The Great Economic Depression: An Event for Structural Restructuratation of The Theoretical Frame Work of Economic is – A Historical Analysis

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Abstract

The great Depression of the 1930s is a landmark in the economic history of the world. It marked a historical transition in economic theorizing. The classical thought lost its prominence and Keynesian theory became main pillar of Economic thought. It prescribed an immediate and lasting solution to the depression which was engulfed the entire world. It stood for government intervention and govt. spending to revive the economy during a period of depression. It was not against capitalism, rather an attempt to rectify the inherent flows of capitalism and make it stronger. Keynesian theory served as the standard economic model in the later part of the Great Depression, Second World War and post war economic expansion, though it lost some influence following the oil shock and resulting stagflation of the 1970s.Eventhough many scholars in addition to classical and Keynesian theories offered various solutions to redeem the crisis, it was the Keynesian solution offered timely and effective solution. The Great Depression marked the breakdown of the classical world of business cycles and laissez-faire, and emerged as leading one on both the national and international levels. In addition to Classical and Keynesian theories a slew of other economic theories and concepts came to arena with solutions to it. This paper attempts to look into some of the theories which tried to find solution to the great Depression in historical ways.

Keywords: *Depression, Keynesian Economics, Neoclassical Economics, Marxian Economics, boom, recession, stagflation, Capitalist Crisis*

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Great Economic Depression of 1930s is an event of great significance revolves round four pillars viz Boom, Recession, Depression and Revival. Everything in the universe undergoes these four stages in the life cycle. This was happening from the very beginning. But it was given serious dimension only after the Great Depression of 1930s.The USA the most developed country in the world was most affected by the same. The Ripples of the same was seen in one form or the other throughout the world. India had also its most severe depression ever experienced by the world. Even though it was started in USA it brought about drastic declines in output, severe unemployment and acute deflation in every country of the globe. Economic Historians estimate that in the 75 years before the Depression there had been 19 recessions. But they lasted an average of less than two years. The Great Depression lasted for more than a decade. The severity and the duration of the Great Depressions distinguish it from other contractions. Therefore we give it a much stronger name than recession. The Great Depression began with the sudden and total collapse of U.S. stock market prices on October 29, 1929, known as Black Tuesday. After the Wall Street crash the severest economic crisis of the 20th century began, followed by one of the greatest humanitarian catastrophes of the 20th century, World War II. The Great Depression spread like a virus throughout many institutions and countries. Banks, companies, governments, and families were infected and the world's economic growth came to a long lasting halt.

When depression became acute countries each other adopted a protective trade policy. As a result of the desire to protect each economy from others the great Depression witnessed a rapid circulation of anti-free trade sentiment demanding tariff and quota protection for local production and employment. Countries competed each other for setting up barriers to imports. The capitalists in each other country wanted to preserve what was left of their markets from foreign competition by setting up barriers to imports and their workers often thought such protection would help them to keep their jobs. The result was a serious of competitive protection measures such as countries responded to export barriers by creating more walls to keep out imports. The result was a dramatic decline in world trade, drying up of export markets and deeper depression in output and unemployment. The breakdown in international trade was a major factor in making the Great depression a worldwide phenomenon and in making it so deep and so prolonged. It led to the abandonment of the Gold standard. Business cycle collapsed. People were thrown out of work and those who had jobs were more likely to accept lower wages which capitalists translated into lower costs, higher profits, more optimistic expectations and new investment.

Great Economic depression sowed the seeds of untold miseries in socio political and economic life of the people. Total anarchy existed everywhere. Industrial sector experienced a great set back due to steep fall in the demand and industrialist forced to adopt some new strategies for existence. Industrial firms adopted the policy of downsizing the labour force by implementing new work methods such as Taylorism and Fordism-the division of the work into very simple deskilled jobs. The generalized imposition of this kind of work resulted in the de-skilling of a whole work force and older craft unions were no longer become relevant to a new generation of workers in manufacturing. It led to the massive unemployment. The discontent of the labour class became wide spread and they thought about forming trade unions and fought for union recognition, higher wages and such benefits as unemployment compensation. Thus 1930s saw the formation of the major industrial unions. Therefore socio political and economic situation in the entire world became turbulent. Unemployment became a burning issue. An urgent and effective solution became the need of the time.

