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Interpretations of the Great Depression[1]

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Abstract

Underconsumption theories played an important part in the economic policy debates during the Great Depression of the 1930s. The commonsense appeal of the arguments and the clear cut policy advice secured their proponents' popular support. Here, the contributions of John A. Hobson, Emil Lederer, Waddill Catchings and William Foster are analyzed. The background to their thinking in terms of the economic policy debates in the respective countries is discussed and compared. Switzerland is an interesting case in this context since there underconsumption arguments were the only arguments used to challenge the orthodoxy of balanced budgets with the demand for active government policies. In evaluating the contributions discussed here with regard to the innovations of Keynes's *General Theory* on the one hand, the tradition of classical political economy on the other, it is argued that although underconsumptionists share certain concerns with Keynes's analysis, central theoretical notions are carried over from classical economics.

Keywords

Pre-Keynesian business cycle theory, classical economic thinking, Keynesian economics, explanations for the Great Depression, cycles and growth.

JEL Classification

B2, B3, E3, N1.

Introduction

Underconsumption theories played an important part in economic policy debates before the publication of John Maynard Keynes's *General theory of employment, interest and money* (1936). In face of an abundance of unused factors of production and excess stock on the one hand, poverty and unsatiated needs on the other the intuitive appeal of these arguments explain their popular success.

The arguments used date back to the early 19th century when Lord Lauderdale and Thomas Robert Malthus in Great Britain and Jean Charles Sismondi on the continent explained crises as disequilibria between (aggregate) supply and demand for consumption goods. Their contentions focus on the effects of savings. High savings diminish the demand for consumption goods and, as investment, increase production capacities and future supply. Overproduction is the consequence of underconsumption and background to the crisis. Often, income distribution is seen as the source of underconsumption. Sismondi argued that the share of capital owners' receipts in national income grows over time. The expansion of consumption goods output financed by their savings is not matched by an increase in the income of the masses who would be willing to buy the goods. These arguments recur in the underconsumption theories of the 20th century.

David Ricardo and James Mill dismissed the underconsumptionists' case unconditionally which lead to its disappearance from the theoretical discourse. The concepts addressed in their theories such as aggregate demand or aggregate production were not central to the classical system. Underconsumption theories survived "below the surface" (Keynes 1973[1936], 32). In the 1920s and 1930s they gained considerable popular support in several countries. Although their proponents were still considered heretics, they managed to engage professional economists in discussions or even enter academics.[1] The openness of the profession for unorthodox arguments during those years can be interpreted as a sign of crisis - not only in the real world but also within the profession. The

[1]See Dimand 1991, Haberler 1963 [1937] and the literature discussed below.

commonsense appeal of underconsumption arguments gave their proponents a big audience. They entered the debates over the adequate policy responses to the Great Depression with clear cut remedies of active government policy and were successful in shaping public opinion.

Underconsumption arguments came in different flavors and degrees of sophistication. John A. Hobson's writings merit attention since the book that established his fame as underconsumptionist was published well before the period we are interested in here. Therefore the other writers I draw attention to were all aware of Hobson's ideas in one way or another. In an overview over the theories of Hobson, Emil Lederer, Waddill Catchings and William Foster differences and similarities are analyzed. The background to their contributions in terms of the economic policy debates in the respective countries is discussed and compared. Switzerland is an interesting case in this context since there underconsumption arguments were the only arguments used to challenge the orthodoxy of balanced budgets and to demand active government policies. The common characteristics of the underconsumption theories discussed here are presented and confronted with Keynesian economics. It is argued that underconsumption theorists share with Keynes the distrust in the natural harmony of the economic system presupposed by classical and neoclassical economists alike. By stressing demand factors in the explanation of the crisis they apparently foreshadow aspects of Keynes's *General Theory.* Their focus on consumer goods demand leads them to suggest government policies that are narrower in scope than Keynesian policies. Underconsumptionists' concern with issues of growth show their closeness to the 19th century classical tradition. With classical economists they share the assumption that planned savings equal planned investment, hoarding is not seen as a cause of the crisis although it is discussed as a possible concomitant. In sum, I argue that although underconsumptionists share certain concerns with Keynes's analysis, central theoretical building blocks are drawn from classical economics.

Underconsumption theories in the early 20th century.

John A. Hobson

John A. Hobson's writings on underconsumption date back to long before the crises of the inter-war period. He first stated an underconsumption theory in *The Physiology of Industry*, a book written jointly with A. F. Mummery in 1889. It was written on the background of the experiences with the trade depression of the 1880s and, as Alon Kadish (1994, 70) argues, in a context where explanations of crises using underconsumption and overproduction arguments were widely accepted. In later publications, especially *The problem of the unemployed* (1896) and *The industrial system* (1909) Hobson developed the ideas presented in this book. The following overview over his chief propositions is kept brief as his work is analyzed in detail by others.[2]

Central to Hobson's underconsumption argument is the rejection of the classical idea that thrift is beneficial as much on an individual as on the community level:

> "Now saving, while it increases the existing aggregate of Capital, simultaneously reduces the quantity of utilities and conveniences consumed; any undue exercise of this habit must, therefore, cause an accumulation of Capital in excess of that which is required for use, and this excess will exist in the form of general over-production." (Mummery and Hobson 1956 [1889], v)

Factor coefficients are assumed fixed, substitution between capital and other factors of production ("natural agents" and labor) does not take place as savings increase. Mummery and Hobson (1956 [1889], 22-29, 66-71) stress the temporal structure of production where capital enters into the production process at each stage. For a given technology the ratio of capital to consumable output is given, implying an accelerator theory of investment. An increase in the demand for consumer goods requires an increase in capital to allow the production of the additional consumption goods. The amount of capital necessary to produce the output matching a given consumers' demand is denoted "real" capital, any excess above this amount "nominal" capital. Correspondingly "real" and "nominal" savings are distinguished. Nonetheless, Mummery and Hobson assume that

[2] See for example Schneider (1996), the volume edited by Pheby (1994) and the literature cited there.

savings are automatically invested (Schneider 1996, 104).[3] Despite several classical traits in their argument the overall vision of the economic process differs from the classical: in Mummery and Hobson the long-term growth path of the economy is driven by consumption goods demand which calls for a certain level of investment via the acceleration principle. In contrast, classical economics argues that production generates income that is then used for consumption or savings where consumption is at the expense of capital accumulation.

Keynes praises Hobson for providing "...the first explicit statement of the fact that capital is brought into existence not by the propensity to save but in response to the demand resulting from actual and prospective consumption." (Keynes 1973[1936], 368) Investment necessary to meet "actual and prospective consumption" is what Mummery and Hobson denote as "real" capital. "Nominal" capital in their opinion does not result from "mistakes of foresight" as Keynes argues. "The root of Hobson's mistake" (Keynes 1973[1936], 367) is therefore the crucial dividing line between Hobson's classical and Keynesian thinking. Savings ex ante equal investment ex ante in Hobson, that investment may turn out to result in "nominal" rather than "real" capital does not deter investment. In other words, an investment decision independent of the decision to save is not proposed as in Keynes.

