Chapter 1

Introduction

In the 'seventies, a division developed in U.S. academic economics between the orthodox or "bourgeois" economists in the mainstream and the radicals and Marxists throwing rocks from the shore. Macroeconomics is no exception to this rule. On the one hand, the old distinction within orthodox macroeconomics between monetarists and Keynesians has become less important. Thus we see the omission from a recent intermediate-level macroeconomics text of the traditional long and systematic comparison between the two schools. Instead, a synthesis is presented. (Dornbusch and Fischer, 1978.) Another text sees the difference as being simply a matter of economists' differing attitudes toward the government: some economists prefer policy activism while others, distrusting government "meddling" advocate a commitment to rules. (R.J. Gordon, 1978.) On the other hand, radical political economists have criticized the assumptions of orthodox macroeconomics as being infused with either apologetic conservatism or technocratic liberalism and have rejected orthodox models as being too idealized.

The increased popularity and theoretical revival of Marxism coincided with the world economic crisis of the 'seventies. Thus, many radicals have embraced a uniquely Marxian approach to macroeconomics -- crisis theory -- that employ a broad political-economic approach rather than the narrow technical approach of orthodox economics. While the orthodoxy emphasizes the essential stability of the system, seeing economic disasters as arising outside the market (in technology, Nature, or foreign affairs), Marxists argue that the capitalist system itself is the principal cause of these disasters. The purpose of this
dissertation is to develop this Marxist approach to macroeconomics.

The problems that radical economists saw in orthodox economics were not only theoretical but empirical. Some economists concentrate their energies on analyzing ideal worlds, but this is by no means true for all of the orthodoxy. There is a large body of literature that tries to predict the future movements of the economy. But as Business Week notes,

> Not only have the economists missed the intensity and timing of each of the seven postwar recessions, but their forecasts seem to be getting worse, even as their acceptance by policymakers and businessmen rises. (July 14, 1980, p. 88.)

Neither of the two intermediate macroeconomics texts cited above have sections on the business cycle, despite the severity of recent fluctuations. If the business cycle is not obsolete (as was said in the 'sixties) then perhaps it is neoclassical macroeconomics that is the problem. Thus, there is an opening for a new approach to macroeconomics. The trick is to develop a new approach without falling into a common Marxian trap, that of always predicting -- often on the basis of nothing but faith -- that the economy will fall into utter disaster.

Marxian macroeconomics has other problems. It is an arena of continuous debate rather than being a unified school. There are two levels to this debate. First, there is the Crisis -- within a capital "C" -- the protracted difficulties of disasters of the U.S. and world economies and societies during the last ten years or so. Second, there are crises -- with a small "c" -- cyclical economic downturns. Though these two issues ultimately cannot be separated, this dissertation focuses on the latter. But even for this narrower topic, however, there is continuous, sometimes acrimonious, debate. The most prominent problem is that there are three major theories. These are the theory of
the tendency for the rate of profit to fall due to capital deepening (due to the rise of the value composition of capital), underconsumptionism, and the theory of the wage squeeze on profits at low levels of unemployment. Not only do these theories seem mutually exclusive and contradictory, but as orthodox economists are quick to point out, they suffer from severe logical flaws.

In view of these problems, it is necessary to start again with the basics to reconstruct a specifically Marxian macroeconomics. This dissertation will argue that all three of the major theories -- plus the minor theory of the raw material shortage -- contribute something to our understanding of cyclical fluctuations, but that each of them must be rejected as an isolated theory. They must be synthesized into a common framework after ridding them of theoretical misconceptions. The critical analysis of these theories is the subject of chapter 2. The theory of the tendency for the rate of profit to fall must be largely rejected, at least as it has been formulated so far. Its general approach of seeing capitalism as expanding "too far" due to capitalist competition and class conflict will be retained, however. The view that crises occur due to rises of the value composition of capital must be replaced with a theory that places the over-accumulation of fixed capital at the center of the analysis. The theory of the wage squeeze on profits must be seen in conjunction with this over-investment, as must the theory of the raw material shortage. At the same time, the problem of why capitalists cannot protect profits by simply raising prices must be addressed. Finally, we shall see that underconsumptionism is most relevant to an understanding of the period after the crisis, that is, during the period of stagnation. When investment is already depressed, consumer demand
dominates aggregate demand.

