej fazy przemian kapitalizmu**, 43-50.

For the English translation, see M. Kalecki, **The Last Phase in the Transformation of Capitalism**, 99-105. The Swedish translation, "Vara dagars fascism," appeared in M. Kalecki, **Tillväxt och stagnation i modern kapitalism**, 68-73. The Italian translation, "Il fascismo dei nostri tempi," appeared in M. Kalecki, **Sul capitalismo contemporaneo**, 91-6. The Spanish translation, "El fascismo de nuestro tiempo," was published in M. Kalecki, **Sobre el capitalismo contemporáneo**, 93-100. All translations were based on the 1968 edn. Of the paper. The Monthly Review Press permission to reproduce this article is gratefully acknowledged.

Among some clippings from *Monthly Review* which survived in Kalecki's papers there is an article "Fascism in America" (signed "Historicus," 4/6, 1952). Its author points out that a political system does not have to have the features of the German or Italian fascism, or use their symbols, and still be fascist in nature. Kalecki's article appears to be a continuation of this line of thought.

* Vol. VII, pp. 287-291.

espouses the reverse ideology by criticizing government intervention and proclaiming the return to *laissez-faire*.

- b. They appeal to reactionary elements of the broad masses of the population by a variety of racist or chauvinistic slogans. For each of the countries considered these slogans can easily be condensed into one word: Algeria, *revanche*, Negroes. The fascist groups also proclaim the anti-communist crusade by capitalizing on a long period of official propaganda.
- c. The fascist elements are subsidized by the most reactionary groups of big business, which in this way usually also further their particular interests-the defence of their investments in Algeria, the expansion of certain branches of the armament industries, etc. The fascists are also supported by certain groups in the armed forces.
- d. However, the ruling class as a whole, even though it does not cherish the idea of fascist groups seizing power, does not make any effort to suppress them and confines itself to reprimands for overzealousness.

We shall try to examine these characteristics of contemporary fascism point by point below and in this way to put them into proper perspective.

2. One of the basic functions of Nazism was to overcome the reluctance of big business to large-scale government economic intervention. German big business agreed to a deviation from the principles of *laissez-faire* and to a radical increase of the role of the government in the national economy-on condition that the government machine would submit to direct control in their partnership with the Nazi leaders. However, the purely capitalist mode of

production was guaranteed by directing increased government expenditures to armaments rather than to productive investment (which would signify some bias toward state capitalism).

Today government economic intervention has become an integral part of 'reformed' capitalism. In a sense the price of this reform was the Second World War and the Nazi genocide which were the final effect of the heavy rearmament that initially played the role of stimulating the business upswing.

Thus fascism is no longer the necessary basis of a system of government intervention. It cannot proclaim the slogan of elimination of mass unemployment because in developed capitalist countries employment is maintained at a rather high level. On the contrary, Barry Goldwater, while exhibiting racist and Cold War demagoguery, about which more will be said below, attacks not only government 'interference' in the economy but even social insurance. It is in this way that the support of the most reactionary business groups is paid for. And this is also the reason why he has no chance of seizing power. (It is interesting that in the pre-election polls even in the Southern states twice as many people favoured Democrats over Republicans in the matter of maintaining prosperity.)

What all the present-day fascist currents have in common with Nazism is the anti-trade-union attitude, which again reflects the link with the reactionary big business groups. This will be discussed in more detail below.

3. Who makes up the mass basis of the fascist movement? Goldwater won 40 per cent of the votes; and although the Republicans suffered a crushing defeat, Goldwater achieved a tremendous success.

In each of the countries considered a different part of the population yields, according to specific conditions, to a different slogan—each of which, however, is racist or chauvinistic in character. In the case of France those who yielded included the Algerian Frenchmen and those in the metropolis who were antagonistic toward the numerous Algerian immigrants. In West Germany the former Nazis, with quite a few things to hide in their pasts, are the Right candidates; they are interested in embellishing Hitlerism, and this links up nicely with the revanchist ideology proclaimed in a somewhat milder form by the government. The resettlers who did not arrange their affairs to their full satisfaction (definitely a minority) are another group susceptible to neo-Nazism. Finally, in the USA the opponents of the Negro emancipation drive provide recruits for the reactionary groups considered; and this includes not only the Southern racists but all those hostile to Negro aspirations for jobs at present available only to whites.

In addition, in all cases the fascist ranks are reinforced by anticommunist fanatics who are the product of prolonged propaganda spread through the mass communications media.

