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# **Hilferding, Woytinsky and the fiscal orthodoxy of interwar social democracy**

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### Abstract

In 1931, when the Great Depression hit Germany, German social democrats discussed a proposal for a (proto-Keynesian) public-debt financed employment program, the so-called WTB plan drafted by Vladimir Woytinsky. But under the leadership of Rudolf Hilferding, the SPD's main economics spokesperson (and a former finance minister), the SPD rejected the proposal. The paper argues, firstly, that Hilferding's endorsement of the gold standard and fiscal austerity can be traced to his analysis in *Das Finanzkapital*. It, secondly, rejects purely ideational interpretation of social democracy's hostility to public employment programs. This becomes apparent when considering the experience of other European countries. In the British case a non-Marxist labour government under Ramsey MacDonald also endorsed the gold standard and fiscal orthodoxy. The WTB plan represents a missed opportunity to develop a socialist Keynesianism that would have complemented the Austro-Marxist strategy of a democratic socialism well.

**Keywords:** Keynesianism, Marxism, social democracy, economic policy, gold standard, Austro-Marxism

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## Introduction

In 1931, when the Great Depression hit Germany, major banks going bankrupt and unemployment rising sharply, German social democrats discussed a proposal for a (proto-Keynesian) public-debt financed employment program, the so-called WTB plan (named after Woytinsky, Tarnow and Baade). But under the leadership of Rudolf Hilferding, the SPD's main economics spokesperson (and a former finance minister), the SPD rejected the proposal. This raises interesting questions about the economic policy strategy of interwar social democracy. Hilferding was concerned about the inflationary impact of public debt and ultimately thought that the contradictions of capitalism could not be resolved by government spending. Effectively under Hilferding the SPD tolerated Brüning's deflationary policy with the aim to re-establish the gold standard.

The main author of the WTB plan, Wladimir Woytinsky, was a Russian Jewish Socialist, who had during the short-lived revolution in 1905/06 developed a public employment program on behalf of the Petrograd Soviet of the Unemployed. In 1917, on the Menshevik side, he worked for the Petrograd Soviet, had to emigrate after the October revolution and worked as economist for the German trade union confederation. He developed proto-Keynesian employment programs and played a key role in changing the unions' position of public employment programs.

This paper asks why the interwar social democrats rejected this proto-Keynesian employment plan. We will investigate these questions at two levels. First, we revisit Hilferding's *Finanzkapital* to explore to what extent his later economic policies are based in it. Second, we will (if briefly) put the SPD's reaction in the broader European context to explore whether the German social democracy's rejection of Keynesianism was typical or unique. We compare it to the British experience and comment on the literature that has asked similar questions.

*Das Finanzkapital* is a seminal and innovative work in Marxist economics that takes concentration processes seriously, considers changes in the role of the state and develops a theory of imperialism. It also offers an interesting discussion of what one would today call endogenous money creation (via bills of exchange). However, this endogeneity is restricted to domestic money. The fact that internationally currencies required gold reserves and were measured against gold (i.e. the gold standard) was for Hilferding a proof of the labour theory of value. His crisis theory is based on a close reading of Marx and emphasises profit squeeze as well as disproportionality crises, but have little independent role for aggregate demand or finance. Hilferding's rejection of Keynesian strategies and of deviating from the gold standard are rooted in his Marxist reading of capitalist development. That is significant as, at the time, the gold standard was not merely an exchange rate regime, but stood for an entire policy package that came with orthodox fiscal policy and (often) with pro-cyclical interest policy.<sup>1</sup>

This may suggest that adherence to Marxist (economic) theory is behind Hilferding's fiscal orthodoxy. Indeed Sheri Berman in her comparison of German and Swedish interwar social democracy argues that the difference in the strategies between the two is due to ideational factors, in particular the adherence of German social democracy to an ideology (but not policy) of Marxist revolutionary socialism, which economically prevented them from developing a constructive approach to fiscal policy and, politically, from formulating a theory of the state that would underpin

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<sup>1</sup> Polanyi 2001 [1944], Eichengreen 2008.

a successful reformist project.<sup>2</sup> I deviate from this ideational reading, even though I agree that his Marxist background did provide Hilferding with a theory of crisis that prevented him from appreciating Keynesian strategies. Berman's interpretation suggests that the less Marxist social democrats were, the more open they should have been to using Keynesian strategies. However, this is not borne out by a comparative study of European socialist parties. The problem of how to respond to rising unemployment during the Great Depression was one faced by socialists across Europe.<sup>3</sup> We will briefly consider the British case as its social democrats at the time had a notably weak Marxist tradition.

Almost at the same time as the Woytinsky-Hilferding controversy the British Labour Party, which had no Marxist tradition comparable to German or Austrian Social democracy, was faced with similar questions. Ramsey Macdonald's Labour minority government fell apart over the question of cutting unemployment benefits in the face of budget deficits. While the labour unions defended unemployment benefits as one of the major achievements of social reforms MacDonald adhered to fiscal orthodox (and the gold standard) and cut benefits. The Labour government fell, the Labour Party split and was decimated at the next general election. Across the political spectrum interwar social democrats, with the notable exception of Sweden, adhered to fiscal orthodoxy and, with the unions defending the welfare state, failed to develop a coherent economic strategy.<sup>4</sup>

In the 1930s Social democrats across Europe, while critical of capitalism, missed an opportunity to develop credible reform plans. The reformist demand for a stronger welfare state was unreconciled with fiscal orthodoxy. Only the Swedish social democrats developed and applied such policies. Other applications of Keynesianism were more liberal (USA) or authoritarian (Nazi Germany). This represents a missed opportunity to develop a socialist Keynesianism, for which Woytinsky's proposal could have been a starting point. Such a socialist Keynesianism might have discarded some Marxist economic theory and but would have built on the Austro-marxist third way to socialism,<sup>5</sup> the work on economic democracy and Hilferding's organised capitalism.

