THE THEORY OF
CAPITALISTIC STAGNATION

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CHAPTER I

INTRODUCTION

The problem to be dealt with in this paper is the theory of capitalistic stagnation. Why is it important to examine the theory of capitalistic stagnation? The continuity of the theory of stagnation is the only portion of economic doctrine that is held in common by the Classical, Marxian, Keynesian, and Institutional economists.

Is there any evidence of the theory of capitalistic stagnation in contemporary economic thought? Yes, one finds the theory of stagnation latent in the postulates of the theory of the matured economy which was held by Alvin H. Hansen, Seymour E. Harris, Sumner H. Schlicter, and other members of the Economic Faculty of Harvard University in the days of the Great Depression.\(^1\) The subject of capitalistic stagnation has also been discussed in several recent economic journal articles.\(^2\)

\(^1\) The theory of the matured economy will be discussed in Chapter IV. The relationship of the theory of the matured economy to stagnation may be best understood in connection with the theories of the late Lord Keynes.


George Terborgh, The Bogey of Economic Maturity.
During the years 1935 to 1945 the fear of stagnation was minimized because of the Chinese, Spanish, and Second World War; however, with the coming of peace in 1946 the threat of depression and stagnation are once more with us; therefore, it is once more time to examine the theory of stagnation.

Many governmental economists today feel that there is no need for further worry about depression; however, with the postulates of Classical Economics as a basis for prosperity, the soundness of their optimism is questionable.

The optimism of the present economic thinking may be shown in the following quotation:

... The feature of the present age which will cause historians to regard it as great is its unprecedented efforts to translate ideals about the good life into reality—to give men the opportunity to live the good life here and to bring this opportunity and security to all members of the community ... 3

... A year ago I reported to this congress that the state of the Union was good. I am happy to be able to report to you today that the state of the Union continues to be good. Our Republic continues to increase in enjoyment of freedom within its borders, and to offer strength and encouragement to all those who love freedom throughout the world ...

... Today, by the grace of God, we stand a free and prosperous nation with greater possibilities for the future than any people ever had before ... 4

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And yet, in spite of this most optimistic message 'in this best of all possible worlds,' within less than three months this report on unemployment has been handed to President Truman.

The Council of Economic Advisers has just presented a three-page analysis of the country's economic problems to the President. Here is what President Truman's advisers told him:

1. The major problem facing the country today is unemployment.

A. During January, unemployment set a record postwar high with 4,500,000 out of work—almost 1,000,000 higher than the previous month. Unemployment is now 7 per cent of the total labor force as against only a little over 4 per cent a year ago.

B. The increase of 1,000,000 in the ranks of the unemployed in a thirty-day period is considerably more than would normally occur at this time of year . . .

... The basic problem is one of expanding the United States economy fast enough to absorb the ever-increasing number of people available to work. During 1949, for example, the labor force increased by 1,300,000. Today's high level of unemployment is due to the failure of the economy to grow sufficiently during 1949.5

It would seem to be of the utmost importance to explore the question of capitalistic stagnation to its very foundation in order to discover whether or not there is any way to stave off this impending disaster that lurks in the background of all economic thought.

The method of procedure in this study will be an examination of the writings of the foremost exponents of the various schools of economic thought.

Chapter two will be devoted to an inquiry into the views of the Classical School and will begin with Thomas R. Malthus because "the element of disharmony which he introduced into the economy of competition of individuals, was one factor which paved the way for Marx's use of Ricardian Doctrine in his Theory of the Evolution of Capitalistic Society." Chapter three will be an inquiry into the stagnation theory of Marx and his successors. Chapter four will be an inquiry into the stagnation theory of the late Lord Keynes. Chapter five will be an inquiry into the stagnation theory of the Institutional economists. Chapter six will contain a critique of the theories of stagnation.

Encyclopaedia of the Social Sciences, X, 69.
CHAPTER II

CLASSICAL ECONOMICS AND STAGNATION THEORY

The theory of stagnation to be found in the writings of the Classical Economists is, to a large extent, based on Malthus' argument in An Essay on the Principles of Population; therefore, it will be necessary to examine these principles before proceeding to our study of the stagnation theories of David Ricardo and John Stuart Mill.

The Malthusian theory of population states that the means of subsistence limits the population of the earth and that the food supply increases in an arithmetical ratio, while the population increases in a geometrical ratio.\(^1\)

The theory of population mentioned in the above paragraph was modified by Malthus in the second and subsequent editions, but economists have failed to take note of this change in their economic writings.\(^2\)

\(^1\) Thomas R. Malthus, An Essay on the Principles of Population, Everyman Edition, Vol. I, pp. 8-10. "...The human species would increase as the number 1, 2, 4, 8, 16, 32, 64, 128, 256, and subsistence as 1, 2, 3, 4, 5, 6, 7, 8, 9..."

\(^2\) The problems posed for the economists by the modifications in Malthus' principles of population will be discussed in Chapter VI.
Malthus was of the opinion that if his concepts of the growth of population and the food supply were correct the following must be the result:

The necessary effects of these two different ratios of increase, when brought together, will be very striking. Let us call the population of this island 11,000,000; and suppose the present produce equal to the support of such a number. In the first twenty-five years the population would be 22,000,000, and the food being doubled, the means of subsistence would be equal to the increase. In the next twenty-five years, the population would be 44,000,000, and the means of subsistence only equal to the support of 33,000,000. In the next period the population would be 88,000,000, and the means of subsistence just equal to the support of one-half that number. And, at the conclusion of the first century, the population would be 176,000,000 and the means of subsistence only equal to the support of 55,000,000, leaving a population of 12,000,000 totally unprovided for. ³

Up to the time of the publication of Thomas R. Malthus' An Essay on the Principles of Population political economy had retained the optimistic and meliorative trend that Adam Smith had announced in The Wealth of Nations and the philosophers Godwin and Condorcet had developed in their works. Whereas Adam Smith and his followers considered, "every increase in the stock or revenue of society as an increase in the funds for the maintenance of labor," ⁴ Malthus rejected this line of reasoning and held "that the funds for the maintenance of labor do not necessarily

⁴ Ibid., 128-129.
increase with the increase of wealth, and very rarely increase in proportion to it."\textsuperscript{5}

The fascination that the Malthusian theory of population had for the political economists and the growing class of industrialists has never been shown more clearly than by E. A. J. Johnson in his book \textit{Some Origins of the Modern Economic World}:

The Malthusian theory of population fell like mana from Heaven into the hands of English capitalists. Here was a convenient explanation of poverty and low wages, a body of social theory supported by an imposing parade of facts which proved the universality of a 'Natural' principle of population. Here then was a philosophical fount in which factory owners could wash their unclean hands. Low wages had their origin in the 'passions between the sexes,' which resulted in a natural tendency for population to outstrip the food supply. For these conditions surely the employer of labor could not be held responsible; in fact, he was rather a social benefactor who gave employment to a large number of those super-poor. The real culprits were the parents who, by failing to curb their reproductive propensities, had brought into existence these unfortunate children whom the factories employed.\textsuperscript{6}

The Malthusian doctrine, as we have stated before, laid the foundation for the Classical School's stagnation theory. The Classical Economists from David Ricardo to Alfred Marshall have held that production is limited by 'The Law of Supply and Demand,' and 'The Law of Diminishing Returns.' By examining the Malthusian theory of population

\textsuperscript{5}Ibid., p. 129.

carefully one may see the inception of 'The Law of Diminishing Returns.'

The first portion of this chapter was devoted to an examination of Malthus' *An Essay on the Principles of Population*. With our knowledge of the principles of population as an aid to the understanding of the Classical School's theory of stagnation, we will now proceed to an examination of the views of David Ricardo and John Stuart Mill.

**Ricardo's Stagnation Theory**

David Ricardo in his *Principles of Political Economy* and *Taxation* develops even further the stagnation theory that lies dormant in the work of Malthus and his predecessors.

We will trace Ricardo's stagnation theory from its beginning, in his theory of rent, through his examination of the tendency of profits to fall in manufacturing industries.

David Ricardo, in his theory of the differential fertility of land, accepts Malthus' formulation of 'The Law of Diminishing Returns' in his theory of rent. This

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7 John W. McConnell, *The Basic Teachings of the Great Economists*, p. 121. "The Law of Diminishing Returns" states that as additional amounts of capital or labor are added to production past an optimum point the profits to be gained will be less and less with each addition of capital or labor.
formulation of the differential fertility of land gives rise to one of Ricardo's arguments that the economy of a capitalistic society will end in stagnation. 3

Ricardo, having assumed the possibility of differential rents, then proceeds to show how the discrepancy of one rent over another will drive the profits of the farmer down.

In the first place, the price of corn would rise in proportion to the increased difficulty of growing it on land of a worse quality. It has already been remarked, that if the labor of ten men will, on land of a certain quality, obtain 130 quarters of wheat, and its value be 4 pounds per quarter or 720 pounds; and if the labor of ten additional men will, on the same land or any other land produce only 170 quarters the labor of ten men is necessary in one case, and only that of 9.44 in the other, the rise will be as 9.44 to 10, or as 4 pounds to 4 pounds 4 s. 8d. In the same manner it might be shown that, if the labor

3 John W. McConnell, op. cit., pp. 55-56. "Rent is that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil. There is no rent when land of nearly equal fertility is present in sufficient abundance to supply human demands. When an increase in population causes land of inferior quality and less advantageous situation to be called into cultivation, then rent is paid. Assuming the presence of land of three degrees of quality, let us suppose an increase in population creates a demand for food, making it necessary to call into cultivation the land of the second quality. The greater costs of production, either in labor or transportation, will cause the price to rise. Obviously, the smaller costs of production on the first quality land in relation to the price paid for each unit of the product will yield a surplus to the first land over the second. This, says Ricardo, is rent. If further increase in population brings the land of the third quality into production, rent on both first and second quality land will rise. The price of natural products will be determined by the higher labor costs necessary to produce the additional quantities needed under the least favorable circumstances."
of ten additional men would only produce 160 quarters, the price would rise to 4 pounds 10 s.; if 150 to 4 pounds 16 s.

But when 180 quarters were produced on land paying no rent, and its price was 4 pounds, per quarter, it sold for . . . . . . . . . . . . . . . . . . . . . 720 pounds

And when 170 quarters were produced on land paying no rent, and the price rose to 4 pounds 4 s. 8 d., it still sold for . . . . . . . . . . . . . . . . . . . . . 720 pounds

And 160 quarters produced at 4 pounds 10 s. produced . . . . . . . . . . . . . . . . . . . . . 720 pounds
And 150 quarters produced at 4 pounds 16 s. produced . . . . . . . . . . . . . . . . . . . . . 720 pounds

Now it is evident that, if out of these equal values, the farmer is at one time obliged to pay wages regulated by the price of wheat at 4 pounds, and at others at higher prices, the rate of his profits will diminish in proportion to the rise of corn.9

Ricardo in the preceding quotation showed the manner in which the differential rents on land of several qualities tended to drive down profits. If the falling rate of the farmer's profits merely hurt him, it would not drive the economy into stagnation; however, "there are few commodities which are not more or less affected in their price by the rise of raw produce, because some raw material from the land enters into the composition of most commodities."10

The conclusions that Ricardo drew from 'The Law of Diminishing Returns' and his theory of the differential fertility of land are as follows:

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9 David Ricardo, Principles of Political Economy and Taxation, pp. 87-89.