The analogy between France and the USA is worth noticing here: in either case the main driving force of the fascist movement is the potential emancipation of the oppressed nations, or decolonization in the broad sense. The German variety of fascism is different, although even in this case the *Herrenvolk* notion can be found at its roots.

4. Information about the capitalist groups supporting the fascist currents is, of course, very incomplete. In France these no doubt included groups which

had invested heavily in Algeria, although they were certainly not the only OAS sympathizers.

In the USA the oil interests in Texas, the armament industries of the West, and the Bank of America, also very active there, are some of the main groups. All are 'young', 'dynamic' concerns. They are not particularly worried about slumps because they think that not only will they survive them but that they will increase their possessions at the expense of 'old' capitalist groups. At the same time the oilmen of Texas are afraid of losing the special tax privileges they enjoy, and the armament industries are afraid of a slackening of the Cold War—hence their dislike of government intervention and of the doctrine of coexistence.

It should be noted that these capitalist groups are much less 'experienced' than the old rulers of the USA who, after a period of opposition to the New Deal, finally understood the inadequacies of *laissez-faire* capitalism. And last but not least: the political power of the upstarts does not at present correspond to their financial weight and so they are striving to create a government in which they will be the controlling stockholders.

It is they who permeate their political agents, like Goldwater, with the spirit of resistance against government intervention, including social insurance. They are the youngest of the capitalist oligarchy and paradoxically just for this reason the most anachronistic group. They cannot win but they do not lose either as they perform, together with their hirelings, a definite function in present-day capitalism.

The fascist groups have one other important protector. These are the 'angry' members of the military establishment who love the game of balancing on the brink of a precipice—if not on that of a preventive war. They are in a sense

the counterpart of the 'predatory' business groups and are frequently linked together. It is probable, however, that the weight of the 'angry' members of the armed forces is greater than that of the 'predatory' groups in the ruling class.

5. It would be a very crude simplification to maintain that only the 'upstarts' or some other specific groups of big business support the fascist movements. The boundaries are by no means so sharply drawn. It is very likely that many concerns financially support the official politicians of the ruling class as well as the less respectable adherents of fascism. This in turn is only one aspect of a broader phenomenon: the majority of the ruling class does not like the idea of the fascists seizing power, but at the same time it does not wish to crush them. The fascism of our times is a dog on a leash; it can be unleashed at any time to achieve definite aims and even when on the leash serves to intimidate the potential opposition.

Let us recall in this connection the role in the Algerian war of the OAS, that illegal terrorist organization which had 'insiders' in all government offices and which was by no means persecuted by the government-indeed, it had its uses as a whip against the Algerian rebels and the internal opposition to the war. After the conclusion of the Evian agreement, OAS activity naturally slackened since the Frenchmen in Algeria were already powerless and the repatriates were settled in France under very favourable conditions. But OAS adherents probably managed to survive in the Gaullist party and the government establishment, especially in the armed forces. The threat of this alternative to the present government has some impact upon the present political situation: the government may be understood as keeping a bad dog on a leash.

A similar duality will be seen in West Germany. Even though the government disclaims any affinity whatever to Nazism and even though trials of war criminals take place from time to time, former Nazis who have hardly been 're-educated' occupy important administrative posts, especially in the armed forces. In the propaganda of *revanche* the fascist groups display, as said above, much more extreme views than the representatives of the government, who by no means find them embarrassing. At the same time the dog on the leash, which is fairly long, makes itself useful by extinguishing any glimpse of resistance to the official policy of Cold War, *revanche*, and militarism.

An analogous phenomenon may be observed in the USA. It seems fairly certain that after the murder of John Kennedy the government would have been able to deal a mortal blow to the right-wing extremists. But the way of conducting the inquiry, as presented in the Warren Commission report, shows the contrary tendency to evade implicating anyone but Oswald-who in the meantime has been successfully eliminated. It is in this state of lawlessness that the origin of Goldwater's candidacy may be found. In turn, this candidacy was not very firmly opposed inside the Republican Party, as it was directly controlled by big business. The behaviour of Eisenhower, who never tended to right-wing extremism, is quite significant here.

Goldwater is right, at least in a sense that this is not the end of his career. For Goldwaterism is wanted by the ruling class as a pressure group against an excessive relaxation of international tensions and in order to restrain the Negro movement. Goldwater will exist not only because of the support of the 'predatory' groups of big business and the 'angry' elements of the military

machine, as well as of his racist and reactionary followers, but most of all because he will be saved by those to whom he lost.