Underconsumption is a result of "'irrational' factors in the operation of the economic system," namely what Hobson calls "unearned income" out of rents, surplus profits and windfall gains (Hobson 1933, 416). That the community's normal savings and investment are sufficient to satisfy the future demand for consumer goods within the entire community will not deter individuals from increasing savings and from investing "unearned income." Hobson argues that above a certain level any additional income is almost automatically turned into savings, because "a satiety point in most standards of high living" has been reached (Hobson 1933, 416-7). Individuals might even succeed in putting additional capital to work. But since the amount of capital necessary to satisfy the given consumption goods demand is limited, this will only mean that already existing capital becomes unprofitable, that "real" capital is turned into "nominal" capital. The excessive increase in capital will not be visible initially. But as the additional capacity comes into production the boom will end because orders are insufficient to keep these

[3] Although Mummery and Hobson assume that savings are invested as a rule the possibility of hoarding is allowed for (Backhouse 1994, 84-6).

capacities employed. As profits cannot be realized, savings and investment fall. The crisis spreads from the production goods industries to consumer goods industries with falling employment. The efforts to keep up a minimum level of consumption will eventually lead to price increases, a stimulus for recovery (Hobson 1933, 417).

Hobson extends the original underconsumption argument to analyze business cycles. Underconsumption explains the onset of the crisis, a floor in consumption demand generates forces that bring the economy onto a path of recovery. At the heart of his theory is a model of growth equilibrium where the "ratio between spending and saving (or investment)" is of critical importance (Hobson 1933, 403). The economy is in equilibrium as long as spending, i.e. the demand for consumption goods output, and saving (i.e. investment) are kept at the "right" balance. The "right" balance implies that the additional capital financed out of savings is just adequate to provide the supply satisfying future demand for consumption goods.[4] The equilibrium is therefore an intertemporal equilibrium determined by a given technology. Furthermore, income distribution is crucial to warrant equilibrium. As saving habits are assumed to differ between different groups of income recipients consumption goods demand and savings depend on income distribution.

Hobson's policy prescriptions follow from these arguments. Sufficient consumption goods demand can be brought about by an adequate income distribution. Hobson advocates progressive income taxes, wage increases through union action and minimum wage legislation (Schneider 1996, 68-9). Public works are seen to reduce the problem of underconsumption as they provide income for workers with low propensities to save. Hobson supports tax financed public works and financing through borrowing (Hutchison 1966 [1953], 123). Hobson's advocacy of nationalization of key industries is in keeping with the logic of his underconsumption analysis although it was also inspired by political considerations (Brailsford 1948, 20). National control would make it possible to avoid excessive surpluses and thus limit excessive investment. Macroeconomic planning would similarly allow the prevention of overproduction. All these measures are aimed at keeping the economy on an equilibrium growth path, at bringing about the necessary balance between saving, investment and consumption. They would imply a lower ratio of saving

[4] The similarities and differences between Hobson's argument and growth models of the Harrod-Domar type is discussed by Schneider in 1994, 105-20 and in 1996, 77-88.

to spending. But by preventing periodical crises and allowing uninterrupted growth Hobson expected them to soon lead to an increase in the level of savings.

With his support for public works Hobson was in good company during the Great Depression. By the early thirties the majority of British economists supported credit financed public works during crises (Hutchison 1978, 186). The argument that unemployment should be addressed through demand side policies rather than wage decreases goes back to the Minority Report of the Royal Commission on the Poor Laws of 1909. Far-reaching counter-cyclical policies of public works and investment were advocated there. Although these policies were not adopted support for public spending to reduce unemployment spread in the economics profession during the 1920s (Hutchison 1966 [1953], 414-9).

"The massive obstacles to the adoption of expansionist policies in the *early* 1930s lay not with academic opinion, but in Whitehall, the City, and Westminster." (Hutchison 1978, 192) Public spending as a cure for unemployment was vehemently rejected by the economists at the Treasury. Ralph G. Hawtrey expounded the theoretical argument. He explained the business cycle as "a purely monetary phenomenon," where the cycle is caused by changes in the supply of money. "According to Hawtrey the trade cycle is nothing but a replica, on a small scale, of an outright money inflation and deflation." (Haberler 1963 [1937], 16). The Treasury view maintains that public expenditure is ineffective in bringing about an increase in employment since every penny spent by the government is accompanied by an equal reduction in spending by the private sector. Funds are diverted from private to public use, full crowding out takes place. This view was supported by economists at the London School of Economics, for example Friedrich A. Hayek and Lionel Robbins who based their policy recommendations on an over-investment theory. They demanded balanced budgets, the reduction of public spending and a liberalization of trade and capital markets (Hutchison 1978, 185). With these policy prescriptions they comprised a minority of academic economists in Britain though.

"[T]he majority view of economists, aided perhaps by the grim demonstration by Nazi Germany of how a government then could spend its way out of unemployment, began to sway a wider body of opinion as the 1930s wore on." (Hutchison 1978, 194) Hutchison argues that by early 1935 even the experts in the Treasury and the Bank of England had

given up their stark opposition to public spending. But the changed convictions did not lead to policy action until in 1937 the rearmament program was launched. As in other countries, the imminent war seems to have done more to move the politicians than the arguments of economists.[5]

Hobson's contribution to the gradual persuasion of professional and public opinion concerning government spending is hard to evaluate. Academic recognition for his work was sparse and came only late in his life. Edgeworth's devastating critique of *The Physiology of Industry* on its publication did not deter Hobson from continuing his studies and publishing. Hobson was a prolific journalist. Between 1907 and 1923 he wrote steadily for the *Nation*, then the leading progressive weekly. "It may not be possible to propagate an economic system in this way, but an attitude of mind, a way of interpreting current events and tendencies, a practical programme, can be argued out and rendered familiar." (Brailsford 1948, 13)

Hobson's influence came not only from his extensive written work, but also from his political activities. From 1890 on he was engaged in a number of progressive or reformist organizations (Schneider 1996, 7). As a supporter of the Liberal Party he played a major role in formulating what came to be known as "New Liberalism" in the 1890s. After he left the Liberal Party in 1916 he became involved in Labour Politics, in 1918 as a member of the Advisory Committee on International Relations. In 1924 Hobson joined the Labour Party. In the same year he served on its Policy Committee. The report on the "living wage" was based on underconsumption ideas and drafted largely by Hobson. It was rejected by the party. Even though the Labour Party provided a minority government in 1929 and was part of the "National Government" between 1931 and 1935 the expansionary policy prescriptions advocated by Hobson were not implemented.

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[5]Hutchison (1978, 193) maintains that the intense debates that followed the publication of *The General Theory* might even have retarded the acceptance of the expansionary policy advice. The debates did certainly not convey the considerable agreement among economists in the 1930s regarding unemployment policies.

Hobson in his days might have been too progressive for the Labour Party as the rejection of the "living-wage" recommendations suggest. But his influence lasted well beyond his days. Hutchison (1966 [1953], 129) claims that "The economic policies of the British Labour Government after 1945 in respect of 'full employment' and nationalization followed Hobson's ideas very closely, and these ideas may well go down as the most important single intellectual inspiration of that particular phase of British economic history and policy."

