Profitability, Long Waves and the Recurrence of General Crises

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Material is based on my forthcoming book

Capitalism: Real Competition, Turbulent Dynamics, and Global Crises, Oxford University Press, 2015

1. Growth is normal in capitalism

- Profit drives growth
- Marx and Keynes: rate of accumulation driven by the excess of the profit rate over the interest rate

2. Cyclical fluctuations are normal in capitalism

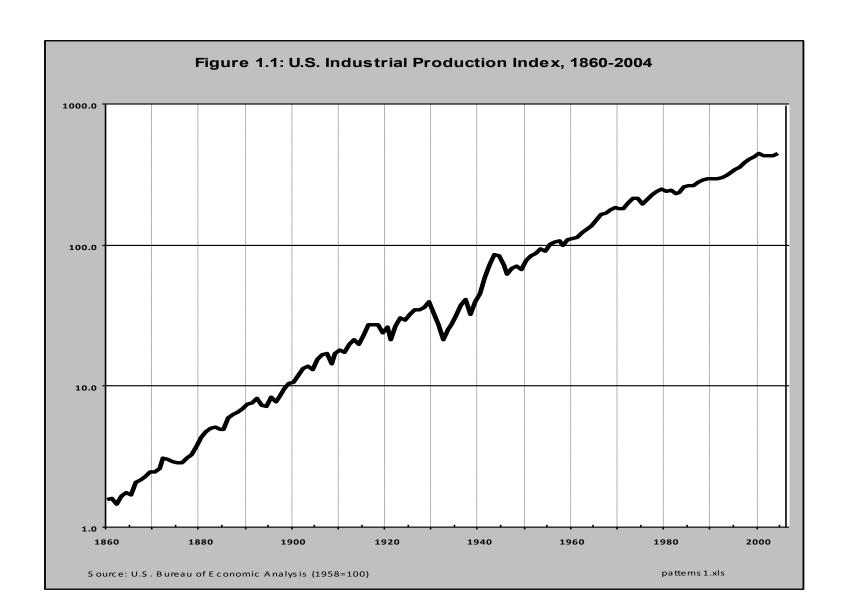
- 3-5 yr. inventory cycle → now called "the" business cycle
- 7-11 yr. fixed capital cycle → called "the" business cycle prior to mid-20th century
- Conjunctural shocks: wars, weather, etc.

