6.2 The Political Economy of Inflation

Since World War II, the capitalist states in the advanced countries are no longer merely repressive institutions that act to suppress opposition to capitalism or to the more broadly defined status quo. They are also Keynesian state and welfare-warfare states that attempt to "fine tune" the economy or socialize the costs of production. But although the U.S. state apparatus utilizes Keynesian techniques, wage and price controls, and other policy tools, it has not yet tried to directly plan the economy. Nor is the international economy planned. This forms the context for the discussion of demand-management policies and inflation. In order to make this analysis more concrete, it will be done in conjunction with a sketch of the political economy of the U.S. since World War II. This sketch is not meant to be the final word. Rather, it sets the agenda for further research. (See also Gold, 1977, and Castells, 1980.)

Similarly, rather than present a complete "theory of the capitalist state" (see, for example, Jessop, 1977) a simple theory of the state will be utilized without further ado. The state is a "relatively autonomous" part of the capitalist mode of production whose policies are shaped by pressures put on it from the outside by contending social forces and are constrained by the dynamics of the capitalist system. Except in cases such as the use of the police and army to protect private property in the means of production -- where the short- and long-term interests of the capitalist class coincide -- state policies often do not correspond to capital's long-term interests. This happens because of uncertainty concerning these interests, individual capitalists' pressures on the state for their short-term aggrandisement, and the
pressures on the state by the working class and other social forces.  

In chapter 4 it was argued that it is extremely difficult, if not impossible, for government to plan away crisis tendencies. But Keynesian-style demand-management can affect the movement of the economy. Cheap credit affects the demand for consumer durables and investment goods. Direct government expenditure helps realize the product (raising the rate of utilization). But the success of Keynesian high employment policies is limited by (1) the international economic situation, (2) the longer-term effects of demand-management on the rate of profit, and (3) the determination of state policies by the political pressure of social forces.

First, high employment policies are constrained by the international status of the nation under consideration. A large economy with a dominant role in the world economy (or the ability to develop autarkically) has the greatest success with these policies. There is a much smaller chance of demand leakages and a greater scope for price rises without devaluation. For an economy of this sort we need not worry very much about the effects of credit and fiscal policies on short- and long-term capital flows. Immediately after World War II, the U.S. economy approximated this picture. (A symptom is that economics textbooks in the U.S., in contrast to those in Britain, de-emphasized the role of international complications.) And U.S. hegemony in the capitalist world economy created a stability that allowed other, smaller, countries to follow high employment policies (with varying degrees of success).
This environment allowed Japan and West Germany to build up their industry and eventually challenge U.S. industry's dominance. It, and the rise of transnational corporations, also created greater scope for capital flight from the U.S. By the 'seventies, the U.S. economy had lost its privileged position. While it had been exempted from the whip of international competition and U.S. officials had been able to dictate international policies to the rest of the capitalist world, in the 'seventies they found that they had to argue in international conferences for cooperative plans of reflation by the advanced capitalist countries so as to avoid further deterioration of the dollar and the international monetary system. Not only have they proposed the "convoy" plan where the advanced countries grow in step and the "locomotive" plan where the U.S., Japan, and West Germany grow together, but a plan with a major emphasis on West German growth alone! (See N. Kaldor, 1979.)

Capitalist enterprises based in the U.S. have lost most of their ability to raise export prices when costs rise. Between 1968 and 1978, the U.S. changed from being a net exporter of goods to being a net importer of goods. In 1970, West Germany wrested the honor of being the number 1 exporter of manufactures from the U.S. In the late 'seventies and 1980, Japan threatens to replace the U.S. as number 2. The role of capital flight has risen (see below). The mobility of capital from the U.S. has meant a widening gap between what's good for the U.S. economy and what's good for the U.S. capitalists.