Vietnam and US Big Business¹ (1967)*

1. The last sentence of *"The Fascism of Our Times,"* written more than two years ago, was as follows: 'Goldwater will exist not only because of the support of the "predatory" groups of big business and the "angry" elements of the military machine, as well as of his racist and reactionary followers, but most of all because he will be saved by those to whom he lost.' This anticipation, which at that time might have seemed to some too pessimistic, appears in the perspective of the war in Vietnam rather too mild. It is true that not much is heard any longer of Goldwater himself, but his spirit coexists in the White House.

It would be wrong, however, to shift to the other extreme and to maintain that the Johnson administration carries out all the postulates of Goldwaterism and thus represents the views and interests of the business groups which support it. There has been, indeed, no change in the government's attitude toward social insurance, trade unions, and the principles of government economic intervention. But the aggression in Vietnam, with its repercussions upon the armament industry (especially on the West Coast), is fully satisfactory to Goldwater and his masters.

1 T. N.: Refer to the Addendum by the end of this chapter for the Editor's note.

* Vol. VII, pp. 292-298.

It seems that at least until quite recently Johnson represented sort of a synthesis of the interests of all the big business groups. Indeed, the slogan of fighting the revolutionary movements in underdeveloped countries is shared by all these groups, and none of them objects to resorting to the most ruthless methods. At the same time, it was not until the middle of 1966, as we shall see in a while, that the economic repercussions of the war in Vietnam contributed to a weakening of the position of 'old' big business-usually associated with the East Coast-in relation to such new 'empires' as the Western and Southern armaments industry, the Bank of America, or the oilmen of Texas.

2. When writing about the war in Vietnam people refer frequently to the total US military expenditure. In fact the gigantic level of this expenditure can be traced back to 1951; since then it has been an integral element of the US economy. However, the increase in this expenditure up to the middle of 1966 was rather moderate. In the years 1964 and 1965 military expenditure on business products and personnel was maintained at a level of about \$50bn. per year; in the first half of 1966 it amounted to \$54bn. per year (after an approximate adjustment for the rise in prices). Moreover, even this moderate increase was not a fiscal business stimulant because the rise in public expenditure was offset by the hampering of consumption resulting from higher tax revenues.

The motive force of the boom in this period was in fact the increase in private investment (exclusive of residential building): from \$61 bn. in 1964 to \$69bn. in 1965 and to \$75bn. in the first half of 1966 (all in 1964 prices). This was the result of earlier tax concessions of a type stimulating business investment and large orders-but not yet actual expenditures-in connection with the war in

Vietnam. It is this increase in private investment which, together with its effects on consumption through higher employment and wages, led to the expansion of the GNP² from \$632bn. in 1964 to \$669bn. in 1965 and to \$699bn. in the first half of 1966 (in 1964 prices). It follows from the above that: (i) the increase in military expenditure was not large in relation to the increase in national product and could not therefore lead to a major shift in the division of profits from 'old' to 'new' big businesses; and that (ii) the war in Vietnam stimulated a business upswing by way of the impact of armament orders upon investment.

3. In the second half of 1966 the economic situation in the USA underwent a fundamental change. Military expenditures jumped from an annual rate of \$54bn. in the first half of 1966 to \$59bn. in the third quarter of that year (in 1964 prices). This very large increase, considering the short period in question, is probably accounted for by the investment in the armament industry having created the appropriate productive potential; this made it possible to increase the output in branches working up to capacity (e.g., in the production of bombers).

At the same time the private investment boom slackened and in residential building, which since 1964 had just managed to maintain its level, there was even a decline. It is military expenditures that now become the motive force of the business upswing as they increase, more than the hampering effect of tax revenue upon consumption. The GNP increased from an annual rate of \$699bn. in the first half to \$708bn. in the third quarter of 1966 (in 1964 prices).

2 This is GNP in the sense of official statistics: in contrast with 'The Economic Situation in the USA as Compared with the Pre-War Period', neither net income from foreign investment nor administrative services (i.e. remuneration of armed forces and government employees) are deducted.

The situation is thus quite different from that prior to this period. The increase in military expenditure constitutes one-half of the increase of the national product; as a result, there appears a tendency for redistribution of national income to the armaments industries. Military expenditures begin to play a role as a business stimulant. To sum up: a typical war (or semi-war) boom started only in the second half of 1966.

To complete the picture it should be added that despite the increase in the cost of living the real wage bill from 1964 to the third quarter of 1966 rose at a rate of nearly 6 per cent per year. This rapid rise was associated with increases both in employment and in real wages.

