Why is economic growth periodically interrupted by economic crises? Does this imply the breakdown of the system? Can Marxism explain the survival, and continuing dominance, of capitalism?

Why should there ever be problems in an economic system in which capitalists put so much effort into the pursuit of profits, capital accumulation, and economic growth? The classical political economists were confident that such commercially motivated behaviour would produce generally positive economic outcomes. Marx disagreed, emphasising the distinctive flaws in the capitalist system that he predicted would lead to deepening crises and eventually capitalism's demise. This is not to say that capitalism cannot be a progressive economic order. Marx thought it was progressive in comparison to what had preceded it, helping to eradicate 'the idiocy of rural life'. Capitalism has facilitated the phenomenal development of the forces of production. So, why might it be only a transient phase in human history, eventually yielding to a yet more progressive socioeconomic system?

The most remarkable of all Marxist claims is that capitalism will eventually be replaced by socialism. It is a claim that rests on distinctive views about the combination of structural forces and purposeful political activity capable of effecting that transformation. Elements of both 'structure' and 'agency' are integral to the process.

The structural aspect concerns economic crises. These are periods during which capital accumulation slows, the production of goods and services falls, and unemployment rises. 'Economic crisis' 'slump' 'depression' 'recession'—terms of varying emotive impact—all describe essentially the same phenomenon: economic downturn. Marx thought that capitalism would be afflicted with such periodic crises and, indeed, that these crises would likely deepen over time. Why? His reasoning rests on three distinct theories: the theory of disproportionalities, the theory of the tendency of the rate of profit to fall, and the theory of underconsumption. It is useful to look at each of these theoretic explanations of economic crisis first, before asking how they interrelate, whether they do indeed explain economic crises in practice, and, if they do, what political responses might follow.

THE ANARCHY OF CAPITALIST PRODUCTION

There is a recurrent possibility in a capitalist economy that the production decisions of firms in different industries will not be synchronised. Steel producers usually
have to decide how much steel to produce before they know how much steel will be bought from them by car manufacturers, engineering firms, and their other customers. Car manufacturers, in turn, have to decide how many vehicles to produce without knowing (unless they engage in illegal industrial espionage) how many their competitors are planning to make. They cannot know for sure what their market share will be. Even the total market demand is uncertain; an unexpected event, such as a sharp rise in petrol prices, may cause consumer demand for cars to deviate from projections based on past trends. So, firms' production decisions, in the absence of industry-wide or economy-wide planning, do not necessarily produce a balance between supply and demand.

This situation has been described as the 'anarchy of capitalist production'. Anarchy in this context denotes an unplanned, quite likely chaotic, situation (not to be confused with 'anarchism' which is a coherent political philosophy emphasising the desirability of basing society on voluntary cooperation rather than state-sponsored coercion). The absence of a centralised planning mechanism in a capitalist economy is the source of the uncertainty, if not chaos. Such central planning mechanisms have their own problems, it should be noted, if only because of the sheer size and complexity of the task of coordination. Further, markets are not altogether chaotic: the price mechanism plays a coordinating role. If a steel producer makes too much steel, for example, the market price will fall, which will help sell the surplus steel and also signal the need to scale back production. The price system thereby restores some balance between output and demand. The problem is that it operates after the plans for steel production for the coming period have been made. In the interim, the imbalance may spiral into a generalised economic crisis.

Why might this occur? Consider the steel industry example again. If the steel producer makes too much steel, workers at the steel plant are likely to be laid off. Without income, these workers will not be likely to buy cars or washing machines, for instance. This will mean that the producers of such consumer goods will demand less steel from the steel producers. The laid-off workers will also have less income to spend on food or clothing, which will create economic downturn and unemployment in the food and clothing industries. So, a localised structural imbalance becomes a generalised recession. The original 'disproportionality' triggers an economic crisis.

The term 'disproportionality' formally refers to imbalances between the two sectors in the model Marx developed to examine the necessary conditions for reproduction and growth of the economy (as depicted in box 15.1 see p. 122). Disproportionality implies that the condition for balance identified in that model \( (c_i = v_i + s_i) \) is not attained. It is perhaps remarkable that intersectoral balance is ever attained, other than by pure luck, in an economy like capitalism. Without coordinated economic planning, it would seem that disproportionality is likely, if not probable, most of the time. Therein lies a problem with this particular theory of economic crises: it seems too general. It leaves us wondering why capitalism is not usually, if not always, experiencing recession.