10 Ibid., p. 90.
The natural tendency of profits, then is to fall; for, in the progress of society, and wealth, the additional quantity of food required is obtained by the sacrifice of more and more labor. This tendency, this gravitation as it were of profits, is happily checked at repeated intervals by the improvements in machinery connected with the production of necessities, as well as by the discoveries in the sciences, which enables us to relinquish a portion of labor before required, and therefore to lower the price of the prime necessities of the laborer. The rise in labor is, however, limited; for as soon as wages should be equal to 720 pounds, the whole receipts of the farmer, there must be an end to accumulation, for no capital can yield any profit whatever, and no additional labor can be demanded and consequently population will have reached its highest point.\textsuperscript{11}

Ricardo argued that without improved technology the capitalistic economy would end in stagnation because of the discrepancy in the different profits to be derived from lands of differing qualities; however, in later chapters of the \textit{Principles of Political Economy} he denies that increased technology will prevent the stationary state except for a very short time. Adam Smith says:

\begin{quote}
\ldots The same causes that raise labor do not raise the value of machines, and therefore, with every augmentation of capital a greater proportion of it is employed on machinery. The demand for labor will continue to increase with an increase of capital, but not in proportion to its increase; the ratio will necessarily be a diminishing ratio \ldots \\
\ldots The demand for labor depends on the increase of circulating and not of fixed capital.\textsuperscript{12}
\end{quote}

\textsuperscript{11}Ibid., pp. 96-99.

\textsuperscript{12}Adam Smith, \textit{The Wealth of Nations}, Everyman Edition, I, 244-248. In Classical Economics, fixed capital is capital in machinery and other types of equipment; circulating capital is the capital used to pay labor or in the normal processes of business.
Were it true that the proportion between these two sorts of capital is the same at all times, and in all countries, then indeed, it follows that the number of laborers employed is in proportion to the wealth of the state. But such a proposition has not the semblance of probability. As arts are cultivated, and civilization is extended, fixed capital bears a larger and larger proportion to circulating capital. The amount of fixed capital employed in the production of a piece of British muslin is at least a hundred times, probably a thousand times greater than that employed in the production of a similar piece of Indian muslin. And the proportion of circulating capital is a thousand times less. It is easy to conceive that under certain circumstances, the whole of the annual savings of an industrious people might be added to fixed capital, in which case they would have no effect in increasing the demand for labor.13

Ricardo's arguments concerning the downward trend of profits grew out of his theory of differential rents; however, he at first held that increased technology might make up the difference in profits caused by the different types of land. In the preceding quotation, however, we have shown that Ricardo later was of the opinion that the discrepancy between fixed and circulating capital would drive the economy into stagnation even though improvements were made in the state of the industrial arts.

Ricardo through his acceptance of the Malthusian law of population and the differential theory of rent, and his theory of the downward trend of profits due to the discrepancy between fixed and circulating capital, painted a most

13Ricardo, op. cit., pp. 335-337.
pessimistic picture of the future of capitalistic society; as Roll says in his *History of Economic Thought*:

It has been the fashion in recent years to regard Ricardo's work as the most distinct exposition of the beliefs contained in the classical theory that the economic system automatically achieved full employment and market equilibrium through time, and that fluctuations of economic activity or protracted stagnation were impossible. Closer examination reveals, however, that Ricardo's analysis, because it penetrated to greater depths than did that of his contemporaries, was by far the least polished statement of these classical beliefs. It left open many problems to which subsequent theories of crises and under-employment could be attached. Many theories of technological unemployment or of disproportions in the structure of production can be traced back to the views enunciated by Ricardo. And the Marxian theory of crises, too, has a close connection with Ricardo's theory of economic development. 14

Chapter three will contain an examination of the Marxian theory of crises; however, for the present, we will examine the stagnation theory of John Stuart Mill.

**John Stuart Mill's Theory of Stagnation**

The remainder of this chapter will be devoted to an examination of the works of John Stuart Mill in an endeavor to discover his views on the stationary state.

Mill's theory of stagnation grows out of the Malthusian theory of population growth, and the loss of

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savings which drives the economy into stagnation.\textsuperscript{15}

\ldots The capacity of increase is necessarily in a geometrical ratio; the numerical ratio is different.

To this property of organized beings, the human species forms no exception. Its power of increase is indefinite, and the actual multiplication would be extraordinarily rapid, if the power were exercised to the utmost. It is never exercised to the utmost and yet, in the most favorable circumstances known to exist, which are those of a fertile region colonized from an industrious and civilized community, population has continued, for several generations, independently of fresh immigration, to double itself in not much more than twenty-five years.\ldots \textsuperscript{16}

The Malthusian law of population growth was one of the basic reasons that Mill gave for his belief in the stationary state; however, he also believed that 'The Law of Diminishing Returns' would lead to the stagnation of the economy.

\ldots Though the general thriftiness of the laboring class is much below what is desirable, the spirit of accumulation in the most prosperous part of the community requires abatement rather than an increase. In these countries there would never be any difficulty of capital, if its increase were never checked or brought to a stand by too great diminution of its returns. It is the tendency of the returns to a progressive diminution, which causes the increase of production to be often attended with a deterioration in the conditions of the producers; and this tendency, which would

\textsuperscript{15}John W. McConnell, \textit{The Basic Teachings of the Great Economists}, pp. 150-160. The Classical Economists believed that all funds for investment must come from the savings of the community; they were not familiar with the present-day practice of banks' creating money through loans.

in time put an end to increase of production altogether; is a result of the necessary and inherent condition of the production from the land.\(^{17}\)

Mill's belief in the 'Law of Diminishing Returns' lead him to be pessimistic about the future of a capitalistic society even though there was an abundance of capital and technical knowledge.

When a country has long possessed a large production, and a large net income to make savings from and when, therefore, the means have long existed of making a great annual addition to capital; it is one of the characteristics of such a country, that the rate of profit is habitually within, as it were, a hand's breadth of the minimum, and the country therefore on the very verge of the stationary state.\(^{18}\)

The only way to stave off stagnation, according to Mill, would be to cut the wages of the laborer or to force into the labor market those persons not engaged in productive labor.\(^{19}\)

Mill's suggestions for the prevention of the stationary state, however, were not even seriously believed by himself or his followers.

On the whole, therefore, we may assume that in such a country as England, if the present amount of savings were to continue, without any of the countervailing circumstances which now keep in check the natural influence of those savings in reducing the profits, the rate of profit would speedily attain

\(^{17}\)Mill, op. cit., pp. 187-188.

\(^{18}\)Ibid., p. 446.

\(^{19}\)Ibid.
the minimum, and all further accumulation of capital would for the present cease. 

Mill's view of the tendency for profits to fall and for capitalistic society to end in a state of stagnation led him to make the following observation:

If the choice were to be made between Communism with all its chances, and the present state of society with all its sufferings and injustices; if the institution of private property necessarily carried with it as a consequence, that the produce of labor should be apportioned as we now see it, almost in an inverse ratio to the labor . . . if this or Communism were the alternative, all the difficulties, great or small, of Communism would be but as dust in the balance.

Adam Smith in 1776 published The Wealth of Nations and launched the optimistic spirit of capitalism, but, within less than a hundred years we find the following statement as voiced by one of the followers of Adam Smith:

This impossibility of ultimately avoiding the stationary state—this irresistible necessity that the stream of human industry should finally spread itself out into an apparently stagnant sea—must have been, to the political economists of the last two generations, an unpleasing and discouraging prospect, for the tone and tendency of their specu-

lation goes completely to identify all that is economically desirable with the progressive state.

David Ricardo saw capitalistic society foredoomed to stagnation because of the differential rates of rent on

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lands of differing qualities and because of the discrepancy between fixed and circulating capital.

John Stuart Mill envisioned a stagnant capitalistic society because of the workings of 'The Law of Diminishing Returns,' the Malthusian theory of population, and the loss of investment funds for the improvement of the country.
CHAPTER III

MARXIAN ECONOMICS AND STAGNATION THEORY

Karl Marx and his followers saw the future of capitalism as an economy of stagnation, privation, and general misery.

Ricardo in his Principles of Political Economy and Taxation and John Stuart Mill in his Principles of Political Economy, as we have shown in chapter two, based their theory of stagnation on the Malthusian principles of population, 'The Law of Diminishing Returns,' and the tendency for profits to fall because of the discrepancy between fixed and circulating capital.

Marx, in Volume one of Capital, denied the validity of the Malthusian theory of population in a lengthy footnote, but the following quotation leaves this denial open to question:

"The production of a relative surplus-population, or the setting free of laborers, goes on therefore yet more rapidly than the technical revolution of the process of production that accompanies, and is accelerated by, the advances of accumulation; and more rapidly than the corresponding diminution of the variable part of capital as compared with the constant. If the means of production, as they increase in extent"

1Karl Marx, Capital, I, 675-677.
and effective power, become to a less extent means of employment of laborers, this state of things is again modified by the fact that in proportion as the productiveness of labor increases, capital increases its supply of labor more quickly than its demand for laborers. The overwork of the employed part of the working class swells the ranks of the reserve, whilst conversely the greater pressure that the latter by its competition exerts on the former, forces these to submit to overwork and to subjugation under the dictates of capital. The condemnation of one part of the working-class to enforced idleness by the overwork of the other part, and the converse becomes a means of enriching the individual capitalists, and accelerates at the same time the production of the industrial reserve army on a scale corresponding with the advance of social accumulation.\textsuperscript{2}

Therefore, although Marx held that "an abstract law of population exists for plants and animals only, and only insofar as man has not interfered with them,"\textsuperscript{3} he also taught that capitalistic society would be driven into stagnation by 'The Industrial Reserve Army of the Unemployed,' and by 'The Law of the Increasing Misery of the Proletariat.'

Marx's theory of capitalistic society's stagnation would seem to be based on a population theory as the following quotation will show:

But if a surplus laboring population is a necessary product of accumulation or of the development of wealth on a capitalist basis, this surplus production becomes, conversely, the lever of capitalistic accumulation, nay, a condition of existence of the capitalist mode of production. It forms a disposable industrial reserve army, that belongs to

\textsuperscript{2}Ibid., pp. 697-699.

\textsuperscript{3}Ibid., Vol. II, Chapter 25.
capital quite as absolutely as if the latter had bred it at its own cost. Independently of the limits of the actual increase of population, it creates, for the changing needs of the self-expansion of capital, a mass of human material always ready for exploitation. With accumulation, and the development of the productiveness of labor that accompanies it, the power of sudden expansion of capital grows also. The mass of social wealth, overflowing with the advance of accumulation, and transformable into additional capital, thrusts itself frantically into old branches of production, whose market suddenly expands, or into newly formed branches, such as railways, the need for which grows out of the development of the old ones. In all such cases, there must be the possibility of throwing great masses of men suddenly on the decisive points without withdrawing them from the other branches of production. Overpopulation supplies these masses.