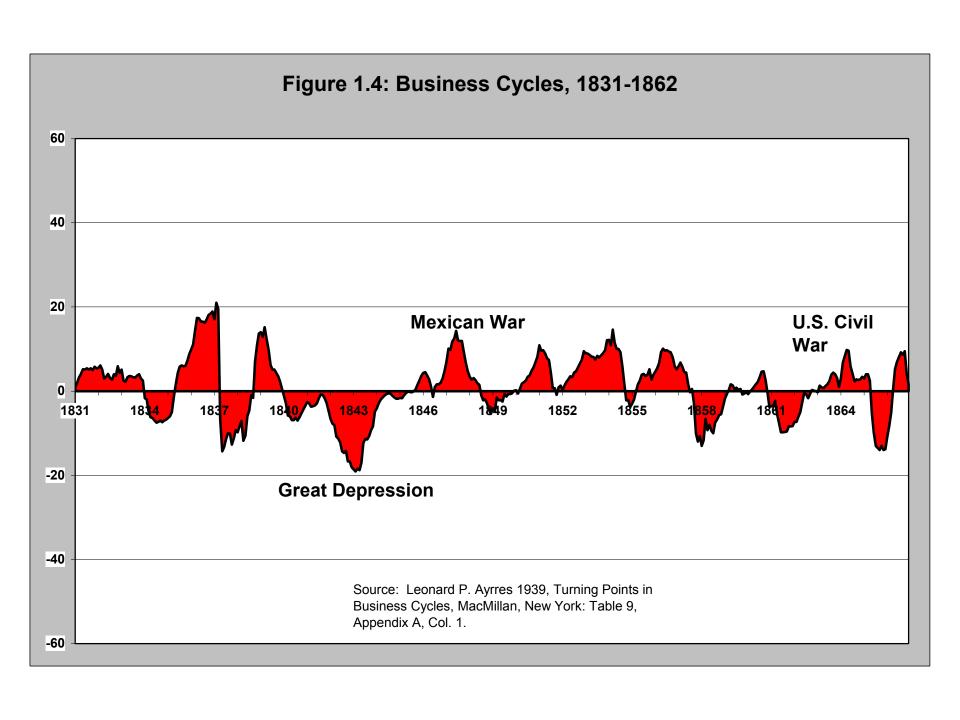
3. Unemployment is normal in capitalism

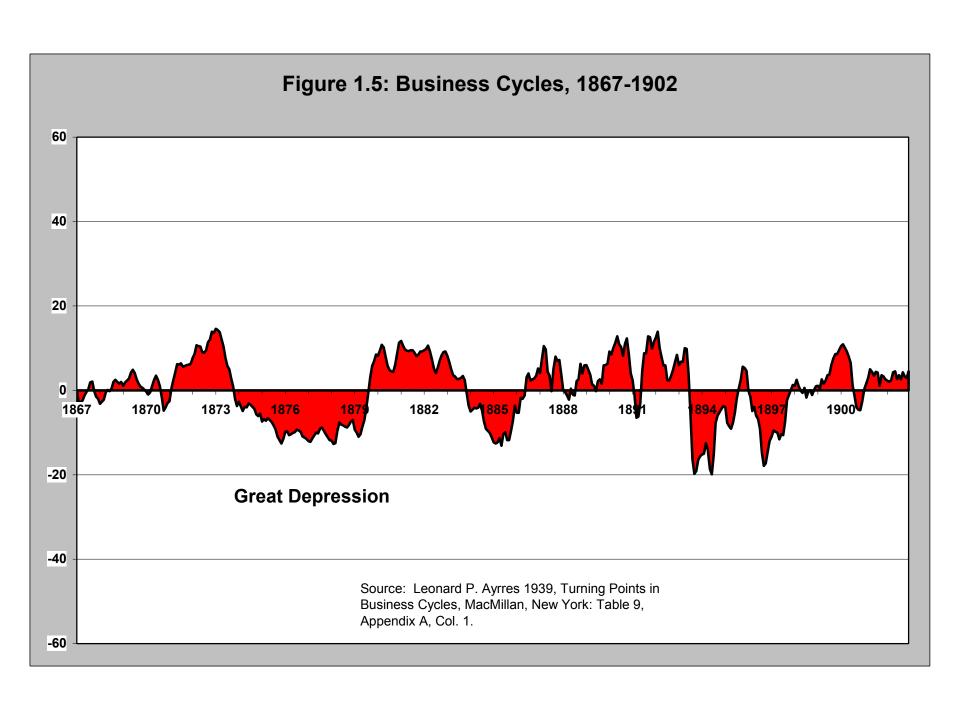
System maintains a normal rate of unemployment

