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CRISIS THEORY — ROOT CAUSES OF THE CURRENT CRISIS

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There are several points concerning the current financial meltdown that I believe all, if not most, revolutionary socialists agree about:

- The current financial crisis is not simply the result of the neo-liberal deregulation of the financial sector. *Instead, the crisis reflects the deeper dynamics of capitalism as an economic system*.
- The severity of the financial crisis is not simply the result of the default of approximately 10%-15% by those holding sub prime mortgages, which make up less than 25% of all mortgages. *The severity of the financial crisis flows from the fundamental weakness of profitability and accumulation in the "real economy."* Even if a financial collapse is avoided—which I believe it will—we should expect a very sharp and prolonged recession in the next 18-36 months.
- There is no solution to the crisis that will benefit both capitalists and workers. Unlike many on the left—such as Bill Fletcher in his article in the latest issue of *New Labor Forum*—we do not believe that pro-worker policies (moratorium on foreclosures/evictions, expansion of social spending, etc.) will promote the health of some abstraction called the "economy." Any policy that benefits working people will undermine profitability and accumulation; and any policy that promotes profitability and accumulation will come out of the hides of working people. *Put simply, any pro-working class reforms will only be won through massive and militant struggle from below*—not through alliances of union bureaucrats, social movement functionaries, and Democratic Party politicians.
- This crisis comes at a period when the organizations of working and oppressed people in the US are at their weakest state at any point in historical memory. The weakness of working and oppressed people poses the danger a further growth of right-wing ideas among working people (nativism, racism, homophobia, sexism, individualism, etc.). However, the crisis may provide opportunities for collective struggle that target capital rather than other working people, in particular struggles against evictions and foreclosures, for the extension of unemployment benefits, and against cuts to education and other social services.
- The crisis also provides us with an opportunity to engage in anti-capitalist, socialist education. The crisis will help create an audience for what our tradition has called "transitional demands" (public ownership, national health insurance, etc.). It will also create opportunities for socialists to present our critique of capitalism as an unstable social system incapable of meeting human need.

This is all we need to agree about to *act together*. Revolutionary socialists do not and should not have a "line" (unified approach) on crisis theory. However, each of us need to clarify our thinking about the underlying causes of the crisis—*of what leads profits to fall periodically and accumulation in the "real economy" to stagnate*—for two reasons:

1. People we meet in the course of our political activity will be looking for a "big picture" analysis of the economic mess. Each of us needs to be able to give them some explanation that goes beyond a general (and correct) "capitalism sucks!"
2. We need to be able to debate those on the left, in the unions and social movements who argue that there are "win-win" solutions to the crisis. These folks hold to one or another explanation—*theory*—of the crisis which they use to back up their political arguments. We need to be able to make arguments to counter claims of a "win-win" solution that can be won through an alliance of union officials, social movement functionaries, and Democratic politicians.

What follow is a very brief outline (and totally unoriginal—see bibliography) presentation of the *four* main radical and Marxist theories of crisis: under-consumptionism, profit-squeeze, over-competition, and falling rate of profit as a result of increasing mechanization/capitalization of capital. After presenting each theory, I will attempt to evaluate them in terms of their political implications, logical structure, and factual/empirical validity.

It is important to understand that there is no automatic correspondence between a crisis theory and a political strategy. While both under-consumptionist and profit-squeeze arguments are usually associated with reformist/social-democratic politics, revolutionaries (Rosa Luxemburg, Glyn and Sutcliffe) have embraced these theories. However, each theory of the crisis defines a *range of possible resolutions* of the crisis, *the concrete program* to be fought for, and *the social forces* expected to implement that program.

UNDER-CONSUMPTIONISM

The historically dominant crisis theory on the socialist and liberal left (Communist Party, *Monthly Review*, Democratic Party liberals through the 1980s) is one or another variant of *under-con sumptionism*. At the heart of this theory is the idea that capitalism lacks any internal mechan ism to generate total demand sufficient to buy-back a growing total supply. In its simplest form, the fact that workers are paid a wage that is less than the value of what they produce is said to give rise to a gap between demand and supply in a growing system. In its most sophisticated form, it is the periodic paucity of invest ment opportun ities which produces periods of inadequate total demand.

