

CRISIS AND DISTRIBUTION¹

Anwar Shaikh

Text books typically depict the advanced world as a wonderfully perfect machine chugging along, subject to shocks but with no possibility of falling apart. Quite to the contrary, studying the history of the advanced world predisposes one to expect a standard recurring pattern which is called, historically, great depression. Global crises tend to occur with surprising regularity; not a perfect regularity in terms of schedule, but they tend to stay within certain dimensions of typically 30-45 years.

The financial crisis of 2008 arose in the advanced world and it is significant to the understanding of capitalism in the historical context of other crises. There were similar crises in the late 1840's, from 1873 onwards, in the 1930's, and in 1968 and 2008. The 1970's crisis was branded at the time as "IT", implying it was similar to the great depression due to bankruptcies, business failures, high unemployment. Many but not all countries got out of the crisis through high inflation; countries like Japan followed a different path. Countries like the U.S. and the UK followed the path of massive volatility in unemployment, eroding labor's power, dismantling the part of the state that supported progressive and labor activities and inflation. In those countries, inflation without wages keeping up was an important means of making workers lose ground.

The element that can account for a recurrent pattern in a system that evolves all the time is by necessity a central one. Capitalism is like a virus; its form is constantly evolving. So no matter what defenses we structure and put up to contain it, it evolves to get around them. At the heart of capitalism and its driving force is profitability; more completely, what drives this system is the difference between the profit rate and the interest rate. This difference is central to the arguments of Keynes, Marx and most classical economists including Smith, Ricardo and others.

This crisis was not caused by the mortgage crisis. The mortgage crisis triggered the burst of a bubble but that bubble was built on a boom that lasted from the early 1980's up to the late 2005-2006 period. Historical events played a role in this, e.g., the undoing of regulation in the U.S. allowing banks to invest in risky activities implicated many more financial institutions in the bubble than would have been otherwise. Not all capitalist countries followed this path; Canada, for instance has a different banking and mortgage structure and so has felt the impact of this crisis much less on the financial structure; it has of course felt the impact on exports which is global.

What we are experiencing is a recurrent structural crisis. We are entering another great depression, on schedule with the 30-40 years range, and this one would last for a while. Theoretically, accumulation is a function of the rate of profit of enterprise (in Marx's terms, profit of enterprise is the excess of profit rate over interest rate). $g_k = f(r - i)$. g_k is the rate of growth of capital or the rate of accumulation.

The central argument in classical economics and also in Keynes is that the difference between the profit rate and interest rate is what creates the viability of accumulation. This is the driver of animal spirits because r in Marx is the general profit rate and i is the interest rate but in Keynes, r represents the marginal efficiency of investment and i represents the interest rate. Again, Keynes focuses on the short run but these variables are crucial to this discussion. Movements of these variables create a moment where the amount of profit becomes stagnant and that is where r is equal to i . The incentive for accumulation disappears and that moment is where the system undergoes phase change from healthy growth to unhealthy accumulation followed by decline and a series of crisis.

Empirical evidence supports this argument. A key variable from both a classical and a Keynesian point of view is growth rate of profit for U.S. non-financial corporations. Data for the period 1947-2008 depicts a long term decline in profitability which is subject to many fluctuations, among them the 1960's period which peaked at around 1968 due to a spike in government expenditure in the Vietnam War. As that effect started to wear off, the graph reverts to its trend. The trend essentially continued through the 1960's but after that the profit rate starts to increase mildly. The trend would have continued downwards had two significant events not occurred. First, real wages were lowered tremendously relative to productivity. The second crucial variable is the interest rate. Recall that accumulation is driven by the difference between profit rate and the interest rate. The interest rate is the cost of capital or the opportunity cost. Historical data shows that the interest rate rises from a very low rate (below 1% in 1947) and peaks at 14% in the late 1980's, which is only in part attributable to the Volker shock, and starts declining substantially thereafter. This pattern is common to the U.S. and its major trading partners. A graph of the difference between the profit rate and the interest rate depicts a steady decline in the profit rate of enterprise until the 1980's, followed by a dramatic rise. This can be attributed to two variables: the reduction in growth of real wages relative to productivity (in Marx' terminology, a tremendous historical rise in the rate of surplus value) and a decline in the interest rate. Both these variables are policy variables.

The relative movement of real wages and productivity shows a clear trend. They intersect in the 1980's, after which point the growth rate of real wages fell behind. Cohesion within labor remained in place until the 1980's, when Reagan and Thatcher came to the center of the world stage, which is when labor fell apart. What followed is that productivity continues to rise due to the intensification of labor and the increase in the mechanization of labor. At the

same time, real wages start to stagnate due to the lack of labor institutions. The gap between the two variables is the old-fashioned rise in the rate of exploitation. This is quite unparalleled in recent history and for it to happen required breaking the institutions supporting labor.