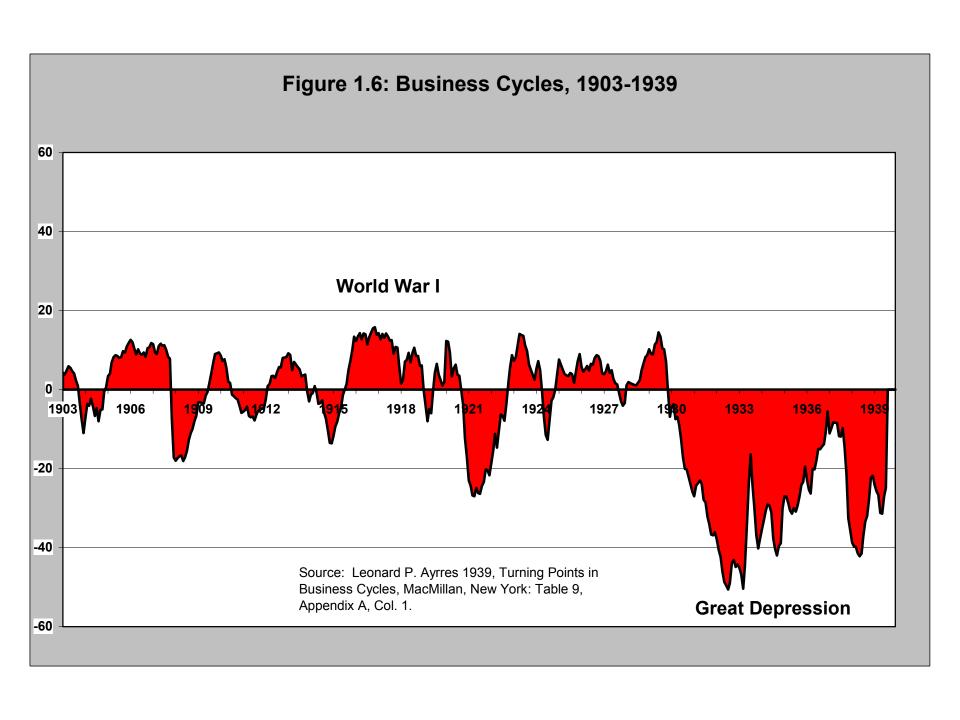
4. Crises are normal in capitalism

- Cycles are not crises
- Crises = Great Depressions
- The history of market systems reveals recurrent patterns of booms and busts over centuries, emanating precisely from the developed world.
- Economic historians speak of the Great Depressions of
 - 1840s: Marx and Engels in the streets
 - 1870s: the "Long Depression" 1873-1893
 - 1930s: the "Great Depression"
 - 1970s: the "Stagflation Crises"
 - 2010s: the Great Global Crises









5. Long Waves

- Kondratieff uses the word "crises" to refer to business cycles, as was common in 19th century.
- He explicitly refers to 7-11 year cycles as "business cycles", as well as shorter cycles 3-3½ years identified by Kitchin.
- His main point is that business cycles are recurrent and "organically inherent" in the capitalist system
- They are also inherently nonlinear and turbulent:

"the process of real dynamics is of a piece. But it is not linear: it does not take the form of a simple, rising line. To the contrary, its movement is irregular, with spurts and fluctuations".

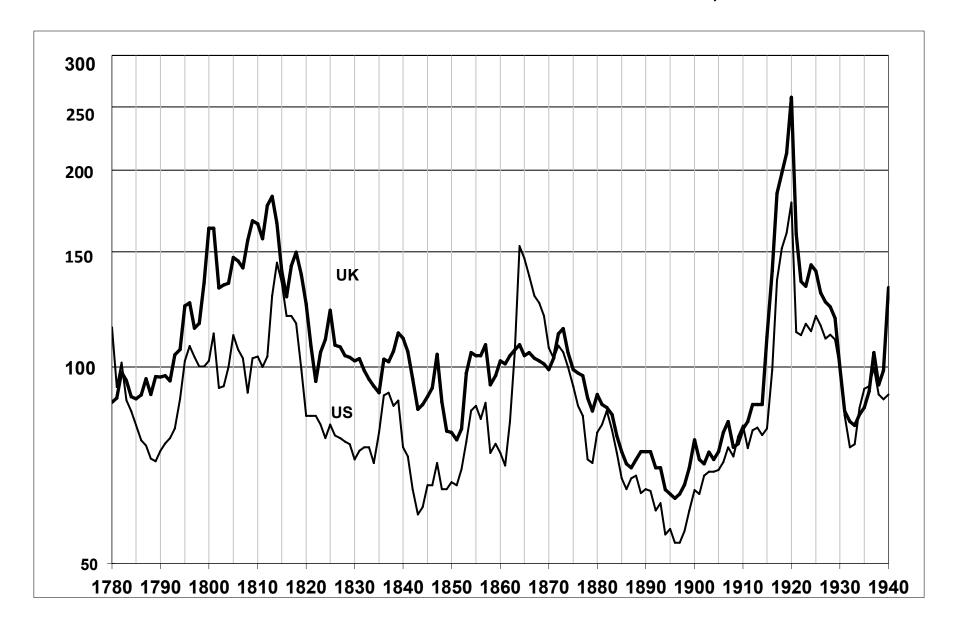
 His own research led him to also believe in long waves as intrinsic patterns of capitalist development

6. Long Waves and Great Depressions

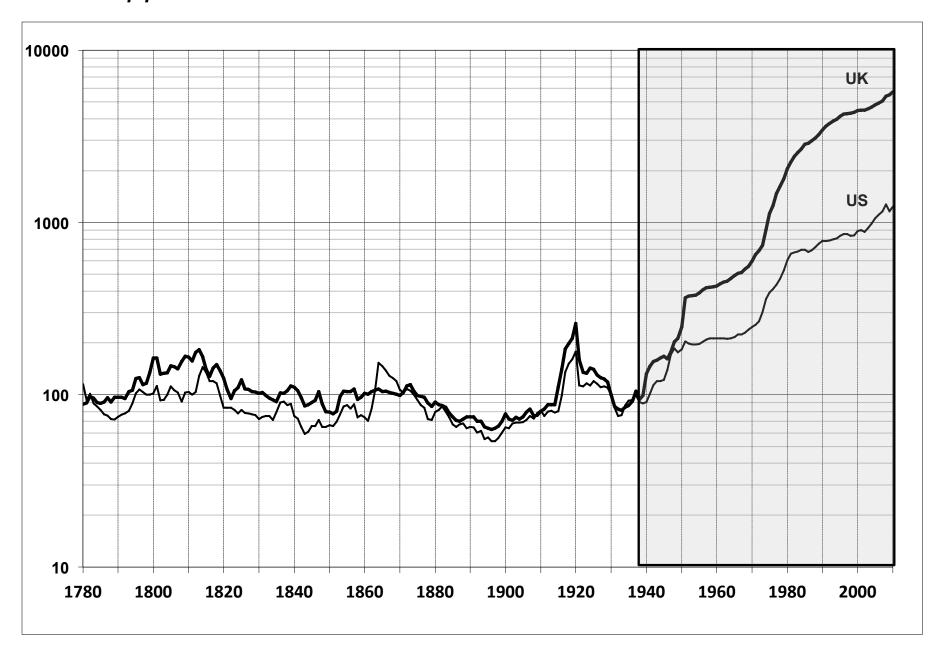
Kondratieff believed that Depressions were linked to Long Waves