The leadership of different countries responded to this challenge based on their historical social and political situations. In Russia Stalin adopted the policy of raising the surplus through the forced labor camps which is known as Gulag, generalized police state repression and collectivization of the peasantry mainly to collect their produce. Hitler took the power amidst the crisis of the Weimer Republic and solved the problem of workers 'revolt and capitalist accumulation by instituting Nazism, corporatism and labour camps. But such policies never offered a solace to the problems. Searching for literature about the Great Depression, one finds out that a wide range of theories exist from a wide range of sources. Focusing on only a few models does not create a complete understanding of the reasons the crisis occurred in the first place. The models often contradict each other, or explain only small aspects. Combining these theories, which can be seen as pieces to a puzzle, decodes the larger underlying causes of the Great Depression. It is true that the Great Depression came as a rude shock to both economic theorists and economic Historians all over the world .As far as economists are concerned it questioned the credibility and practicability of conventional wisdom of economics. To Economic Historians its course and repercussions are far way of their predictions. It was an economic catastrophe which shackled very foundation world Economic order. It led to a periodization in the world economic history viz World Economic History before and after the Great Depression. It necessitated structural restructuration of the theoretical frame work of economics. Until 1929 theoretical foundations of Economics was built upon classical tradition of macro economics. The classical economic theory is also known as liberal economic theory. It asserts that markets function best without government intervention. It was developed in the late 18th century by Adam Smith, Jean-Baptiste Say, David Richardo, Thomas Robert Malthus and J.S Mill. Many writers found that Adam Smith's idea of free markets is more convincing and widely accepted at the time of Protestantism.

The Great Depression marked a theoretical shift in Economic thought. Economists all over the world entered into the platform of theoretical debate and discussion putting forward different theories and concepts to tide over the crisis. Even common man prescribed their own solutions to this problem as it was inversely affected their everyday existence. The Great depression actually broadened the theoretical and intellectual levels of economic theorizing. The Most leading theories that dominated theorizing are classical school of Economics, Keynesian Economics, Austrian Business cycle Theory, Marxism Debt-Deflation theory and Monetarism.However main theoretical confrontation was between classical and Keynesian school of Economics. It shackled the foundation of classical economic theorizing which started with publication of Adam smith's treatise 'The wealth of Nations' in 1776 .The fundamental message in Smith's influential book was that the wealth of nations was based not on gold but on trade. It is based on the assumption that when two parties freely agree to exchange things of value, both parties see a profit in exchange and therefore total wealth increases. Classical economists totally rejected state intervention in economy. They held the view that the markets is not the best place for state intervention and state has no role ensuring common good and that should be done by those who best able to afford them. The Classical economists observed that market was always free from external forces and rooted in the concept of Laissez-faire economic market. It permits individuals to act according to their own self interest regarding economic decisions. Economic resources are allocated according to the desires of individuals and businesses in the market place. It emphasizes on value theory to determine prices in market. A value is determined based on production output, technology and wages paid to produce the item.

The classical economics focused on creating long term solutions for economic problem. The classical economist held the view that all problems in an economy would be solved in natural ways in long run. Economy has its own ability to adjust its problems in the long run and has ability to maintain its natural level of growth, to bring potential output, natural level of employment etc. Economists of the classical school saw the massive slump that occurred in much of the world in the late 1920s and early 1930s as a short term aberrations. But Keynesian theory is totally against classical economic theory. Great Depression of 1930s brought a radical theoretical shift .It challenged formula put forward by classical economists to tide over serious economic crisis. However it was not against capitalism it suggested state intervention is important in such crisis situation. The new theory was developed by the British economist John Maynard Keynes during 1930s in an attempt to understand Great Depression. Keynes prescribed increased government expenditure in economy and reduction of taxes to stimulate demand and pull global economy out of the Depression. Keynesian economics is not left wing, but attempted to solve the crisis at earliest. Keynes said that capitalism is a good economic system. Under capitalism People can freely earn money and spend their money on things they want.