While under-con sumptionism appeals to many socialists because it makes the relative impoverishment of workers the cause of the crisis, it has usually been associated with the notion of a “regulated capitalism.” Under-consumptionism is often used to support capitalist state income redistri bution and investment planning (the “Keynesian” policies which most capitalist states in the global North pursued between the 1930s and 1970s), which would provide the incentives to investment that the market itself fails to provide. This “win-win” solution to capitalist crisis can be put in place through the actions of a coalition of union officials, social movement leaders, and “progressive” Democratic Party politicians. Put simply, under-consumptionism generally leads to the reformist conclusion that capitalist crises can be avoided if the state, as a “neutral arbiter,” can successfully balance the interests of capital and labor.

Under-consumptionist theories rest on a fundamentally false assumption about capitalism—that all capitalists produce only consumer goods, and the only "market" for consumer goods are workers. In reality, however, capitalists produce both consumer and *capital* goods—machinery, buildings, raw materials and the like. Workers employed in the consumer *and* capital goods sector can earn enough to buy the output of the consumer good sector; while capitalists in both the consumer and capital goods sector can spend enough to buy the output of the capital goods sector. As long as capitalists in both the capital and consumer goods sectors are investing, supply and demand can be balanced.

Continued investment—capital accumulation—depends upon rising profits. When profits fall, investment slacks, employment drops, and demand for both consumer and capital goods drops, and there is "over-production." Put simply, "overproduction" of goods is the *result,* not the *cause,* of falling profits.

There is considerable evidence to challenge the notion that insufficient demand causes falling profitability. Most economists recognize that capitalist firms adjust to fluctuations in demand by adjusting capacity utilization—increasing or reducing the number of workers through the addition or elimination of work shifts. Shaikh (1989: 10-11, 13) has developed a statistical method to adjust profit rate data for capacity utilization. The result is that profits, even when adjusted for capacity utilization—fluctuations in demand—still fall.

PROFIT-SQUEEZE

Profit squeeze theories argue that the increasing strength of workers in the late 1960s and early 1970s caused a sharp and general fall in profits in all of the industrial capitalist societies. Two revolutionary socialists, Glyn and Sutcliff, argued in the early 1970s that rising workers’ wages led to a decline (‘squeeze’) in capitalist profitability. In the 1980s, three left social-democrats, Bowles, Gordon and Weiskopf, claimed that the ability of workers to raise wages, win broad social reforms and block corpo rate attempts to reorganize the labor process was the primary cause of the crisis. Workers’ struggles led to a declining rate of growth of labor product ivity, rising costs of maintaining capital ist control over workers in production and a rising "social wage" (social welfare payments), all of which squeezed corporate profits.

Like under-consumptionist arguments, profit squeeze theories appeal to radicals and socialists because they make class power—the strength of capital (under-consumption) or labor (profit-squeeze)—the key determinant of profitability. However, as with under-consumptionist theories, the apparent centrality of class struggle to accumulation and crisis easily leads to a politics of *class collaboration*.

Gordon, Bowles and Weiskopf were important propone nts of various forms of "co-management" and "labor-management coopera tion." Purported ly, such experiments in "work-place democracy" would raise productivity, allowing both profits of capital and the living and working conditions of labor to rise simulta neously. Like the proponents of under-consumptionist theories, many advocates of the profit squeeze theory believed that "workplace democracy" could be won by an alliance of labor officials and liberal Democrats. As we all know, such experiments in labor-management cooperation have been, at best, a cover for the introduction and spread of lean production in unionized workplaces. [See Mike Parker and Jane Slaughter, *Working Smart: A Union Guide to Participation Programs and Reengineering* (Detroit, MI: Labor Notes Books, 1994)]

Logically and theoretically, declining profits as a result of either rising wages or declining worker efforts in production are, at best, *temporary and sectoral*. Capitalists in a particular industry can respond to rising wages or declining worker effort through either the introduction of new and more productive machinery; or, if this is not immediately possible, by diverting new investment into industries where wages are lower, worker effort more intense and profits are higher. Put simply, neither rising wages nor declining worker effort can lead to a general and prolonged crisis of profitability.