Emil Lederer

Lederer's analysis of growth, cycles and crises underwent considerable changes over the years that he published on these issues. In the context of our discussion his article "Konjunktur und Krisen" of 1925 is of interest. There he uses arguments reminiscent of both traditional and contemporary underconsumption theories. Lederer's work reflects the broad variety of influences that he was exposed to as student and which formed his genuine approach to economic issues. The Austrian and Historical Schools, Marxist, classical and neoclassical theories left traces in his thinking.

Lederer's business cycle analysis builds on an extension of the Marxian schemes of reproduction (Lederer 1925, 368). Six social groups are distinguished according to their different economic functions: next to entrepreneurs and workers in the industrial and in the agricultural sectors, public employees and rentiers are singled out. In contrast to the former, the last two groups receive their incomes as transfers from the productive sectors. Most importantly these incomes are fixed in long term contracts. That they do not fluctuate in nominal terms during the business cycle as do profits and wages is the crucial stabilizing effect in Lederer's theory.

Disturbances in the circular flows of goods and income streams within the system are distinguished from crises (Lederer 1925, 371-6). Misjudgements of demand developments by producers, unexpected harvest results, etc. can lead to inconsistencies between supply and demand for individual goods. Price adjustments induce a redistribution of purchasing power between income groups and a redirection of demand. Capacity reserves and stocks of goods allow the supply side to adjust to such disturbances. In other words, Say's law of markets is at work.

Crises are explained in the context of an analysis of the business cycle. The static state of depression is overcome through an increase in effective demand (Lederer 1925, 361). The resulting price increases are made possible by an increase in the velocity of circulation and more importantly by additional credit as distinct from a mere transfer of savings. It is additional credit that makes a boom possible, savings are invested in all phases of the cycle. Money and credit are thus essential although monetary factors are not seen as initiating the cycle.

During the upswing wages rise more slowly than prices, leading to a reduced share of wages in the social product and an increased share of profits. Since Lederer (1925, 393) assumes that wages are predominantly spent on consumption and profits are predominantly invested this implies an alteration in the composition of demand. With rising profits and accumulation, demand for production goods rises, whereas demand for final products stays behind. Production goods industries grow faster than consumer goods production. The unbalanced growth reflects the uneven development of different types of income though. Therefore such disproportions are fundamentally different from the disequilibria in individual markets which imply an allocation not corresponding to purchasing power as discussed above. Here, in contrast, the development of supply corresponds to the disproportional development of demand. That it is unsustainable becomes obvious in the later phases of the boom. As the capacities built up during the upswing enter into production the insufficiency of demand for consumption goods materializes. "Uncertainty in the market" (Lederer 1925, 363), usually in conjunction with a credit contraction will start the downturn. The crisis is the prelude to depression, the economy returns to a static state without new investment. During the depression income shares are reverted as prices fall faster than wages. Profits are reduced and the purchasing power of wages and in particular of fixed incomes is restored. This is reflected in the composition of aggregate demand; production will adjust accordingly.

What defines the appropriate proportions in the production sphere and the corresponding income shares which are to be brought about in crisis and depression is not stated explicitly. In other words, Lederer does not spell out how the intertemporal equilibrium underlying his argument is determined. Considering Lederer's later contributions on technical progress and unemployment it can be argued that these conditions are defined by technology as in Hobson. If production processes are inflexible

concerning the input of labor and capital at any point in time and if technology is exogenous and presumed not to change in response to relative factor prices then the growth path is defined in real terms for both income shares and corresponding sectoral developments. Lederer's rejection of wage increases or credit financed public spending to prevent a crisis and prolong the boom by creating demand can be explained on this background. In his discussion of the effects of such measures Lederer stresses their impact on aggregate savings and long-term growth.

Lederer explains the business cycle as an endogenous movement driven by the disproportional development of income shares.[6] Price movements are a necessary part of the business cycle. As prices, wages and fixed incomes do not adjust at the same speed, uneven developments of income streams result which cause the fluctuations in economic activity.[7] In the depression the increased purchasing power of fixed income recipients stabilizes demand, depletes stocks and leads to an increase in production, starting the upswing. In much the same way the reduction in purchasing power of this part of national income during the boom eventually leads to a downturn.

Furthermore, Lederer (1925, 368) argues that cycles are a necessary concomitant of growth in a capitalist economy. Cyclical fluctuations could only be avoided in a planned economy (Lederer 1925, 413). Lederer's vision of planning as a solution to fluctuations does not imply the elimination of markets though. Instead, macroeconomic planning is expected to prevent disproportional developments that result from profit-oriented individual decisions with insufficient information. Lederer argues that credit control and the supervision of credit policies could take over this function under the guidance of the central bank (Lederer 1925, 412). Disproportional developments of sectors of the economy could thus be prevented.

[6]Lederer (1925, 390) also discusses exogenous causes of business cycles such as increased export demand.

[7]Schumpeter (1954, 1133 fn. 25) mentions Lederer's contribution (1925) as an example of disproportionality theories "that locate the source of cyclical troubles in 'maladjustments' as between different groups of prices and quantities."

Since Lederer explains business cycles as integral part of the capitalist process he rejects most contemporary suggestions of economic policies to overcome recessions as either ineffective or undesirable. The crisis is necessary for eliminating the disproportionalities in the production sphere that develop during the boom, the depression has to run its course. Therefore credit creation in the depression would only lead to inflation as long as the necessary adjustments have not taken place (Lederer 1925, 406). In theory a redistribution of income from profit to wage recipients could prevent the crisis (Lederer 1925, 401). But Lederer rejects the possibility since this would postpone necessary corrections in the production sphere. Likewise, wage increases would run counter to the deflation that is necessary in a depression to reverse the inflationary excesses of the boom. However, Lederer (1925, 403) welcomes trade unions' resistance to wage reductions in the depression, as stabilized wages will help stabilizing demand for consumption goods.[8] This is also the effect of public works and other support for the unemployed motivated by the aim of alleviating the hardship of workers.

Forms of government spending that go beyond such a limited extent are rejected by Lederer (1925, 407). He explicitly mentions bond financed government spending on war materials. Even though this would allow production and income generation during the crisis which would otherwise not take place, it is undesirable. Lederer argues that future taxes to finance present government spending - which Lederer assumes to be government consumption - would reduce savings and private investment. A reduction in capital accumulation and growth potential would therefore result from bond-financed government spending. In sum, although Lederer stresses the lack in aggregate demand as characteristic of the crisis he argues that demand stabilization in a Keynesian manner is not desirable.

Amongst the "particularly important English and American literature" that Lederer (1925, 355) lists in his article Hobson (1909) is mentioned in first place.[9] There are several aspects in Lederer's contribution that resemble Hobson's argument. Most importantly it is the vision of the economy's growth path as being ultimately determined by

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[8]Wages need to fall in the depression, but they should fall less rapidly than prices. Otherwise the crisis will be deepened.