The course characteristic of modern industry, viz., a decennial cycle (interrupted by smaller oscillations) of periods of average activity, production at high pressure, crisis and stagnation, depends on the constant formation, the greater or lesser absorption, and the reformation of the industrial reserve or surplus population.\(^4\)

Therefore, although Marx denied the validity of the Malthusian theory of population, his preconceptions laid in Classical Economics and his preconceptions of 'The Reserve Army of the Unemployed' and 'The Law of the Increasing Misery of the Proletariat' would seem to point to Marx's unconscious acceptance of the Malthusian theory of population.

\(^4\)Ibid.
Marx in his theory of surplus-value\(^5\) drove to its logical conclusion the theory of capitalistic exploitation of the working class to be found in the works of Ricardo and John Stuart Mill.


\(^{5}\)John W. McConnell, *The Basic Teachings of the Great Economists*, pp. 33-34. "Labor is paid on the basis of its physical reproduction and maintenance costs; but the laborer is required to work hours over and above the hours necessary to meet these costs. Thus every additional hour that he works above the point necessary to produce sufficient articles to supply the laborer's reproduction and maintenance costs (his wages), he is producing value which is appropriated by the employer. This value above his reproduction and maintenance costs is surplus-value."

\(^{6}\)Karl Marx, *Capital*, Vol. I, pp. 232-233. "... The value of that part of capital expended by the capitalist for procuring means of production--i.e., raw and auxiliary materials, and instruments of labor--is therefore not altered in the course of the process of production. We consequently call it constant capital.

"On the other hand, the value of that part of the capital expended on buying labor power is altered during the process of production. It reproduces its own value and yields a surplus-value over and above the latter; and this surplus-value can be greater or less as the case may be. This part of the capital is being continually transformed from a constant (unchangeable) magnitude into a variable (changeable) one. We therefore call it variable capital."
Marx makes the following differentiation between constant and variable capital:

Suppose a capitalist to employ a hundred workmen, at thirty pounds a year each, in a carpet factory. The variable capital annually laid out amounts, therefore, to 3,000 pounds. Suppose also that he discharges fifty of his workers, and employs the remaining fifty with machinery that costs him 1,500 pounds. To simplify the matter, we take no account of buildings, coal, etc. Further suppose that the raw material annually consumed costs 3,000 pounds, both before and after the change. Is any capital set free by this metamorphosis? Before the change, the total sum of 6,000 pounds consisted half of constant, and half of variable capital. After the change it consists of 4,500 constant (3,000 pounds raw material and 1,500 pounds machinery), and 1,500 variable capital. The variable capital, instead of being one half, is only one quarter of the total capital. Instead of being set free, a part of the capital is here locked up in such a way as to cease to be exchanged against labor-power; variable has been changed into constant capital. 7

This observation by Marx on the different compositions of constant and variable capital led him to his formulation of the famous Law of the Falling Tendency of the Rate of Profit. 8

7Ibid., pp. 473-479.
8Ibid., III, 253. "If you take any quantity of the average social capital, say a capital of one hundred, you will find that an ever larger portion of it is invested in means of production, and an ever smaller portion in living labor. Since, then, the aggregate mass of the living operating the means of production, it follows that the unpaid labor, and the portion of value in which it is expressed, must decline as compared to the value of the advanced total capital. Or, an even smaller aliquot part of the invested capital is converted into living labor, and this capital absorbs in proportion to its magnitude less and less surplus-labor, although the proportions of the unpaid part of the employed labor may simultaneously grow as compared with the paid part."
The Law of the Falling Tendency of the Rate of Profit, states that with each new addition of capital to the constant capital there will be a reduction in the amount of variable capital. The capitalist makes his profits from the exploitation of the laborer; therefore, if more capital is put into machinery, the capitalist receives less surplus-value because only labor produces surplus-value.

The Classical Economists had held that the use of machinery would not only aid the capitalist but would also improve the living-standard of the workmen; however, Marx denied this by his formulation of the Law of the Increasing Misery of the Proletariat.

The aim of machinery is to save labor. The same quantity of commodities—or a larger one—is produced by less labor. Living labor becomes more productive and more fertile. The alpha and omega of economic progress is the increase of productiveness.

But this means that the same number of workmen work up an ever increasing mass of raw material and utilize an ever increasing number of implements of labor. For instance, when the workmen, with the help of the machine, is able to produce ten times as much cotton yarn in the same time as he formerly did, he consumes also ten times as much cotton, to say nothing of the immense and costly machine, which is far more valuable than the simple tool formerly in use. In other words, every economic progress—but in by far the largest measure the progress due to machinery—increases the quality of constant capital consumed by a given number of laborers.

But at the same time such progress diminishes, as a necessary consequence, the percentage of profit, as is clearly illustrated by the following table:

If for 100V we take:

50C Total Capital of 150 of which 100S = 66 2/3%
1000C Total Capital of 200 of which 100S = 50%
2000C Total Capital of 300 of which 100S = 33 1/3%
3000C Total Capital of 400 of which 100S = 25%
4000C Total Capital of 500 of which 100S = 20%

Consequently, it is always the same quantity of surplus-value, which with every increase of the total capital, yields a smaller rate of profit. The result of technical progress—a result which manifests most clearly, with the introduction, and, with every subsequent improvement of machinery—is thus to gradually augment the constant capital in proportion to the variable capital, and therefore to reduce gradually the rate of profit. The same number of workmen and the same amount of labor power consumes a constantly increasing quantity of implements of labor, of machines, of raw and auxiliary materials, i.e., a constant capital of continuously increasing value...9

The falling rate of profit as represented above, will, according to Marx, lead capitalistic economies into stagnation because of the discrepancy between constant and variable capital, and because the capitalist draws surplus-value only from the laborer (variable capital). The increased use of machinery, therefore, leads to the fall in the rate of profits, and eventually to stagnation because of the loss of surplus-value upon which basis the capitalistic system rests.

"The Law of the Falling Tendency of the Rate of Profit," according to Marx, "does not argue in any way against the fact that an absolute mass of the employed and exploited

9Ibid., pp. 247-249.
labor set in motion by the social capital, and consequently the absolute mass of the surplus-labor appropriated by it, may grow."  

How does Marx explain this paradox of the falling tendency of the rate of profit, the increase of surplus-value, and the exploitation of labor?

Marx gives the following example of the growth of surplus-value with a corresponding decrease in the rate of profit:

Let us assume the existence of three different capitals having the following organic composition:

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<tbody>
<tr>
<td>I</td>
<td>30 C</td>
<td>plus</td>
<td>20 V</td>
</tr>
<tr>
<td>II</td>
<td>50 C</td>
<td>plus</td>
<td>50 V</td>
</tr>
<tr>
<td>III</td>
<td>20 C</td>
<td>plus</td>
<td>30 V</td>
</tr>
</tbody>
</table>

If we assume that the exploitation of labor-power is identical in all three branches, e. g., that in each case labor power furnishes exactly twice the amount of value which it receives in the shape of wages, we obtain the following results:

I gains twenty dollars surplus-value.
II gains fifty dollars surplus-value.
III gains eighty dollars surplus-value.

This means—seeing that profits, as percentages of the surplus-balance are calculated on the entire consumed capital—profits of twenty per cent, fifty per cent, and eighty per cent respectively. We must also bear in mind that the exploitation of the labor is not everywhere the same, but that it is greater in some undertakings and less in others. Further, there are other circumstances which enter into the determination of the amount of surplus-value in the various branches and even in individual undertakings—e. g., the rapidity of the turnover of capital, of

\[10\text{Ibid.}, \text{p. 253}.\]
which we shall speak later. It ensues that the amount of surplus-value really produced cannot be the same in two different undertakings much less in two different branches. How, in spite of this, is the equality of the rate of profit—which, as a matter of fact, exists—brought about?

Let us take five different branches of production, each having a different organic composition of the capitals invested therein (and on the assumption that labor in each case supplies one hundred per cent of its own value as surplus-value).

<table>
<thead>
<tr>
<th>Capital</th>
<th>Surplus Value</th>
<th>Value of Product</th>
<th>Rate of Profit</th>
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<tbody>
<tr>
<td>I</td>
<td>80C plus 20V</td>
<td>20</td>
<td>120</td>
</tr>
<tr>
<td>II</td>
<td>70C plus 30V</td>
<td>30</td>
<td>130</td>
</tr>
<tr>
<td>III</td>
<td>60C plus 40V</td>
<td>40</td>
<td>140</td>
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<tr>
<td>IV</td>
<td>85C plus 15V</td>
<td>15</td>
<td>115</td>
</tr>
<tr>
<td>V</td>
<td>95C plus 5V</td>
<td>5</td>
<td>105</td>
</tr>
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We have here very different rates of profit for different branches, the exploitation of labor remains the same in all cases. The total capital invested in the five branches is five hundred; the total amount of surplus-value produced by it is one hundred; the total value of the manufactured commodities is six hundred and ten. If we assume that the figure five hundred represents a single capital, merely divide into the categories one to five—if we assume this, we shall find that the average composition of the capital of five hundred is three hundred and ninety C plus one hundred and ten V, or calculated per hundred, seventy-eight C plus twenty-two V. If we regard each capital of one hundred as representing only one-fifty of the total capital; its composition would be this average one of seventy-eight C plus twenty-two V; in the same way an average surplus-value of twenty-two would be obtained by every fraction of one hundred. The average rate of profit would consequently be equal to twenty-two per cent, and, finally, the price of each fifty part of the total product would equal one hundred and twenty-two,
the product of each fifty part of the total capital advanced must therefore be sold for one hundred and twenty-two.11

It will be noted from the foregoing passage that the rate of profit refers to the profit of a given society; therefore, individual rates may differ according to the various amounts of exploitation. But if the average rate of profit of society tends to fall with the discrepancy between constant and variable capital, how may stagnation be prevented?

Marx in his theory of The Law of Concentration held that the larger industries would join together to gain more surplus-value from the worker and to jointly share the burden of the increasing amounts of constant capital.

Marx was also of the opinion that stagnation, brought about through the discrepancy between constant and variable capital, might be staved off for a time by the following methods: Cheapering the Elements of Constant Capital, Raising the Intensity of Exploitation, Depression of Wages Below Their Value, Relative Overpopulation, and Foreign Trade.12

The Marxian theory of capitalistic stagnation also arises from Marx's views on the distribution of commodities in a capitalistic society. Marx was of the opinion that in

11Ibid., pp. 132-134.
12Ibid., pp. 272-278.
pre-capitalistic society goods were exchanged in the following manner: Commodities—for Money—for Commodities; however, with the advent of capitalism, according to Marx, the structure of exchange changed to the pattern, Money—for Commodities—for Money. The outcome of this changed method of distributing the goods and wealth of society leads to stagnation because:

The capitalistic mode of production has a tendency to develop the productive forces absolutely, regardless of value and of the surplus-value contained in it and regardless of the social conditions under which capitalistic production takes place; while on the other hand for its aims the preservation of the value of the existing capital and its self-expansion to the highest limits. Its specific character is directed at the existing value of capital as a means of increasing this value to the utmost. The method by which it aims to accomplish this comprises a fall of the rate of profit; a depreciation of the existing capital, and a development of the productive forces of labor at the expense of the already created productive force.