4. It is probable that military expenditures will continue to mount. This will change the distribution of profits to the advantage of the armaments industries, as well as reinforce the importance of, armaments expenditures as a factor in the general economic situation. This in turn will no doubt strengthen the economic and political position of the 'new' business groups. Their close association with the adventurous elements of the military machine will also contribute to such a shift in the structure of the ruling class.

Other factors will work in the same direction: a further expansion of the war will be accompanied by an ever-increasing disregard for world opinion. This will adversely affect civil liberties, in particular the Afro-American problem, where the opinion of newly created African states has been a factor of considerable importance. The USA will drift toward membership in the club of 'shameless countries', now including South Africa, Rhodesia, and Portugal. This will lead to the promotion in public life of reactionary politicians associated with 'predatory' big business groups. It is these groups that are the beneficiaries of

the war in Vietnam and it is they that are interested in its continuation. At the same time the war will enhance their importance and this will in turn facilitate their pressure for its continuation.

The growing influence of armaments expenditures will work on the economic situation in the same way: the higher this expenditure, the more difficult the return to its former level—huge though it was—without causing a crisis. (Purely theoretically, this could be done by increasing other public expenditures or reducing taxes; in practice such a shift encounters serious difficulties because of the different interests and ideas among various big business groups.)

5. In the light of the above argument the 'old' business groups should have serious misgivings about the continuation of the war in Vietnam: what is advantageous to their competitors undermines their own economic and political position in the ruling class.

Nor is this the end of the story. What they had in common with their adversaries—the effort to show the hopelessness of revolutionary movements in underdeveloped countries—has failed miserably. In this sense the war in Vietnam has already been lost. Indeed, the present impasse in the struggle of the country having the highest industrial potential—and one of two highest military potentials—against a revolutionary movement in a small underdeveloped country and against its similar socialist neighbour is nothing to boast about (even if the assistance of the Soviet Union to North Vietnam is taken into account). And in addition the ruling classes in the areas of potential future revolutions will not necessarily aspire to the 'glorious' role of General N. C. Ky

and in the light of Saigon's experience will not be particularly keen to call for US assistance.

Finally, the more enlightened part of the US ruling elite cannot help but see the rapid decline of American influence in Europe; this is most visible in French foreign policy but is by no means confined to it. This aspect of the war in Vietnam is particularly important for the 'old' groups of big business because they are linked to Europe by their heavy investment there.

It follows from the above that the 'old' groups of American big business have many reasons for not being enthusiastic about the war in Vietnam. The most reactionary elements of these groups dream about cutting it short (for instance, by means of nuclear bombing; however, that might, to put it mildly, involve some undesirable 'complications'). The more reasonable may be inclined to withdraw from this hideous and misfired adventure.

This, regrettably, seems to be the only way to peace. It is difficult to expect any pressure in this direction on the part of organized workers in the near future. The most important factor here is the steady rise in employment and real wages since 1964 mentioned above. The central trade union organization, the AFL-CIO, whose bargaining position is reinforced by this development, has never uttered any objection to the war in Vietnam which would stimulate protests against it among its rank and file. Only a few left-wing trade unions, which do not belong to this central organization, have taken a different attitude.

It is true that various groups of intellectuals, in particular professors and students, have reacted strongly against the war in Vietnam. These, however, are a rather thin stratum of society in the USA without much political weight. It is possible that this awakening of the intelligentsia is important for US political

developments on the longer run, but it cannot have a major significance for stopping the war in Vietnam.

6. But is it possible that the groups of 'old' big business associated with the East coast might play a role in the war in Vietnam comparable to that de Gaulle played in terminating the Algerian war? We have so far argued only that following this pattern would correspond to the basic interests of this group. Is there, however, any sign of a tendency to undertake such an action?

There is only one phenomenon, I think, pointing in this direction: the great number of publications in the USA since autumn 1966 on the subject of the murder of Kennedy. It is remarkable that these did not begin to appear until two years after the report of the Warren Commission and just at the time that, as said above, the war began to play a decisive part in the economic situation. During the preceding two years there had been no lack of books and articles criticizing the official version of Kennedy's death, but the books did not find publishers and were printed abroad, and the articles only appeared in periodicals with small circulations. The daily press and the leading weeklies accepted without reservation the verdict of the Warren Commission. Now the situation has changed. Books are being published and articles are appearing in such weeklies as *Look* or the *Saturday Evening Post* (associated with big business on the East coast) which not only criticize the conduct of the inquiry into the murder of Kennedy but even demand that it be reopened.