Keynesian economics offered a new framework of macro economics analysis to solve the historic economic crush down of 1930s. In historical point of view it radically changed macro economic analysis of classical thought in economics. It dismissed the notion that the economy has innate ability to achieve state of equilibrium in the long run. It upheld the notion that Intervention of the state is essential in an economic system. Role of State is crucial in crisis situation of an economy. State is able to solve any long term and short term crisis through its monetary and fiscal policy in an economy. When Keynesian theory became popular, Laissez-faire and business cycle as a regulatory mechanism lost its significance in economic theorizing. Keynesian economics was an attempt to understand the Great Depression. Keynes advocated increased for increased government expenditures and lower taxes to stimulate demand and pull the global economy out of the depression. Subsequently the term Keynesian economics was used to refer the concept that optical economic performance achieved and economic slumps prevented by influencing aggregate demand through activist stabilization and economic intervention policies by Government.

The Great depression proved that classical economic theoretical framework could not be able to provide an effective and stable solution to this great financial crush. In the wake of Great financial crush of 1929, as the economy plunged in to crisis, the cycle went down and did not come up again itself. It stayed down. The financial crush became generalized down turn, recession became depression and there was no restoration of growth. When depression started the classical economists followed the older strategies. Crisis deepened and deepened day by day. Both internal and international economic adjustment mechanisms crumbled. Instead of helping to solve the problems, the gold standard became a vehicle for the rapid circulation of crisis from country to country. Trade deficits accentuated the contraction of the money supply and put even greater downward pressure on prices; which in turn provoked further cut backs in output and employment. The classical economists ignored the importance of government spending in an economic system and stressed much on consumer spending and business investment .To classical economists government spending and involvement could retard the economic growth of the nation by increasing public sector and decreasing the private sector. But Keynesian theory dictates that government spending can improve or take the place of economic growth in the absence of consumer spending or business investment.

Keynesian Economics focused on immediate result oriented theories. Its strategies concentrate on short term needs and how economic policies can make instant corrections to a nation and economy. This is why government spending is a key log of Keynesian economics. During economic recessions and depression individuals and businesses do not usually have the resources for creating immediate results through consumer spending or business investment. The Government is seen as the only force to end these downturns through monetary or fiscal policies providing instant economic results.

The experience of the Great Depression provided an impressive confirmation of with Keynesian arguments. The reduction in aggregate demand took economy from its potential output to below its potential output. The reduction in aggregate demand began with a collapse in investment. Due to the stock market crush of 1929 all business enterprises reduced investments in market and reduced the wealth of a small fraction of the population. Therefore money supply in economy was plunged. It certainly reduced the consumption of the general population. The stock market crush reduced consumer confidence throughout the economy. Keynesianism became an international monetary system through agreements signed at a conference at Bretton Woods, New Hampshire in 1944. It replaced the pre-war system of the gold standard that had broken down during the global depression of the 1930s. Keynesianism asserted that adjustments in international relations could be carried out by national governments. Under the gold standard, deficits or surpluses in the balance of payments would tend to be corrected by automatic changes in gold flows, money supply and prices. But under the Bretton Woods' regime of fixed exchange rates, although gold was still used for international payments, domestic money supplies were no longer tied to gold and it was up to governments to take whatever measures they deemed appropriate to correct imbalances.

Like Keynes Ludwig von Mises, An Austrian Economic theoretician expounded a theory to redeem the crisis. He was the acknowledged leader of the Austrian School of economic thought. He was a prodigious originator in economic theory, and a prolific author. His writings and lectures encompassed economic theory, history, epistemology, government, and political philosophy. He developed an economic theory which emphasized on important clarifications on the quantity theory of money, the theory of the trade cycle, the integration of monetary theory with economic theory in general. He was against socialism and asserted that and that socialism could not solve the problems of Depression. Mises was the first scholar to recognize that economics is part of a larger science in human action, a science that he called "praxeology." Ludwig von Mises lived through the Great Depression as Keynes did, and produced his own explanation of it.