The paper will at various points refer to 'Marxism'. This will refer to Hilferding's interpretation of Marxism or, more broadly, into interwar Marxism and the Marxism of the 2<sup>nd</sup> Internationale. A discussion of whether an integration of Keynesian arguments on aggregate demand and financial instability into Marxist economic theory is possible or a comparison of Hilferding's economic theory with other interpretations of Marxism is beyond the scope of this paper.

The paper is structured as follows. Section two discusses the WTB plan and the SPD's reaction. Section three provides some background on Woytinsky. Section four discusses Hilferding's work and considers his economic policy in the light of *Das Finanzkapital*. Section five considers the SPD's reaction in the European context and section six laments the missed opportunity to develop a socialist Keynesianism.

## **The WTB plan and the SPD's reaction**

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<sup>2</sup> Berman 1998.

<sup>3</sup> Sturmthal 1944.

<sup>4</sup> Sturmthal 1944.

<sup>5</sup> Bauer 1971, Krätke 1997.

In 1931 the economic crisis escalated rapidly in Germany. Unemployment rose sharply from 2m in 1928 to 6m 1932. In the 1930 elections the NSDAP had its break through, gaining 18% (up from 2.6% in 1928); the SPD was still the largest party (at 24%, the KPD had 13%). The SPD tolerated the Brüning government, which pursued austerity policies, with the aim of keeping Hitler out of power. In July 1931 the Darmstaedter und Nationalbank (Danat Bank), Germany's third largest bank, went bankrupt. Amidst the deepening recession the membership of the (social democratic) German trade union federation (ADGB) declined sharply, while the (substantially smaller) SPD membership still held up.<sup>6</sup> In the Ruhrgebiet, the ADGB lost members to communist organisations. In these circumstances the unions came close, for the first time, to endorsing a public employment program, the WTB plan.

The Woytinsky-Tarnow-Baade (WTB) plan was a public employment program proposed in 1931 by Wladimir Woytinsky, at the time a statistician and economist working for the German trade union federation, Fritz Tarnow, president of the wood worker unions and Fritz Baade, MP for the SPD and SPD spokesperson for agriculture. This was employment program, with aim to create 1m jobs, which would be financed by a 2 billion Reichsmark loan by the central bank (that corresponds to ca 3% of German GDP at the time). Thus this is was a deficit-financed public employment program. The plan was led by Woytinsky, who had proposed a similar plan a year earlier.<sup>7</sup> Woytinsky was an avid follower of the work of John Maynard Keynes, but the program well preceded the publication of Keynes' General Theory.<sup>8</sup> The WTB plan this is widely cited as one of the main proto-Keynesian proposals.<sup>9</sup>

The almost endorsement of the WTB plan by ADGB 1931 marked an important turning point. First, ADGB had previously endorsed balanced budgets; second, the division of labour between the party and unions usually precluded unions from proposing legislation. It was ultimately dissuaded to formally endorse the program as to not undermine the unity with the SPD and the AfA-Bund (the white collar union), however it pushed within the party for an adoption of the program. The WTB plan then was discussed at a joint SPD parliamentary fraction and ADGB leadership.

At the meeting Woytinsky, Tarnow and others made the case for the plan, which was, however, rejected by Rudolf Hilferding, the SPD's main economics spokesperson (and twice finance minister) and party leader Otto Wels as inflationary (inflation will undermine purchasing power of working class). The SPD then muddled through. It did eventually endorse an employment program, but that would have to be tax financed, and it proposed socialisation of industries (hardly a realistic proposal at this point in time; nationalisation had failed in the aftermath of the 1<sup>st</sup> world war, when labour was much stronger). Effectively, the SPD grudgingly supported Brüning's deflation policies. Not so the Nazis. They adopted a similar employment program, in part motivated to drive wedge between SPD and unions. At the time (after the collapse of Danat Bank) there was a group of industrialists and bankers that also sought to develop proto-Keynesian programs, though other parts of the industry supported fiscal orthodoxy.<sup>10</sup> While it is not obvious that an SPD support for a public employment

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<sup>6</sup> Harsch 1993, chap. 6

<sup>7</sup> Woytinsky 1931.

<sup>8</sup> Keynes 1936

<sup>9</sup> e.g. Grotkopp 1958, Bombach et al 1978

<sup>10</sup> Harsch 1993, Grotkopp 1958

program would have changed the political dynamics in favour of expansionary fiscal policy, by rejecting such a program there certainly was no chance of it being implemented.

One complicating aspect of the debate at the time is that Germany was still under the obligation to pay war reparations and it had the ambition to join the gold standard again. With the ambition to pay reparations usually came a commitment to austerity, thus a deficit-financed employment program was often interpreted (rightly or wrongly) as ceasing reparation payments. Some participants in the discussion thus rejected the WTB plan because of its international implications (disturbing relations with France).

However, the main reason for rejection by the SPD was a more fundamental and economic one. Hilferding in the meeting is reported to have said: "*Colm and Woytinsky are questioning the very foundations of our program, Marx's theory of labour value. Our program rests on the conviction that labour, and labour alone, creates value. Prices deviate from labour values under the impact of the interplay of supply and demand. Depressions result from the anarchy of the capitalist system. Either they come to an end or they must lead to the collapse of this system. If Colm and Woytinsky think they can mitigate a depression by public works, they are merely showing that they are not Marxists.*"<sup>11</sup>

Hilferding at the time did write in *Vorwärts*, the main social democratic newspaper, at the occasion of Britain leaving gold:<sup>12</sup> "*Utopias of a national and international inflation are quite pointless. Quite apart from their economic impossibility and harmfulness, they are politically impossible, because of the economic and thus the political power of France and the USA. ... the use of gold in order to restore the disturbed international balance of payments is the way to solve the tremendous credit crisis as quickly as possible*".<sup>13</sup> This unqualified endorsement of the gold standard may sound surprising for today's reader, who after the work of Polanyi and Eichengreen is more likely to conceive of the gold standard, not only as an exchange rate system, but an economic policy regime that imposes austerity in times of economic crisis (in the name of maintaining parity to gold). But such an interpretation already presupposed a Keynesian understanding of economic policy. Inter war socialists had, like liberals, a much stronger belief in the self-healing capacity of the market system. Naphtali, a close collaborator of Hilferding and author of *Wirtschaftdemokratie* said about economic policy during a crisis: "*I don't believe that we can do very much, nor anything very decisive, from the point of view of economic policy, to overcome the crisis until it has run its course. When prosperity has developed so far, so disproportionately, and so unchecked as is now normally allowed under capitalist conditions – and as has occurred in recent years on a world scale-then it is hardly possible to stop the crisis during its actual progress. For then, the crisis with all its destruction of the value of capital, with its changes and shifts of purchasing power, is a means of correction which must necessarily be accepted. ... If we tend towards a policy of controlling the business cycle in its various forms, corrective measures must not be taken at the time of the crisis but during the period of prosperity.*"<sup>14</sup>

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<sup>11</sup> quoted in Woytinsky 1962, 471 (emphasis added); the statement widely accepted by historians and Garvey (1975) reports that it was confirmed by Wels.