[9]Lederer erroneously indicates 1910 as the publication date.

consumption goods demand. Firms react to perceived increases in effective demand and expand output accordingly. The same is true for the beginning of the crisis: insufficient demand leads to a reduction in supply. Furthermore, the intertemporal equilibrium concept underlying the analysis of disturbances builds on a given production technology with fixed income coefficients. Although Lederer does not explicitly discuss this issue, his argument can be understood to rest on assumptions similar to Hobson's.

Many of the theoretical arguments and economic policy conclusions that contrast Lederer and Hobson are linked to the Austrian heritage in Lederer's thinking. This is particularly conspicuous in Lederer's argument that crisis and depression are necessary to correct the misallocations of the boom period and in his rejection of policy measures that shorten the depression but possibly impede adjustments. Again in line with Austrian authors and in contrast to Hobson, Lederer stresses the importance of a credit expansion in the upswing. Monetary conditions are relevant in all phases of the cycle in Lederer's reasoning. Even though both authors are preoccupied with long term growth perspectives, Lederer stresses this "classical" concern more than Hobson. Lederer explicitly argues that savings are desirable in that they allow accumulation and growth. Therefore he rejects income redistribution aimed at an overall increase in consumption. It was argued above that in both Lederer and Hobson an intertemporal equilibrium concept underlies the analysis of the business cycle. In contrast to Hobson, Lederer is not interested in the analysis of the equilibrium growth path. This is substantiated in his later work on technical progress, where Lederer argues that growth processes are prone to interruptions and irregularities.

Lederer participated in the ongoing wage-employment debates in Germany. Together with the economists around Adolf Löwe in Kiel he fought against the opinion held by the majority of contemporary economists that wage cuts would lead to increased employment and recovery (Hagemann 1999, 121). In his contribution on the effects of wage reductions (1931b) he uses two sets of arguments. On the one hand he builds on the underconsumption explanation of the business cycle presented above, on the other hand he argues that the unemployment of the 1920s is a result of rationalization investment, an analysis that is developed in detail in his work on technical progress (1931a). If unemployment is the result of more capital intensive production techniques, wage reductions do not lead to an increase in employment. He rejects the traditional argument

that reduced wages implying reduced costs allow an increase in output by restoring profitability. This argument builds on the assumption of falling returns to scale. But as the modern capital intensive production technology is characterized by increasing returns to scale wage reductions have no such effect. Crucial for profitability is an increase in demand so that larger quantities can be produced at lower costs. Wage reductions do not lead to increased demand though. More likely they result in a reduction in the demand for consumption goods, unless the additional income that capitalists receive through wage cuts is spent on consumption. Investment of the additional income is undesirable since overcapacities are already existent.

Wage cuts were part of the policies of the German government in reaction to the crisis. Heinrich Brüning's government (March 1930 to May 1932) enforced deflationary policies (James 1986, 226-36). Measures aimed at balancing the budget and price and wage cuts characterized his orthodox response to the crisis. In line with prescriptions of the dominant over-investment explanations of the business cycle balanced budgets would leave savings for private sector investment. Furthermore, balanced budgets were seen as necessary to support the stability of the currency and thus as precondition for orderly debt services and reparations payments. The interventions concerning prices and wages were supported even by liberal economists who had argued that downward rigidities in prices and wages due to monopolistic trade and collusion kept markets from clearing. Brüning's response to the crisis was not only supported by the majority of German economists but approved by the experts of the Bank for International Settlements and Germany's creditors (Sanmann 1965, 120 and 127).

In the course of 1931, especially in the wake of the banking crisis, the downturn was no longer seen as part of a "normal" business cycle by many economists and politicians (Janssen 1998, 409). This view was also expressed by Lederer. He argued that the economy was "paralyzed" (Lederer 1932a, 40 and 1932b). The functioning of the market economy was disturbed by protectionism, incomplete capital mobility, government interventions into the production process through subsidies, and by collusion of market participants.[10] The automatic stabilization of demand during the depression as described in his business cycle theory of 1925 was not taking place. Bankruptcies and plant closures

[10]The view that the crises of the 1920s were "crises of interventionism" was widely held by economists (James 1986, 327).

exceeded the necessary restructuring during a “normal” depression. Instead, a downward spiral of falling prices, falling demand and falling incomes had set in (Lederer 1932a, 31).

Lederer argued that the banking system, taking over functions of macroeconomic planning, could encourage production and prepare the ground for recovery. A credit expansion would have to be directed at consumer goods industries, considering that additional investment demand was unlikely and undesirable in a situation of excess capacities in all sectors of the economy. If the automatic recovery in the course of a “normal” business cycle could no longer be expected, credit policy could drive the economic process and shape production (Lederer 1932a, 34). Lederer doubted that public works even on a large scale would be able to initiate a recovery by increasing demand and production beyond the scale of public spending. In other words, Lederer questioned that multiplier effects could induce a recovery. As in 1925 he emphasized the dangers of inflationary effects of public spending.

Lederer’s cautioning against credit financed public spending came in the context of a flood of expansionary policy plans that had started to be published in 1931 (James 1986, 332-42). Early in that year Brüning’s government had appointed a commission chaired by Heinrich Brauns to suggest measures to overcome the crisis. In their report Wilhelm Röpke’s suggestion to “start the economic engine” with a limited credit financed public spending program (“Initialzündung”) was laid out (Röpke 1931, 447). In January 1932 Ernst Wagemann presented a plan to overcome the paralysis of money and credit markets by a reform of the monetary system. The unions’ public works program based on Wladimir Woytinski’s ideas followed in April of the same year.[11] In addition to these suggestions based on business cycle analysis and theoretical debate a number of reform plans inspired by the perceived urge for action and contempt for theoretical economics were published. Jansen’s careful analysis and discussion is summed up in his statement that “During the years 1931 / 32 the confrontation was not between classical orthodoxy and German Keynesianism. Instead, an anti-theoretical reformism and activism, fed by strands of historicism, that found its most radical form in national socialism, was confronted with academic economics unable to come up with a joint majority view.” (Janssen 1998, 407) Controversial public debates followed. Central was the conflict about

[11] Bombach (1976) contains reprints of this and other contemporary policy proposals.

the possibilities of expansionary policies given the boundaries of the obligations towards the allies and the experience with the post-war hyperinflation. Lederer also voiced his concerns about inflationary effects once conservative monetary and budgetary policies were given up.

Such effects are avoided in Lederer's suggestion to organize a "barter sector" isolated from the rest of the economy (Lederer 1932a, 12-16). Within the barter sector idle factors of production would be employed and goods designated for the use of unemployed workers would be produced. Shut down plants could thus be reopened. Their owners would get compensation for depreciation but no profits. Workers would receive goods which they could only exchange within the barter sector but not sell to the rest of the economy. As soon as the proprietors would be willing to take up production the plants would be returned into their possession and output and employment would be part of the regular money exchange economy again. This suggestion reflects Lederer's belief that a planned economy could follow the aim of satisfying necessities where a profit-driven capitalist economy by necessity needs to grow. An impulse for the recovery of the entire economy was thus not intended with such measures. They should be interpreted in the tradition of 19th century public works programs that aimed at supporting the unemployed rather than in a Keynesian manner. Lederer offers a concept for such traditional unemployment policies corresponding to a modern economy with capital-intensive production techniques. The burden on budgets and credit markets is kept to a minimum.