Around 1930 Mises joined an Austrian government economic commission to study the causes of the depression in Austria, The report of the committee blamed the inflationary expectations in Austria and the rises in taxation and government spending and increased wage rates which had all squeezed business profits and failed to attract foreign capital. Foreign capital needed to facilitate quicker adjustment and recovery from the depression. But Mises was not satisfied with the report and formed his own explanations for the depression, which were published as various articles and papers. On February 28, 1931, Mises gave a lecture called "The Causes of the World Economic Crisis" in Czechoslovakia. In the published version of that lecture, he expounded his famous Austrian business cycle theory (ABCT).It basically an economic theory that explains how business cycles occur. The theory views business cycles as the consequence of excessive growth in bank credit, due to artificially low interest rates set by a central bank or fractional reserve banks. This theory emphasizes a free market, minimal government intervention, laissez-faire, and commodity-backed currency. The ABC theory is an unorthodox business cycle theory .It stresses non-intervention as opposed to mainstream Keynesian policy. Because it is an outlier in economic teachings it has received less attention.

The ABCT theory explains that the economic down turn of 1930s was an outcome of credit expansion. It was an unavoidable sequel to a boom. Such a crisis necessarily follows every boom generated by the attempt to reduce the natural rate of interest through increasing the fiduciary media. However, the crisis of 1930s differs in some essential points from earlier crises, just as the preceding boom differed from earlier economic upswings. The most recent boom period did not run its course completely, at least not in Europe. Some countries and some branches of production were not generally or very seriously affected by the upswing which, in many lands, was quite turbulent. A bit of the previous depression continued, even into the upswing. On that account in line with this theory and on the basis of past experience one assumed that this time the crisis would be milder. However, it is certainly much more severe than earlier crises and it did not appear likely that business conditions would soon improve. The unprofitability of many branches of production and the unemployment of a sizable portion of the workers were not due to the slowdown in business alone. Both the unprofitability and the unemployment were being intensified by the general depression.

Mises prescribed a solution to overcome the crisis. That was eliminating unemployment relief, cutting government spending and taxes and not only to cut wages but also to make wage determination free from labour unions. But he was silent about how could suppression of trade unions be achieved and their freedom of association be restricted except by government coercion. He was the strong supporter of fascism as it smashed trade unions.

But his theory invited much criticism from all corners because its analysis of Great depression was much confusing. He was ignorant of economics and economic reality. This theory is, of course, false and untenable because banks could not push interest rates below a non-existent natural rate. The ABC theory could not adequately explain the severity and length of the Great Depression. In the Great Depression, business expectations were shattered in an unprecedented way. Simply reducing wages was no reliable or effective cure for unemployment in the 1930s or indeed during recessions in general when business expectations were deeply pessimistic, demand was stagnant and uncertainty about the future deep.Another theory which was in circulation to combat the Great depression was Debt deflation Theory. It is a theory of economic cycles that holds that recessions and depressions are due to the overall level of debt rising in real value because of deflation, causing people to default on their consumer loans and mortgages. This theory regarding the depression was put forward by Irving Fisher. Following the stock market crash of 1929 and the ensuing Great Depression, Fisher developed a theory of economic crises called "debt-deflation", which rejected general equilibrium theory and held that the depression was occurred due to the bursting of a credit bubble. Theory explains a sequence of effects of the debt bubble bursting occurs: 1. Debt liquidation and distress selling. 2. Contraction of the money supply as bank loans are paid off. 3. A fall in the level of asset prices. 4. A still greater fall in the net worth of businesses, precipitating bankruptcies. 5. A fall in profits. 6. A reduction in output, in trade and in employment. 7. Pessimism and loss of confidence. 8. Hoarding of money. 9. A fall in nominal interest rates and a rise in deflation adjusted interest rates.

But this theory was ignored in favor of Keynesian economics, partly due to the damage to Fisher's reputation from his overly optimistic attitude prior to the crash, but has experienced a revival of mainstream interest since the 1980s, particularly since the Late-2000s recession, and is now a main theory with which he is popularly associated.

