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

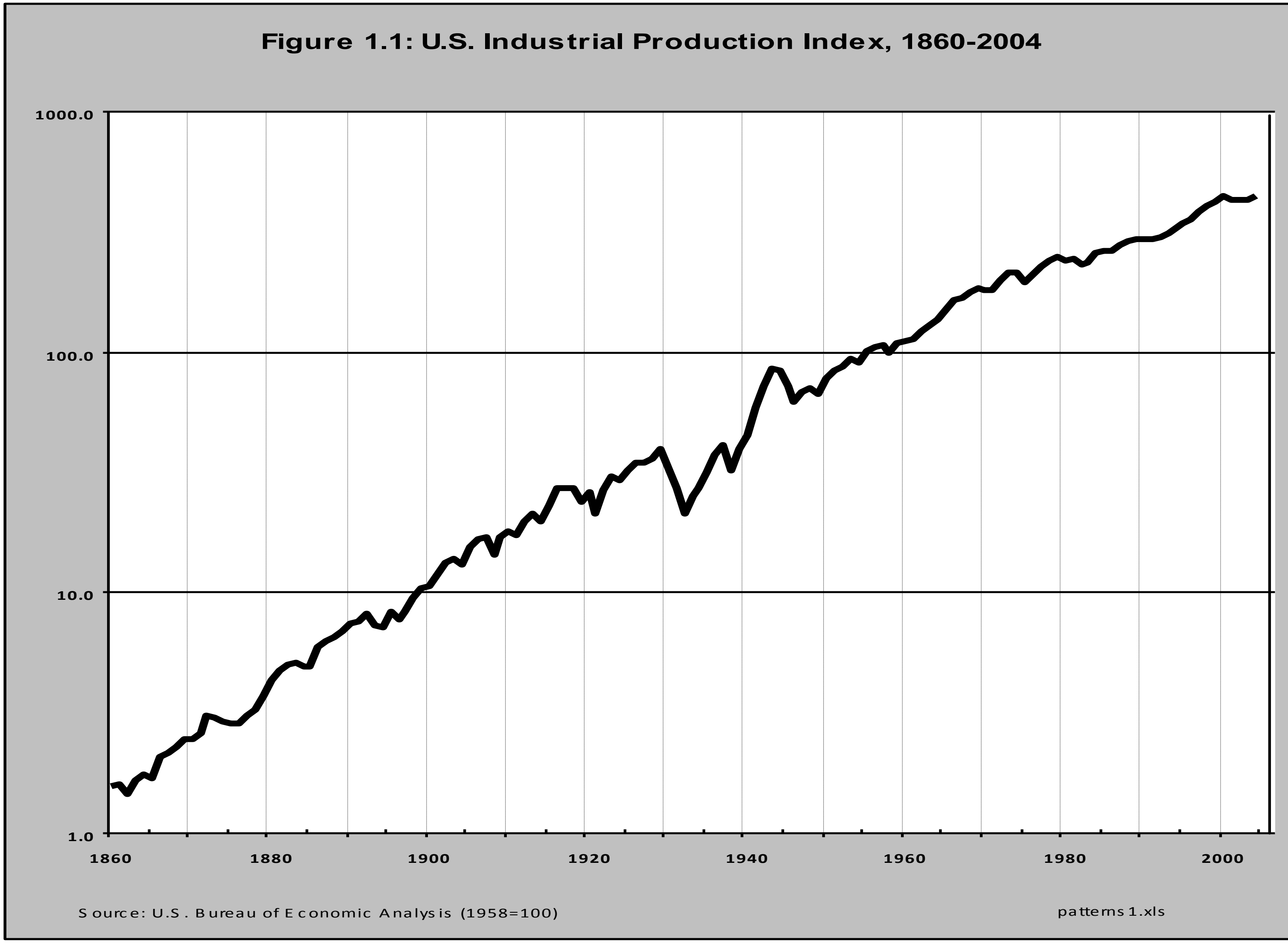


Figure 1.1: U.S. Industrial Production Index, 1860-2004
1000.0
100.0
10.0
1.0
1860
1880
1900
1920
1940
1960
1980
2000
Source: U.S. Bureau of Economic Analysis (1958=100)
patterns1.xls