Data also challenges both versions of the "profit squeeze" arguments. The rate of growth of productivity began to fall in the mid-1960s—well before the upsurge of worker militancy—as the result of falling capital investment. The fall in capital investment was a response to falling profit. Put simply, the slowdown of productivity growth was an effect, not the cause of the onset of the crisis in the mid-1960s. (Shaikh, 1989: 12, 17-18)

OVERCOMPETITION

Robert Brenner, a revolutionary socialist and editor of *Against the Current*, has recently made a contribution to crisis theory. According to Brenner, increased competition in the late 1960s and early 1970s—between relatively new capitals in Japan and Western Germany and the relatively older capitals in the US—led to a generalized and prolonged decline of profitability across the industrial capitalist world.

Brenner's explanation of the crisis share a number of assumptions with the falling rate of profit argument we will discuss below. In both theories, competition forces capitalists to constantly find new and more efficient methods of production. Newer capitals (like Japan and West Germany after World War II), with little or no previous fixed capital investment are in the best position to introduce the latest methods of production. They are able to lower costs and prices and raise their profits in comparison to older capitals (like the US), who cannot abandon older investments in fixed capital until they are "used up" economically. However, Brenner rejects the idea that an increasing mechanization of production causes falling profits for *all capitals*. He embraces the notion that capitalists choose new techniques in order to simultaneously lower unit cost and raise profits.

According to Brenner, faced with declining prices set by the newer and more efficient capitals, older capitals experience lower profits and over-capacity. Falling profits and overcapacity becomes generalized across the capitalist world economy in periods, like the late 1960s and early 1970s, when international competition intensifies and produces a long-period of economic stagnation. Brenner claims that whatever recovery of profits have occurred since the early 1970s has been short-term and anemic because there has not been, in his estimate, a sufficient devalorization of older, less efficient capitals through massive bankruptcies.

Politically, Brenner draws revolutionary political conclusions from his analysis of the crisis. Only a massive attack on working class living standards combined with a massive destruction of older and inefficient capitals can raise profits. There are no "win-win" solutions to the crisis. As with the falling rate of profit thesis, the notion of a "regulated capitalism" where the state can prevent crises is *utopian*.

The major problems with Brenner's theory of "over-competition" are logical and factual. (Shaikh 1999) Theoretically, Brenner's argument suffers from similar problems as the "profit-squeeze" arguments he correctly rejects. Just as rising wages and declining worker effort must lead capitalists in a given economic sector to replace labor with capital or divert new investment to arenas with higher profits, so must sharpened and generalized competition lead older capitalists to adapt the latest techniques of production, reduce capacity, or shift investment to new branches of production.

In addition, Brenner's notion that capitalists are free to choose techniques that both lower their unit costs (improve their competitive position) and raise profits on their investments is problematic. This claim runs counter to the reality of capitalist competition, which forces each and every capitalist to "choose" the technique that allows the lowest unit costs, even if it raises the total capital investment and induces a decline in the overall rate of profit.

Factually, there are a number of problems with Brenner's theory. First, the sharpening of international competition in the early 1970s cannot explain the decline of profits in the US and other industrialized countries throughout the post-WW II period. Second, there is no clear indication of a sharp increase in international competition before total profits begin to stagnate in the US in the mid 1960s. In fact, evidence indicates that sharpened international (and domestic) competition is the result, not the cause of falling investment after the mid-1960s. Third, rates of profit decline more quickly in the late 1960s and early 1970s in Japan—the location of the newer and more efficient capitals—than in the US, the location of older and less efficient firms. Finally, there is ample evidence of a secular recovery in profit rates in the 1980s and 1990s, which Brenner's account denies. (See Graph)

FALLING RATE OF PROFIT AS A RESULT OF INCREASING MECHANIZATION/ CAPITALIZATION OF CAPITAL

At the center of the theory of the falling rate of profit are the most fundamental dynamics of capitalism. (Shaikh, 1989: 3-10) Capitalist competition forces capitalists to seek out and introduce new and more advanced methods of production in order to cut per unit costs. The result is an *increasing capitalization of production*—what Marx called the "organic composition of capital." As capitalists replace workers with machines—replace living with dead labor—the rate of profit falls.