Well it may be asked, how does this link up with the war in Vietnam? The point is that the USA is so deeply involved in it that the big businesses which embarked upon large-scale investment in connection with this war will be so desperately insisting on its continuation that it will require quite an upheaval to

bring it to an end. The role of such an upheaval might be performed by the reopening of an inquiry into the murder of Kennedy—on the condition, of course, that it would not use the methods of the Warren Commission. Such an inquiry might establish the links between the 'predatory' groups of big business and the scheme for the murder of Kennedy and thus compromise the present administration. In the atmosphere of this terrific scandal it might be possible to achieve the acceptance of the U Thant appeal for stopping the bombing of North Vietnam, for an armistice in South Vietnam, and for a start of negotiations with the Vietcong.

It is a sad world indeed where the fate of all mankind depends upon the fight between two competing groups within American big business. This, however, is not quite new: many far-reaching upheavals in human history started from a cleavage at the top of the ruling class.

Editor's Addendum

This article first appeared as "Wietnam przez pryzmat USA," **Polityka**, 11/3 (1967), repr. in M. Kalecki, **Zostatniej fazy przemian kapitalizmu**, 51-8. For the English translation, see M. Kalecki, **The Last Phase in the Transformation of Capitalism**, 107-145. The Swedish translation, "Vietnam och USA:s storfinans," appeared in M. Kalecki, **Tillväxt och stagnation i modern kapitalism**, 52-8. The first Italian translation, "Capitalisti 'vecchi' e 'nuovi'," (without section 6 and with considerable cuts in section 5), appeared in **II Manifesto** (6 June 1970), 22-4. A new Italian translation was published as "II Vietnam nell'ottica USA" in M. Kalecki, **Sul capitalismo contemporaneo**, 97103. The Spanish translation,

“Vietnam y las grandes empresas norteamericanas,” was published in M. Kalecki, **Sobre el capitalismo contemporáneo**, 101-9. All translations except the first Italian one were based on the 1968 edn. of the paper. The Monthly Review Press permission to reproduce this article is gratefully acknowledged.

Shortly after the publication of this article in **Polityka**, Kalecki received letters of support from Mr Jerzy Baumritter (the Chief Editor of *The Great PWN Encyclopedia*) and Mr Wiesław Górnicki (then correspondent of the Polish Press Agency and of *Zycie Warszawy* daily in New York). In reply to Górnicki Kalecki wrote in a letter of 24 Feb. 1967 among other things:

Dear Mr Górnicki,

Your mentioning of my article in your correspondence for *Zycie Warszawy* and your letter of 23 January 1967 gave me great pleasure. My article was written on the basis of reading the press (not very extensive) and on the data on the American national income, taken from the Survey of Current Business Hence the recognition for my idea of someone who is on the spot is extremely valuable for me.

I completely share your views on the spread in our country of the 'American myth' and on the close analogy between the USA and Hitlerite Germany. For the present Hitlerism in the strict sense of the word is only 'for export', but it is being unavoidably accompanied by corresponding developments at home. (I point this out also in my paper.) This is indeed, as you say, a sick country. It seems to me that in the meantime the contest among the various groupings has intensified, for those East Coast papers, which we both mention, have already begun to criticize the Vietnam War directly (though, obviously, only from the viewpoint of its efficacy).

I even wonder whether these new scandals (CIA and Garrison) are not somehow connected with this—perhaps only in the sense that the atmosphere of this contest emboldens people to make certain

disclosures. But how all this will end is very difficult to say (Kalecki's Papers).

On 23 November 1966 the 'International War Crimes Tribunal' started its investigations in London. It was founded by Lord Bertrand Russell (together with J.-P. Sartre and I. Deutscher) with the immediate objective to investigate American actions in Vietnam. At its session on 20 November-I December 1967 the Russell tribunal unanimously passed a verdict that charged the USA with a crime against peace and genocide in Vietnam. After the verdict was announced, *Trybuna Ludu* (the daily of the Polish United Workers' Party) interviewed a number of Polish intellectuals, Kalecki among them. He said:

The condemnation by the Russell tribunal, headed by the famous French writer Jean-Paul Sartre, of the shameful nature of the American war in Vietnam is fully justified. This nature results directly from the essence of this war. It resulted from a peasant uprising against the south Vietnam feudal landowners and bears a clearly class character. It is supposed to have a deterring effect on similar agrarian revolutions elsewhere, especially in Latin America. That is why there are no checks in it against destroying the civilian population and the sources of its livelihood. Its continuation threatens the gradual extermination of the Vietnamese people (**Trybuna Ludu**, 20/355, 23-26 Dec. 1967, 10).