 "during the period of downward waves of the long cycle, years of depression predominate, while during the period of rising waves of a long cycle, it is years of upswing that predominate"

Existence of Kondratieff Price Waves: US & UK, 1780-1940



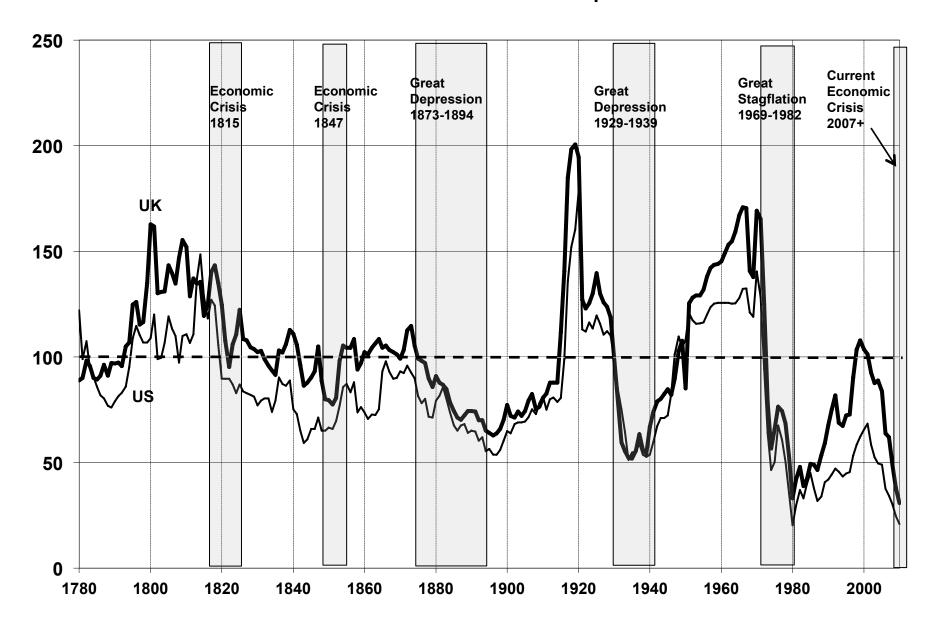
Disappearance of Kondratieff Price Waves after 1940



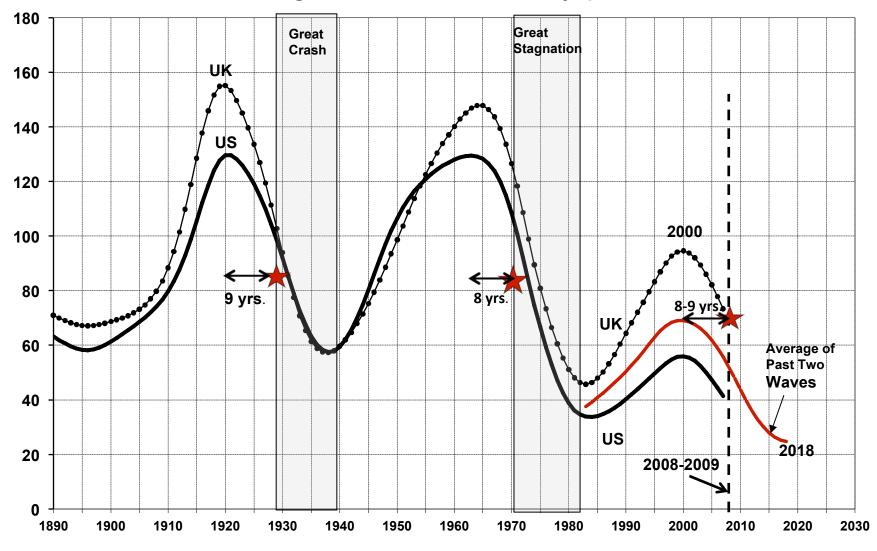
7. Kondratieff had two forms of price data