The rate of profit—total profits divided by total capital invested and total wages—falls in both long periods of capitalist growth and long periods of stagnation. Profit rates decline during long waves of growth because the capital intensity of production—total capital divided by total wages—increases. As profit rates decline, the rate of increase of investment falls as well. During the long-boom, the rate of increase of total investment falls at a slower rate than the decline in profit rates. The result is that total profits—the *mass of profit*—continues to grow. Growing total profits translate into positive (although declining) rates of profit on the newest investments capitalists make. As long as profits on new investments are positive, capitalists will continue accumulate. Put simply, a rising mass of profit allows capital to experience a long wave of expansion with relatively short and shallow recessions, even though the rate of profit continues to fall.

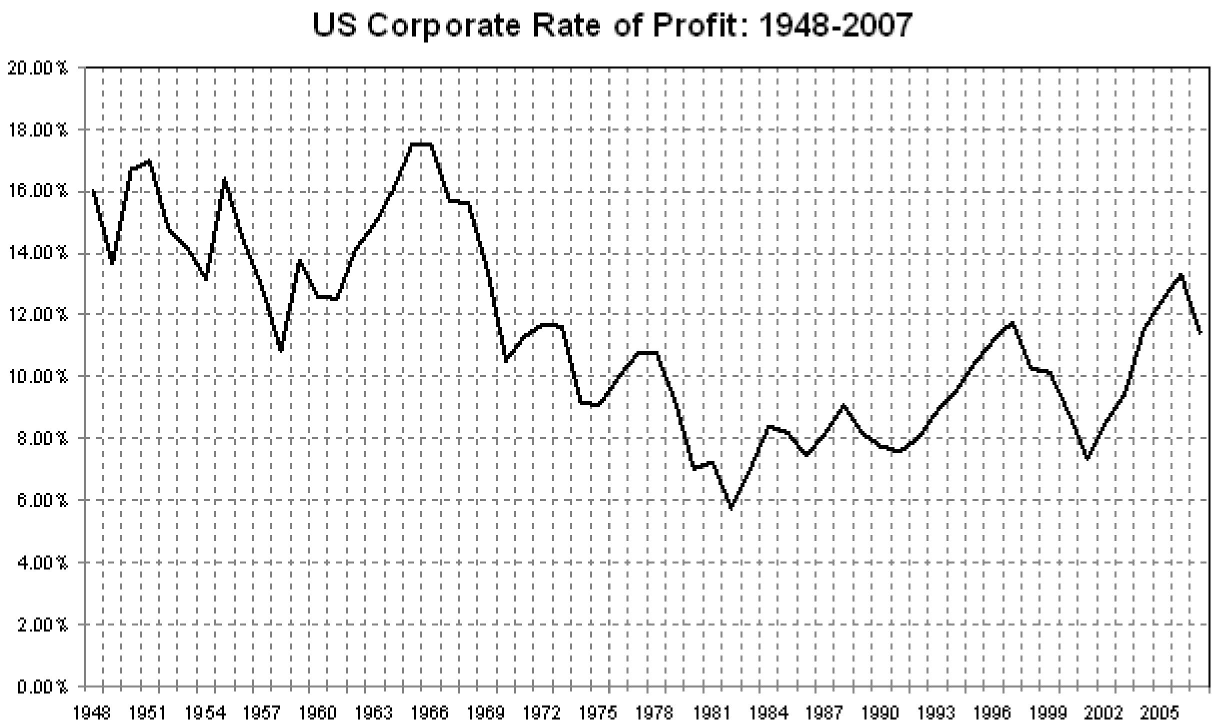
However, at some point the falling rate of profit leads to an accelerating fall in the rate of growth of investment. When the rate of decline in investment growth is greater than the decline of profit rates, the mass of profit *stagnates*. When total profits stop growing, the rate of profit on new investments will become negative, and capitalist stop investing. As a result, the long wave of expansion turns into a long wave of stagnation with relatively longer and deeper recessions. (For evidence of these trends from 1948-1980, see Shaikh, 1989: 10-16)

Unlike the other theories of capitalist crisis, the falling rate of profit does not view conjunctural or accidental factors like a mismatch of supply and demand; rising wages/declining efforts; or increased competition as the cause of falling profits. Instead, falling profits are the result of *the most basic and necessary dynamics of the capitalism*. While capitalism inevitably generates crises of profitability and accumulation, there is no automatic *collapse of capitalism*.