<sup>12</sup> Hilferding 1932.

<sup>13</sup> quoted James 1981, p. 868 (emphasis added)

<sup>14</sup> quoted in Sturmthal 1944, p. 74 (emphasis added).

In the Great Transformation, Polanyi had written “Belief in the gold standard was the faith of the age. With some it was a naïve, with some a critical, (...). Yet the belief itself was the same, namely, that banknotes have value because they represent gold. Whether the gold itself has value for the reason that it embodies labor, as the socialists held, or for the reason that it is useful and scarce, as the orthodox doctrine ran, made for once no difference.”<sup>15</sup>

The extent to which leading social democrats, and in the case of Hilferding arguably one of the leading Marxist economists of the time, endorsed orthodox policies, including fiscal austerity, balanced budgets and the gold standard is remarkable. This is based (as Naphtali explains) on the notion that recessions are necessary as part of the self-cleansing process of capitalism. As we shall see later this rejection of Keynesian strategies was widely shared among socialists at the time. Woytinsky was an avowed socialist, who had worked with the Petrograd Soviet. This episode thus represents a missed opportunity to develop a socialist Keynesianism. However that was a road not take. German social democrats (as well as German communists and Jews) would pay dearly for the failure to respond to the worsening crisis. Only a year after the meeting where Hilferding rejected the WTB plan, the Nazis got to power (and Hilferding would die in 1941 in a Gestapo prison). This paper wants to explore the background of why Hilferding and social democrats rejected proto-Keynesianism.

### **Woytinsky: from the leader of the Petrograd Soviet of the Unemployed to the WTB plan**

Woytinsky was born to intellectual Jewish family in Petrograd.<sup>16</sup> He became a student leader in the 1905/06 revolution, is closely involved with the Bolshewiks and became leader of the *Petrograd Soviet of the Unemployed*, which petitions the Petrograd дума and eventually gets support for a worker-organised public employment program, which at its peak employed 3,500 unemployed and distributed 13,500 free meals daily.<sup>17</sup> The program, as the revolution it emerged from, however, was short-lived. Woytinsky declined an offer from Lenin to flee to Switzerland and spends 1906-17 in prison and then in exile in Siberia. In spring 1917, as thousands of other political prisoners he is released, moves back to Petrograd and works for the (then Menshevik dominated) Central Executive Committee of the Petrograd Soviet. After the October revolution, he and other Mensheviks flees Russia to (short-lived) independent Georgia. In 1919 he is sent to Italy to represent Georgia internationally. The Bolshewiks take over Georgia; Mussolini comes to power in Italy; Woytinsky moves goes to German and works for German Trade Unions. He is an empirically oriented economist, follows the work of Keynes and continues his advocacy for public employment programs. In 1931 he drafts what would become known as the WTB program. Initial versions are framed as finance by international credit, as it becomes clear that that would not be forthcoming, he suggests a central bank-financed credit. He writes tirelessly (in union and party affiliated magazines and convinces Tarnow (who was initially opposed) and Baade to join the program.

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<sup>15</sup> Polanyi 1944, p. 26.

<sup>16</sup> Woytinsky 1961 is a fascinating autobiography.

<sup>17</sup> Preobrazhenskii 2005.

There are three aspects of Woytinsky's longer discussion of active economic policy that somewhat predates the WTB plan worth pointing out.<sup>18</sup> First, there is a political justification for public employment programs: in periods of prolonged unemployment the labour movement is on the defensive. Unemployment demoralises workers and weakens labour unions. Thus the labour movement needs an active economic policy get on the offensive again. Second, Woytinsky, writing in 1931 is very clear in his assessment that this crisis will last long and there will be no swift return to growth. Third, he offers an analysis of inflation and deflation that is similar to what Fisher will write in his theory of debt deflation. In the contemporary situation, Woytinsky argues, a sustained reflation is necessary to lower the real debt burden of firms. Any short-lived inflation (in Germany) would be insufficient as firms face high debt burdens. This assessment of inflation will differ sharply from Hilferding's.

While Hilferding did not reply in writing to Woytinsky's proposal, his close collaborator Fritz Naphtali did. Naphtali comments on the early version of the proposal which was based on international financing.<sup>19</sup> He argues that crises are due to sectoral disproportionality problems caused by the anarchy of capitalist competition. Thus a general reflation (that Woytinsky is advocating) is unhelpful as it does not facilitate sectoral re-alignment. Part of the reflationary effect would lead to inflation growing faster than nominal wage, thus resulting in real wage declines. He emphasises that inflation is the effect rather than the cause of upswings. He implicitly endorses sound, gold-backed money as a precondition for recoveries, even if that comes with higher interest rates. He also emphasises that inflation caused by monetary experiments can easily spin out of control. He considers an internationally financed employment program for Germany helpful, but sharply argues against purely national credit financed programs. Generally he rejects that monetary factors play an independent role of in the crises and the credit creation can help resolve it. In concluding he argues for an active economic policy, but other than anti-monopoly policies it is not clear how they would look. Two features of Naphtali's response are rather notable. First, it is rather stunning how orthodox (in the liberal sense) the views expressed by Naphtali are. Second, his concern about inflation getting out of control contrasts sharply with the fact that Germany experienced around 10% deflation in 1931 as well as in 1932.<sup>20</sup>

Woytinsky then develops some variations of the employment program, in particular he moves towards more domestically financed versions. Woytinsky tries to disarm the concern about inflation and offers detailed calculations for the budgetary impact of the employment program. He emphasises that a large part (45% according to his calculations) would be self-financing as expenditures of the unemployment insurance would decline and tax income increase.<sup>21</sup> He also gives assessment of the relevant orders of magnitude of the impact and argues that at a maximum money supply would increase by 3-5%; as there would also be positive output and employment effects (which he substantiates by reporting excess capacity and stocks in various consumption good sectors). Thus inflationary effects would be very small. Overall, his analysis is empirically grounded and has a clear Keynesian flavour. However, it does not seem to have the concept of the multiplier.

