The Economic Crisis - The Marxian Explanation

At the present time world capitalism is in depression. Throughout the world there are millions of unemployed. So it is important to know why this depression is happening, whether or not it could have been avoided. Will it pass away, and if so, when? Will depressions happen again in the future?

We hold that depressions are inevitable under capitalism, and that no reformist policies based on Monetarism or Keynesianism, or anything else, will make any difference. We agree with Karl Marx that capitalism and depressions go together and that the only way to get rid of depressions is to replace capitalism with socialism.

CAPITALISM’S TRADE CYCLES

"Capitalist production moves through certain periodical cycles, it moves through a state of quiescence, growing animation, prosperity, over trade, crisis and stagnation" (Marx, Value, Price and Profit)

Nowadays we would use the word "boom" where Marx used "prosperity" and "depression" where Marx used the word "stagnation", but these terms mean exactly the same thing. The cycles are not tidy and regular like the movement of a clock. It is not possible to say how long will be the period between the end of one depression and the arrival of the next crisis, and it is not possible to say how long a depression will last. Some depressions have been quite short, but what was known as the Great Depression in the last quarter of the 19th century lasted for twenty years. There were ripples of partial recovery during this long period which faded out.

It seems safe to accept, as did Marx, that the period of prosperity, or boom, never lasts for long. Marx put it that boom conditions are the harbinger of a coming crisis, but the Keynesians and the Monetarists believe that they have discovered a way in which governments can make the boom permanent.

Marx did not use the term "crisis" to mean the same as "depression". The crisis is the sudden break which brings the boom to an end, the depression is the decline of production and increase of unemployment which comes after the crisis. It is important to recognise the difference between these two stages of the trade cycle, because the factors which govern the period up to the crisis and the crisis itself, are different to the factors which operate during the period of depression.

The state of quiescence, as Marx called it, is the period towards the end of the depression when production has ceased to fall and when unemployment has ceased to grow, when things are moving along a fairly even but low level. We seem to have been in a period of "quiescence" for the last year or year and a half; in other words, unemployment having increased fairly rapidly about two or three years ago, and production having fallen sharply, in the last year or so, things have been moving along fairly quietly, without getting worse.

The period of "growing animation" is when most industries are working to full capacity and unemployment is correspondingly very low. The boom moves into the next phase which Marx called "overtrade", when a number of industries find that they have each produced more than they can sell at a profit in their particular market. Then comes the sudden crisis followed by the depression.

HOW THE BOOM ENDS

It is important to be clear about the state of "overtrade" which produces the crisis. It does not mean
that there is a fixed total size of the market and that a crisis occurs when total production exceeds it. After every depression the total market and total production have gone to higher levels and will do so again. Nor does it mean that each and every industry is at the same time producing more than can be sold in its market. Such a situation does not arise and the term "general overproduction" is meaningless. Each industry produces for its own particular market but to some extent the expansion of production in one industry creates a larger market in some other industries. If, for example, British motor manufacturers, having produced and sold a million cars last year, decided to expand production so that, in total, an additional million cars are being produced this year, the production of this additional million will create additional markets for steel, rubber, glass, engines and other requirements of expanded motor car production even before the additional million cars are sold.

What actually happens in the boom is that some industries produce too much for their particular market. Competition to sell the excess reduces prices, leading to reduced profits, or no profit at all. Companies then scrap plans for further investment, reduce output and sack workers no longer needed. This in turn affects the market for other industries and if the combined effect is large enough, results in depression with its heavy unemployment.

In the autumn of 1973, after a period of expanding production and falling unemployment, a survey of companies was conducted, asking them if they were producing below capacity and if not, why not. While a considerable number reported that they were producing below capacity because of falling orders, about half the companies had more orders than they could meet and were producing below capacity because they could not recruit enough skilled workers or could not obtain enough materials and components. Among the listed scarce materials was steel. A few years later, when unemployment had risen sharply, there was a surplus of steel for which no market could be found and steel workers were being made redundant.