Lederer's contributions to the debates during the Great Depression proof how difficult it is to fit him into the usual classifications. He rejects wage reductions as an ineffective measure to reduce unemployment. Part of his reasoning is built on underconsumption arguments. Added is the explanation of unemployment as a result of labor saving technical change independent of wage levels. Here Lederer is in opposition to the majority of economists, where in his stance on credit-financed public spending he stays with the orthodox. Fear of inflation on the one hand, cautionary expectations concerning the effectiveness of public spending on the other keep him from supporting expansionary budgetary policies. His concern with long-term growth perspectives surpasses fears of underconsumption as had already been the case in his 1925 article.

Switzerland

When discussing underconsumption arguments in the economic policy debates during the Great Depression Switzerland is a case worth mentioning. Since the social democratic opposition to the government's deflationary policies was based on underconsumption arguments they received an importance in the public debates which they did not have elsewhere. In Switzerland the depression set in later than in other industrialized countries. Although it was not as severe in terms of the decline in output and employment it was the worst and longest lasting recession Switzerland had experienced. The Swiss government followed an orthodox strategy of balancing the budget by tax increases and spending cuts. Wage and price decreases were considered necessary to bring the Swiss price level back in line with world market prices, since a devaluation was not considered a policy option until very shortly before the actual devaluation took place in 1936.

Public controversies over the adequate economic policy response to the crisis was initiated by the government's budget proposal presented to parliament in late 1932. The bill included a provision to cut the wages of public employees. It was taken to popular vote by the Social democratic opposition and forcefully rejected in May 1933. Economists participated on both sides of the debate. Eugen Böhler, economics professor at the Federal Technical Institute in Zurich, provided a justification for the government's policy along the lines of over-investment theories of the business cycle (Böhler 1932). The opposition view was represented in the academic debate by Fritz Marbach, a professor of economics at the University of Bern. He used underconsumption arguments in his business cycle analysis and policy suggestions (Marbach 1933). Like Hobson he sets out with criticizing the classical assumption that every act of saving is positive because it allows the future supply of goods to be increased. Marbach argues that rapid technical progress in the recent past has made plentiful supply possible. However, the distribution and absorption of the output does not take place smoothly. Marbach describes an underconsumption tendency. He argues that wage recipients are the principal source of demand for consumption goods and postulates that wages grow more slowly than output. Therefore an underconsumption crisis is inevitable.

This presumed tendency is aggravated in the business cycle. Marbach argues that high profits during an expansion induce high savings and an increase in investment. Therefore capital goods industries expand reacting to the increased demand for their products.

Aggregate wages grow due to an increase in employment, raising the consumption goods demand. However, growth in the capital goods industries exceeds the capacity necessary to sustain the expanded consumption goods demand (Marbach 1933, 32). As the additions to plant and equipment go into production the disproportionalities become apparent. The demand for capital goods declines. Through lay-offs the wage sum falls and the demand for consumer goods decreases correspondingly. Compared to the situation before the boom an increased supply of consumer goods now faces a reduced demand. A cumulative recession sets in.[12]

Where the argument so far is similar to Lederer's the conclusions that Marbach draws are different from his. Marbach claims that to overcome the crisis consumption goods demand has to be increased through income redistribution or wage payments in public works (Marbach 1933, 36). Marbach fights against the wage and price adjustment strategy supported by the Swiss government. Since he expects administered price cuts to be less effective than administered wage reductions a fall in real wages would result. This would aggravate the underconsumption crisis by further reducing the consumption goods demand of wage recipients (Marbach 1933, 47). Purchasing power would also be reduced by wage cuts for public employees. Marbach concedes that the reduction in the wage bill would be compensated by lowered tax payments. But this "redistribution of income" would reduce the demand for consumption goods (Marbach 1933, 62-64): wage cuts would predominantly reduce low incomes and thus consumption whereas the tax relieve would mainly benefit the wealthy who would save the additional income. Whereas savings would be invested in normal times, they would be left unexploited because of lacking profit expectations during the crisis (Marbach 1933, 38). The same argument with differing propensities to consume stood behind Marbach's call for tax financed public works. Progressive taxes would liquefy hoarded income or unexploited savings; public works would provide income to formerly unemployed who would spend it on consumer goods. The redistribution of income from wealthy to poor would thus increase consumer goods demand.

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[12]Similar to Lederer in his work on technical progress Marbach (1933, 27) argues that modern capitalist production is characterized by an increase of fixed in relation to variable capital. According to Marbach this puts additional pressure on the profitability of firms as output falls, an observation that reminds of similar arguments in Lederer.

The above shows that Marbach was much more of a "crude" underconsumptionist than the authors discussed so far. He uses several lines of thought familiar from Hobson and Lederer in developing a vision of economic activity determined by consumption goods demand. In contrast to Hobson and Lederer his discussion is limited to a short-term perspective, concentrating on current demand and supply of consumption goods. Marbach argues that in the depression savings are not automatically invested. Hoarding and "unexploited savings" are central to his vision of the depression. Aspects of growth that are important in both Hobson and Lederer are not mentioned, an intertemporal perspective is not developed.

William T. Foster and Waddill Catchings

In contrast to the authors discussed so far William T. Foster and Waddill Catchings advance a monetary explanation for underconsumption crises in *Profits* (1925). The argument starts from familiar presentations of "Say's identity:" supply and demand are necessarily equal in a barter economy as goods brought to the market constitute an equivalent demand for other goods (Foster and Catchings 1925, 249). Foster and Catchings (1925, 231) continue that in a monetary economy equilibrium cannot be attained, "unless consumers somehow obtain enough money, year in and year out, to buy the goods about as rapidly as they are produced" but "the present money and profit economy does not enable consumers long to obtain the required money." This statement is substantiated by the following reasoning: Savings lead to disequilibria as they interrupt the flow of money between producers and consumers with the result that consumers do not command the entire amount of money necessary to buy the output of consumption goods. Foster and Catchings argue with the effect of corporate savings.[13] If firms retain and reinvest profits instead of distributing dividends money is withdrawn from its "normal" circulation between producers and consumers. As consumers command less than the full amount of money, demand for consumption goods is lacking. At the same time output is increased through the additional investment. Excess supply results, stocks pile up and producers react with curbing production, laying off workers and thereby further decreasing consumers' demand. The attempt to increase output is self-defeating because the monetary system does not enable consumers to absorb the increased

[13]Individual savings have the same effect if they are channeled through the banking system into investment (Foster and Catchings 1925, 288-95).

production. The authors do not doubt the necessity of saving in order to improve living standards through increased production. But savings lead inevitably to deficiencies in "consumer purchasing power." This is Foster and Catchings' "dilemma of thrift" (Foster and Catchings 1925, 196). Solving the "dilemma" would eliminate the business cycle and allow sustained growth.