Another problem is the rise of third world nationalism. The victory of the Vietnamese severely undermined the U.S. ability to police the underdeveloped world. O.P.E.C., in cooperation with the major oil
companies, raised the price of oil and its derivatives. In the 'fifties the U.S. had been able to prevent such events: it successfully engineered the overthrow of Mossadegh's nationalist Iranian regime in 1953. In 1954, it was able to intervene and quickly end the nationalist Arbenz regime in Guatemala. On the other hand, in the 'seventies the U.S. could save neither the Shah of Iran nor Somoza of Nicaragua, though they were important allies. All of this provoked Business Week (March 12, 1979) to present a special issue on the U.S. international decline. See also MacEwan (1978).

This decline meant severe limits on high employment policies. As we shall see, these policies may have contributed to this decline.

Alcaly summarizes the role of the second two problems with demand management policies:

In a very real sense economic crises serve an essential restorative function for capitalism if they are not accompanied by widespread unrest and the development of movements for social change which threaten capitalism's continued existence. By forcibly, and at great social cost, reestablishing the basis for profitable production, crises set the stage for subsequent expansions...The classical way to deal with an economic recession has been to ride it out essentially on the backs of working people.... [For example,] Fredrich von Hayek has recently argued that the 'teachings of Lord Keynes' are a 'seductive doctrine' which merely postpones, and thereby intensifies, the inevitable economic downturn.... In some respects the Hayekian position, with its recognition of the inevitability of the downturn and the consequences of the Keynesian attempt to eliminate this phase of the capitalist business cycle, is similar to the Marxian view....However, the Marxian analysis is far more sophisticated. It recognizes the capitalist state's stabilization policy must maintain some sort of business cycle to maintain profits. But it is also cognizant of the fact that the restorative effects of cycles on profits must be balanced against the social unrest which is likely to accompany severe downturns and full restoration of profits. This balancing act...constitutes the real problem of "fine tuning" which crops up so often in discussions of
government macroeconomic policy. (1974, p. 122-123)

Demand management that rides capitalism of its "normal" process of purging imbalances that depress the rate of profit will produce a downward trend in the potential rate of profit. Inefficient companies and obsolete plants will not be pushed out of production (as would happen in the normal cycle), so that aggregate productivity growth will be hurt. This is an especially important problem for an economy — such as the U.S. after World War II — that is sheltered from international competition. Existing investments will be protected; surplus will be invested in other sectors and countries. Second, the relative strength of the working class will increase in the trend if the disciplining role of the reserve army is undermined. These combine to hurt the potential rate of profit and increase the inflationary potential of the economy. That is, the trade-off between profit squeezes and accelerating inflation will worsen, narrowing the options for state policy.

Thus, to follow the long-term interests of the capitalist class, state policies should be biased toward allowing imbalances to be purged. But as Alcay and others argue, there are political constraints that push the state away from purgative policies in the cycle. Let us examine these pressures more closely.

Capitalism is not only conflict-ridden. There is often consensus on many questions of short-term policy. In the post-World War II United States, what might be called the "Keynesian Consensus" arose, centering on high employment policies. What were its roots?

Some observers emphasize that the working class is kept relatively happy by high employment rates. Accordingly, those legislators most open to working class pressure push for "full employment." This
explanation, however, cannot be sufficient to explain high employment policies since the U.S. working class has been organizationally weak since the early 'fifties (if not earlier). The U.S. working class is deeply divided by racism, sexism, and segmentation of the labor-power market. (See Edwards, 1979, and Reich, 1981.) Labor unions -- the major working class institutions -- are weak, bureaucratic (undemocratic), and sometimes corrupt. Many are still organized along exclusionary craft lines. The percentage of the labor force they represent has steadily declined. In 1953 (the peak), 25% were unionized; in 1979, unions accounted for less than 20%. For manufacturing, the figures are 50% (1956) and 45% (1979). (Edwards, 1979, p. 202.) Organized labor has never successfully organized workers in the South. In terms of labor law, the union movement's strength has been on the wane since the Wagner Act (1935). The Smith-Connolly Act (1943), the Taft-Hartley Act (1947), and the McCarren Act (1950) reflected, and in turn, intensified the weakness of labor. Unions now act as brokers of labor-power that buy the security of the three-year contract with the promise to discipline the rank and file and avoid wildcat strikes. The working class was unable to prevent real wages from stagnating or declining in the 'seventies. On the political level, unions often trade support for right-wing foreign policy stances for the passing on social legislation. Neither an independent electoral party nor a revolutionary party of the working class exists. Finally, as many observe, U.S. working class culture and ideology is much more dependent on capitalist ideology than that of the Western European working classes. For example, there is no widely distributed newspaper oriented to the working class.
There have been important social movements that have shaken the status quo in the last fifteen years: the civil rights movement, urban rebellions, black, Native American, and Chicano nationalism, the feminist and gay movements, environmentalism, consumerism, and the movement against the Vietnam War. But none of these have been deeply rooted in the working class or have been organized along class lines. Few of them have pushed consistently for full employment.