The capitalists in each industry are in business to make profit—the more the better. How much they succeed in making depends on several factors. Their profits will increase with bigger sales and higher selling prices, and a lower wages bill. Their profits will fall if sales fall or selling prices fall or the wages bill rises.

As heavy unemployment tends to depress wages, unemployment is also a factor. This has led some British Labour Party spokesmen to put the view that the Thatcher government in Britain deliberately created 31/2 million unemployed in order to hold down wages, help curb the rate at which the general price level is rising, and also to increase the amount of profit going to the capitalists. If it were true that governments control the rise and fall of unemployment, the Labour Party would need to explain why, in the four periods of Labour government in Britain in the 50 years 1929-1979, unemployment was higher at the end of each of the four periods than it was at the beginning.

If governments had such control, no government would want heavy unemployment, and the capitalists would want to have the unemployed at work producing profits for them. Capitalism is not under government control in that way: crises and depressions occur from time to time irrespective of the party in office and the policies it applies.

The Labour Party case against the Thatcher government is that Mrs Thatcher deliberately increased unemployment from 5.4 per cent in 1979 to 12.5 per cent in 1982 in order to depress wages and increase profits. But the reverse happened. Wages went up and profits went down. Official figures show that "income from employment" rose between 1979 and 1982 by £41,000 million while gross trading profits of companies fell by £331 million. More light is shed on it by showing gross trading profits each year as a percentage of total income from employment in that year. The percentage rose from 17.7 per cent in 1975 to a peak of 25.2 per cent in 1979, after which it declined each year, to 18.3 per cent in 1982. So, in the years 1979-1982, as unemployment went up, the relative amount of profit went down. With the recent expansion of sales, profits are now rising sharply again.

Looking further into the question, what causes a boom to develop into a crisis, it is useful to start with the early 19th century French economist J.B. Say, who thought that capitalism is a self-regulating system which, if left to market forces, would keep industry working to full capacity. He is remembered for his saying "every seller brings a buyer to market", by which he meant that every capitalist who sells a commodity then has money with which to buy another commodity.
But, as Marx pointed out, while each seller is able to buy another commodity, "no one is forthwith bound to purchase because he has just sold". He may choose not to do so and "if the split between the sale and the purchase becomes too pronounced", this "asserts itself by producing a crisis".

An example of this is the General Electric Company. At the beginning of the present depression, having sold commodities they had £400 million "cash" but instead of using it to buy materials with which to produce more of the commodities in their range of products, they chose to lend it and get income from the high current rates of interest. By the end of 1983 GEC's "cash mountain" had reached £1,400 million.

If GEC had behaved as J.B. Say supposed, they would have used their cash to recruit more workers, and expand output, but like many other companies, they have been closing some of their factories and declaring workers redundant. They have not done so because, so far, they have seen no prospect of making more profit by doing so.

**NO SOLUTION IN MONETARY POLICY**

Many economists and politicians blame the banks for the depression. They say that if only the banks would lend money to industry, production would expand again and unemployment would fall. The banks are in business to make profit by re-lending the money depositors lend to them and they do not need economists and politicians to tell them how to run their business. But banks are only interested in lending more money to companies which themselves see prospects of using it profitably. When trade improves and companies can expand investment and production profitably, there is no dearth of funds for that purpose, either direct from investors or through the banks. Marx dealt with the fallacy that depressions are the result of industry's inability to borrow funds and his case receives striking confirmation in the fact that, far from wanting to borrow from the banks, some of GEC's cash is lent to the banks.

Why does the prospect of investing profitably disappear for many companies and a crisis occur. One of the factors already mentioned is that some industries find at the height of the boom that they have produced more than can be sold at a profit in their particular market. It is inevitable. In the period of recovery from a depression the market for each industry is seen to be expanding, and the firms in that industry in each country are set to take advantage of the expansion. But they do not know with any precision how great the total expansion will turn out to be, and even if they did, they are in competition with each other and each section tries to get in as quickly as possible and to capture as large a share as it can. As Marx said, they all behave as if the market is limitless.

Another factor is the rise of wages causing a reduction of profits. In the phase of expansion and boom unemployment falls and the unions are in a position to push wages up. A general rise of wages beyond a certain point will wipe out profit for some companies and will influence the decisions of the more profitable companies about further investment and expansion of output.