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<sup>18</sup> Woytinsky's 1931.

<sup>19</sup> Naphtali 1931.

<sup>20</sup> Hetzel 2002, Table 1

<sup>21</sup> Woytinsky 1932

After the Nazis get to power he, a Russian Jewish Socialist, has to leave the country and gets out just in time. He 1933 leaves to France and Switzerland, writes report for ILO on unemployment. Finally he moves to the USA and works for Bureau of Labour Statistics and Roosevelt's New Deal administration. He dies 1964 in the USA. While he was close to the Bolsheviks in 1905, he later became a Menshevik and was a social democrat. In the USA he politically moved further to the right. As many Mensheviks, who knew Bolshevik brutality, he turned anti-communist.

### Reading *Das Finanzkapital* after 1932

This section will revisit Hilferding's magnum opus, *Das Finanzkapital*, but first a few biographical notes. He was Born in Vienna (1877) to a Jewish family. He studies medicine and become part of the circle socialist students who would become the Austro-Marxists (Otto Bauer, Karl Renner, Max Adler etc). Hilferding (1904) took on the leading Austrian neoclassical economist von Böhm Bawerk who had written a sharp criticism of Marx' Kapital.<sup>22</sup> And in 1910 publishes *Das Finanzkapital*, which establishes him as one of the leading Marxist economists. The book is a restatement of Marxist value theory, a further development of Marxist theory of money and finance, an implicit reply to the revisionist Bernstein and theory of imperialism that Lenin would draw on heavily. Hilferding moves to Berlin, works for SPD party school, and become the editor of *Vorwärts* the SPD's main theoretical journal. He is widely considered the heir to Kautsky as the party's main intellectual leader. Consistent with his analysis of in *Finanzkapital* he is critical of the war and the SPD support of war credits, but initially maintains party discipline. Eventually he and others (including Bernstein) he had to leave the SPD and join the USPD (the independent social democrats) during the war and for the first and second postwar elections (in 1920 it wins 17.9% of votes (coming close to the Mehrheits-SPD's 21.7%). The tensions in the USPD rise and it eventually splits into those joining the communists and those joining the SPD. Hilferding is among the latter. He becomes one of the chief SPD intellectual leaders, often describes as the SPD chief ideologue (after Kautsky, whose close friend he was).

Among Hilferding's innovations is the concept of 'organised capitalism'.<sup>23</sup> Monopolisation would lead to closer links between the state and industry and to price regulation. Capitalism thus goes beyond its competitive stage and begins a more rational planning of prices. It prepared the potential takeover of industry by the state. While Hilferding was not a revolutionary, he certainly was sincere about developing a social democratic strategy with socialism as its final goal. As a German social democrat he endorsed a parliamentary strategy (indeed the SPD was the main support for German democracy in the Weimar republic), but Hilferding argued for nationalisation of industry and tried (with Naphtali) to develop specific strategies for managing nationalised industries.<sup>24</sup> He made the case that the SPD needed to broaden its appeal beyond the industrial working class such that it could win an absolute majority.<sup>25</sup> Rather than abandoning Marxism wholesale, like other Austro-Marxists he sought to develop a democratic socialist strategy that involved a rethinking of the role of

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<sup>22</sup> Hilferding 1904, von Böhm-Bawerk 1898

<sup>23</sup> Hilferding 1915, 1924, Krätke 2003

<sup>24</sup> Naphtali 1966 [1928]

<sup>25</sup> Smaldone 2000

the state; like Otto Bauer one could say he was trying to identify paths to Gramsci's cultural hegemony.

Hilferding was twice Finance Minister (1923, 1928/29). The second episode is instructive and foreshadows the tensions that social democracy would find itself in the 1930s. From 1928 to 1930 the SPD led an ideologically diverse coalition, in which Hilferding was finance minister. The government revealed that the SPD struggled to find its role within the state and to maintain its goals within the compromises of a coalition. In 1928/29 ministers agreed to fund the first of four warships, which led to outrage not only among the party's grassroots, but also its MPs, leading to strong tensions between ministers and parliamentary fraction. In 1929, due to the worsening economic situation and rising unemployment, the costs of the unemployment insurance systems increase. The government, committed to fiscal consolidation, decides to cut unemployment, which, again, unleashes a storm of protest among unions and party members. Hilferding as finance minister supports cutting unemployment benefits and after sharp and calculated criticism by Reichsbank president Hilmar Schacht that the government was unable to balance its budget, has to resign.<sup>26</sup> The SPD, a year later, quits coalition over reduction of unemployment benefits.

After the Nazis get to power, Hilferding, a Jew, flees to Prag and then to Paris. He dies 1941 in a Gestapo prison in France.

Hilferding's main work is *Das Finanzkapital*. The main question we want to explore here is to what extent Hilferding's fiscal orthodoxy and adherence to the gold standard are theoretically rooted in his interpretation of Marxist economics or whether it can be interpreted as a change in his view, maybe an indication of bureaucratization or excessive compromising in the prolonged interaction with liberal and conservative forces in his role as one of the social democratic parliamentary leaders. It turns out, the former. *Finanzkapital* is an impressive and innovative work that rightly established his reputation as a leading Marxist economist. Unfortunately it shares, and often amplifies, Marx' own weaknesses. Let us begin with the strengths. Hilferding develops further Marx theory of money and finance. One of the most interesting aspects here is that he develops (what one would now call) a theory of endogenous money creation based on bills of exchange. While he overall endorses a commodity theory of money (money as a produced commodity); we will return to this below. Other innovative aspects of *Finanzkapital* include the discussion of futures and equity prices, the fact that he takes monopolisation seriously and argues that it impacts international relations (it leads to imperialism) and it changes the relation between industry and the state (this explains the move from laissez faire to protectionist imperialism). *Finanzkapital* also has prescient discussion of the rise of racism and how it will mobilise middle classes against labour (flagged nicely in Sweezy's *Theory of Capitalist Development*).