It seems likely, therefore, that the strength of the working class that some have observed (for example, Bowles and Gintis, 1980), has been largely due to the strength of capitalist accumulation, more an effect than a cause of the high employment levels. As Sachs (1979) points out, the high wage theory of the profit squeeze works much better for Europe than the U.S. (Of course, from the capitalists' points of view, the working class is always too strong.) In the context of a long boom such as that of the 'fifties and 'sixties, even weak and bureaucratic unions could negotiate significant gains for their members. (And in this context it is more likely that the union rank and file will rely on the existing structure.)

So we must look at the other classes for the roots of the high employment consensus. First, capitalists gain in the short term from high rates of capacity utilization which raise the rate of profit. Small businesses especially prefer full utilization to minimize the chance of bankruptcy. Inefficient firms of all sizes push for high rates of utilization for similar reasons. Each of these capitalists is either unaware of the long-term interest of the capitalist class or is unable to act on it. In sum, just as the competition among different sections of the capitalist class produces the tendency toward over-
investment, it also produces a pressure on the state to make the economy stay at high levels of utilization and avoid the cleansing crisis.

Second, "far-sighted" capitalists and their representatives see high employment as maintaining social order and consensus. Some sections of the professional and managerial strata see high employment as part of a liberal social engineering program. Finally, all groups fear a return to a depression such as that of the 'thirties with its massive unemployment, social unrest, and perhaps its underconsumption trap.

The support for high employment policies in the U.S. should not be exaggerated. After all, the unemployment rate (as officially measured) fell below 4.5% only during the Viet Nam war. That rate is high compared to those of Western Europe and Japan. At least two explanations are possible. First, the U.S. working class is relatively weak, lacking the clout to push for full employment successfully. Second, the U.S. labor-power market is not under control. The utilization of "guest workers" in Northwest Europe allows unemployment to be exported in recessions, keeping the domestic unemployment rate low. In Japan, it seems that the working class is so weak that there is no problem of a full employment profit squeeze. But more investigation of the political economy of relative unemployment rates is needed.

There are some conservatives (such as Hayek) who argue that the state should refrain from interfering with the system so that the long-term consequences can be avoided. Many small business people and middle-class people distrust any state action, seeing it as serving big capital, "Eastern" interests, and so forth, and yearn for the self-regulating system of the nineteenth century. These political forces have proven to be a potent barrier to any state planning efforts in the
U.S. So why did high employment policies prevail in the 'fifties and (especially) the 'sixties and not before? Part of the answer was the dominant role of the U.S. in the world economy. We can point to two other factors, the demands by various groups for a larger state budget and the form of the fiscal policies used.

A large state budget acts as a balance-wheel on the economy even when it is fully financed with tax revenues, as shown by the balanced budget multiplier theorem. This stabilizing effect is independent of macro-policy: the government deficit increases automatically as the level of business activity declines, acting as an "automatic stabilizer" that smooths the cycle.