The periodic depreciation of the existing capital, which is one of the imminent means of capitalistic production by which the fall in the rate of profits is checked and the accumulation of capital-value through the formation of new capital promoted disturbs the existing conditions, within which the process of circulation and reproduction of capital takes place, and is therefore accompanied by sudden stagnation and crises in the process of production.

The relative decrease of variable capital as compared to the constant, which goes hand in hand with the development of the productive forces, gives an impulse to the growth of the laboring population, while it continually creates an artificial over-population. The accumulation of capital, so far as its value is concerned, is checked by the falling

\[13\text{Ibid.}, \text{I}, 163-173.\]
rate of profits, in order to hasten still more the accumulation of its surplus-value, and this in turn, adds new speed to the accumulation of its value.\textsuperscript{14}

The Law of the Falling Tendency of the Rate of Profit, therefore, shows the connection between the capitalistic system's method of distribution and the stagnation of society's resources.\textsuperscript{15}

Whereas, the pre-Marxian economists had predicted capitalistic stagnation and were pessimistic, with but few exceptions, Marx and his followers leave us with no doubt as to the future of capitalistic civilization.

The barriers of the capitalistic mode of production becomes apparent after our study:

1. The fact that the development of the productive powers of labor creates in the falling rate of profit a law which turns into an antagonism of this mode of production at a certain point and requires for its defeat a periodic crisis.

\textsuperscript{14}Ibid., III, 292-293.

\textsuperscript{15}Ibid., p. 567. "So long as the process of reproduction is in flow, and the reflux assured, this credit lasts and extends, and its extension is based on the extension of the process of reproduction itself.

"As soon as a stoppage takes place, in consequence of delayed returns, overstocked markets, falling prices, there is a superfluity of industrial capital, but it is in a form, in which it cannot perform its function. It is a mass of commodity capital, but it is unsalable. It is a mass of fixed capital, but largely unemployed through the clogging of reproduction. Credit is contracted, because this capital is unemployed, that is, stops in one phase of its reproduction, not being able to complete its metamorphosis; because confidence in the continuity of the process of reproduction has been shaken; because the demand for this commercial credit decreases. The spinner, who restricts his production and has a mass of unsold yarn in stock does not need to buy any commodities on credit, because he has more than enough of them."
2. The fact that the expansion or contraction of production is determined by the appropriation of unpaid labor, and by the proportion of the unpaid labor to the materialized labor in general, or to speak the language of the capitalist, is determined by profits and by the proportion of this profit to the employed capital, by a definite rate of profit, instead of being determined by the relation of production to social wants, to the wants of socially developed human beings. The capitalistic mode of production, for this reason, meets with barriers at a certain scale of production which would be inadequate under different conditions. It comes to a standstill at a point determined by the production and realization of profit, not by the satisfaction of social needs.\(^\text{16}\)

Marx, in answer to his proposed remedies for staving off stagnation made this reply: "... capitalistic production is continually engaged in the attempt to overcome these imminent barriers, but it overcomes them only by means which again place the same barriers in the way in a more formidable size."\(^\text{17}\)

The capitalistic system would come to a close, Marx thought, when the Reserve Army of the Unemployed forced by the Law of the Increasing Misery of the Proletariat arose and revolted against their oppressors, and established over themselves the Dictatorship of the Proletariat until the masses were sufficiently trained to no longer need any form of government whatsoever. Short of this revolution

\(^{16}\)Ibid., p. 303.

\(^{17}\)Ibid., p. 293.
Marx saw no satisfactory answer to the dilemma posed by the Laws of Capitalistic Production.

The Classical Economists and Marx are both agreed that a capitalistic society can only end in stagnation. Therefore, in our next chapter we will examine the economic thinking of the late Lord Keynes.
CHAPTER IV

KEYNESIAN ECONOMICS AND STAGNATION THEORY

The Classical Economists and the Marxian Economists that we have discussed in the previous chapters saw the future of capitalistic civilization as one of stagnation. John Stuart Mill and his followers were of the opinion that this state of stagnation would be a very highly advanced civilization;\footnote{John Stuart Mill, Principles of Economics, pp. 746-751.} however, Marx and his followers considered this state of capitalistic stagnation merely as a phase of the dialectical movement leading to a classless society.

The late Lord John Maynard Keynes in his book The General Theory of Employment, Interest, and Money, tried to discover a method by which capitalistic society might be saved from unemployment, depression, and eventual stagnation.

The stagnation thesis of capitalistic society contained in the philosophical preconceptions of Classical Economics were observed by David Ricardo, John Stuart Mill, and Karl Marx. The Keynesian economists of the present, however, do not seem to be aware of the fact that this
stagnation thesis is also inherent in their economic doctrines and beliefs.

It is our intention in this chapter to examine *The General Theory of Employment, Interest, and Money* and to point out certain postulates of the Keynesian system that will lead logically to capitalistic society's stagnation.

The theory of stagnation that arises from the doctrines of the Keynesian system may be viewed from two vantage points:

1. The Marginal Efficiency of Capital\(^2\) and The Rate of Interest.\(^3\)

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\(^2\)John Maynard Keynes, *The General Theory of Employment, Interest, and Money*, pp. 135-136. "I define the marginal efficiency of capital as being equal to the rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-assets during its life just equal to its supply price. This gives us the marginal efficiencies of particular types of capital-assets. The greatest of these marginal efficiencies can then be regarded as the marginal efficiency of capital in general."

\(^3\)Ibid., p. 167. "The rate of interest, is in itself nothing more than the inverse proportion between a sum of money and what can be obtained for parting with control over the money in exchange for a debt for a stated period of time."
2. The Liquidity Function and The Propensity to Consume.

The Keynesian system of economics emerged as an attempt to solve the problems facing capitalistic society in the days of the Great Depression of 1929-1939.

Keynes believed that full employment might be secured by widening the gap between the Marginal Efficiency of Capital and the Rate of Interest.

... It is to our best advantage to reduce the rate of interest to that point relatively to the schedule of the marginal efficiency of capital at which there is full employment.

There can be no doubt that this criterion will lead to a much lower rate of interest than has ruled hitherto; and, so far as one can guess at the schedule of the marginal efficiency of capital corresponding to increasing amounts of capital, the rate of interest is likely to fall steadily, if it should be practicable to maintain conditions of more or less continuous full employment unless, indeed, there is an excessive change in the aggregate propensity to consume (including the State).

I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to point where its marginal efficiency has fallen to a very low figure. This would not mean that the

4Ibid., p. 168. "Liquidity-preference is a potentiality or functional tendency, which fixes the quantity of money which the public will hold when the rate of interest is given so that if r is the rate of interest, M the quantity of money and L the function of liquidity preference, we have M = L (r)."

5Ibid., p. 90. "We shall define the propensity to consume as the functional relationship X between Yw as a given level of income in terms of wage-units, and Cw the expenditure on consumption out of that level of income so that: Cw = X(Yw) or C = W. X(Yw)."
use of capital instruments would cost almost nothing, but only that the return from them would have to cover little more than their exhaustion by wastage and obsolescence together with some margin to cover risk and the exercise of skill and judgment. In short, the aggregate return from durable goods in the course of their life would, as in the case of short-lived goods, just cover their labor-costs of production plus an allowance for risk and the cost of skill and supervision.

Now although this state of affairs would be quite compatible with some measure of individualism, yet it would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital. Interest today rewards no genuine sacrifice, any more than does the rent of land. The owner of capital can obtain interest because capital is scarce, just as the owner of land can obtain rent because land is scarce.6

Keynes, as it is evident from the above quotation, held that interest was a reward for not hoarding, whereas the Classical Economists taught that interest was a reward for saving.7

The preceding quotation does not show all of the reasoning behind Keynes' belief that full employment might be stimulated by a lowering of the rate of interest; however, the following quotation may do much to clear up this difficulty:

... If there is some tendency to a measure of long-run uniformity in the state of liquidity-preference, there may well be some sort of rough

6Ibid., pp. 375-376.

relationship between the national income and the quantity of money required to satisfy liquidity-preference, taken as a mean over periods of pessimism and optimism together. There may be, for example, some fairly stable proportion of the national income more than which people will not readily keep in the shape of idle balances for long periods together, provided the rate of interest exceeds a certain psychological minimum; so that if the quantity of money beyond what is required in the active circulation is in excess of this proportion of the national income, there will be a tendency sooner or later for the rate of interest to fall to the neighbourhood of this minimum. The falling rate of interest will then, ceteris paribus, increase effective demand, and the increasing effective demand will reach one or more of the semi-critical points at which the wage-unit will tend to show a discontinuous rise, with a corresponding effect on prices.\(^8\)

The gap that can be made to exist between the Rate of Interest and the Marginal Efficiency of Capital, according to Keynes, may be manipulated by the Government so as to provide full employment and a high propensity to consume, thus solving the problem of secular stagnation.

Now in connection with the stagnation thesis of the matured economy with which we are dealing in this paper, the following question arises: granted that by a constant lowering of the Rate of Interest to zero a gap is created between the Rate of Interest and the Marginal Efficiency of Capital which will for a time stimulate investments and consequently full employment, will not the secular trend of such a program lead to a reduction of the Marginal

\(^8\)Keynes, op. cit., pp. 306-307.
Efficiency of Capital to zero? If this be the result of the lowering of the Rate of Interest to zero, has the problem of secular stagnation been removed or merely postponed for a brief time?

Keynes expressed his doubts as to the efficacy of this remedy for stagnation and unemployment in these words, "Thus even if the rate of interest is zero, there is a strict limit to the proportion of prospective consumers' demand which it is profitable to begin providing for in advance . . ."  

Keynes' The General Theory of Employment, Interest, and Money has often been used as an argument for Governmental deficit financing as an answer to secular stagnation.  

The question arises with regard to pump-priming or deficit financing; where is the government to procure the necessary funds for pump-priming?

9 Ibid., p. 217.

10 Ibid., p. 164. "... I am now somewhat skeptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directing and organizing investments; since it seems likely that the fluctuations in the market estimations of the marginal efficiency of different types of capital, calculated on the principles I have described above, will be too great to be offset by any practicable change in the rate of interest."
Is the government to gain sufficient funds for deficit financing through the borrowing of money? This method of collecting funds may restore a certain level of employment, and postpone for a very brief time stagnation; however, when the time comes that this money, interest and principle must be repaid will it not affect the whole economy adversely? Will it not set the Keynesian 'multiplier' in reverse, and will not this reversal not only destroy any advantages but much more along with it?

One of Keynes' followers might answer this argument by saying, 'The Government would not have to borrow these necessary funds for investment. The Government might nationalize the banking system and create the necessary funds in its hour of need.' The Keynesian economist might point out that Lord Keynes was aware of the fact that banks and government can and do create money using the following quotation as a basis for his reasoning:

The notion that the creation of credit by the banking system allows investments to take place to which 'no genuine savings' corresponds can only be the result of isolating one of the consequences of the increased bank-credit to the exclusion of the other.11

However, we may also cite The General Theory of Employment, Interest, and Money to prove that Lord Keynes did not realize that banks and governments can create money.