The era of the Great Depression Marxism became a legitimate article of political faith, but also the emergence of Marxist theory as an intellectual and even academic endeavor for the first time. The predictions of Marxism had been legitimated by the severity of economic decline and the scant prospects for capitalist revival. The intellectuals as well as many workers, including African Americans along with immigrants and the children of immigrants, were attracted to Marxian ideologies. During the early Depression years, movements of unemployed workers and campus antiwar activities were among the most dramatic manifestations, yielding to struggles for industrial unionism.

During the Great Depression period Marxist Economists came to the scenario of theoretical discussions offering a solution to the cataclysm with anti-capitalist methods of thinking. In Marxian perspective Great Depression was the most severe economic crisis in the history of capitalism. Marxian Economists explained that recession and depression was unavoidable under free-market capitalism because there were no restrictions on accumulations of capital. Capitalism always creates unbalanced accumulations of wealth which leads to over-accumulations of capital which inevitably leads to a crisis. Marxist Economists argued that only socialism could end the crisis. Socialism would increase the economic and political strength of the working class. A socialist economic order would be capable of introducing an era of lasting well-being, lasting security and rapidly progressing adjustment of the production process to the needs of the working class, an era which we must characterize as the proletarian revolution. Most Marxists, however, agreed with Friedrich Pollock of the Frankfurt Institute that the Great Depression was deeper, geographically more extensive and longer-lasting than its predecessors, even that of 1873-9, and that it therefore needed a special explanation. American society during the Great Depression offered no end of stimuli to economic thought. Financial crash and industrial stagnation threw millions out of work, growth was anemic at best until the Second World War, and the consequent conviction that Karl Marx's economic anticipations had been proven correct that led unprecedented numbers of intellectuals to embrace Marxism.

But Marx's theory of capitalist crisis was nowhere well worked out, nor, indeed, even organized systematically, while the political history of the 1930s involved novel developments. The most notable phenomena were the success of fascism in Germany, the New Deal in the United States and the growth of state intervention elsewhere. It is also criticized on the ground that Marxism employed neoclassical conception of demand and strongly criticized. Most Marxists, however, agreed with Friedrich Pollock of the Frankfurt Institute that the Great Depression was deeper, geographically more extensive and longer-lasting than its predecessors. However Marxism enjoyed a modest revival during the depression period it remains a more profoundly unacceptable discourse, it is charged with propagating determinist materialism incapable of explaining a complex, multi-dimensional world. Marxism failed to offer a lasting solution to the depression. Even among the Marxist scholar there was no uniformity of opinion as to what measures should be taken to overcome the crisis. It actually created theoretical embarrassment only. Anti -capitalist tendencies played vital role in formulating Marxist theoretical perspectives to combat depression. But Keynesism holds that capitalism can be controlled by governments so as to function

Great depression played an outstanding role in the history of ideas and theories. It was the Great Depression that unquestionably paved the way for confirmation of Keynesian ideas. Keynesian theory became main stream theory until the end of 1960swhwn it was first challenged by Friedman and monetarist and subsequently replaced by new classical Macro economics. The Great Depression provided the fertile ground from which modern macro economics sprouted. The Depression produced the economists of the twentieth century who began and nurtured the economic literature in particular and the development of modern macro economics in general. It was Great Depression that most widely discussed and debated subject in the history of economic thought. As the Great Depression forced to adopt some new mechanism throughout the world the period witnessed a clash of economic ideas. This ideological clash led to practical policy making and finally led current market situations like Globalization and liberalization. The clash of ideas during the period of great depression led to an era of extraordinary political innovation which expressed in the reforms enacted by Franklin D. Roosevelt's New Deal and his administration's attempts to cope with the problems of poverty, unemployment, and the disintegration of the American economy. It was also a time when a significant number of Americans flirted with Marxist movements and ideas, as well as with the notion that the model for a more humane society could be found in the Soviet Union. Above all, it was a decade of cultural ferment, in which American writers, artists, and intellectuals experimented with new, more socially oriented forms of literature, painting, theatre, music, and mass entertainment.

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