The first source of the demand for a large state budget is the working class, which has pushed for a higher "social wage." This is, roughly, expenditure on health, education, and welfare that directly benefits the working class. (With after-tax wages -- that is, take-home pay minus indirect taxes -- the social wage adds up to the total wage. This may or may not be greater than gross pay before taxes.) Raising the social wage is often easier than raising the private wage, especially if unions eschew militance and pursue legislative strategies. Government provision of services is often seen as more efficient (or more equitable) than provision through the market. Employers also have a short-term interest in having workers pressure the state rather than going on strike for higher living standards. The social movements listed above have also encouraged the state budget to grow.

Second, the anarchy of production is reflected in the state: few can perceive the long-term effects of governmental expansion (though many claim to do so). Individual capitalists -- often backed by labor's
legislative lobbyists — push for federal subsidies. Logrolling, boondoggles, porkbarrel, and trade-offs are quite popular in U.S. legislative history. Third, a welfare state is seen as being in the long-term interests of capitalism by some sectors of the capitalist class. Parts of the professional-managerial strata favor social engineering while other parts profit as individuals: for example, much to its surprise the medical profession has profited by raising the rates paid by medicaid and similar projects. Fourth, the U.S. role as the dominant power since World War II has required massive military expenditure to maintain "law and order" in the third world and to compete in the arms race with the Soviet Union. This motivation for expenditure meshed with the short-term interests of individual capitalists and sections of the working class. This seems the origin of the hyper-trophied and inefficient "military-industrial complex" with not only its lucrative cost-plus contracts but also, until very recently, an abundance of seemingly superfluous military bases that propped up local economies. And as noted above, labor's lobbyists have by and large favored the U.S. military establishment. So to use O'Connor's phrase, the U.S. state is a "welfare-welfare state." The size of the state (government expenditure as a percentage of GNP) rose to its post-war peak in the late 'sixties as Vietnamese resistance produced a full-scale war and as urban unrest stimulated the ballooning of the welfare state.6

Resistance to the growth of the state budget has also been undermined by the form of fiscal policies. The absolute size of the state budget is usually not considered a policy tool. Instead tax cuts (and sometimes, surcharges) are used. In general, these tax cuts
have favored profits. The corporate tax provided 30.3% of all federal receipts in 1954; for the period 1970-76, this proportion had fallen to an average of 15%. Payroll taxes made up for most of the lost revenue. (See Pechman, 1977, p. 340-41.) The data in table 6.1 show that the after-tax rate of profit fell less than the pre-tax profit rate since World War II. The effective tax rate on profits (1 - after-tax/before-tax) fell from 57% for 1951-54 to 39% for 1975-78 for nonfinancial corporations. For manufacturing this rate fell from 59% to 43% between the same two periods.7

The large state budget is not a problem for the economy if that budget consists of nonwasteful expenditures. That is, if government expenditure had been primarily aimed at the restructuring and increasing the productivity of U.S. industry, then its long-run effects need not have been disfunctional. But much of the U.S. state budget is devoted to armaments, to boondoggles, or to welfare state programs that do not contribute to productivity. On the role of warfare expenditure and productivity, see Melman (1974) and Smith (1977, 1978). Smith shows a negative correlation between military expenditure (as a percentage of GNP) and productivity growth among the advanced capitalist nations. The obvious case is Japan which benefitted from U.S. military expenditure and has not spent much on the military. Accordingly, U.S. diplomats have argued for larger military budgets for both Japan and N.A.T.O.

Thus, we can hypothesize that U.S. high employment policies and "wasteful" utilization of the state budget were factors that contributed to the slowing down of productivity growth. This in turn contributes to the downward trend in the rate of profit.
### Table 6.1