Capitalism can experience new periods of prolonged growth if there is a sharp increase in the rate of profit. This can only occur through a radical increase in the rate of exploitation, a massive destruc tion of inefficient capitalists, and a substantive expansion of the boundaries of the capitalist world economy. Concretely, this means an employers' offensive to drive down wages and reorganize work; capitalist state cuts in social welfare; a wave of bankruptcies, mergers, and acquisitions; and a geographic expansion of capitalist production. *Put simply, the notion that a "regulated capitalism" in which state policies simultaneously raise working class living standards and working conditions and capitalist profits is utopian.*

A coming together of these factors led to a revival of profitability across the capitalist world—and especially in the US—since the early 1980s. The generalization of lean production through industry and services has sharply raised labor productivity—the rate of exploitation. Waves of bankruptcies and mergers and acquisitions (the primary source of the growth of the financial sector) led to the junking of the oldest and least efficient operations. At the same productive capacity was reduced in some industries (steel) and investment shifted to new branches of production (US Steel's diversification into oil exploration). The construction of global production chains has expanded the boundaries of the world economy, allowing the shift of labor-intensive operations to low-wage regions of the global South.

The consolidation of neo-liberal capitalist state economic policies systematically promoted this restructuring of capital. The deregulation of capital and labor markets, combined with a fiscal policy that promoted disinflation, ensured that capitalist firms responded to rising profits with continued investment in new plant and equipment (especially computer machinery and inventory systems) and a continuous reorganization of work along the lines of lean production. The deregulation of capital promoted the growth of transnational production chains, while the deregulation of labor markets (cuts in social welfare, etc.) increased competition among workers and contributed to the stagnation or fall of real wages.



Sources: BEA, Corporate Profits, NIPA Table 1.13, line 7; Corporate Current Cost Capital Stock, Fixed Assets Table 4.1, line 13 (Corporate Nonresidential) plus Table 5.1, line 3 (Corporate Residential)

The long wave of expansion that began in the mid-1980s was not—and could not be permanent. As profits rose, capitalist accumulation began anew. The resulting increasing capitalization of production led to declining rates of profit, and eventually a stagnation in the mass of profits in the past few years. The capitalist world has entered a long wave of stagnation—lower profits on new investment in the face of overcapacity, resulting in longer and deeper recessions. *It is this new economic context that makes the current financial meltdown so dangerous for capital.*

As I have argued elsewhere (http://www.solidarity-us.org/crisis), financial crises as the result of increased investment in "fictitious capital"—claims on future wealth—is a feature of the top of every business cycle. If the underlying conditions of profitability and accumulation are healthy for capital, then financial crises are relatively mild and lead to a new cycle of strong growth. This was the case with the stock market crash of 1987, the savings and loan crisis of the early 1990s, and the dot.com bubble of the early part of this decade.

However, when the underlying conditions of profitability and accumulation are unhealthy for capital—as they are today—financial crises carry with them much greater risks.

The recent capitalist state bailout of the financial system—including a partial "nationalization" of the banks—will probably prevent a total collapse of the financial system and a new 1930s style depression. However, it will not prevent a very sharp and prolonged recession—high and persistent unemployment and sharp declines in output and investment over the next eighteen to thirty-six months. The recovery that follows will likely be anemic. Continued low profits as a result of over capitalization will result in slow growth. At the same time, the infusion of money into the economy through the bailout will fuel inflation. Put simply, we are likely to see a n*ew period of stagflation* similar to that the capitalist world experienced in the late 1960s and 1970s.

Just as in the early 1980s, there will be no solution to this crisis that will benefit both capital and labor. The only way out of a prolonged period of stagnant accumulation is a new wave of bankruptcies/mergers and acquisitions, the deepening of lean production, and deep cuts in the remnants of social services. This crisis, like all crises, presents both opportunities and dangers. Opportunities for new collective working class and popular struggles against capital. Failing such successful struggles, there is a growing danger of different segments of the working class attempting to defend their declining social position against other sections of the working class.

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