Although Foster and Catchings emphasize that they want to refrain from drawing policy conclusions in *Profits* (1925, vi), their later recommendations are implied. The solution to the "dilemma of thrift" is to increase the amount of money at consumers' disposal. This is best achieved through financing public works, where the additional money is spent on wages. The effect is not offset by an increased consumer goods supply, since government expenditures "put the money into the hands of consumers without putting commodities into consumers' markets" (Foster and Catchings 1925, 335).[14] An expansion of the money supply flowing into investment will not reduce excess supply in consumption goods. Although aggregate wage payments are increased only part of the additional money will reach consumers, the other part flows into profits. As these are invested output is further increased. Demand deficiencies will therefore be aggravated unless the money supply is increased continuously at an accelerating rate (Foster and Catchings 1925, 310). Nonetheless, Foster and Catchings support expansionary monetary policies in general.[15] They become advocates of replacing the gold standard by a fiat money system and support the reflation propositions of the early thirties (Foster 1932/33, 66-8).

[14]Tax cuts which are not accompanied by reduced spending but offset by borrowing have the same result. Tax financed expenditure does not diminish the deficiency in consumers' demand according to this logic (Foster and Catchings 1925, 337). Hence Foster criticizes the Hoover and Roosevelt administrations' attempts to balance the budget (Foster 1932/33, 67).

[15]Foster and Catchings emphatically criticized the Federal Reserve for applying pressure on the Federal Reserve District Banks in early 1929 to deny rediscounting to banks who used the funds to lend in the call market (Barber 1985, 75-6).

Foster and Catchings refer to Hobson and discuss some of his propositions. It is possible that they were first introduced to underconsumption ideas through his teachings.[16] Even if they took their inspiration from Hobson they changed basic assumptions leading them to completely different conclusions. Although Hobson explains his theory in monetary terms, money is merely a medium of exchange. In contrast, Foster and Catchings assign important functions to money. Another fundamental difference concerns the treatment of capital. On the surface Foster and Catchings' investigation in terms of a fully integrated production process could be envisioned as a development of Hobson's description of production as transforming primary inputs into final products in a series of stages. The crucial difference arises from their conception of capital. Whereas Hobson defines capital as the value of (physical) capital goods applied at the different stages of the production process, in Foster and Catchings capital is a fund.

Foster and Catchings (1925, 355-7) reject Hobson's suggestion to increase consumption goods demand through redistribution. The basic problem of insufficient consumer purchasing power as they define it would not be solved. During the Great Depression Foster concedes that demand deficiencies can be mitigated and urges to "...increase the incomes of those who desire to consume, and reduce the incomes of the very wealthy" through progressive taxation and the taxation of profits and inheritances (Foster 1932/33, 60). Furthermore unlike Hobson and in keeping with their ideas Foster and Catchings reject planing since it does not offer a solution to the "dilemma of thrift" (Foster and Catchings 1925, 305-6).

Robertson (1983[1929], 161) summarizes his critique of Foster and Catchings in his statement that "The tools with which they work are not sharp enough." This pertains to their concepts of saving and of capital. While Foster and Catchings condemn a popular understanding where saving "merely means saving money instead of spending it," they only advance beyond it by pointing to the reduction in consumers' demand in the period in which savings are made (Foster and Catchings 1925, 400). They lack a notion of the process of real saving, where saving implies a reduction of current in favor of future consumption. In Foster and Catchings savings increase production. In the arithmetic

[16]Brailsford points out that Hobson's ideas were disseminated in the United States not only through his books but also through newspaper articles and public lectures (Brailsford 1948, 12-3).

models the authors use to demonstrate their assertions this means that savings are used to pay additional wages to expand a fully integrated production process. Their understanding of capital remains obscure though. This is true as much for real capital as a means of production as for financial capital which they explicitly analyze by introducing credit. Additional investment does not change the capital intensity of production but increases employment at unchanged wages.[17] This presupposes unemployment, an assumption that is not made explicitly. With a fully integrated production process Foster and Catchings are unable to perceive of the underconsumption crisis as a sectoral imbalance as Lederer and Hobson do. It therefore remains unclear which form "increased capital facilities" take and where they come from. Their role in production is not discussed (Foster and Catchings 1925, 276-7).

The problems arising from the inadequate elaboration of the functions of saving and capital in the economy are compounded by a superficial conceptionalization of money. This is particularly obvious in their equating money with income and in their discussion of corporate saving and of credit (Foster and Catchings 1925, 235, 266, 309). The deficiency of money in the hands of potential buyers is brought about by restrictive assumptions about the circulation within their arithmetic models. In his detailed discussion of these models Robertson (1983[1929], 145-7) highlights the importance of the authors' assumptions about the payment of dividends. Foster and Catchings assume that dividends cannot be paid until the receipts out of which they are paid have actually been collected by the firms. Robertson discusses the role of this assumption in the emergence of demand deficiencies. Furthermore, Foster and Catchings presume that dividend payments do not change following an increase in production. Robertson points out that this assumption is neither explained nor justified by experience. He relates it to the authors' restrictive propositions about the circulation of money and the use of credit (Robertson 1983[1929], 154-7).

[17]This is the starting point for Hayek's critique of Foster and Catchings' ideas (Hayek 1939[1929], 221). He explains the effects of saving and investment in an Austrian model and shows how an expansion of output is possible without leading to a crisis. He points out the possibility of imbalances between different stages of production following misguided credit policies (252-3). Based on this he rejects their policy prescriptions and argues along familiar lines of his own business cycle theory that expansionary monetary policy would magnify disequilibria (256-63).

Foster and Catchings had very little if any formal training in economics, in contrast to Lederer and Hobson.[18] Their analysis reflects popular notions and an acquaintance with economic issues from a business perspective. They do not seem to be familiar with even basic concepts of traditional economics. They were true "cranks" and as such also truly convinced of their findings.[19] Their ideas seem to have been developed within a rather limited time frame and didn't change much in response to criticism. The Pollak Foundation was brought into existence by them with the purpose of proselytizing the economics profession and the general public. The publication of *Profits* (1925) was accompanied by a prize contest: $ 5000 were offered for the best "adverse criticism" of the theory.[20] Although the participants pointed out several shortcomings of their ideas and although Hayek and Robertson published diligent assessments in professional journals, Foster and Catchings could not be convinced that any of their teachings were lacking. They restated their central ideas and policy prescriptions in popular language in several books and essays and toured the country with talks.

Public opinion in the early years of the Great Depression in the United States was more sympathetic to expansionary policy suggestions than either in Great Britain, Germany or Switzerland. The post-World War I sentiment towards the economy had been characterized by two contradictory currents. On the one hand the official rhetoric, especially during the 1920 election campaign, cherished laissez-faire and a minimal role

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[18]Foster and Catchings had been undergraduate classmates at Harvard. Foster was a pedagogue and the first President of Reed College, Catchings had made a successful career in business, accumulating a considerable fortune as a partner at Goldman-Sachs (Barber 1985, 208). Being a member of the War Labor Board started his interest in issues of employment stabilization. In 1920 he and some former Harvard colleagues founded the "Pollak Foundation for Economic Research." Foster became director of the institution. Apart from several books by renown economists, the foundation published a series of contributions by Foster and Catchings (for a listing see Hayek 1939 [1929], 201, 203).