**Estimated Real Rates of Return for Manufacturing Corporations and All Nonfinancial Corporations, 1947-48**

<table>
<thead>
<tr>
<th>Year</th>
<th>All Nonfinancial After Tax</th>
<th>All Nonfinancial Before Tax</th>
<th>Manufacturing After Tax</th>
<th>Manufacturing Before Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929-35</td>
<td>3.2%</td>
<td>4.2</td>
<td>9.4%</td>
<td>17.7%</td>
</tr>
<tr>
<td>1936-40</td>
<td>6.2</td>
<td>8.3</td>
<td>6.9</td>
<td>16.9</td>
</tr>
<tr>
<td>1941-45</td>
<td>8.7</td>
<td>19.6</td>
<td>6.8</td>
<td>14.5</td>
</tr>
<tr>
<td>1946-50</td>
<td>7.1 (7.9)*</td>
<td>14.2 (15.1)*</td>
<td>7.7</td>
<td>14.6</td>
</tr>
<tr>
<td>1951-54</td>
<td>5.8</td>
<td>13.6</td>
<td>7.4</td>
<td>15.0</td>
</tr>
<tr>
<td>1955-58</td>
<td>6.1</td>
<td>12.2</td>
<td>8.5</td>
<td>15.0</td>
</tr>
<tr>
<td>1959-62</td>
<td>6.6</td>
<td>12.1</td>
<td>8.9</td>
<td>15.8</td>
</tr>
<tr>
<td>1963-66</td>
<td>9.5</td>
<td>15.5</td>
<td>9.5</td>
<td>15.0</td>
</tr>
<tr>
<td>1967-70</td>
<td>7.6</td>
<td>12.7</td>
<td>6.0</td>
<td>11.4</td>
</tr>
<tr>
<td>1971-74</td>
<td>6.0</td>
<td>10.1</td>
<td>6.3</td>
<td>11.0</td>
</tr>
<tr>
<td>1975-78</td>
<td>5.9</td>
<td>9.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Holland and Myers (1978, 1980).

*Data for 1947-50.

### Table 6.2

**Before-Tax Rates of Profit for All Nonfinancial Corporations, for Different Times of the Business Cycle 1949-1975**

<table>
<thead>
<tr>
<th>Cycle*</th>
<th>NDI Trough</th>
<th>Profit Peak</th>
<th>NDI Peak</th>
<th>Cycle Average**</th>
</tr>
</thead>
<tbody>
<tr>
<td>1949.4-1953.2</td>
<td>11.5</td>
<td>17.4</td>
<td>13.3</td>
<td>13.7</td>
</tr>
<tr>
<td>1954.2-1957.1</td>
<td>11.1</td>
<td>14.7</td>
<td>12.2</td>
<td>12.0</td>
</tr>
<tr>
<td>1958.2-1960.1</td>
<td>8.7</td>
<td>13.4</td>
<td>12.5</td>
<td>11.4</td>
</tr>
<tr>
<td>1960.4-1969.2</td>
<td>10.2</td>
<td>16.3</td>
<td>12.5</td>
<td>13.1</td>
</tr>
<tr>
<td>1970.4-1973.3</td>
<td>8.7</td>
<td>11.1</td>
<td>10.1</td>
<td>9.4</td>
</tr>
<tr>
<td>1975.1</td>
<td>6.5</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Weisskopf (1979, tables 1 and 2)

*Cycles dated from NDI trough to NDI peak.

**Average is for NDI trough to NDI trough.

NDI is net domestic income in 1972 dollars.
Denison (1978) calculates that for the nonresidential business sector, labor productivity (adjusted for cyclical effects) grew at an average rate of 2.7% for 1948-69, 2.1% for 1969-73, and only 0.1% for 1973-76. (See also Denison, 1978.) This slowdown was also reflected in manufacturing: productivity growth slid from 2.8% (1955-65) to 1.5% (1973-78). This is stagnation relative to the U.S. competitors. For the period 1963-73, U.S. productivity grew at a rate of 1.9% per year. During the same period, productivity grew at annual rates of 4.6% and 8.7% for the West German and Japanese economies. For the period 1973-79, U.S. productivity growth averaged 0.1% while for West Germany and Japan it was 3.2% and 3.4% respectively. (Council of Economic Advisors, 1980 Economic Report of the President, p. 85.)