The objective of neoliberalism, which was an expeditor of these events, was not to attack the state but to re-align the state; concentrating the state on the interest of capital on a global scale. Consequently, the state had to become more powerful in some ways and more focused on one side. The drop in the interest rate allowed globalization of financial capital. It made capital movement extremely cheap, which created not only a boom in accumulation due to a rise in the profit rate of enterprise, but also bubbles in the stock market and the financial sector and others. With stagnant wages and cheap interest rates, consumption was kept up by encouraging borrowing, leading to an increase in the debt to income ratio. Cheaper borrowing led to a boom in consumption and business spending.

The issue with this scheme is that interest rates cannot be lowered forever. Interest rates will eventually reach a limit around zero. This is not just a liquidity trap but an objective limit to this policy. The result was a situation marked by two significant features: first, attacks on labor supporting institutions which weakened workers' position and depressed real wages, and second, globalization which brought the world's reserve army in contact with the U.S. and developed countries' labor markets, which again checked the pretensions of labor, since the threat of the unlimited supply of the reserve army prevented the growth of real wages.

Household spending, the real estate bubble, the financial bubble and the real growth of accumulation are all elements of the same story. The limits arise when labor cannot be squeezed any more or interest rates cannot be lowered further. The limit in the former variable has not yet been reached, but it has already been achieved in the latter, hence, the bubble and the boom came to a halt.

The global effects are uneven. Some countries like Iceland, Greece and Spain experienced extreme financial problems, despite the fact that they had been thought to have been safeguarded by European Union. The chasm in development has surfaced. The developed world, including the U.S. and north-western Europe, faces almost equally problematic financial situations with speculations against the British Pound. There are countries like Norway and Canada which have been circumspect and have avoided some of the financial difficulties, but they still face unemployment due to the contraction in world exports. The developing world has been in a kind of shock since it came out of the bad decade of the 1980's, when the previous extended crisis was having a terrible impact on development. In that case, too, cheap finance was a way to expand employment through finance-related

activities like real estate booms, export led growth, foreign remittance growth, etc. All of these led to increased inequality among the population.

A good outcome of the current crisis would be if it lasts 10 years. A bad outcome would be if it lasts 10 years with increased unemployment and increased poverty. In the former case, the balance of power might shift back to labor while in the latter scenario, people like Reagan and Thatcher might come back to do the same all over again.

To finish, I want to mention a few issues that arise from a Marxist perspective with respect to the response so far in the current crisis. There are serious issues regarding the composition of stimulus spending. Funds given to the banks are completely sequestered. The banks' assets are fictitious so they will keep the money. Funds awarded to failing businesses would have the same – non-existing – impact; why would companies spend additional money when they already have overflowing inventories? Funds to businesses that have to be used for infrastructure and social care have the potential to generate a modest impact. What is missing in the current policy debate is the solution adopted in the 1930's, that is, direct employment. The government should undertake a project type employment which funnels capital to workers directly instead of going through private firms.

Another issue is the consequences of limits to government spending. Since the advent of fiat money, government can create immediate money for expenditure but they will eventually have to cover the deficit. This is not due to any technical problem but rather to economic history. In his book "Money", John Kenneth Galbraith notes that the American and French revolutions were financed entirely through the creation of money. That led to first known major hyper-inflations in human history and as Galbraith and Riley note, the revolutions succeeded but the currency failed. Since then, there are limits on all government expenditures. Without these limits, unchecked government expenditure growth leads to hyper-inflation, as happened in Argentina or Brazil.

In economic theory, there are at least three broad points of view regarding the effects of government deficits. The neo-classical idea is that government expenditure crowds out private investment, so it will not be stimulatory in the long run. The second view may be called the Keynes-Kalecki-Post-Keynesian position, which is that the stimulus is fine as long as you have unemployment but once full employment levels are achieved, there might be inflation. Lastly, the classical position is that the stimulus would have a positive short term impact, but that there are limits to it which would come about depending on the effects of profitability. Profitability is determined by the normal profit rate corresponding to normal capacity utilization times the actual rate of capacity utilization. Hence a rise in the latter increases the former. However, if it lowers the normal profit rate by raising wages relative to productivity, then it is not clear what its long term impact would be. It's possible to have no

long term impact or a negative long term impact. This is common thinking in the neo-classical tradition. A crucial issue is the existence of a limit to government debt. Greece, Spain, Portugal, Italy and maybe the UK are now discovering what the result is when capital markets do not buy a country's debt.

Lastly, an important issue is the accountability of the economics profession. The whole episode since the 1980's is a period of market worship in which economists are the priests and the incantation is the perfect market, perfect knowledge, perfect foresight and maybe perfect nonsense. This has dominated the profession for too long; it is time to accept that economic theory is fundamentally imperfect. A theory that does not understand the world cannot accuse the world of being imperfect, but it needs to understand that it is imperfect. Hence, one of the institutions that the current crisis needs to sweep away is the orthodoxy of economics.

END NOTES

¹ Transcription: Abid Khan, editing: Miriam Rehm.

Talk given at the conference on The Effect of Financial Crises on Distribution at The New School for Social Research, March 5 2010. We thank Anwar Shaikh for the permission to transcribe and publish his remarks.