The value of disproportionality theory is its insight into the transmission process: it shows how a localised problem can trigger an economy-wide downturn. It shows how the price mechanism performs a corrective function when such a downturn does occur. As already noted, discounting unsold stock may help it to be sold. Fundamentally, the cheapening of capital will tend to restore the potential for future profitability. This is what Marxists call the 'devalorisation of capital'. The reduction in the
value of capital helps raise the rate of profit because less capital now has to be laid out to achieve those profits. Recessions are painful for capitalists as well as workers: some capitalist enterprises are usually forced out of business altogether. However, Marxists regard the weeding-out of the more inefficient capitals as 'cleansing' the economy as a whole, thereby creating the conditions for renewed capital accumulation process. No gain without pain, it seems. The swelling of the ranks of the 'reserve army' of unemployed labour is also conducive to the enforcement of more discipline on the workforce. For all these reasons, a capitalist economy is likely to 'bounce back' from a recession brought on by structural imbalance or 'disproportionality'. Yet, according to a second strand of Marxist crisis theory, more fundamental problems remain.

THE TENDENCY OF THE RATE OF PROFIT TO FALL

Is the problem of recession deeply embedded in the capital accumulation process itself? This second strand of Marxist crisis theory posits that the more successfully capitalists accumulate capital, the greater the downward pressure on the rate of profit. Seeing their profit rates falling, capitalists will be less inclined to expand the productive capacity of their enterprises. Investment and output falls. An economic crisis occurs. Individual success causes systemic failure.

This paradox can be explained in various ways. Box 17.1 sets out the formal explanation, using some simple algebraic notation. The basic proposition is that the capital accumulation process tends to raise the organic composition of capital, which is the ratio of constant capital to variable capital. Broadly speaking, this means that capitalists install more machinery and equipment in the process of expanding their businesses. If the rate of surplus value remains unchanged, the rate of profits would then tend to decline. This is definitional, but what is the underlying economic logic? Recall that, according to the labour theory of value, labour produces value. So, if the process of capital accumulation causes less labour to be used in production (relative to capital goods such as plant, machinery, and equipment), the rate of profit will fall. The total amount of surplus value generated may well continue to rise but, expressed as a ratio of total capital outlay (constant capital and variable capital), the rate of profit will decline.

One might wonder why capitalists would continue to accumulate capital and expand their businesses if the ultimate effect is to undermine their own rate of profit. It seems self-defeating. The best explanation of this paradox hinges on the tension between individual and collective rationality. It is indeed rational for individual capitalists to invest and expand, perhaps by installing the latest equipment in order to gain an advantage relative to their rivals. If their rivals follow suit, however, the advantage is eradicated. All the firms then face the common tendency for the rate of profit to fall. The source of capitalism's vitality—individual initiative in search of higher profits—becomes its Achilles heel as falling profit rates periodically herald recession.

Explained in this way, one might think that recession would not be an intermittent problem. The tendency for the rate of profit to fall could be expected to be even more persistent than the problem of sectoral 'disproportionality' perhaps destined to sound the death knell of the whole system. Indeed, Marx did expect this tendency of the rate of profit to fall to be manifest in intensifying economic crises
over time, but he also conceded that there would be *offsetting forces*. Obviously, the rate of surplus value could rise. That would offset the effect of increases in the organic composition of capital. Of course, capitalists are always concerned to raise the rate of surplus value. If installing new machinery enables capitalist firms to increase the pace of work performed by their workforce, they thereby increase the intensity of labour. If the resulting increase in the rate of surplus value is proportionately larger than the increase in the organic composition of capital, the overall profit rate will actually rise. The crisis tendency is averted.

Other offsetting forces (or ‘counteracting causes’) noted by Marx included the effect of foreign trade in cheapening raw materials, the depression of wages below the value of labour power, and the cheapening of constant capital. The first of these—foreign trade—may provide a short-run counter to a falling profit rate.

---

**Box 17.1**

**The mechanics of the falling rate of profit**

As shown in box 15.1 (see p. 122), the total value of commodities produced

$$= c + v + s$$

where $c$ is constant capital

$v$ is variable capital

$s$ is surplus value

Three important ratios using these terms can be defined as follows:

$s/v$ is the rate of surplus value (sometimes called the rate of exploitation)

$c/v$ is the organic composition of capital

$s/(c + v)$ is the rate of profit.

This rate of profit can be expressed in terms of the rate of surplus value and the organic composition of capital by dividing each term in the numerator and denominator by $v$, that is:

$$\frac{s/v}{c/v + 1}$$

This is an alternative expression for the rate of profit, showing its positive relationship with the rate of surplus value ($s/v$) and its inverse relationship with the organic composition of capital ($c/v$).