Table 6.1 shows the decline in the rate of profit for the U.S. since World War II. (Note, however, that it has risen since 1929.) This fall occurred before the oil crisis and there has been no major recovery since. Table 6.2 shows that there is a downward trend in the rate of profit even when corrections are made for cyclical effects. Measuring the rate of profit at the "profit peak" or the Net Domestic Income peak gives us some indication of the trend in the potential rate of profit. For other data showing a downward trend in the rate of profit, see Nordhaus (1974a), Lovell (1978), and the Council of Economic Advisors (1980, p. 303). Lovell shows that the trend is not an artifact of definition by looking at a large number of different measures of the rate of profit.8

The decline in the rate of profit was associated with a decline in domestic investment. As the rate of profit fell, so did the ratio of investment to the capital stock, as shown by column 1 of table 6.3.
Table 6.3: The Rise of Foreign Investment

<table>
<thead>
<tr>
<th>Period</th>
<th>I / K</th>
<th>DFI / L</th>
<th>Developed Countries</th>
<th>Underdeveloped Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-50</td>
<td>24.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1951-54</td>
<td>22.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1955-58</td>
<td>21.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1959-62</td>
<td>20.6</td>
<td>35.9(^a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1963-66</td>
<td>21.8</td>
<td>41.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1967-70</td>
<td>20.1</td>
<td>43.7</td>
<td>12.0(^b)</td>
<td>11.6(^b)</td>
</tr>
<tr>
<td>1971-74</td>
<td>19.3</td>
<td>45.6</td>
<td>15.5</td>
<td>12.6</td>
</tr>
<tr>
<td>1975-78</td>
<td>16.6</td>
<td>53.2</td>
<td>16.6(^c)</td>
<td>12.7(^c)</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td></td>
</tr>
</tbody>
</table>

Notes:

(1) \(I / K\) = gross private investment, nonresidential current dollars.

(2) \(K\) = current dollar net stock of nonresidential business capital.
Source: *Survey of Current Business*, April 1976; August 1976;

(3) DFI = U.S. direct foreign investment. Source: *Survey of Current
Business*, June 1980.

\(a\) = average for 1960-62.

(3), (4) The rate of profit is calculated as

\[\text{Income + Fees and Royalties} \times \frac{DIP(t) + DIP(t+1)}{2} \times 0.5\]

where DIP(t) is the U.S. direct investment position at the
beginning of year t. Source: *Survey of Current Business*,
August 1979, table 12.

\(b\) = average for 1966-70.

\(c\) = average for 1975-77.
This has contributed to the decline in the rate of growth of productivity and the potential profit rate. This is a vicious circle.

Though the rate of profit on domestic investment has fallen, columns 3 and 4 of table 4.3 show that the rate of profit on U.S. corporate foreign investment has risen. These figures are for manufacturing. Thus they are on similar types of investment as those in the U.S.; they do not reflect raw material rents. (Note however, that because of differences in definition the profit rates in the different tables are not comparable.)

There are two further conclusions here. First, the crisis of declining profitability is not as much for U.S. capitalists as for the U.S. economy. Though international "law and order" has been undermined by nationalist movements, there are still countries such as Taiwan that are safe for corporate investments. Western Europe and other advanced countries are also still safe havens. There is a possibility, however, that Crisis in the U.S. will intensify the international Crisis since the U.S. market is so important to the world economy. Second, the increase in U.S. corporations' rate of profit on foreign investment has meant an increase in capital flight. Column 2 of table 6.3 shows a steady increase in the ratio of direct foreign investment to U.S. domestic investment. This is associated with the shift to service production in the U.S. economy since services (unlike goods) cannot be shipped and must be produced in the market. Because of the slow pace of productivity growth in service production, this has intensified the role of capital flight in the vicious circle of productivity stagnation. Most business-oriented solutions to the Crisis (such as that of Business Week) ignore the problem of capital flight; they ignore the problem of the export of
much of the profits promoted by their plans.