A popular belief among trade unions is that raising wages is a cure for depression because it "expands the market". But of course a rise of wages does not "expand the market". What it does is to expand the market for the goods the workers buy, but correspondingly reduces the market for the consumer and luxury goods bought by the profit receivers and reduces the amount available for investment.

Marx dealt with the argument that raising wages would solve the problem by pointing out that in the boom wages do rise but without the supposed effect of averting a crisis.

If one were to attempt to clothe this tautology with a semblance of a profounder justification by saying that the working class receive too small a portion of their own product, and the evil would be remedied by giving them a larger share of it, or raising their wages, we should reply that crises are precisely always preceded by a period in which wages rise generally and the working class actually get a larger share of the annual product intended for consumption. From the point of view of the advocates of "simple" commonsense, such a period should rather remove a crisis. It seems, then, that capitalist production comprises certain conditions which are independent of good or bad will and
permit the working class to enjoy that relative prosperity only momentarily, and at that always as a
harbinger of a coming crisis. (*Capital* Vol II, page 476)

In the real world of capitalism the total demand for commodities is not increased either by raising
wages at the expense of profits or by raising profits at the expense of wages, but there is a widely
held belief today that there is another source of increasing demand in the supposed power of banks,
by their lending transactions, to "create deposits" and thus add to total purchasing power. This belief
was aptly described by the late professor Edwin Cannan as the "mystical school of banking
theorists". It is held by the Keynesians and by the Monetarists. It is quite baseless; the banks can
lend no more than depositors choose to lend them.

If the "mystical" theorists were right and the banks could create deposits which depositors could
withdraw and spend on purchasing commodities, it would follow that the price level is determined by
the banks. If you think that nobody could hold such an absurd view, this is what J.M. Keynes wrote in
his book *Monetary Reform*:

The internal price level is mainly determined by the amount of credit created by the banks, chiefly
the Big Five. .. The amount of credit, so created, is in its turn roughly measured by the volume of the
bank deposits ... (1923, p.178)

According to this, if the banks "create" more deposits prices go up and if the banks "create" less
deposits, prices go down. There is nothing in actual experience of capitalism to justify this fallacy,
any more than there is in the Keynesian belief that depressions could be averted by the government
borrowing more and spending more, or in the Monetarist belief that depression could be averted by
the government borrowing less and spending less.

It was in 1977 that the British Labour Chancellor of the Exchequer Denis Healey, having seen
unemployment rise from 600,000 to 1,700,000, announced the abandonment of Keynesian doctrine
and the adoption of the Monetarist policy continued by the Thatcher government. Though
unemployment did fall a little for a time, it then rose to 3½ million. Seven years after the adoption of
Monetarism, it is still over 3 million.

**IRRELEVANCE OF KEYNESIANISM**

The Keynesians have two showpieces. One of them is Roosevelt's New Deal which is supposed to
show how successful Keynes was. The other is what has happened in Britain between 1945 and
1977.

The man who said Roosevelt's New Deal was a piece of Keynesian success was Professor Dudley
Dillard, Professor of economics at Maryland University, who wrote a book called *The Economics of
J.M. Keynes*, published in 1948. Dillard said that Roosevelt in his New Deal did all the things which in
1936 Keynes advocated should be done in a depression. He ran a high budget deficit, he borrowed
the money, he increased government expenditure, and government investment. Dillard said that it
was a great success, and that the economic expansion between 1933 and 1937 "was one of the
most rapid in the history of American business cycles. The speed of the recovery was undoubtedly
conditioned by the depths to which activity had plummeted in 1932. It was nevertheless a
remarkable recovery which was nurtured by fairly large-scale borrowing."

You will notice, by the way, that Dillard hedges a bit; he doesn't say that it was the only recovery, he
says it was one of the most rapid. But Dillard did a useful thing. He compared America under
Roosevelt with what was happening in Britain at the same time under the Ramsay MacDonald
National Government. Whereas Roosevelt was running a policy which Keynesians later claimed was
in line with their views, the British government were doing the opposite. In 1932 they were running
the same policy which Mrs Thatcher is running now. So you have the two contrasted, Keynes in
America and anti-Keynes in Britain, and what actually happened?

