Marx's crisis theory–still relevant?

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Intro

- The economic and financial crisis of the late 2000s showed the inability of mainstream economics to perceive and explain the fundamental characteristics and the contradictory nature of capitalist market economies.
- Can Marx's economics give us a better explanation of the crisis?
- Marx's theory can provide an explanation of some fundamental causes of the recent crisis but it cannot offer a full explanation of it and, in particular, its prolongation over a significant span of time.

Specific and general characteristics of crises

- Crises take on specific characteristics that are contingent on the historical phase in which they occur. The present crisis is no exception.
- But there are some basic features that are common to all.

Common features

- The recent crisis is characterized by the fact that the process of growth was accompanied by growing inequality in terms of income and wealth.
- The financial sector has played a crucial accelerating role.
- Both these aspects can be explained and interpreted in Marxian terms.

Specific features

- The structural transformations undergone by capitalist economies imply that crises do not take any longer the form described by Marx, i.e. violent market perturbations ('overproduction crises').
- Finance now plays a much more pervasive role than at Marx's times.
- The recessive phase lasted much longer than at Marx's times.

Marx's theory of crises: possibility and actuality

- Marx shows that there is no reason why aggregate demand should always equate aggregate supply. In his terminology, general overproduction crises are possible.
- An initial actual fall in market prices induces capitalist entrepreneurs to expect future prices and profits to be below what they regard as their normal levels. Money is hoarded and as a consequence the demand for commodities and labor falls with further negative effects on prices.
- Crises always take the form of a general overproduction of commodities, which brings about a fall in prices and profits.
- It is so because Marx carried out his analysis by considering an economic system in which free competition is the prevailing market form and firms produce at constant short-period returns.

Marx's 'micro-foundations'

For Marx:

- in so far as the price expected by a firm is above its unit variable cost, it is

$$X = X_M \text{ for } \forall p^e \geq v \tag{1}$$

  X_M is the firm's maximum level of production, p^e is the expected price and v is the (constant) unit variable cost.

$$X = X_m \text{ for } \forall p^e < v \tag{2}$$

  X_m is the minimum level of production and v is the unit variable cost.

- As for investment, profit-maximizing firms increase their productive capacity to the maximum in so far as the expected rate of profit is above a certain minimum rate of profit (r^*):

$$\begin{aligned} \Delta K &= \max \text{ for } \forall r^e \geq r^* \\ \Delta K &\leq 0 \text{ for } \forall r^e < r^* \end{aligned} \tag{3}$$

Overproduction crises

- Marx starts from the hypothesis of an initial excess supply in the consumer-good industries.
- The overproduction of consumer-goods then affects the capital-goods industries, which experience overproduction as well. This affects the consumer-goods industries, and so on.
- The initial partial overproduction crisis turns into a general overproduction crisis.
- The reason why overproduction occurs first in the consumer-goods sector is that the bulk of the demand for these goods comes from the working class, whose purchasing power is constrained.
- The economic system, faces a contradiction. From the point of view of demand, wages should grow at a rate that ensures that consumer-goods can be sold at their normal prices. From the point of view of the profitability of the process of production, wages are constrained.

The role of finance

- Marx never arrived at an organic exposition of his analysis of credit and finance, but he offered some important indications.
- Credit functions as a sort of accelerator of the process of accumulation and growth.
- But it cannot prevent the economy from experiencing crises, generated by its inherent contradictions.
- Moreover, credit and finance favor speculative behavior, which is another factor of crisis.

Marx and 'underemployment equilibria'

- During crises there is a higher rate of unemployment and underutilization of capacity: 'underemployment levels of activity'.
- The question is whether underemployment levels of activity can be interpreted as underemployment equilibria in a Keynesian/Kaleckian sense, that is to say positions of the economy that tend to persist over time if there is no factor that pushes the economy away from them.
- The answer must be in the negative.
- To argue that an underemployment level of activity can be a stable position, it must be maintained that crises are permanent phenomena. But crises are not permanent.
- One main factor propels the economy away from its 'underemployment level of activity': the fall in the general level of prices.

The conditions for Marxian underemployment equilibria

- For the economy to remain at an 'underemployment level of activity', it is required that

$$\begin{aligned} p^e &< v \\ r^e &< r^* \end{aligned} \tag{4}$$

- The fulfillment of those conditions is not ensured. As a consequence of the fall in market prices, v falls as well and this will affect both conditions above.
    1. If v falls, expected prices can become higher than unit costs and firms start to produce to capacity again.
    2. A fall in market prices also affects the expected rate of profit, $r^e = \frac{(p^e - v)X - F}{K}$. When prices fall, v, F and K fall as well and the expected rate of profit is positively affected. If r^* is given and constant, it is not necessarily ensured that $r^e < r^*$ holds over time.

Conclusions: Finance

- Marx's view of finance as an accelerator of the capitalist process of growth and crisis relates to the destructive role that the financial sector played recently.
- But Marx's analysis cannot be applied to the present situation in a mechanistic way.
- Marx did not consider the possibility of a growing indebtedness of households, which can maintain high levels of demand despite their limited growth of income.

Conclusions: The real economy

- As for the real sector, Marx's analysis is inadequate.
- Despite the fall of effective demand, production and employment, the economy generally does not experience general overproduction.
- The prices of goods remained substantially stable.
- Deflation is mostly experienced in the markets for real and financial assets. It has not positive effects on the economy; it is the other way around.
- This state of the economy lasted for quite a long period, rather than being rapidly followed by recovery.
- Situations of such a kind cannot find a satisfactory explanation within Marx's analytical context.
- Marx's analysis must be developed by drawing inspiration from the Keynesian/Kaleckian tradition.

Some more general considerations

- Marx analyzed the vital and expanding Western capitalism of the 19th century.
- Today Western capitalism is not so vital.
- Paradoxically, it is so because one of Marx's prophecies was confirmed: the globalization of capitalism.
- But the forms taken by the globalization are different from those predicted by Marx.
- Capitalism outside the Western world has take new and original forms.
- The economic and social structure of Western capitalism has been deeply affected in ways that were not predicted by Marx.