Hilferding strikes a fine balance between developing further Marx' analysis of finance and money and restating Marx' theory. He develops a limited theory of endogenous money creation, but endorses a commodity theory of money of the last instance. He recognizes that a monetary system strictly based on commodity money (i.e. gold) would be too restrictive for financing needs of capitalist dynamics. Thus rather than relying on proper (gold-backed) money, bills of exchange are used to settle obligations, they effectively create a private fiat money as a form of credit. Importantly, money via bills of exchange can readily be created by capitalists in response to their

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<sup>26</sup> Harsch 1993, 55-56.

(short-run) financing needs. Instead of paying for a delivery firms issue a bill of exchange (a short-term debt), which is then tradeable and can be cashed (against a discount) at a bank. However, Hilferding argues that it is only possible because it extends and builds on a monetary system underpinned by commodity money, if that were held only by central banks.

A pure paper money system would not be viable in the long run: “as [the] value [of paper money] is determined by the value of circulating commodities, which are subject to permanent fluctuation, its own value would also fluctuate. Money would not be the measure of the value of commodities, but rather the inverse, its value would be measured (...) through the value of commodities.”<sup>27</sup>. A proper paper or credit money system thus would contradict the (or Hilferding’s) labour theory of value. The true nature of money gets revealed in international transactions, which rely on gold, a produced commodity. „in reality such a paper currency would be impossible. This paper money would be valid only within a single state; for settling international balances metal, money with a value of its own, is necessary“.<sup>28</sup> Thus, the gold standard is declared the experimental proof of the labour theory of value: “the impossibility of an absolute paper currency is a strict experimental proof of the objective value theory”.<sup>29</sup>

Hilferding’s later adherence to the gold standard is thus firmly rooted in (his) Marxist theory. This is very different from a long tradition, associated with Keynes, Polanyi and Eichengreen, who criticized the gold standard as the incarnation of the liberal policy regime, which would enforce austerity and cause unemployment in the name of maintaining gold, Hilferding accepts it as a natural feature of the capitalist system.<sup>30</sup> Eichengreen argues that the gold standard was inconsistent with democracy as it withheld key elements of economic policy making (namely monetary policy) from pursuing national goals (e.g. full employment). It is worth quoting the relevant passage in length:

“What was critical for the maintenance of pegged exchange rates [under the gold standard] (...) was protection for governments from pressure to trade exchange rate stability for other goals. Under the nineteenth century gold standard the source of such protection was insulation from domestic politics. The pressure brought to bear on twentieth-century governments to subordinate currency stability to other objectives was not a feature of nineteenth-century world. (...) Come the twentieth century, these circumstances were transformed. It was no longer certain that, when currency stability and full employment clashed, the authorities would opt for the former. Universal male suffrage and the rise of trade unionism and parliamentary labour parties politicized monetary and fiscal policy making.”<sup>31</sup>

Hilferding, in contrast, did not recognize the gold standard as political choice, but regards it as a natural feature of a capitalist economy, in line with the Marxist labour theory of value.

Frustratingly, Hilferding’s discussion of crisis (chapters 16 and 17) is one of the least innovative chapters of the book. Hilferding identifies three general conditions for capitalist crises: the doubling of commodities and money, which gives rise to the possibility of overproduction crises; the anarchy of capitalist production (which he will connect to disproportionality crises); and the disjunction of consumption and production. The last is the most important one in our context. Capitalist production is aimed at realising surplus value, not at satisfying social needs (desired consumption).

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<sup>27</sup> Hilferding 1968 [1910], p. 65; here and below, own translation.

<sup>28</sup> Hilferding 1968 [1910], p. 66.

<sup>29</sup> Hilferding 1968 [1910], p. 68.

<sup>30</sup> Polanyi 1941.

<sup>31</sup> Eichengreen 2008, p. 2.

The profit orientation implies that production will contract when the profit rate declines (in modern terminology: demand is profit led). Thus capitalism leads to overproduction due to the profit motive. "if consumption were arbitrarily expandable, overproduction would be impossible. However under capitalist conditions an increase of consumption means a reduction in the profit rate. This is because the expansion of consumption of the masses is tied to an increase of wages. But this implies a reduction of the rate of surplus value and thus of the profit rate".<sup>32</sup> Thus the requirements of the accumulation are in contradiction to the realisation of profits.<sup>33</sup>

There is a basic tension in capitalist accumulation. Higher consumption would require higher wages. But higher wages lead to a lower rate of surplus value and thus negatively impact accumulation. That will slow down growth and employment, growing the industrial reserve army, thereby dampening wage pressure, which will eventually lead to a recovery of the rate of surplus value and ultimately accumulation. In modern terminology this is a version of the Goodwin cycle: during the boom the industrial reserve army gets depleted, which drives up wages and squeezes profits.<sup>34</sup> That results in a slowdown of accumulation. Implicit is the assumption that profits get re-invested.<sup>35</sup>

In the Marxist tradition the analysis of the business cycle is geared towards demonstrating the contradictions of capitalism and inevitability of crises rather than at identifying entry points for economic policy to mitigate crises.

The most innovative part of his business cycle theory is on of delayed adjustment of the capital stock in capital intensive sectors. As it takes time to build capital intensive equipment, there is a substantial time lag between planned investment and actually increased capacity. This may be exacerbated if the temporarily elevated profitability (due to slowly adjusting supply) attracts additional capital investment from other sectors. Hilferding, to his credit, takes concentration and the increasing role of large corporations seriously. The main impact of that on business cycle dynamics is a stabilising one: large firms are better positioned to avoid the 'anarchy of the market' and offer a better planned system. Thus crises are likely to be less severe in a monopolised capitalism.