In 1932, unemployment in America was 24.1% and 22.1% in Britain. Five years later, in 1937,
unemployment in America had fallen to 14.3%. In Britain it had fallen to 10.82%. The same thing
happened in both countries; it was a bit more favourable in the anti-Keynesian Britain than it was in
the Keynesian America. What sort of success is this? In 1938, which was 6 years after Roosevelt had obtained power, unemployment in America was 19.1% and it was 13.5% in Britain. In other words, after 6 years of Keynesian policy, it was double what it was in America in 1983 in the midst of this present depression.

There is one other interesting aspect of this. The Keynesians say that if the government spends more it will not only create jobs directly, but it will stimulate private industry so that the private capitalists will spend more and invest more so you get the jobs being created both directly from government expenditure and throughout industry generally.

It would not however be of any use for the government to increase expenditure, if at the same time the capitalists were reducing their expenditure. What happened in America? If you compare the pre-depression year 1929 with 1938, government expenditure went up from 22 billion dollars to 34 billion dollars. That was an increase of 12 billion dollars. Fine, jobs were created and all the rest of it. But at the same time, private investment went down from 39 billion dollars to 21 billion dollars. So while government expenditure was going up, private investment was going down, which explains of course why unemployment was 19.1%. Dillard recognised this and he actually says that private investment “remained abnormally low” during that depression.

He and Keynes both worried about this. They said that it didn't seem to work the way they thought it would, and they both put forward the view that perhaps it would have been all right if only Roosevelt instead of increasing government expenditure by a mere 12 billion dollars had increased it by more. It is worth noticing that in Germany in 1920 to 1923 when the government didn't just increase expenditure by 22 billion dollars, but were doubling expenditure every month, after 3 years of it 25% of the German workers were out of work and nearly another 25% on half time.

BRITAIN AFTER THE WAR

The second showpiece of Keynesianism is what happened in Britain between 1945 and 1977. It is absolutely true that in the first ten years after the war unemployment was abnormally low in this country and averaged about 2% or less, but from 1955 unemployment began to rise there. Unemployment never remains absolutely stable, it goes up and down in this way, and in 1955 it began to rise. It went up from 500,000 in 1955 to 700,000 in 1963, 800,000 in 1968 and up to a million in 1970 under Heath and to 1,700,000 under the Labour Government in 1977.

Was Keynesian policy really the reason why unemployment was very low for the ten years after the war? We can quote two Keynesian economists. One is J. Robinson and the other is Alvin Hanson, who wrote in 1950 and 1953, both of whom, though they were Keynesians, said that the low unemployment was nothing to do with Keynes and that it would have happened in any event.

Now look at the real reason why unemployment started to rise after 1955. During the war, Germany and Japan, and some other countries, were devastated. They were no longer in the world market producing goods. It took them years to recover. They recovered, largely with the aid of American finance, and when they did so, they didn't only have their factories rebuilt, but they had them completely modernised and re-equipped, so that Germany and Japan became the leading cheap producers of commodities in the whole world. And as Germany and Japan came back into the market, British exports were squeezed out. There is quite a useful way of looking at it. There are figures available showing 11 countries, which included Germany and Japan, and their total export of manufactured goods and the proportion going to British capitalism. You can see that in 1955 the British proportion was about 20%, and you can see it coming down to 16%, 18%, 15%, 10%. You will have noticed that it was recently announced that for the first time in British history, Britain is now an importer of more manufactured goods than it exports.

So it can be seen that the two showpieces of Keynes had nothing whatever to do with Keynes. It did not work and the whole claim made for Keynesian policy is an illusion.

The course of events has justified Marx's explanation of crises and depressions against both the Monetarists and the Keynesians. It only needs to add that, unlike Keynes and the Monetarists, who were vainly trying to improve capitalism, Marx reached the conclusion that the only solution is to
abolish capitalism and establish socialism.

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