11Ibid., p. 82.
For example, "Money, cannot be readily produced; labor cannot be turned on at will by entrepreneurs to produce money in increasing quantities. The supply of money is fixed."\(^\text{12}\)

Therefore, with the foregoing confusion as to the monetary supply we would be loath to put out faith in this method of preventing or even postponing the stationary state.

In the preceding portion of this chapter we have discussed the theory of stagnation that would seem to be inherent in Keynes' theory of monetary manipulation. In the remainder of this chapter we will devote our attention to the discrepancy between the Propensity to Consume\(^\text{13}\) and the Propensity to Save\(^\text{14}\) and their relation to the theory of secular stagnation that grows out of *The General Theory of Employment, Interest, and Money*.

Keynes lists the following objective factors as influencing the Propensity to Consume:

1. A change in the Wage Units.
2. A change in the difference between income and net income.

\(^{12}\text{Ibid.}, p. 230.}\)

\(^{13}\text{Ibid.}, p. 90. \text{"We shall define what we shall call the Propensity to Consume as the functional relationship } X \text{ between } Yw \text{ a given level of income in terms of wage-units, and } Cw \text{ the expenditure on consumption out of that level of income.}\}

\(^{14}\text{Ibid.}, p. 62. \text{"Saving is the excess of income over consumption."}\)
3. Windfall changes in capital-values not allowed for in calculating net income.
5. Changes in Fiscal Policy.
6. Changes in expectations of the relation between the present and the future level of income.  

Keynes, considering the factors that influence the Propensity to Consume, concluded that, "in a given situation the propensity to consume may be considered a fairly stable function, provided that we have eliminated changes in the wage-unit in terms of money."  

The Propensity to Consume is one of the factors that contributes to employment and to the full utilization of economic resources; therefore, if the Propensity to Consume be stable or tends to fall there will be a tendency for the economy to have less than full employment and eventually to stagnate.  

Keynes concluded from his examination of the secular trend in The Propensity to Consume and The Propensity to Save that there has been a chronic tendency throughout human history for the propensity to save to be stronger than the inducement to invest. The weakness of the inducement to invest has been at all times the key to the economic problem. Today the explanation of the weakness of this inducement may chiefly lie in the extent of existing accumulations; whereas, formerly, risks and hazards of all kinds may have played a larger part. But the result is the same. The desire of the individual to augment his personal wealth by abstaining from

\[15\text{Ibid.}, \text{ pp. 91-95.}\]
\[16\text{Ibid.}, \text{ p. 95.}\]
consumption has usually been stronger than the inducement to the entrepreneur to augment the national wealth by employing labor on the construction of durable assets.\textsuperscript{17}

If the Propensity to Consume and the Propensity to Save are factors in full-employment and the development of the economic system and there is a tendency for saving to exceed consumption, what has prevented the stagnation of capitalistic society?

Keynes answered this question in the following manner:

\[ \ldots \text{the frequency of war over the average of} (\text{say}) \text{each decade seems to have been sufficient, taken in conjunction with the propensity to consume, to establish a schedule of the marginal efficiency of capital which allowed a reasonably satisfactory average level of employment to be compatible with a rate of interest high enough to be psychologically acceptable to wealth-owners.}\textsuperscript{18} \]

Keynes again stated that because of the discrepancy between the Propensity to Consume and the Propensity to Save he doubted if, "except during the war (World War I) we have had any recent experiences of a boom so strong that it led to full employment."\textsuperscript{19}

The readers will please note that these interesting observations on the nature of capitalistic society were not voiced by a Marxist, but on the contrary by Lord John Maynard Keynes who was trying to solve the problems of a depressed capitalistic society.

\textsuperscript{17}Ibid., pp. 347-348. \hspace{1cm} \textsuperscript{18}Ibid., p. 307.
\textsuperscript{19}Ibid., p. 322.
In our study, thus far, of the Keynesian system of economics we have pointed out the discrepancy between the Propensity to Consume and the Propensity to Save that will tend to drive capitalistic society into stagnation. We have also examined the Keynesian doctrines of the Marginal Efficiency of Capital and the Rate of Interest and noted even though banker or governmental manipulation of the Rate of Interest might postpone stagnation for a time the Marginal Efficiency of Capital tends to fall to zero, and this in turn will lead capitalistic society into stagnation.

In the early days of the 'Keynesian Revolution' the economists of Harvard University and several other schools used the General Theory of Employment, Interest, and Money as a basis for their theories of 'The Matured Economy.'

What is the theory of The Matured Economy, what are the postulates of The Matured Economy? The basic postulates of the Theory of the Matured Economy are as follows:

1. The declining rate of population. The decline in the birth rate according to the followers of the Theory of the Matured Economy means that the entrepreneur cannot find enough places in which to invest his money profitably; therefore, the economy becomes stagnant and unemployment increases.
2. The disappearance of the frontiers, with the consequential loss of investment opportunities.\textsuperscript{20}

3. The lack of new industries that will create jobs and investment opportunities that were created in the last century by the railroads and by the automotive industry in the earlier portions of this century.

The followers of the Theory of the Matured Economy were high in governmental circles in the early days of the Great Depression and tried to assist President Roosevelt in solving the economic ills of the country with their pet remedies.\textsuperscript{21}

In this chapter we have shown that John Maynard Keynes, his system of economics, and the postulates of his economics as set forth in the Theory of the Matured Economy not only will not solve the problems of capitalistic stagnation, but that his line of reasoning will cause capitalistic society to stagnate in the same manner as the economic systems of his predecessors in the Classical and Marxian schools of Economic Thought.

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\textsuperscript{20} The effects of the frontier on American civilization were first studied by Frederick Jackson Turner in \textit{The Frontier in American History}.

\textsuperscript{21} See Alvin H. Hansen's testimony before the Temporary National Economic Committee for his views on the matured economy, \textit{Temporary National Economic Committee, part 9, Savings and Investment}. See also Hansen's \textit{Full Recovery or Stagnation}.
CHAPTER V

INSTITUTIONAL ECONOMICS AND

STAGNATION THEORY

The previous chapters of this study have been devoted
to an examination of the Classical, Marxian, and Keynesian
views of capitalistic stagnation. Our attention in this
chapter will be turned to an examination of the doctrines
and teachings of Institutional Economics with reference to
their theory of the stagnation of capitalistic society.

The term 'institutional economics' loosely includes
the teachings of the following economists: Richard T. Ely,
Simon Nelson Patten, Thorstein Veblen, John R. Commons,
Wesley C. Mitchell, John W. Clark, Rexford Guy Tugwell,
Gardiner C. Means, and other American economists with a
similar approach to economic studies.¹

Institutional economics has many followers; however,
for our purpose we will limit our examination of

¹Allan G. Gruchy, Modern Economic Thought, p. vii.
Institutional Economics to the writings of Thorstein Veblen\(^2\) and C. E. Ayres.

Before proceeding to our examination of Veblen's theory of the stagnation of capitalistic society it will be necessary to examine some of the preconceptions of Institutional Economics.

The economic thought of the Classical and Keynesian economist is founded in Classical philosophy with its doctrines of 'Natural and Immutable Laws,' and the Malthusian theory of population. The Marxian economist's thought is founded in the Malthusian theory of population, and in the Idealistic philosophy of Hegel.

\(^2\)Ibid., pp. vii-viii. "In the first three decades of the current century the American movement to revamp economic science came to be known as 'Institutionalism,' while the work of the economists concerned with this movement was described as 'institutional economics.' In the closing years of Veblen's career there appeared other American economists who were also greatly interested in the reconstruction of economics. Although their work has much in common with Veblen's economics, the younger exponents of economic heterodoxy do not describe their thought as 'institutional economics.' Such terms as 'social,' 'experimental,' and 'collective' have been substituted for 'institutionalism' in descriptions of the new economics. Since 1929, the year in which Veblen died, it has increasingly become the custom to use the term 'institutional' to refer to Veblen's special accomplishments rather than to describe the efforts of post-Veblenian economists to carry on the work of reconstructing economics. It is not proposed in this study that any attempt should be made to alter the use of the term 'institutional' which is now well established in this country and abroad. The writer is of the opinion that no useful purpose would be served in running counter to the usage which keeps the term 'institutional' intimately associated with the name and work of Thorstein Veblen."
Institutional economic thought is based on the same preconceptions that underlie the 'Instrumentalism' of John Dewey and the 'Pragmatism' of William James. In other words, Institutional Economics, Pragmatism, and Instrumental Logic are all based on the doctrines of "the Metaphysical Club, founded by Charles S. Pierce in the sixties and attended by William James, John Fiske, the younger Holmes, Chauncey Wright, and a few other Cambridge intellectuals."3

Veblen's theory of stagnation, as we shall show later in this chapter, is based on a dichotomy of technology and institutions. The dichotomy in Veblen's thinking arises from his early training in Hegelian philosophy4 and from

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3 Richard Hofstadter, Social Darwinism in American Thought, 1860-1915, pp. 105-106. "Wright was probably the first American thinker to publish a thoroughgoing critique of Spencer from a naturalistic point of view. Steeped in the writings of John Stuart Mill, Wright objected to the popular tendency to classify Spencer as a positivist. He condemned him as a second-rate metaphysician presuming to deal in ultimate truths, and charged him with a misleading devotion to useless abstractions. In this essay he declared: 'Nothing justifies the development of abstract principles but their utility in enlarging our concrete knowledge of nature. The ideas on which mathematical Mechanics and the Calculus are founded, the morphological ideas of Natural History, and the theories of Chemistry are such working ideas, --finders, not merely summaries of truth.'

As an alternative to the finality of Spencer's views of scientific knowledge, Wright believed in the probability of novelties of the universe, a conviction based upon a strict interpretation of the inductive character of scientific laws. It is possible for 'accidents' or novelties to arise which are not predictable from our knowledge of their antecedents -- for example, the evolution of self-consciousness, or the application of the voice to social communication."

4 Joseph Dorfman, Thorstein Veblen and His America, pp. 40-45.
the teachings of Charles S. Pierce. But, this dichotomous thinking in Veblen may also be seen in John Dewey's thinking—for technology substitute education and for the imbecile institutions substitute "the quest for certainty."

Veblen's theory of the stagnation of capitalistic society may be best observed from the vantage point of his analysis of The Machine Process and Business Enterprise. Veblen defines the Machine Process in the following manner:

In its bearing on modern life and modern business, the machine process means something more comprehensive and less external than a mere aggregate of mechanical appliances for the mediation of human labor. It means that, but it means something more than that. The civil engineer, the mechanical engineer, the navigator, the mining expert, the industrial chemist and the mineralogist, the electrician,—the work of all these fall within the line of the modern machine process, as well as the work of the inventor who devises the appliances of the process and that of the mechanician who puts the inventions into effect and oversees their working. The scope of the process is larger than the machine. In those branches of industry in which machine methods have been introduced, many agencies which are not to be classed as mechanical appliances, simply have been drawn into the process, and have become integral factors in it. Chemical properties of minerals, e.g., are counted on in the carrying out of metallurgical processes with much the same certainty and calculable effect as are the motions of those mechanical appliances by whose use the minerals are handled. The sequence of the process involves

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5Stanley Matthew Daugert, The Philosophy of Thorstein Veblen, pp. 16-25.