The articles "The Fascism of our Times" and "Vietnam and the US Big Business" especially gave rise to different comments of the reviewers of Kalecki's collection **Zostatniej fazy przemian kapitalizmu** and of its English translation. On the one hand, J. Beksiak wrote: "What is especially noteworthy here is that the author goes beyond economics in the narrow sense. The economic mechanism is examined in the context of the present social and political

relations, and both aspects of the problem are treated as an inseparable whole. ... The analysis of links between extremely reactionary political tendencies and government interventionism must be also pointed out." (see "Stimulating the Business Upswing in Nazi Germany" [**Collected Works of Michał Kalecki; Studies in Applied Economics, 1927-1941**, VI, Oxford, Clarendon Press, forthcoming], "The Fascism of our Times" and "Vietnam and the US Big Business"). "The author shows how the understanding of the mechanism of the capitalist economy helps not only to comprehend current developments, but also enables us to foresee their further course" ("Two Books by Michał Kalecki", **Nowe Książki**, 20/15, 1968, 1063).

On the other hand, J. L. Dietz wrote: "The next three articles [i.e. "The Economic Situation in the United States as Compared with the Pre-War Period," "The Fascism of Our Times," and "Vietnam and the US Big Business"] all emphasize the growing importance of the military-industrial complex in an advanced capitalist economy. The last two of these essays are the least satisfying of the six essays. They reflect a more emotional side of Kalecki; his usual logical and theoretical argument is weighted with the type of rhetoric that may be less than convincing to the uninitiated" ("The Last Phase in the Transformation of Capitalism, by Michał Kalecki," **Quarterly Review of Economics and Business**, 14, 1974, 132).

The II Manifesto translation of the "Vietnam and the US Big Business" was followed by a comment by P. M. Sweezy, who apparently was asked by the editor of the journal to bring Kalecki's article up to date. However, Sweezy thought it was pointless, and this for the following reasons: 1. Kalecki was no doubt right in that ever since 1966 there was a shift in the US to a war or a semi-war economy.

This has not changed since Kalecki wrote his article, only inflation has accelerated, as the monopolies have brought about sharp price increases also in branches where capital equipment was not fully employed. Taking into account the rise in prices and tax-rates, real wages have even fallen somewhat compared to 1965. Hence, for the first time after the war, voices of protest against the war could be heard among workers and leaders of the smaller trade unions. These protests, according to Sweezy, might turn out to be important for the future of the movement against the war.

2. The Nixon administration represented 'old' rather than 'new' groups of big capital. This could be clearly seen in the way anti-monopoly legislation and other legal regulations were used to restrain the offensive of 'new' capital against what was subject to the 'old' and to the disadvantage of concerns which often had their headquarters in the West or the South West. The fall in the Stock Exchange in the middle of 1969 completed the defeat of 'new' capital. The limitations of armament expenditures that next followed, though not very large, have struck an especially heavy blow at the aircraft and rocket industries which were the bastion of 'new' capital.

3. The division in the ruling class caused by the war in Vietnam hardly ran along the line separating big capital into 'old' and 'new'. Regardless of what forces pushed the USA into the quagmire of South East Asia (in this matter Sweezy thought Kalecki's division into 'old' and 'new' capital to be of great significance), the fact was that in 1970 the entire ruling class feared the global political consequences of withdrawing from there (i.e. of a decisive military defeat). The reason was that despite the negative consequences of continuing the war (domestic and international) the ruling class in the USA had not by then

taken and decisive measures towards bringing it to an end. Moreover, under the American political system essential political changes are almost impossible during the term of office of the same president. An opportunity for such a change came up during the elections in 1968, but then the ruling class still expected a 'miracle' in Vietnam. In 1970 the situation was developing in the direction of the ever greater involvement of the USA in South East Asia and an ever more complicated domestic situation in the USA; the result of this was beyond prediction.

4. According to Sweezy, the goal of the anti-war movement in 1970 and later should be to make it impossible to govern the USA normally so long as the war in South East Asia lasted. When that became clear, the ruling class would have to make a choice between total repression aimed at the anti-war movement (i.e. between some forms of fascism or a military dictatorship) and withdrawal from Vietnam, Laos, and Cambodia, although for some time probably not yet from Thailand (see "Una nota di Sweezy," **Il Manifesto**, 6 June 1970, 24).