- The disappearance of the Kondratieff wave is ironic because he actually had *two* different expressions of price levels in his data:
 - price levels expressed in national currency, which were the ones he chose to display graphically
 - and price levels expressed in the terms of gold which he chose to list in *tabular form* in the back of his book (<u>Kondratieff, 1984, Table 1 pp. 134-135</u>).
- Up to 1925, which is when his own data ends, both sets yield similar patterns.
 - But after 1939, only the golden-price series continues to display long waves.
- Had Kondratieff' chosen to instead graph the golden-wave, his argument might have continued to hold sway.

Golden Price Waves and Recurrent Depressions: 1780-2012



Current Crisis was right on schedule: my prediction in 2003



Average of smoothed US & UK waves, trough-,to-trough, 1897-1939 and 1939-1983

Smoothing via HP Filter (parameter = 100)

8. Summary and implications

- I was concerned here to demonstrate the connection between the existence of Long Waves and the recurrence of Great Depressions
- The material I presented is only small portion of my forthcoming book Capitalism: Real Competition, Turbulent Dynamics, and Global Crises, Oxford University Press, 2015
- The book itself is concerned with the actual operations of capitalism
 - Analysis is rooted in classical theory of competition and turbulent dynamics, including a formal classical path from real micro to real macro
 - All theory is compared to actual data in every chapter, as well as to neoclassical and Keynesian/Post Keynesian arguments
 - The theory of real competition is developed and applied to explain empirical relative prices, profit margins and profit rates, interest rates, bond and stock prices, exchange rates and trade balances.
 - This framework is developed to encompass effective demand in the context of turbulent growth and real competition, which I argue is the proper foundation for Keynes' own argument
 - Keynes famously rejects imperfect competition as his foundation
 - Demand and supply are shown to both depend on profitability, and interact in way that is neither Says' Law nor Keynes' Law
 - The relation between flexible real wages and employment leads to a persistent rate of unemployment
 - A classical theory of inflation is developed and applied various countries
 - A theory of crises is developed and integrated into macrodynamics

8. Summary and implications (continued)

- On the surface, the current crisis is a crisis of excessive financialization → fixing the financial sector will prevent future crises
- But this would not work because it fails to identify the real cause of the crisis.
- Keynesians and Post Keynesians argue that fixing the finance sector is not enough because the cause is inequality and unemployment → hence the remedy is Keynesian*
 - link wages to productivity so as to maintain a stable wage share
 - use fiscal and monetary policy to maintain full employment

^{*} Palley, Thomas (2009), "The Limits of Minsky's Financial Instability Hypothesis as an Explanation of the Crisis"

8. Summary and implications (continued)

- I argue that such policies would <u>not</u> work because
 - At least in the US, the crisis was preceded by a long fall in the rate of profit
 - The neoliberal attack on labor from 1980s suppressed wage growth and reduced the wage share *in order to stabilize the rate of profit (r)*
 - The enormous fall in the interest rate in the 1980s that fueled credit expansion and massive debt finance served to raise the net rate of profit (r i)
 - The system creates and maintains a normal rate of *involuntary* unemployment
 - Fiscal policy by itself may pump up employment but will not restore growth → Direct state employment?
 - For growth it is necessary to raise the net rate of profit
 - The interest rate is already at its floor
 - Concentration and centralization raises the profit rate but requires destruction of unsustainable capital values
 - So important to keep suppressing real wage *relative* to productivity growth
 - + the secret to Neoliberalism
 - → the secret to globalization → cheap labor
 - → the secret to "Austerity Economics"

9. Link back to Long Waves

- If net profitability drives accumulation, how is this linked to long waves? → Point of absolute over-accumulation when mass of profit of enterprise stagnates → increase in capital does not lead to increase in profit of enterprise
- Why does this manifest itself as long waves in "golden price"? → price of gold begins to shoot up as crisis approaches
- Why does this manifest itself as long waves of 40-50 years?

10. Importance of theory to data, analysis, & policy

 Interventions in interest rate, exchange rate, unemployment rate, growth rate depend on theory of what the market produces