6John Dewey, The Quest for Certainty. One might ask modern educators, who follow the teachings of John Dewey, whether or not their educative programs will not also lead to stagnation because of their preconceptions?
both the one and the other, both the apparatus and the materials, in such intimate interaction that the process cannot be spoken of simply as an action of the apparatus upon the materials. It is not simply that the apparatus reshapes the materials; the materials reshape themselves by the help of the apparatus. Similarly in such other processes as the refining of petroleum, oil, or sugar; in the work of the industrial chemical laboratories; in the use of wind, water, or electricity.  

Veblen gives the following definition of Business Enterprise:

... The economic welfare of the community at large is best served by a facile and uninterrupted interplay of the various processes which make up the industrial system at large; but the pecuniary interests of the business men in whose hands lies the discretion in the matter are not necessarily best served by an unbroken maintenance of the industrial balance. Especially is this true as regards those greater business men whose interests are very extensive. The pecuniary operations of these latter are of large scope, and their fortunes commonly are not permanently bound up with the smooth working of a given sub-process in the industrial system. Their fortunes are rather related to the larger conjunctures of the industrial system as a whole, the interstitial adjustments, or to conjunctures affecting large ramifications of the system. Nor is it at all uniformly to their interest to enhance the smooth working of the industrial system at large in so far as they are related to it. Gain may come to them from a given disturbance of the system whether the disturbance makes for heightened facility or for widespread hardship, very much as a speculator in grain futures may be either a bull or a bear. To the business man who aims at a differential gain arising out of the interstitial adjustments or disturbances of the industrial system, it is not a material question whether his operations have an immediate furthering or hindering effect upon the system at large. The end is pecuniary gain.

7 Thorstein Veblen, The Theory of Business Enterprise, pp. 5-6.
the means is disturbance of the industrial system, except so far as the gain is sought by the old-fashioned method of permanent investment in some one industrial or commercial plant, a case which is for the present left on one side as not bearing on the point immediately in hand. 8

Before proceeding to our analysis of Veblen's theory of capitalistic stagnation it will be best to examine his analysis of the Business Cycle for any information and light it may throw upon his later analysis of capitalistic stagnation.

There have been and there continues to be at the present many explanations of the Business Cycle, among which are: An Act of God, Seasonal Variations in Agriculture, Sun Spots, Optimism and Pessimism in the Business World, The Loss of New Frontiers, and many others, but Veblen attributes the Business Cycle to the Use of Loan Credit. 9

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8Ibid., pp. 27-23.
9Ibid., pp. 190-192. "... An industrial crisis is a period of liquidation, cancelment of credit, high discount rates, falling prices and 'forced sales,' and shrinkage of values. It has a sequel, both severe and lasting, a shrinkage of capitalization throughout the field affected by it. It leaves the business men collectively poorer, in terms of money values; but the property which they hold between them may not be appreciably smaller in point of physical magnitude or of mechanical efficiency than it was before the liquidation set in. It commonly also involves an appreciable curtailment of industry, more severe than lasting; but the effects which a crisis has in industry proper are not commensurate with its consequences in business or with the importance attached to a crisis by the business community."
Whereas the Classical Economist attributes depressions to the hand of God, Veblen stated that depressions are of necessity tied to the mechanisms of a capitalistic society and that the immediate occasion of such a crisis, then, is that there arises a practical discrepancy between the earlier effective capitalization on which the collateral has been accepted by the creditors, and the subsequent effective capitalization of the same collateral shown by quotations and sales of the securities on the market.\(^\text{10}\)

In other words, Veblen was of the opinion that depressions are, "A malady of the affections. The discrepancy which discourages businessmen is a discrepancy between the nominal capitalization which they have set their hearts upon through habituation in the immediate past and that actual capitalizable value of their property which its current earning-capacity will warrant."\(^\text{11}\)

Veblen's analysis of depressions and crises further points out that depressions do not commonly involve an appreciable destruction of property or a large waste of the material articles of wealth. It leaves the community at large poorer in point of market value but not necessarily in terms of the material means of life. The shrinkage incident to a crisis is chiefly a pecuniary, not a material, shrinkage; it takes place primarily in the intangible items of wealth, secondarily in the intangible items of wealth, secondarily in the price ratings of the tangible items. Apart from such

\(^\text{10}\)Ibid., p. 193.

\(^\text{11}\)Ibid., p. 237.
rerating of wealth the most substantial immediate effects of a crisis is an extensive redistribution of the ownership of industrial equipment, as noted in speaking of the use of credit.\textsuperscript{12}

Veblen was of the opinion that crises and depressions do not destroy the material wealth of the community, but, only the income of the businessman.\textsuperscript{13}

The late Lord Keynes in his book \textit{The General Theory of Employment, Interest, and Money} made the following statement with reference to the business cycle and full employment: "I doubt that, except during the war (World War I), we have had any recent experience of a boom so strong that it led to full employment."\textsuperscript{14}

It is interesting to note the following remark made some thirty years before the appearance of Lord Keynes' book,

\begin{quote}
It might be a tenable generalization, though perhaps unnecessarily broad, to say that for a couple of decades past the normal condition of industrial
\end{quote}

\textsuperscript{12}Ibid., p. 192.

\textsuperscript{13}Ibid., p. 178. "Under the old order, industry, and even such trade as there was, was a quest of livelihood; under the new order industry is directed by the quest of profits. Formerly, therefore, times were good or bad according as the industrial processes yielded a sufficient or an insufficient output of the means of life. Laterly times are good or bad according as the processes of business yields an adequate or inadequate rate of profit. The controlling end is different in the present, and the question of welfare turns on the degree of success with which this different ulterior end is achieved. Prosperity now means, primarily, business prosperity; whereas it used to mean industrial sufficiency."

business has been a mild but chronic state of depression, and that any marked departure from commonplace dull times has attracted attention as a particular case calling for a particular explanation. 15

The following pages will briefly summarize Veblen's theory of the Business Cycle, and then we will proceed to our examination of Veblen's theory of stagnation.

The scope and method of modern industry are given by the machine. The machine process implies and enforces a sweeping standardisation of processes, goods, services, and consumers. Mankind, in order to get along with the machine process and reap the benefits of its efficiency, must adapt itself to its impersonal, standardised requirements. The machine process denotes a reasoned procedure as against the rule of thumb of the traditional scheme of control, where personal propensity is the dominant feature and where the industrial processes and material procedures must adapt themselves to the needs of the big businessman. Advance in industrial efficiency is due to the comprehensive, concatenated character of the entire process, and the economic welfare of the community is best served by a facile and uninterrupted inter-play of its various parts.

But the greater gains of the modern captain are made in disturbing the delicate interstitial adjustments between plants and processes. Great profits are achieved not from productive efficiency, but from shifts in the distribution of ownership in vendible capital or securities. The modern captain is interested not in the permanent efficiency of the industrial system or of any plant, but in the control of a segment of the system for the strategic purpose of influencing the security market for the flotation of securities, the manoeuvring of a coalition or any other well-known method of manipulation. The results of his manoeuvring and strategic activity is a chronic perturbation of industry, which has become the normal state of affairs. The modern captain does not create opportunities for increasing industrial efficiency, but only watches for opportunities to put his competitors in an uncomfortable position; cut-throat

15 Veblen, op. cit., p. 184.
competition, rate wars, duplication, misdirection, wasted efforts, and even delay of improvements long after they are advisable are the price the community pays. When the game between competing business interests is played to a finish, in a coalition of the competitors under single management, then it may proceed more obviously as a conflict between the monopoly and the community. By virtue of the delicate character of the industrial process as a whole, a small apparent disturbance by the captains has a cumulative effect throughout the system far in excess of the original disturbance and is typified by such phenomena as crises and depressions.\(^{16}\)

Having concluded our examination of Veblen's theory of the business cycle, we shall now resume our study of Veblen's theory of the stagnation of capitalistic society.

The Classical, Marxian, and Keynesian economists, as we have demonstrated in previous chapters, have very pessimistic views of the stationary state of capitalism; however, for a truly gloomy picture of capitalistic society one must turn his attention to the works of Veblen in which he discusses capitalistic stagnation.

Veblen's discussion of capitalistic stagnation takes two directions; one in the direction of a changed social situation and a more equitable utilization of resources that are derived from the machine process, and the other in the direction of a revision to barbarism, militarism, and patriotism.

Veblen takes two views of stagnation; in The Theory of Business Enterprise he has hopes for the future; however, \(^{16}\) Dorfman, op. cit., pp. 225-226.
in Absentee Ownership his view is entirely gloomy. In order to see these trends in Veblen's thinking it will be necessary to examine these books separately; therefore, we will examine The Theory of Business Enterprise with reference to stagnation first and then turn our attention to Absentee Ownership.

The Classical economists viewed stagnation as an end in itself, the Marxian economists conceived capitalistic stagnation as a phase of the dialectic leading to the overthrow of the system by the revolt of the proletariat, the Keynesian economists see stagnation being staved off by the Government's manipulation of the money markets and through a nationalization of basic industries, but Veblen sees stagnation leading either to a total discontinuation of capitalism or to a maintenance of the status quo through 'force and fraud.'

Veblen sees stagnation arising in a capitalistic society due to the Business Cycle and the perfection of competition, as well as from nationalism and the status system, "under the regime of a perfected machine industry and a perfect business organization, with active competition throughout, it is at least probable that depression would not be seriously interrupted by any other cause."17

17Veblen, op. cit., p. 245.
Veblen maintained that stagnation will be the result of a 'conscientious withdrawal of productive efficiency' in a machine civilization.

Depression and industrial stagnation follow only in case the pecuniary exigencies of the situation are of such a character as to affect the traffic of the business community in an inhibitory way. But business is the quest of profits, and an inhibition of this quest must touch the seat of its vital motives. Industrial depression and stagnation means that the business men engaged do not see their way to derive a satisfactory gain from letting the industrial process go forward on the lines and in the volume for which the material equipment of industry is designed. It is not worth their while, and it might even work them pecuniary harm. Commonly their apprehension of the discrepancy which forbids an aggressive pursuit of industrial business is expressed by the phrase 'overproduction.' An alternative phrase, intended to cover the same concept, but less frequently employed, is 'underconsumption.'

In this chapter we have pointed out that Veblen saw capitalistic society doomed to stagnation because of the following 'cultural lags': the business cycle, the conscientious withdrawal of productive efficiency, and from devotion to the imbecile institutions of government, church, national sentiments, and education.

Does Veblen see any way out of the impasse of capitalistic stagnation?

Veblen sees capitalistic stagnation prevented by either of these two methods: a more equitable distribution of the goods of society, or a reversion to militarism.

The largest and most promising fact of cultural discipline—most promising as a corrective of iconoclastic vagaries—over which business principles rule is national politics.