[19]Barber's (1985, 55-7) assessment of Foster and Catchings as "amateur economists" is much more friendly than mine. He interprets their writings through a Keynesian lense, highlighting arguments that make sense in a Keynesian framework. He particularly stresses their mentioning of potentially missing links between saving and investment. As argued above, these arguments are not central to their explanation of crises though.

[20]This considerable sum of money attracted over 400 submissions, many from academics and professional economists. Wesley C. Mitchell (Columbia University), Allyn A. Young (Harvard) and Owen D. Young (Chairman of General Electric Company) appraised the articles. The best essays were published by the Pollak Foundation.

for government. On the other hand a new approach to economic progress took shape under then Secretary of Commerce Hoover (Barber 1985, 1). It partly grew out of the war experience with its unprecedented government intervention under the auspices of a tight cooperation between government, the business community and members of the economics profession.[21] During those years the production in the United States had been expanded well beyond any expectation. The new approach also reflected the post-war sentiment that "the United States had both an opportunity and an obligation to chart a fresh and uniquely American course toward human betterment" (Barber 1985, 4). A central ingredient of this economic concept was the belief that business cycles were not inevitable and that government could play an important role in avoiding them. Among other measures Hoover and his collaborators suggested that anticyclical public spending would contribute significantly to smoothing fluctuations. They stressed not only the direct effect on aggregate demand but also the "multiplying effect of successive use of funds in circulation."[22] Since the bulk of public investment was the responsibility of state and local governments, the federal government's role would consist in guiding them on the proper timing. Furthermore, the federal government would inform the private sector of the advantages of counter cyclical investment. This form of indicative planning would not compromise the freedom of the lower levels of government or of the private sector (Barber 1985, 19). Furthermore, the demand for consumer goods was supposed to be stabilized by supporting wage levels through immigration restrictions and tariffs on imports (Barber 1985, 30 and 34).

But in the course of 1931 the stabilization strategy developed in the 1920s had proved insufficient to address the extraordinary challenges of the Great Depression. Adjustments to this situation had to be made, especially in view of the financial crisis. Whereas the

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[21]Bernstein (2001) discusses the importance of these developments for the professionalization of economics as a field.

[22]These ideas were developed in the *Report of the President's Conference on Unemployment* (1921). Members of the committee that drew up the report included Wesley Mitchell, Edwin R.A. Seligman, Allyn A. Young and other economists, representatives of the business community and public officials (see the comprehensive list in Barber 1985, 201).

Hoover administration at least in the rhetoric returned to more orthodox economic policy, the pressure for increased public spending persisted in Congress.[23]

Roosevelt who had run his election campaign in 1932 on a balanced budget platform mixed this policy prescription with interventionist measures. He did not share Hoover's inhibitions to involve the federal government in areas that were considered the domain of lower levels of government or of the private sector. Also in contrast to Hoover, who had supported the gold standard, Roosevelt believed reflation would contribute to recovery. The gold standard was abandoned in April 1933 and the Dollar weakened considerably over the following months, reverting the deflationary tendencies of the previous years (Eichengreen 1995, 343).

A wide variety of views on business cycle theory and policy were held by American economists in the 1920s and 1930s (Laidler 1999, 181-244). The only occasions where the profession was fairly united in those years was in its opposition to the tariff legislation of the Smoot-Hawley Bill and in its rejection of a relaxation of antitrust laws as advocated by parts of the business community in the course of the depression (Barber 1985, 91 and 166). On all other issues opinions were hardly so unified.

The Hoover camp was also represented in the academic debate as several renown economists had served on the committees that developed the concepts of the 1920s and continued to consult the administration. Parts of the profession adhered at least initially to "classical" economic policy advice rejecting public works as ineffective and inflationary (Dimand 1988, 75). Alvin Hansen was a case in point who blamed the interventionist policies of the 1920s and during the early years of the crisis for the severity and duration of the depression. He argued that the government should support the adjustment process through measures enhancing price flexibility. Public works could only be useful to recovery after the adjustment was completed (Barber 1985, 164-5). Progressive economists were to be found in a group at the University of Chicago around Jacob Viner, Paul Douglas and Henry Simons.[24] They argued for counter cyclical public expenditure.

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[23]Barber (1985, 137-8) argues that Hoover's change in strategies in 1931/32 was not a recantation of the belief in government intervention but an adjustment to new priorities.

[24]Laidler (1999, 222-228) discusses the underconsumptionist arguments of Douglas in detail.

Balancing of the budget over the cycle rather than in every single year was advocated as part of the strategy. These Keynesian policy recommendations were derived from a neoclassical model where price rigidities prevent a return of the economic system to full employment; at the same time ingredients of Keynesian economics such as Kahn's multiplier were integrated into the argument (Davis 1971, 42). The increasing support of economists for public works is also documented by the recommendations made by the participants of the Harris Foundation meetings in 1931/32. They agreed on a petition telegraphed to President Hoover in support of an array of expansionary policies, including sustaining the public works spending of 1930-31 (Davis 1971, 108-15).

This is the context of Foster and Catchings' activities. As mentioned above they disseminated their ideas aiming to convince professional economists as much as the general public. They did not join a political party, but they tried to influence decision makers through an array of venues.[25] They acted as permanent commentators during the depression years with contributions to the leading national periodicals, syndicated columns and publications of the Pollak Foundation (for references see Barber 1985, 58, 75, 87, 100). It is impossible to evaluate how important they were in shaping public opinion towards the acceptance of public works spending. Their message was simple - the depression can be ended - and must have reached a wide audience. That they were effective can only be inferred from Hayek's warning remarks. He feared that Foster and Catchings might be able to "exert a certain influence on policy in Anglo-Saxon countries" because they "are people who spare neither money nor time in the propagation of their ideas." (Hayek 1939 [1929], 200) It is also clear though, that however successful they were in propagating public spending, their audience was already fairly open to this approach. Since at least parts of the administration and of the economics profession had supported the idea that anticyclical spending could smooth the business cycle and that such smoothing was desirable, they were not swimming against the stream.

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[25]In 1928 Foster accompanied Governor Ralph O. Brewster of Maine as expert witness to set out the case for increased public works spending before the Conference of State Governors in accord with Hoover's recommendations as Secretary of Commerce (Barber 1985, 58).

