Marx’s crisis theory—still relevant?

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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

\[ X = X_M \text{ for } \forall p^e \geq v \]  

(1)

- 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 \((r^*)\):

\[ \Delta K = \max \text{ for } \forall r^e \geq r^* \]  

(3)

\[ \Delta K \leq 0 \text{ for } \forall r^e < r^* \]
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

\[ p^e < v \]
\[ r^e < r^* \] (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.