... Business interests urge an aggressive national policy and business men direct it. Such a policy is warlike as well as patriotic. The direct cultural value of a warlike business policy is unequivocal. It makes for a conservative animus on the part of the populace. During war time, and within the military organization at all times, under martial law, civil rights are in abeyance; and the more warfare and armament the more abeyance. Military training is a training in ceremonial precedence, arbitrary command, and unquestioning obedience. A military organization is essentially a servile organization. Insubordination is the deadly sin. The more consistent and the more comprehensive this military training, the more effectually will the members of the community be trained into the habits of subordination and away from the growing propensity to make light of personal authority that is the chief infirmity of democracy. This applies first and most decidedly, of course, to the soldiery, but it applies only in a lesser degree to the rest of the population. They learn to think in warlike terms of rank, authority, and subordination, and so grow progressively more patient of encroachments upon their civil rights.

... Warlike and patriotic preoccupations fortify the barbarian virtues of subordination and prescriptive authority. Habituation to a warlike, predatory scheme of life is the strongest disciplinary factor that can be brought to counteract the vulgarization of modern life wrought by peaceful industry and the machine process and to rehabilitate the decaying sense of status and differential dignity.

... In this direction, evidently, lies the hope of a corrective for 'social unrest' and similar disturbances of civilized life. There can, indeed, be no serious question but that a consistent return to the
ancient virtues of allegiance, piety, servility, graded dignity, class prerogative, and prescriptive authority would greatly conduce to popular content and to the facile management of affairs. Such is the promise held out by a strenuous national policy.  

Veblen was of the opinion that a reinstatement of 'the old virtues' of militarism and a strenuous national policy would prevent stagnation; however, even in this gloomy passage he takes heart and states:

... It is difficult to believe that the machine technology and the pursuit of the material sciences will be definitely superseded (sic), for the reason, among others, that any community which loses these elements of its culture thereby loses that brute material force that gives it strength against its rivals.  

The preceding passages that appeared in 1904 showed Veblen's doubts as to the lasting qualities of a capitalistic society that employed the machine process merely as an aid to increasing its income, but, in 1923, these were his sentiments:


21Ibid., p. 400.

22Veblen, Absentee Ownership, pp. 282-283. "In the civilised (sic) scheme of education and training for the young, solicitude converges on those elements of knowledge and belief that run outside the confines of the three dimensions of space. The foundations of knowledge and belief are laid in the miracles of the faith, and the magic of national allegiance. It is a matter of course to all right-minded citizens of all the Christian nations that a child must first learn to say his prayers and salute the flag. In the institutional scheme of the civilised (sic) nations the beginning of wisdom is the fear of God; whereas in the technology of physics and chemistry the beginning of wisdom is to forget Him. And some forget Him more, others less, but none altogether."
With every further move along the lines on which the industrial arts are advancing, therefore, sabotage—that is to say strategic unemployment at the instance of the owner-employer or of the workmen—becomes a swifter and more widely corrosive agency of miscarriage and decay.

At the same time, and in great part by help of these same technical appliances and powers, the business community is able, also in a progressive fashion to bring sound conservative business principles to bear on industry in a swifter and more comprehensive way and with a sligher margin of error. That is to say novelties will be disallowed with a freer hand and the tactical manoeuvres (sic) of unemployment will gain something in frequency and amplitude; measures to suppress or disable the organization (sic) of workmen and malcontents will take on added scope, assurance, vigor, and dispatch.23

Once more in Absentee Ownership Veblen states, “It is conceivable that the civilised (sic) peoples might yet save themselves alive out of this impasse, in spite of their addiction to business, if it were not for their national integrity.”24

Uncritical devotion to the national pretensions being a meritorious habit, it is also a useful article of camouflage, a shelter for gainful enterprises and transactions which might otherwise be open to doubt, a means of avoiding unfavorable notice and of procuring a profitable line of good-will.25

Veblen’s final words in Absentee Ownership say the following things with reference to capitalistic stagnation:

The outlook should accordingly be that the businesslike control of the industrial system in detail should presently reach, if it has not already reached, and should speedily pass beyond that critical point of

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23 Ibid., p. 421.  
24 Ibid., p. 422.  
25 Ibid., p. 427.
chronic derangement in the aggregate beyond which a continued pursuit of the same strategy on the same businesslike principles will result in a progressively widening margin of deficiency in the aggregate material output and a progressive shrinkage of the available means of life. 26

In other words, capitalistic civilization will end either in a more equitable distribution of the goods of society or in a militaristic state as a result of stagnation.

It seems possible to say this much, that the full dominion of business enterprise is necessarily a transitory dominion. It stands to lose in the end whether the one or the other of the two divergent cultural tendencies wins, because it is incompatible with the ascendancy of either. 27

In reading these predictions of Veblen it might be well to remind the reader of Mill's happiness when he viewed the prospects of a stationary state that might enable all to reap more benefits with less suffering and less privation. 28

26 Thorstein Veblen, Absentee Ownership, p. 445.


CHAPTER VI

A CRITIQUE OF STAGNATION THEORY

The previous chapters of this study have been concerned with an analysis of the Classical, Marxian, Keynesian and Institutional views of capitalistic stagnation.

The concluding chapter will be devoted to an attempt to point out certain points that would seem to undermine and destroy the validity of the theory of capitalistic stagnation.

Let it be agreed at the beginning of this chapter that if all of the basic postulates and mental preconceptions of these economists are correct the stagnation of capitalistic society must follow, but we seem to find the following flaws and misconceptions in the reasoning behind the postulates of capitalistic stagnation.

The Classical, Marxian, and Keynesian economists derive the main support for their theory of capitalistic stagnation from the first edition of Thomas R. Malthus' Principles of Population. The Malthusian principles of population are the ground-work for the Classical Economists' 'law of diminishing returns.'

Malthus in the first edition of his essay on population stated that "the human species would increase as the numbers
1, 2, 4, 8, 16, 32, 64, 128, 256, and subsistence as 1, 2, 3, 4, 5, 6, 7, 8, 9.\textsuperscript{1}

From the preceding illustration of 'the law of diminishing returns' Malthus, in the first essay, drew the following conclusions:

\ldots The necessary effects of these two different ratios of increase, when brought together, will be very striking. Let us call the population of this island 11,000,000; and suppose the present produce equal to the support of such a number. In the first twenty-five years the population would be 22,000,000, and the food being doubled, the means of subsistence would be equal to the increase. In the next twenty-five years, the population would be 44,000,000, and the means of subsistence only equal to the support of 33,000,000. In the next period the population would be 88,000,000, and the means of subsistence just equal to the support of one-half that number. And, at the conclusion of the first century, the population would be 176,000,000, and the means of subsistence only equal to the support of 55,000,000, leaving a population of 12,000,000, totally unprovided for.\textsuperscript{2}

However, in the second and later editions of the *Principles of Population* Malthus denied that 'the law of diminishing returns' would lead civilization to this gloomy end; rather he states that even man may take precautions to prevent this end of civilization,

\ldots With regards to the preventive checks to population though it may be acknowledged that this branch of it which comes under the head of moral restraint, does not at present prevail much among

\textsuperscript{1}Thomas R. Malthus, *Principles of Population*, I, 8-10.
\textsuperscript{2}Ibid., II, 129.
the male part of society, yet I am strongly disposed to believe that it prevails more than in those states which were first considered; and it can scarcely be doubted that in modern Europe a much larger proportion of women pass a considerable part of their lives in the exercise of this virtue than in past times and among uncivilized nations. But however this may be, if we consider only the general term which implies principally a delay of the marriage union from prudential considerations, without reference to consequences, it may be considered in this light as the most powerful check which in modern Europe keeps down the population to the level of the means of subsistence.3

In the preceding passage we have shown Malthus' view of population and its checks at the time of the second edition of his essay. The sociologist and other persons interested in population are aware of the limitations that Malthus placed on his first view of population; however, the economist must still retain his beliefs in the message of the first essay in order to hold the feasibility of 'the law of diminishing returns.'

Why should an economist hold this view of the 'law of diminishing returns' in the face of Malthus' revisions of his theory of population and in the face of many contrary facts such as these mentioned by Eric Roll:

. . . A modern economist inquiring into changes of population will find that the development of contraceptive devices has made a great difference to Malthus's (sic) expectations. But even more important than the changes on the side of population have been those which have affected the food supply. The opening up of new areas of the world and the

3Ibid., I, 315.
development of scientific methods in agriculture have increased and made it possible to increase still further the means of subsistence so as to maintain a larger population at a higher standard of living.  

E. A. J. Johnson in his book Some Origins of the Modern Economic World is of the opinion that economists have held the doctrine of the first essay of Malthus as a rationalization of the status quo: 

The Malthusian theory of population fell like Mana from Heaven into the hands of English capitalists. Here was a convenient explanation of poverty and low wages, a body of social theory supported by an imposing parade of facts which proved the universality of a 'Natural' principle of population. Here then was a philosophical fount in which factory owners could wash their unclean hands. Low wages had their origin in the 'passions between the sexes,' which resulted in a natural tendency for population to outstrip the food supply. For these conditions surely the employer of labor could not be held responsible; in fact he was rather a social benefactor who gave employment to a large number of these super-abundant poor. The real culprits were the parents who, by failing to curb their reproductive propensities, had brought into existence these unfortunate children whom the factories employed. 

If the second essay rather than the first essay is correct, the Classical view of stagnation will fall by the way, and since the Marxian 'Law of the Declining Rate of Profit' and the Keynesian law of 'the declining Marginal Efficiency of Capital' are based on these preconceptions  

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4 Eric Roll, A History of Economic Thought, pp. 210-211.

of the classical economists, their theory of stagnation must also be invalid.

The institutional economics of Thorstein Veblen bases its view of capitalistic stagnation on the conquest of civilization by the 'Imbecile Institutions':

... History records more frequent and more spectacular instances of the triumph of imbecile institutions over life and culture than of peoples who have by force of instinctive insight saved themselves alive out of a desperately precarious institutional situation, such, for instance, as now faces the people of Christendom.\(^6\)

but Veblen claimed to be an evolutionary economist\(^7\) and is against the preconceptions of Classical Economics as based on Natural Law.\(^8\)

If Veblen is a Darwinian evolutionist these questions must be answered by him with reference to capitalistic stagnation:

How may an evolutionist predict stagnation for a capitalistic society when evolution is defined as change and stagnation is defined as the lack of movement?

How can an evolutionist and relativist set up two such seeming absolutes as Institutions and Technology or Captains of Finance and Engineers?

\(^6\)Thorstein Veblen, The Instinct of Workmanship.

\(^7\)Thorstein Veblen, "Why is Economics Not an Evolutionary Science?" The Portable Veblen, edited by Max Lerner, pp. 215-240.

The final question one should ask of Veblen is where is there an empirical verification of his belief that the Imbecile Institutions will conquer technology and thus drive capitalistic society into stagnation?

The Veblenian theory of capitalistic stagnation is, as we have pointed out in the last chapter, based on the discrepancy in civilization that arises from the making of money by the Captains of Finance and the making of goods and the use of technology by the Engineers; however, one, by looking at the present civilization, might question whether there is evidence to show that the Imbecile Institutions have undercut Technology or whether there is evidence to prove that Technology has undercut the Imbecile Institutions.