Why does this rate of profit tend to fall as capital accumulation occurs? Consider the effect of a rise in $c/v$, caused by businesses installing more plant and machinery in their production processes. If $s/v$ remains constant, any such rise in $c/v$ depresses the rate of profit.

The assumption of a constant $s/v$ is crucial to this reasoning. However, the assumption may be relaxed. Then the rate of profit may rise or fall depending on the relative size of changes in $c/v$ and $s/v$. In other words, the rate of profit may fall (heralding a recession) or rise (heralding a period of expansion) according to the relative movements in the rate of surplus value and the organic composition of capital.
However, by drawing distant lands into the capitalist production process (what we would now call 'globalisation'), it ultimately reproduces the same systemic contradictions, but on a larger scale.

The second offsetting force—depression of wages—looks the most obvious counter to the falling rate of profit. Marx actually placed little stress on it because of the general assumption that all wages and prices are market-determined. Wages in general therefore reflect the value of labour power. However, where employers have particular monopoly power, and where the replenishment of the reserve army of labour weakens the bargaining position of labour, wage-cutting is always an option. That, too, may offset the tendency of the rate of profit to fall.

As for the third factor—cheapening of constant capital—it is important to remember that, in Marxist theory, the organic composition of capital is defined in terms of labour values, not market prices. So, if machinery and other capital goods are becoming relatively cheap in the market, increased mechanisation is possible without raising the organic composition of capital. In such circumstances, the overall rate of profit may be constant or even rising, and there need be no general tendency towards economic crisis.

An apparently weak conclusion beckons. The rate of profit may go up or down according to the relative strength of a rising organic composition of capital and these various offsetting forces. In other words, what starts out as a strong proposition about the inexorable tendency towards economic downturn ends up concluding that the outcome is contingent. Capital accumulation can create the conditions for recession, but, equally, it may create the conditions for yet more accumulation. But is this a weak conclusion? Capitalism does indeed alternate between periods of growth and recession. The Marxist theory suggests this pattern is explicable in terms of the relative movements in the rate of surplus value and the organic composition of capital. The wave-like motion of capitalist development is thereby explained.

UNDERCONSUMPTION

What about consumers? Is the inadequacy of consumer spending relative to the vast growth in output of goods and services an alternative explanation of recurrent economic crises? Here is a third strand of reasoning about the cause of recurrent economic crises. It is not exclusively Marxist, reflecting a long-standing tradition of 'underconsumptionist' thought, and also having some echoes in the rather different types of analysis developed by John Maynard Keynes and Michal Kalecki to explain the problem of inadequacies in effective demand. However, it has a central place in Marxist crisis theory. As Marx himself put it:

the epochs in which capitalist production exerts all its forces are always periods of overproduction, because the forces of production can never be utilised beyond the point at which surplus value can be not only produced but also realised; but the sale of commodities, the realisation of the commodity capital and hence also of the surplus value, is limited not only by the consumption requirements of society in general, but by the consumption requirements of a society in which the great majority are poor and must always remain poor.
An influential book by American Marxist economists Paul Baran and Paul Sweezy gives the reasoning a contemporary resonance. According to Baran and Sweezy, modern capitalism is *monopoly capitalism.* The large companies that now dominate the economy have the power to simultaneously raise the prices of their products, sometimes colluding to do so. They also have the ability to lower their costs through technical innovation. A widening gap between prices and costs results, making possible an even greater economic surplus. The problem is who is to buy the goods. Capitalists try to keep workers’ wages down, but thereby undermine the major source of potential consumer spending. Capitalists’ own consumption can partly fill the gap, but the scope for this is limited because (as demonstrated in box 15.1) capitalists must channel a proportion of their funds into business investment if capital accumulation is to continue. Commercial advertising and the ‘sales effort’ is a major push, and the extension of credit facilities does enable consumers’ spending to exceed their incomes, at least in the short run. Governments also ‘do their bit’ to pump up the aggregate demand through various forms of civilian and military expenditure, thereby helping to absorb the economic surplus. However, to the extent that these expenditures are financed by general taxation, they only divert expenditures from private to public sectors; the general problem of underconsumption remains. The root problem is the restricted purchasing power of the mass of the people, which prevents the growth of productive capacity being easily matched by a corresponding growth of demand.

Setting this underconsumptionist reasoning in the context of Marxist theory, a key conclusion is that it illustrates the inherent tension between the conditions for the production and realisation of surplus value. The production of surplus value requires low wages, whereas the realisation of surplus value is facilitated by having high wages. Low wages keep production costs down, but high wages help capitalists sell their products. From the viewpoint of an individual capitalist, the ideal solution is obvious enough: keep the wages of your own workers down but encourage other capitalists to pay high wages in order to generate a buoyant market demand for the output. However, if all capitalists seek that outcome, it will not add up. The tension is systemic. From the viewpoint of capitalists as a whole, wages are always simultaneously too high and too low. This is because wages have a dual role—as a cost of production and as a source of demand for goods and services. Oscillations in the level of economic activity are the result of capitalist firms, and governments acting on their behalf, wrestling with this contradiction.