Hilferding's theory of money and finance allows for endogenous money creation according to the needs of capital accumulation (via bills of exchange a form of trade credit). In chapter 18 he discusses how the creation of money and credit is pro-cyclical (as firms and banks become more optimistic during the boom and thus more willing to accept bills of exchange), credit can extend overaccumulation. At times his analysis even seems to be getting a Keynesian flavour: during the boom there is ample credit and thus interest rates are low; at the onset of the crisis credit conditions tight and the demand for money (rather than bills of exchange) increases This has similarities to Keynes' liquidity preference, but for Hilferding money means gold, not a state-backed liquid asset). But ultimately the analysis remains orthodox Marxist: the boom exacerbated by financial factors is

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<sup>32</sup> Hilferding 1968 [1910], p.330.

<sup>33</sup> Note that this argument only makes sense if we assume that firms produce at (or close to) full capacity. If there is excess capacity (i.e. in a Keynesian crisis) there is no necessary contradiction between increasing wages and increasing profits simultaneously as output can increase.

<sup>34</sup> Goodwin 1967.

<sup>35</sup> Notably, Goodwin's original model of the Marxist business cycle is one where Say's law holds: all profits get re-invested. The business cycle is not due to a lack of aggregate demand, but rather to movements in the volume of the (always fully utilised) capital stock.

followed by a crisis and depression that re-establishes the fundamental relations, based on labour values and commodity money. The deeper factors of the crisis are the fundamental (i.e. 'real') contradictions of capitalism and the financial factors only play an amplifying role. Hilferding approvingly quotes Marx: "The superficiality of Political Economy shows itself in the fact that it looks upon the expansion and contraction of credit, which is a mere symptom of the periodic changes of the industrial cycle, as their cause".<sup>36</sup> In chapter 8 Hilferding had discussed speculation on financial markets. Speculation is regarded as a zero sum game, where the small investors lose out and concentration is supported. Macroeconomic effects of speculation are considered secondary. There are no Minskyan elements<sup>37</sup> in Hilferding's analysis; the degree of indebtedness of business is not a relevant category; the monetary factors in the crisis are reduced to superficial phenomena that need to be explained by the relations of production rather than constituting independent factors in the crisis. There is no indication that financialisation would deepen or prolong economic crises.

Hilferding is inhibiting a solidly classical, i.e. pre-Keynesian, world. Investment is driven by profits (a version of saving causing investment). It is also innocent of the insights of Kalecki (the possibility of wage-led demand and the fact that investment expenditures cause profits in an economy with flexible capacity utilisation). There is no role for demand in Hilferding's story and capitalist crises are necessary to re-establish the conditions for capitalist growth (no Keynesian stagnation here). Again, we conclude that Hilferding's later aversion to expansionary fiscal policy is solidly grounded in his Marxist theory.<sup>38</sup>

### **Interwar social democracy and austerity policies**

The above section has taken a closer look at Hilferding's theoretical work to explore whether his rejection of the WTB plan is consistent with his earlier work. We have had an ideational focus by design. This section explores the question why social democrats failed to endorse public employment programs in a more comparative context and we want to engage with interpretations found in the literature.

So far my argument seems to have great affinity to what Sheri Berman develops in *The Social Democratic Moment*.<sup>39</sup> Berman compares German and Swedish interwar social democracy and identifies ideational factors as key to explaining their differences.<sup>40</sup> About the WTB plan, she writes:

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<sup>36</sup> Marx 1976, p. 786

<sup>37</sup> Minsky 1986, Wray 2016

<sup>38</sup> Sassoon (1996, p. 61) is arguing that Hilferding was rejecting Woytinsky's employment program because it was at odds with the SPD's toleration of the Brüning government, i.e. the SPD had already accepted deflation. While plausible, it still presupposes that Hilferding did consider Brüning's austerity unproblematic. Thus it does seem to constitute a fully independent argument.

<sup>39</sup> Berman 1998

<sup>40</sup> Stephanie Mudge (2018) in *Reinventing Leftism*, offers a more sociological explanation of social democratic adherence to fiscal orthodoxy. She emphasises the generational conflict between the party elites. The older elite had been socialist agitators (as opposed to trained economists) who would eventually be replaced by a new generation of Keynesian economists-politicians in the postwar era. In the 1930s the socialist agitators still held power (except in Sweden). However, that approach neither satisfactorily explains why the socialist agitators were adhering to orthodox fiscal policy, nor why the economists in the 1930s were so progressive (economics is not usually a particularly progressive field and in Mudge's narrative turns more liberal in the 1970s).

“when several reformers proposed a Keynesian-type solution to the crisis, ... the party was divided over how to respond. For some, continued adherence to orthodox Marxism ruled out trying to save and perhaps even improve the capitalist system; other having never really considered the possibility of using the democratic system to control economic development, found Keynesianism simply too large of a brake with the past to be assimilated on such short notice.”<sup>41</sup>

However, Berman’s narrative is a grander one and it parts from my analysis. She identifies several key, ideationally grounded, features of the SPD. “A second characteristic of the SPD’s version of social democracy was a denigration of the value of contemporary reform work. Although the party eventually took up the fight for political and economic reforms in Wilhelmine Germany, it never conceived of this work as part of its long-term goal of transforming society, nor did it integrate such work into its theoretical understanding of the transition from capitalism to socialism. [...] A third characteristic of the SPD’s version of social democracy was relatively strident view of class struggle. Well into the twentieth century, the party remained attached to the view of all nonproletarian groups as a ‘single reactionary mass’.”<sup>42</sup>

Simply put, Berman claims that German social democracy had too strong an orthodox Marxist tradition, which prevented the SPD from responding to the interwar challenges compared to the Swedish case. There certainly was a gap between grand theory (eventual breakdown of capitalism for economic reasons) and daily politics of social democrats (Leser 1968 develops a similar point for the case of Austro-Marxism), but Berman surely overstates these ideational factors.<sup>43</sup> I have two objections. First, Berman’s claim that the SPD had no strategy of how to use the state for the purpose of transformation and that the belief in historic mission of the working class prevented them to reach out to other social groups, seems odd as regards Hilferding and the Austro-Marxists (in particular Otto Bauer). Hilferding developed the concept of organised capitalism, which Berman herself calls “perhaps the most important innovation in Marxist economic theory in the first third of the twentieth century”<sup>44</sup> and was one of the advocates for the SPD to reach out beyond the industrial working class. If Hilferding was indeed the party ideologue, then it would seem contradictory to claim that the SPD’s political views were that rigid.