The method of this dissertation is by no means one of Marxology (so over-used by the so-called orthodox Marxists). Quotes from Marx (or Engels) are not meant to be assertions of Truth. Rather, they are used to show one viewpoint or to present a basic assumption or definition of Marxian political economy. Instead of a dogmatic attachment to Marx's doctrine, Marx's basic theoretical framework (historical materialism) will be applied to the problems of macroeconomics and crisis theory. This framework is summarized in chapter 3, where the capitalist mode of production is described. The theme of the dynamic interaction of capitalist competition and class conflict is developed while the nature and role of the rate of profit is discussed. At the beginning of this and other chapters, a short critical review of orthodox positions, both neoclassical and post-Keynesian, will be presented. We do not simply reject these views, however. We aim to learn from them and their mistakes.

In chapter 4, we arrive at the heart of the matter. The theory of aggregate investment is investigated. As opposed to most theories of aggregate investment which project a static, microeconomic picture onto the macroeconomic screen, investment is seen as a dynamic process where the contrast between microeconomic intentions and macroeconomic results is crucial. We see that competition and class antagonisms drive the system, forcing it to over-expand in the cyclical upswing. Thus, contrary to individual capitalists' intentions, wages and raw material prices rise to squeeze the rate of profit. At the same time, an excess of fixed equipment is installed. These combine to depress investment and cause the crisis. A second subject here is the post-crisis
stagnation. The possibility of the economy becoming stuck in an "underconsumption trap" is explored. Finally, a simple business cycle model is developed that brings these two cases together.

Since over- (or under-) investment is a relative term, the "right" amount of investment must be defined. This is done in chapter 5 where a model of economic growth is developed. In contrast to the orthodox growth models investment plays a relatively independent role, being determined by the rate of profit and other variables rather than by saving (as in neoclassical models) or by exogenously-determined "animal spirits" (as in many Cambridge, England models). The emphasis is not on the steady-state growth of orthodox models but on disequilibrium growth. The economy is assumed to be always in short-term equilibrium (where saving and investment are equal ex post) but is hardly ever in the medium-term equilibrium described by models in the Harrod-Domar tradition. It is shown that the economy in fact tends to move away from this medium-term equilibrium or steady state. (It is also shown that the Harrod-Domar conditions are too simple, even for a one-sector model of growth, when supply-side conditions are made explicit.) In this dynamic process of uneven accumulation, supply-side (production) conditions are crucial and the rate of profit is the key variable determining — and being determined by — accumulation. The description of growth and supply conditions allows us to sketch a more detailed but still abstract picture of the business cycle and to present data showing its plausibility. Finally, a mathematical description of the underconsumption trap is presented.

This framework will not give us the ability to exactly predict the "intensity and timing" of recessions and recoveries. Instead, it will
give us healthy respect for the unpredictability of the capitalist economy. In the boom, we cannot know exactly how long expansion will continue; in the stagnation, we cannot know whether recovery will result or whether the economy will sink into an underconsumption trap. In both these situations, conflicting forces are at work. But we can predict that under certain conditions, the longer an expansion continues, the more imbalances will accumulate and the lower will be the rate of profit measured at full capacity (the potential rate of profit). And the lower this rate of profit, the smaller will be the scope for government "fine-tuning" and the greater the chance of crisis and serious stagnation.

Throughout chapters 4 and 5, the problem of inflation is assumed away. In chapter 6, this assumption is dropped. Here we can replace the simple Phillips curve and conflict theories of inflation with a more general theory. Inflation is a substitute for a decline in the rate of profit in the medium-term, no matter what the cause of this fall. Capitalists can avoid a profit squeeze by raising prices. Inflation may not solve the problem, however, since in the longer run, it does not solve, and may indeed exacerbate, the condition that caused the initial depression of the rate of profit. Because inflation allows accumulation to continue without the cleansing effect of a crisis, the factors that depress the rate of profit persist: the working class remains strong, the sellers' market in raw materials persists, and the capitalists continue to accumulate too much, and to have the wrong combination, of fixed capital. These conditions may worsen, so that the rate of inflation necessary to save a "normal" rate of profit will accelerate.

Chapter 6 also discusses the role of state policy. History suggests that inflation is by-and-large a political phenomenon. Therefore, the
political economy of post-World War II state policy in the U.S., showing the sources of inflationary bias. This analysis allows us to get an inkling of the nature of the Crisis. One factor that may have contributed is the U.S. state's high employment policies which blunted the cleansing role of crises. This contributed to the slowing of productivity growth and the post-World War II decline in the rate of profit.

This dissertation is not primarily an "empirical" one, with a long section devoted to regressions. Nevertheless, the empirical literature concerning the U.S. economy in the post-World War II period to show the plausibility of the arguments. In chapter 7, suggestions for further empirical work are made. At the same time, the conclusions of this study are summarized.