Weisskopf (1979) found that the decline in the U.S. nonfinancial corporate business (NFCB) sector's terms of trade was the key determinant of the downward trend in the rate of profit. The rate of capacity utilization had little to do with it. Contributing also was the capitalists' inability to make the working class pay for all of this decline (in Weisskopf's words, labor's defensive strength). To Weisskopf the decline in the terms of trade reflects "a growing scarcity of exhaustible resources (imported into the NFCB sector), a decline of U.S. hegemony within the world capitalist system, and a slow rate of growth of productivity relative to wages in the service sector of the U.S. economy." (p. 373) We can add the decline of productivity growth in the NFCB sector itself to the list of causes. Stagnant productivity -- especially relative to direct competitors such as West Germany and Japan -- has a clear negative effect on the terms of trade (and on U.S. economic hegemony). If trend productivity growth declines, so must the rate of growth of wages if the economy is to avoid a worsening of the trade-off between profit squeezes and accelerating inflation (or an increase in balance of payments problems).

The contribution of Keynesian high employment policies to declining productivity growth is much less clear. One way to see the link is to examine the alternative, the relatively planned expansions (with little wasted on military expenditure) of West Germany and (especially) Japan. Rather than utilizing pure demand-management policies, these countries' ruling classes embraced state-planned capitalism, modern technology, and rapid productivity growth. The protected environment of the U.S. market allowed U.S. steel corporations, for example, to utilize open-hearth furnaces while
the Japanese moved quickly to use the more modern basic oxygen process. Accordingly, *Business Week* (June 30, 1980) argues that the U.S. must "reindustrialize" following the model of its direct competitors.

When the rate of profit falls and inflation accelerates, support for a large state budget (especially the welfare state) and high employment policies is undermined. The budget (and the automatic stabilizers) are seen as causing inflation. In the 'seventies, the popularity of Keynesian economics and high employment policies declined precipitously, challenged by those who emphasize the role of the "supply side" or the need for state-planned capitalism. Unless the state moves to directly restructure production, engage in nonwasteful investment, and cut real wages relative to productivity, the analysis of this chapter suggests that the association that many economists see between "New Deal" economics and inflation is empirically valid, even if their theories are theoretically shaky.

In this era, capitalists turn against the welfare part of the welfare-warfare state because it is seen as undermining the discipline of the labor-power market. To the extent that the rate of profit is boosted by inflation and that the burden of state finance falls on the working class, many workers will be less willing to support New Deal policies. Without a coherent left-wing workers' movement, there seems no alternative but a shift to the right. For example, in 1978 in California, many of the home-owning workers supported Proposition 13, which cut the tax base of the state government. Many had been pushed by inflation (and real estate speculation) into higher property tax brackets. In general, however, it seems that the working class supports New Deal policies more than other groups in society.
In 1980 either restructuring or an extended period of stagnation seems necessary to rebuild the U.S. economy and boost the rate of profit. Rapid productivity growth and continued real wage stagnation are at the center of many policy prescriptions. Recovery of investment and restructuring will by no means be an immediate solution to the Crisis, however, because they increase productivity only after a lag. And given the internationalization of U.S. investment, it is not clear that it is capital's interest to rebuild the economy unless major subsidies are given. Because of the insecure military position of the U.S. (and the programs of the major candidates for President) it is unlikely that military expenditure will be cut to provide funds for rebuilding. It thus seems that restructuring will be financed by cutting consumption, that is, workers' incomes. After a long period of stagnant or falling real wages, this type of program might provoke popular resistance. The other alternative is continued stagnation of investment until imbalances are purged from the economy. In this situation, the only way to raise the profit rate on existing investments is an intensified employers' offensive against the working class to speed up production and bust unions. This implies, however, that a fall into the underconsumption trap is a greater possibility, especially when international complications are taken into account: trade wars, competitive devaluations, and competitive austerity programs, combined with international demand-linkages may push the economy into a hole.
6.3 Conclusions

To summarize the conclusions of this chapter it is useful to compare its perspective with those of popular Marxist theories of inflation. These are the monopoly theory, the money theory, and the conflict theory. Consider each in turn.

The monopoly theory of inflation (for example, that of Sherman, 1976a) argues that the rise of monopoly in important markets increases the inflationary potential of the market. Demand is incessantly shifting from sector to sector. Under competitive pricing, this implies that some prices rise and others fall, so that there is no inflation. But under modern monopoly capitalism, few prices fall, so that a continual process of inflation occurs as demand shifts. (See Schultz, 1959.)