Second, in the context of this paper the more important point is the following. Berman seems to say ‘if only they had been less Marxist’ they would have been better able to consider Keynesian policies

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<sup>41</sup> Berman 1998, 11

<sup>42</sup> Berman 1998, p. 10

<sup>43</sup> The strong Marxist orthodoxy didn’t seem to keep the German unions from joining collective bargaining agreements. Berman does not discuss the powerful role of the Junkers in Prussia, of the different experience of Germany and Sweden of the world war and specifically the emergence of the Freikorps (proto-fascist military organisations), a different role of the military. Nor is there much discussion of the split in of the German socialist movement into socialists and communists, which is hard to square with Berman’s instance on the orthodox Marxism of the SPD.

<sup>44</sup> Berman 1998, p. 184. Berman goes on to say “Hilferding’s brilliance as a theorist did not however, translate well into the sphere of practical politics; in particular, he was not able to derive from his theory a practical politics; in particular, he was not able to derive from this theory a concrete economic strategy.” This restates her hypothesis that the Marxist theory did not square with practical politics, but it seems to conflate political strategy and economic theory and policy. The previous section tried to illustrate that orthodox macroeconomic policy was fully consistent with his theory of money and crisis. The issue is not a mismatch of theory and practical policy, but a mismatch of economic theory and political strategy: Hilferding’s Marxist economics did not go with his reformist socialism.

and reach out to broader constituencies. This claim does not withstand comparative scrutiny. While it is true that in the case of Hilferding Marxist economic theory proved counterproductive in dealing with the Great Depression, Berman's conclusion based on the Germany-Sweden comparison is unwarranted. There is no link between how Marxist a socialist party was and how open it was to Keynesian policies: social democrats across Europe pursued austerity policies, while some of them had strong Marxist traditions, others did not.<sup>45</sup> In Germany, right wing social democrats criticized the WTB plan.<sup>46</sup>

The starkest illustration is probably Great Britain and Ramsey MacDonald's Labour minority government in 1929. Ramsey MacDonald certainly was no Marxist, and Britain was known for its lack of Marxist tradition. He formed the Labour minority government in 1929. That was the period when the Great Depression hit Britain and, much like in Germany, there were financial problems for the unemployment insurance system. Labour's attempt for social reform clashes with its desire for fiscal orthodoxy. MacDonald suggests sharp cuts in unemployment benefits, which the Labour Party and unions reject. The resulting conflict brings down the Labour government and MacDonald forms a 'national government' with the conservatives and liberals. Only a handful of Labour MPs follow MacDonald and the Labour Party expels them. While the vast majority of Labour MPs remain in the party, the split and the loss of parliamentary leader results in devastating defeat for Labour Party. The conflict that caused that was the same as in Germany while Hilferding was finance minister in 1929: an unresolved tension between the ambition for social reform (here: maintaining unemployment benefits) and the adherence to fiscal orthodoxy. In a crisis the two did not go together. Ironically, while MacDonald was prime minister of the national government, Britain has to quit the gold standard that MacDonald had sought to defend. That was triggered in Sept 1931 by the Invergordon Mutiny, when 1000 sailors of the British Atlantic Fleet went on strike against the wage cuts caused by austerity policies and financial markets lost trust in the Stirling. In 1932 Hilferding would use that as an illustration for the futility of monetary reform and expansionary fiscal policy.

The experience in Britain is even more stark (and indeed depressing) in terms of missed political opportunities as the Liberals had campaigned on an expansionary fiscal policy ticket and Keynes was one of their main advisers. Unlike Germany there would have been much more immediate possibility to implement Keynesian policies.

Adolf Sturmthal, who one might call a 2<sup>nd</sup> generation Austro-Marxist, had worked in the interwar years with Fritz Adler<sup>47</sup> in the secretariat of the Labour and Socialist International, and based on his experience there wrote *The Tragedy of European Labour*, where he systematically analyses the experience of socialist parties in the (western) European countries.<sup>48</sup> Across all countries European socialists were slow to adopt or outright rejected public employment programs, the main exception being Sweden which had a Socialist government which under finance minister Wigforss and Gunnar

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<sup>45</sup> Sturmthal 1944

<sup>46</sup> Harsch 1993, p. 165

<sup>47</sup> Fritz Adler, the son of Viktor Adler (founder of the Austrian socialist party), was on the left wing of the Austrian socialists and in 1916 had the Austrian Minister-President Karl von Stürgkh in protest against the Austrian war policy, which he defended in court as a revolutionary act. Similar to the role of Karl Liebknecht in Germany, he became a leader of the anti-war left, and after he was released from prison, became the leader of the Austrian workers councils (Arbeiterräte). From 1923 to 1940 he was general secretary as of the Labour and Socialist International.

<sup>48</sup> Sturmthal 1944

Myrdal implemented public employment programs.<sup>49</sup> While there were some intermediate cases, namely Belgium and France, the experience of Germany and Britain was symptomatic for interwar social democracy in the face of the Great Depression. Sturmfal concludes: “the full strength of labour organizations was turned against the efforts of the employer to recoup on wages and salaries the continued reductions of profits. Actually, however, labour was barking up the wrong tree. For the decline in business returns did not permit employers to maintain the pre-depression wage rates. The real enemy of the working class was not the employer, who in most cases, had only the alternatives of reducing productions or closing down altogether. The real snag lay in the economic and financial policies pursued by the government, such as the orthodox financial and monetary policies which were the holy tradition of *laissez-faire*.”<sup>50</sup>

Short, social democrats with different ideological backgrounds endorsed orthodox economic policies, specifically: the gold standard and balanced budgets. Marxist theory was unhelpful in overcoming this, but the problem was not specific to Marxist-oriented socialist parties. But there were many paths to socialist fiscal orthodoxy. Only Swedish social democrats did use Keynesian policies effectively (and secured long-lasting hegemony). The fiscal orthodoxy of the social democrats, which contributed to the rise of fascism would cost them, and indeed European democracies, dearly. The Nazis adopted a version of (highly militarised) Keynesianism and the Roosevelt administration, if with quite some inconsistencies, which combined a Keynesianism with liberalism and a dose of social reform that included a regulation of labour relations which boosted union growth.