Evaluation: Underconsumption theories and Keynesian economics

John Stuart Mill's (1987 [1848], 557) assessment of underconsumption arguments characterizes the reception they obtained from traditional economics over more than a century: "The doctrine appears to me to involve so much inconsistency in its very conception, that I feel considerable difficulty in giving any statement of it which shall be at once clear, and satisfactory to its supporters." Keynes (1973 [1936]) challenges this view in chapter 23 of *The general theory of employment, interest and money*. In his "Notes on mercantilism, the usury laws, stamped money and theories of under-consumption" he argues that these strands of economic reasoning have been unduly criticized and rejected by classical economists. He offers reinterpretations on the background of his own theory and finds praise for authors who had developed reasoning that parallels arguments used in the *General Theory*. At the same time he belittles their contributions by using language that implies that the rank and file of the "brave army of heretics" should not be taken too seriously.[26]

Haberler devotes a chapter in his *Prosperity and depression* to "Under-consumption theories." In the introduction he points out that "The authors who have done most in recent times to re-state and propagate the under-consumption theory in a scientific way are Mr. J.A. Hobson in England, Messrs. W.T. Foster and W. Catchings in the United States and Professor Emil Lederer in Germany." (Haberler 1963[1937], 118) Whereas I have here presented the theories of these three authors as attempts at explaining business cycles systematically, Haberler analyzes individual propositions recurring in underconsumption theories. He discusses their relation to over-investment theories and evaluates their plausibility and coherence. Even if he takes pains to do them justice and to single out sound ideas from "unqualified statements" the distrust formulated by Mill prevails.

In the entry on "underconsumption" in *The New Palgrave* Schneider (1987, 744) states that "Underconsumption theories have never been acceptable to orthodox economists, perhaps partly because underconsumptionists in general have lacked rigour in the exposition of their ideas..." The examples we have discussed above vary widely in this

[26] A similar rhetorical strategy is used by Schumpeter (1954, 1130) when introducing Hobson as someone who seems to stand "in something that to many looks very like a halo of glory."

respect. With Lederer, an academic economist, this criticism is least justified. If lack of rigor is perceived in his argument this may be attributable to the fact that Lederer does not stay within a single theoretical tradition but integrates aspects of neoclassical, Marxist and Austrian analysis. Hobson, although writing with a sound background of academic training in economics, aims his contributions at a broader than the academic audience. Therefore, in the exposition of his ideas he appeals to commonsense interpretations of economic phenomena, rigor in the eyes of orthodox economists does not seem to be among his priorities. As argued above, Foster and Catchings merit to be called cranks, their arguments are idiosyncratic and build on insufficiently developed concepts.

After the above discussion of the individual theories in their own right, stressing the differences between them, we are now in a position to reflect on their common ground. The outstanding characteristic is that all authors strive for a vision of economic activity as ultimately determined by the demand for consumption goods. This sets underconsumption theories apart from the classical tradition where production is analyzed as the driving force of economic activity and demand is seen as a logical consequence as implied by Say's law of markets. Instead, underconsumptionists direct their attention to the role aggregate demand for consumption goods plays in regulating aggregate employment and income. This is were underconsumption theories point in the direction of Keynesian economics. They narrowly focus on consumption goods demand as the ultimate incentive to production. The concentration on consumer goods brings with it a relative neglect of all aspects involving investment goods production. Investment is seen only as serving the production of consumer goods. Its role in creating employment and income, a key argument in Keynesian economic theory, is not perceived. The authors discussed here do not develop or integrate the concept of a multiplier in their arguments. These crucial differences to Keynesian economics are underscored in the description of the underemployment situation. In Keynes it is aggregate demand that is insufficient to fully utilize production capacity, in underconsumptionists inadequate demand for consumption goods characterizes the crisis. An increase in investment demand which solves the problem in a Keynesian perspective aggravates the disequilibrium described by underconsumptionists.

Notwithstanding their criticism of traditional economics, underconsumption theorists retain a central classical assumption by positing a direct link between saving and

investment. Although the authors discussed here all address hoarding, it is considered an abnormality and inessential in explaining the crisis. As argued above Marbach stands out in this respect. He does not develop the consequences of this changed perspective though. Hoarding is described as an aspect of the depression not as a cause. Investment equals saving ex ante, no independent investment demand function is introduced. Therefore the vision of a demand driven economy that Keynes develops is only partially anticipated by underconsumptionists. The quasi-automatic increase in production capacity drives the economy into disequilibrium and not autonomous changes in aggregate demand. In underconsumption theories savings and investment break down once the production facilities built up during the boom by excessive saving go into production. At this point the increased supply of consumption goods meets with inadequate demand. The incomes that can be realized in such circumstances fall short of the value of total output (Schneider 1987, 742). This perception is different from a Keynesian circular flow perspective where savings and investment are necessarily equal ex post, the equilibrium being brought about by income adjustments.

Underconsumptionists raise the issue of general or macro-economic disruptions in the context of a growing economy. They discuss intertemporal coordination, i.e. the coordination of consumption, saving, and investment decisions. They analyze divergences between planned and realized values and volumes, the causes and effects of disequilibria. Here again they differ from a Keynesian short-term perspective.[27] Whereas the early phase of the business cycle may provide employment through an expansion of production capacity this does not guarantee that the facilities can be employed profitably in the future given insufficient demand for their output. In this respect the macroeconomic analysis offered by underconsumptionists is closer to classical concerns than to Keynesian economics focusing on short-term equilibria.

The underconsumptionists have in common the rejection of the classical assumption of a natural harmony between the interests of individuals and society. The proposition advanced by classical and neoclassical authors that market forces bring about prosperity and growth is questioned. Instead, underconsumption is seen as responsible for cyclical

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[27]As argued above, in this respect Marbach stands out from the other authors discussed here. He is closer to Keynes in applying a short-term perspective.

or secular decline in growth (Schneider 1987, 741).[28] Government intervention is therefore desirable and increases the “wealth of nations” beyond the level brought about by markets alone. Some of the policy prescriptions based on underconsumption arguments anticipate Keynesian policies although based on different reasoning as has been argued above.

Wage cuts as a remedy for unemployment, a proposition supported by orthodox economists, was rejected by all authors discussed here. The suggestions concerning expansionary fiscal policy vary according to the differences in the theoretical argument. Government spending which increases employment and thus adds to the demand for consumption goods during the crisis is supported. Lederer rejects government spending on a scale that goes beyond the stabilization of consumption goods demand since he stresses the importance of restructuring during the recession which would be postponed or prevented. He also disapproves of income redistribution from groups with high savings to groups with high propensities to consume, a policy proposition favored by Hobson and Marbach. Monetary policy, the preferred means to increase consumers’ spending in the views of Foster and Catchings is also rejected by Lederer. Macroeconomic planning or the nationalization of key industries is seen as a possibility to overcome underconsumption by Hobson and Lederer. The causes of underconsumption as described by Foster and Catchings would not be addressed through such measures.

The theories presented by the underconsumptionists discussed here differ in terms of the quality and stringency of the argument. Their success in influencing public opinion and even policies seems to have been independent of these criteria though. Underconsumption arguments were most influential in Switzerland, since the political opposition used them to advocate changes in the government’s policies. Part of this success has to be attributed to the fact that the underconsumption argument was the only one used to support the demand for increases in government spending in Switzerland. In Great Britain, Germany and the United States underconsumptionists were not alone in criticizing orthodox economic policies. Traditional arguments for public works, the concept of a “secondary deflation” and other arguments derived from mainstream theories were developed to support the demand for expansionary public policies.

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[28]Like Schneider I would support a wider definition than Bleaney who argues that a tendency towards stagnation of the capitalist economy is at the core of underconsumption arguments. The authors discussed here all stress underconsumption as a cyclical phenomenon (Bleaney 1976, 11).

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