But if there are any competitive markets at all (for example, in agriculture) price falls are possible there. In fact, the decline in prices in those markets might very well compensate completely for the rise of the prices in the "monopoly" sector so that monopolization explains only changes in relative prices. Second, it is hard to imagine that monopoly causes a very high rate of inflation unless aggregate demand is increasing at a rapid pace. In that case, aggregate demand must be included as part of the theory; a pure supply-side theory of inflation is inadequate. Despite these criticisms, we do not reject this theory out of hand. The degree of monopolization affects the downward stickiness of prices (as reflected in the parameter $k$).

The money theory of inflation (for example, that of Mandel, 1968, ch. 8) sees the ratio between the actual supply of money and that supply that is socially necessary as the main determinant of the general price
level, so that as this ratio increases inflation will occur. Unlike many monetarists, this school emphasizes that the money (credit) supply is out of state control so that they do not follow Milton Friedman to prescribe rules for monetary growth. The analysis here suggests that since the velocity of money and the money multiplier vary with the level of business activity, the money supply (with or without credit) is more of a limit on inflation than a cause of inflation. Neither supply nor demand can be ignored: the actual determinant of the inflationary potential of an economy is more fundamental, structural imbalances that squeeze the rate of profit and encourage the capitalists to raise prices so as to regain the normal rate of profit. The supply of money and credit is quite important in the determination of the degree to which this inflationary potential is reached or profit rates remain low. We agree with the money school that chaos in international banking encourages inflation by weakening state control over money and credit supplies.

The conflict theory of inflation argues that the fundamental imbalance that squeezes the rate of profit is class conflict. While agreeing with this possibility, this chapter has emphasized that this conflict must be seen in the context of capitalist accumulation and that there are other imbalances. On the former, it is a long period of buoyant growth that encourages conflict-inflation, by allowing working-class strength to accumulate. On the latter, declines in the terms of trade and productivity growth encourage inflation by squeezing the rate of profit. These declines need not be due to class conflict. These imbalances can accumulate over the long haul because high employment policies short-circuit the "normal" cleansing process of the crisis.
thus increasing the inflationary potential of the economy.

The conflict theory also tends to be overly one-sided, ignoring the role of consensus. This can be seen by comparing the two major theories of the political business cycle. First, the neoclassical theory of the political business cycle (of Nordhaus, 1974b; MacKee, 1977; and Tufté, 1978) is based on the assumption of a basic social consensus — except between elected officials' career needs and the "public interest." This argument ignores the possibility that full employment may cause profit squeezes. That is, the conflict over the production and distribution of the product is left out of the picture. We should not reject these theories completely, however, since elections do encourage elected officials to push high employment policies. The most often cited case is the Nixon re-election campaign of 1972. Also, there is sometimes a consensus — due to a convergence of short-term interests — around high employment policies. This consensus is most viable when the rate of profit is high and capitalist accumulation is healthy, as in the 'fifties and early 'sixties.

The Marxist theory of the political business cycle (of Boddy, Crotty, and Rapping) is in many ways the mirror image of the neoclassical theory, seeing only the class-conflictual aspects of state policies. These views downplay the possibility of consensus in the shorter term that can result because of the conflicts of interest within the two main classes. Accumulation means different things to different capitalists and they can often get allies from the working class (and its representatives) who favor the short-term gains that capitalists promise.
It was argued above that this consensus pushes the system toward a crisis in the longer term. It is then that the Marxist political business cycle is more appropriate. Reforms that favor the working class have a much more immediate negative effect on profitability in this period and social consensus is less viable. Even if "high wages" had nothing to do with causing the fall in the rate of profit in the first place, one obvious way to regain the normal rate of profit is to cut the social and private wages. This seems the situation of the U.S. in the 'seventies and 'eighties when there is a major effort to cut wages, speed up production, and cut back social programs.