Veblen's whole theory of stagnation depends on the undercutting of Technology by the Imbecile Institutions; however, from empirical evidences and from socio-cultural trends in the past it would seem that the Imbecile Institutions and Technology are always together and from the present view are likely to remain together in a conflicting bundle for society to deal with as best it may.

If all of the foregoing theories of capitalistic stagnation are untenable, what answer may be made to the stagnationists?
As we have pointed out in the beginning of this chapter, the theory of capitalistic stagnation is based on the 'law of diminishing returns'; therefore, if we may prove the existence of 'increasing returns' we will have answered the question of stagnation that arises from this viewpoint.

Is there anywhere in economic theory a doctrine of 'increasing returns'?

Yes, the following statement from Alfred Marshall's *Principles of Economics* is a doctrine of 'increasing returns'.

... But now let us turn to the other case, in which the long-period supply price for the increased output fell so far that the demand price remained above it. In that case undertakers, looking forward to the life of the firms started in that certain trade, considering its chances of prosperity and decay, discounting its future incomings, would conclude that the latter showed a good balance over the former. Capital and labor would stream rapidly into the trade; and the production might perhaps be increased tenfold before the fall in the demand price became as great as the fall in the long-period supply price, and a position of stable equilibrium had been found.

For indeed, though in the account of the oscillations of demand and supply about a position of stable equilibrium, which was given in the third chapter, it was tacitly implied, as is commonly done, that there could be only one position of stable equilibrium in a market; yet in fact under certain conceivable, though rare, conditions there can be two or more positions of real equilibrium of demand and supply, any one of which if once reached would be stable until some greater disturbance occurred.

Besides positions of stable equilibrium there are theoretically at least positions of unstable equilibrium: they are dividing boundaries between two positions of stable equilibrium, the watersheds, so to speak, dividing two river basins, and the price tends to flow away from them in either direction.
When demand and supply are in unstable equilibrium, then, if the scale of production is disturbed ever so little from its equilibrium position, it will move rapidly away to one of its positions of stable equilibrium; as an egg if balanced on one of its ends would at the smallest shake fall down, and lie lengthways.

Just as it is theoretically possible, but practically impossible, that an egg should stand balanced on its ends, so it is theoretically possible, but practically impossible, that the scale of production should stay balanced in unstable equilibrium.

The foregoing quotation from Alfred Marshall shows a new approach to the question of 'the law of diminishing returns' and an admission that 'increasing returns' are possible. 10

With the possibility of 'increasing returns' rather than 'decreasing returns' the economist no longer would have to face the question of stagnation. The stationary state in its basic assumptions postulates no change and static equilibrium at the lowest possible level; whereas, 'increasing returns' do not have to face stagnation because it takes cognizance of evolutionary and relativity doctrines and of the many advances made over the socio-cultural history of our civilization in technology, agriculture, and education.


10The problem posed by 'increasing returns' for the Classical Economist, with its problem of seeming monopoly is rationalized by Chamberlain in his book The Theory of Monopolistic Competition.
If we accept the view that there are 'increasing returns' and that there will not be stagnation, what type of economic system do we postulate to take the place of static-analysis economics?

The Institutional Economics of Thorstein Veblen is founded on the division of society into two groups, the captains of finance and the engineers. Veblen believed that the captains of finance and the imbecile institutions would drive our society into stagnation and eventually into militarism.

There are, doubtless, many mitigating circumstances, and many fanciful card-houses of cultural and linguistic conceits erected in good faith by the apologists of Chauvinism. But in point of fact, "realpolitik" continues to make satisfactory use of the chauvinist in a pursuit of its own ends by force and fraud. So also the universal type-form of national solemnities, even when staged by the mildest mannered and most amiable curators of the spiritual antiquities, continues to be a worshipful magnification of past warlike adventures, backed with a staging of histrionic obsequies of war-heroes, with parade of guns, uniforms and battle standards.

"Breathes there a man with soul so dead, who never to himself hath said, 'This is my own, my native land,'" when the national anniversary is being magnified with warlike fireworks and bombast, while veterans, Red Cross nurses, and Boy Scouts parade their uniforms to martial music under banners? In any one of these democratic commonwealths the acid test of sound and serviceable citizenship still is the good old propensity to fight for the flag without protest or afterthought. There is no question but this is a meritorious frame of mind. It is also the frame of mind which is sedulously drilled into the incoming generation.11

11Thorstein Veblen, Absentee Ownership, pp. 440-441.
Eric Roll speaking in reference to Veblen's theories of economics and institutions says,

... Veblen, starting with a highly inflated idea of the importance of the hedonistic assumption in the theory of the classics, was forced to very elaborate theorizing on the subject of instincts and motives. Marx's theory thus becomes a truly institutional one, a theory in which private property and its changing forms and the state and its changing forms are the principal categories. Veblen, on the other hand, although the founder of a school which is known as Institutionalist, was in fact primarily concerned with human motives.

... Institutions are defined as principles of action about the stability and finality of which men entertain practically no doubt. Thus the principles of marginal utility find such ready acceptance among the uncritical because they appear to be so much in conformity with the institutions—the habitual, conventional modes of behavior—of a pecuniary culture. ...

... The Veblenian institutions are the religious, aesthetic, literary, and other ideologies which, according to Marx, arise around the legal and political forms which are themselves built to buttress a basic social productive relationship. ...

... But it is difficult to avoid the feeling that Veblen was much more interested in the mental processes which accompany the working of our present economy, in the rationalizations of behaviors which it produces, and in the habits of thought in which it is enshrined, than in its underlying social, economic relations.12

Therefore, Roll would be of the opinion that stagnation from Veblen's point of view would only be a superficial stagnation that did not interfere with the machinery of production.

However, C. E. Ayres, one of Veblen's students, realizes that Veblen's definition of the machine process\textsuperscript{13} is based on the following preconceptions: the cumulative nature of technology, Darwinian evolution, and increasing returns.' In other words, Ayres believes that with these

\textsuperscript{13}Thorstein Veblen, \textit{Absentee Ownership}, pp. 440-441. "The mechanistic system of industry is of a collective and cooperative nature, essentially and of necessity a joint enterprise of all the civilised (sic) peoples, in so far as their civilisation (sic) is of the occidental pattern; and there is substantially only one such pattern. This industrial system runs on a balanced specialisation of work among its working members; standardised quantity of production, which is always and of necessity in excess of the local needs; free draught on a limited range of material resources from far and near. No isolated industrial undertaking and no isolated cultural activity is self-sufficient within the sweep of this industrial system of Christendom. And any degree of wilful isolation is straitway and automatically penalised by a corresponding degree of impotence, under the impassive run of the industrial system at large, which draws impartially on far and near. In this new industrial order of things the national establishments and their frontiers and functionaries come in as an extraneous apparatus of deflection and obstruction employed to perpetuate animosities and generate lag, leak, and friction."
preconceptions the stagnation of capitalistic society is impossible. 14

Present day socio-cultural and anthropological facts, according to Ayres, would seem to point out the existence of 'increasing returns' and the tendency for captains of finance and imbecile institutions to go hand in hand with technology and the engineers, with neither one or the other winning out in the battle of stagnation versus economic prosperity.

14 C. E. Ayres, The Theory of Economic Progress, pp. 102-103. "... The prevalence of dualism in the thinking of the past may perhaps be seen to be significant. Curiously enough, all the dualisms have something in common. All make unmistakable reference to the undeniable achievements and follies of the race. Can it be possible that all have been attempts, unsuccessful perhaps because of the limitations of the intellectual heritage of the past, to understand and characterise the distinction with which we are still concerned? The efforts of economists would seem to bear this interpretation. For the classical tradition in economics has given rise to a most pernicious dualism of the realms-of-being type. It was originally that of the 'actual' and the 'natural' or 'normal,' but during the last half-century these realms have been known as the 'dynamic' and the 'static.' Contemporary economists maintain that the distinction is only an analytical device, but it is certainly more than that. Under both sets of names one of these states is existential and the other is ideal in both metaphysical and moral senses. If one be defined as the realm in which change is occurring and the other as a 'stationary state,' it is at once apparent that change is regarded as something of a nuisance and as an essentially transitory condition. How otherwise could the analysis of imaginary 'stationary states' be regarded as useful analytical device? It is useful only on the supposition that the static world is the real world and the dynamic world phenomenal in the metaphysical sense. The distinction is between 'universals' and 'particulars.'"
Not only have science and technology subjected the institutions of Western society to intolerable strain; it is industrial necessity which likewise defines the conditions under which alone the strain can be relieved. This does not mean that much (indeed, most) of the institutional content of the past will not be retained in the future. Such has always been the case and doubtless will continue to be. It does not even mean that science and technology will necessarily prevail. Perhaps the world will choose authority rather than plenty. But it does mean that if institutions are retained under which industry cannot operate, industrial technology will be destroyed. This seems unlikely. More than ever during the period of strain the world seems to be committed to the truth of science and the efficiency of the machine. War itself employs technical expedi- ents and reinforces the power of scientific ideas while loosening the ties of ancient institutions. The probability is that these ideas will prevail in the end, and when they do the future world-state and economy of abundance will reveal their pattern.15

In this study we have shown that the concepts of capitalistic stagnation and secular stagnation are remnants of pre-scientific, pre-evolutionary thinking that are held because of man's 'quest for certainty.'

The theory of capitalistic stagnation is based on non-evolutionary preconceptions and at our present state of scientific and anthropological progress this is pure superstition, but as Ayres says:

"... To whatever degree of superstition and institutionalized status may prevail at any given time, the habituation of the race to those forms of behavior does constitute a need, just as a cripple needs a crutch. But the fact that a person is habituated to the use of crutches does not establish that crutches are good in themselves or that the

attainment of crutchless health is a fatuous illusion. Needs conceived in weakness are not a sound criterion of possible achievement, for individuals or for societies. The supposition that the prevalence of institutionalized humbug and coercion at any given time proves the impossibility of progress is a special case of the paradox of Zeno. It was precisely by this method that Zeno was supposed to have 'proved' that a moving object does not move, since at any given moment it is at a given point. This fact, as we have long since assured ourselves, does not prevent an object from passing through an infinite series of points during an infinite series of moments, and in the same sense the deplorable conditions which prevail in any community at any given time do not constitute a proof that such conditions must continue to prevail. Doubtless the immediate future will not be wholly different from the immediate past, but the fact that a given difference is infinitesimal does not mean that it is not profoundly significant.16

The evolutionary views of Ayres and other economists of this mind prompt us to ask the secular stagnationists the question Veblen asked in his essay, "Why is Economics Not an Evolutionary Science?"

Future economists in order to have a science of economics must turn from the blank wall of the imbecile institutions and stagnation and be happy with a world of the present rather than a search for things-in-themselves and transcendental certainties.17

16 Ibid., pp. 247-248.

17 It might be worthwhile to point out that the United States will not have to worry about stagnation for the captains of finance as long as the Marshall Plan and projects like aid to Korea are in effect.
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