### **A missed opportunity to develop a socialist Keynesianism**

Keynesianism often became associated with liberal policies and with ‘saving capitalism’ instead of transforming it. In my view that reflects a failure of the socialist movement rather than something intrinsic to Keynesianism. The WTB-plan episode marks an important missed opportunity for the development of a socialist Keynesianism.<sup>51</sup> Woytinsky, Kalecki, Hilferding’s organised capitalism and Otto Bauer’s third way to socialism might have provided such an avenue, but it was a path not taken.<sup>52</sup>

Keynesianism, in my reading, is a macroeconomic theory that offers an analysis of capitalist economies and a set of economic policy instruments; it is not itself a political ideology. The core of its macroeconomics is endogenous money, financial instability; investment is volatile and key for growth; unemployment due to lack of aggregate demand. Thus Keynesianism seeks to develop tools for demand management, in particular on the side of fiscal policy, but also in financial

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<sup>49</sup> see also Tilton 1978

<sup>50</sup> Sturmfal 1943, 19

<sup>51</sup> There is an interesting conversation to be had on whether Keynes himself was a socialist. While the traditional view (Skidelsky) is that he was a liberal, Fuller (2019) and Crotty’s *Keynes against Capitalism* (2019) have forcefully argued that that he regarded himself as a non-Marxist socialist (does not try to save capitalism, but transform it into a liberal socialism). However, that is only tangential to the point of this paper.

<sup>52</sup> Bauer 2017 [1920], Kalecki 1965.

regulation.<sup>53</sup> Keynesianism has little to say on how to organise production or how the ‘socialisation of investment’ (Keynes) could look like. Importantly for our purpose, it can be used for different political purposes (e.g. bankers’ Keynesianism since the Global Financial Crisis). When German social democrats endorsed Keynesianism (somewhat half heartedly) after world war 2, they had already moved further to the right and there was no vision of substantially transforming capitalist economies.

Austro-Marxism was an attempt to develop a democratic socialism emerging from a bourgeois democracy. Hilferding was aware of the need to broaden the appeal of the socialist movement beyond working class. Such a political strategy needs an economic strategy. Marxism simply did not provide that. For a democratic socialism (such as envisioned by the Austro-Marxists) social democrats would have to demonstrate that they can ‘manage the capitalist economy’. For that they need Keynesianism. First to get out to the defensive. As long as unemployment is high, labour is weak. Second, as pointed out by Sturmfels, the core of interwar social democracy dilemma lay a tension between wage aims (‘pressure group’) policies and the need for a feasible macroeconomic strategy. This reflected the division of labour between unions (wage bargaining) and party (other policies). At various junctures labour movement should not press for higher wages, but for control over investment decisions and demand management.

Keynesianism provides an analysis of capitalist macroeconomics that offers a basis for policies that, at least for some time, can benefit labour and capital, i.e. it provides a foundation for class compromise. Capitalism’s growth trajectory is unstable, resulting in reoccurring economic crises and prolonged periods of unemployment. In such situations expansionary fiscal policy has the potential to benefit labour as well as capital. Realised profits depend on aggregate demand (“capitalist earn what they spend” as Kalecki put it).

Expansionary policies will, by reducing the industrial reserve army, also strengthen labour’s bargaining position. That was one of Woytinsky’s main points. Labour needed a government-led employment program to get out of the defensive. This argument about the material basis for class compromise here has similarities with Erik Ohlin Wright’s analysis of class compromise, however, Wright, despite referring to Keynesianism as an example of a ‘positive compromise’ is a surprisingly un-Keynesian in his analysis and essentially retains a supply side focus throughout the paper (organised labour can help overcome some coordination problems of capitalism).<sup>54</sup> Wright neither mentions financial crises nor extensive involuntary unemployment. The Keynesians’ point is that in times of depression, i.e. low aggregate demand and idle capacity, demand stimulus can provide a win-win situation for labour. Obviously these conditions may not last and once the worst part of the crisis is over, capitalists are likely to object to sustained state intervention. Kalecki points out that capitalists (‘captains of industry’) won’t like full employment policies on principled grounds.<sup>55</sup> They may be so concerned about rising power of labour that they prefer a subdued (due to high unemployment) working class to higher profits. Indeed, there were some vicious attacks against the New Deal, but overall capital was split over the New Deal. Socialists would then have to seek to maintain the Keynesian capacities of the state. Kalecki’s analysis also makes clear that having the

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<sup>53</sup> For introductions to and overview of post-Keynesian economics see King 2002, Lavoie 2014, Stockhammer 2021.

<sup>54</sup> Wright’s 2000, p. 965

<sup>55</sup> Kalecki 1943.

fiscal tools to realise investment strategies is crucial for disarming the capitalists' ability to do an 'investment strike'. Thus the need to regulate international capital flows ("above all, let finance primarily be national",<sup>56</sup> as Keynes put) has always been part of the Keynesian policy tool box. Need popular pressure to sustain policies. Need state or not-for profit institutions that can invest (Swedish wage earner fund). In Keynes' words, the 'socialisation of investment'.<sup>57</sup> A socialist Keynesianism presumably would marry Keynesian demand management with the economic democracy proposals of the Austro-Marxists and Naphtali.<sup>58</sup>

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<sup>56</sup> Keynes 1933, p. 755.

<sup>57</sup> Keynes 1973 [1936], p. 378.

<sup>58</sup> Naphtali 1928.

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