**ECONOMIC CRSES AND SOCIAL CHANGE**

These three strands of Marxist crisis theory—emphasising disproportionalities, the tendency of the rate of profit to fall, and the problem of underconsumption—can all be applied to understanding downturns in the level of economic activity in the real world. While explanations for particular economic crises at specific times and in specific places cannot simply be ‘read off’ from these theories, they direct attention to key variables for analysis. A fuller understanding of particular crises then requires consideration of the historical context, the monetary factors associated with
financial institutions, the role played by governments, the problems of inflation impact of international trade, and so forth. The Marxist analysis focuses on underlying conditions, rooted in the nature of capitalist production, but does deny that other factors may play a part.7

An economic crisis does not necessarily herald the demise of capitalism. results in structural economic changes that foster conditions for renewed ca accumulation, slump turns into boom. It is rather like a crisis in your personal if you make the necessary adjustments to cope with it, life goes on—and may be better than before. In the case of economic crises, the adjustments are painful, usually involving the closure of businesses and the loss of jobs. However, that weeding-out of ‘inefficient’ elements in the system results in a more dynamic economy, then capitalism moves again into an expansionary phase. Looked at from this perspective, a theory of periodic economic crises is not a theory of system breakdown. It is an explanation of alternating booms and slumps—what orthodox economists more politely call the business cycle.

Whether it is sensible to retain an economic system whose structural contradictions cause recurrent recessions—not to mention alienation and inequality—remains the big question. If enough people think not, and decide to do something about it, alternative political economic arrangements can be fashioned. This is where human ‘agency’ enters the story—as an instrument for change, operating alongside the ‘structural’ aspects we have been discussing. This is where Marxist view turns towards the workers, not as victims of capitalist exploitat but as the active agents of progressive social change. Marx anticipated that working class, enlightened by radical intellectuals like himself, would bring about the revolutionary transformation from capitalism to socialism. More moderate reformers have anticipated and advocated more incremental changes to the economic system to reduce its tendency to fall into periodic economic crises. This view has been characteristic of Keynesian and institutional economists, as we see in later chapters.

Marxists are usually sceptical of any such attempts to put ‘band-aids’ on the structural problems of capitalism. The fundamental flaw of the system that they identify underlying each of the three strands of Marxist crisis theory, is that economic crises are a feature of an economic system based on production for profit. Crises arise whenever conditions for profit are not present, whether because of structural imbalance, insufficient demand, or any other factor. At such times, unemployment and unfilled social needs coexist. Any genuinely rational economic system would mobilise unemployed resources to make the goods and services to satisfy those needs. Capitalism does not do this because it is based on production for profit rather than production to directly satisfy human needs.

Therein lies the general Marxist case for moving from capitalism, with its inherent class conflicts and crisis-prone character, to a socialist alternative. Marx anticipated that the problems of recurrent economic crisis would fuel this revolutionary sentiment and bring more converts to the socialist cause. The final chapter in this book returns to the question of why this has not come to pass—or at least not yet—in the advanced capitalist nations.
CONCLUSION

Marxism provides a grand theory of the coexistence of cooperation and conflict within the structure of the capitalist economy. It emphasises the economy's essential dynamic and its fundamentally contradictory character. Workers and capitalists have to cooperate to win their 'daily bread' (and cake); but there is a fundamental conflict of interest, manifest in distributional struggles and crisis tendencies. In seeking to develop an analysis of these conditions, Marxist political economy presents us with some particularly distinctive propositions:

- profits come from the exploitation of labour
- growth comes from the accumulation of capital
- crises come from inherent contradictions in the system of production for profits
- conflict comes from the class structure
- change comes from class struggle.

This interpretation of capitalism is as contentious today as it was when it was first developed. Marx just will not lie down. Although his ideas were formulated in an early phase of capitalist development, they continue to have striking resonance today. Indeed, as long as capitalism exists, Marxism will be bound to be a major reference point for the analysis of its contradictions. Equally predictably, the Marxist interpretation of capitalism is hotly contested by those with a stake in maintaining the existing economic system. In the conventional teaching of economics, Marxism usually has a shadowy presence—if it is considered at all. Usually it is sidelined by the overwhelming emphasis on a quite different theory, that of neoclassical economics.