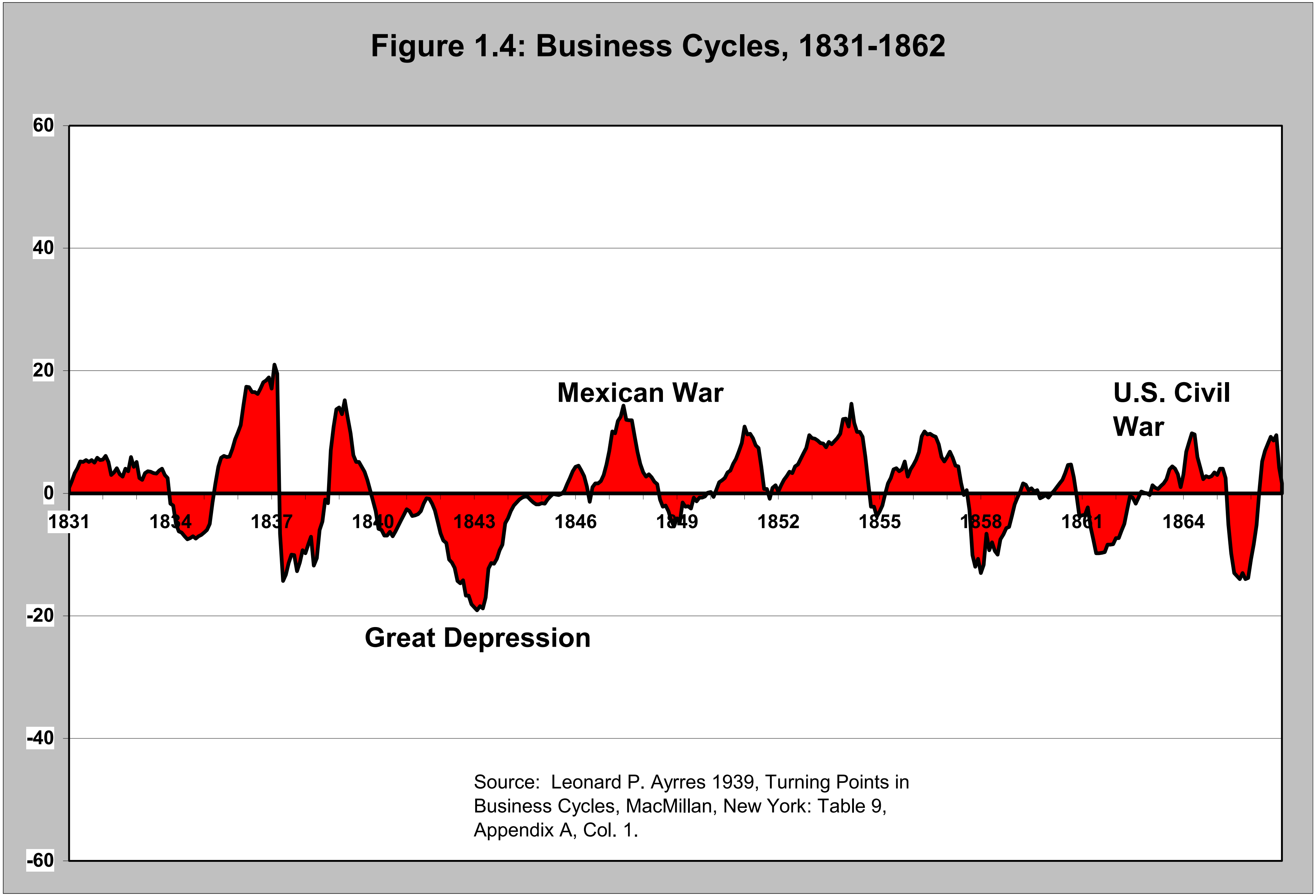


Figure 1.4: Business Cycles, 1831-1862
60
40
20
0
-20
-40
-60
1831
1834
1837
1840
1843
1846
1849
1852
1855
1858
1861
1864
Mexican War
U.S. Civil War
Great Depression
Source: Leonard P. Ayrres 1939, Turning Points in Business Cycles, MacMillan, New York: Table 9, Appendix A, Col. 1.

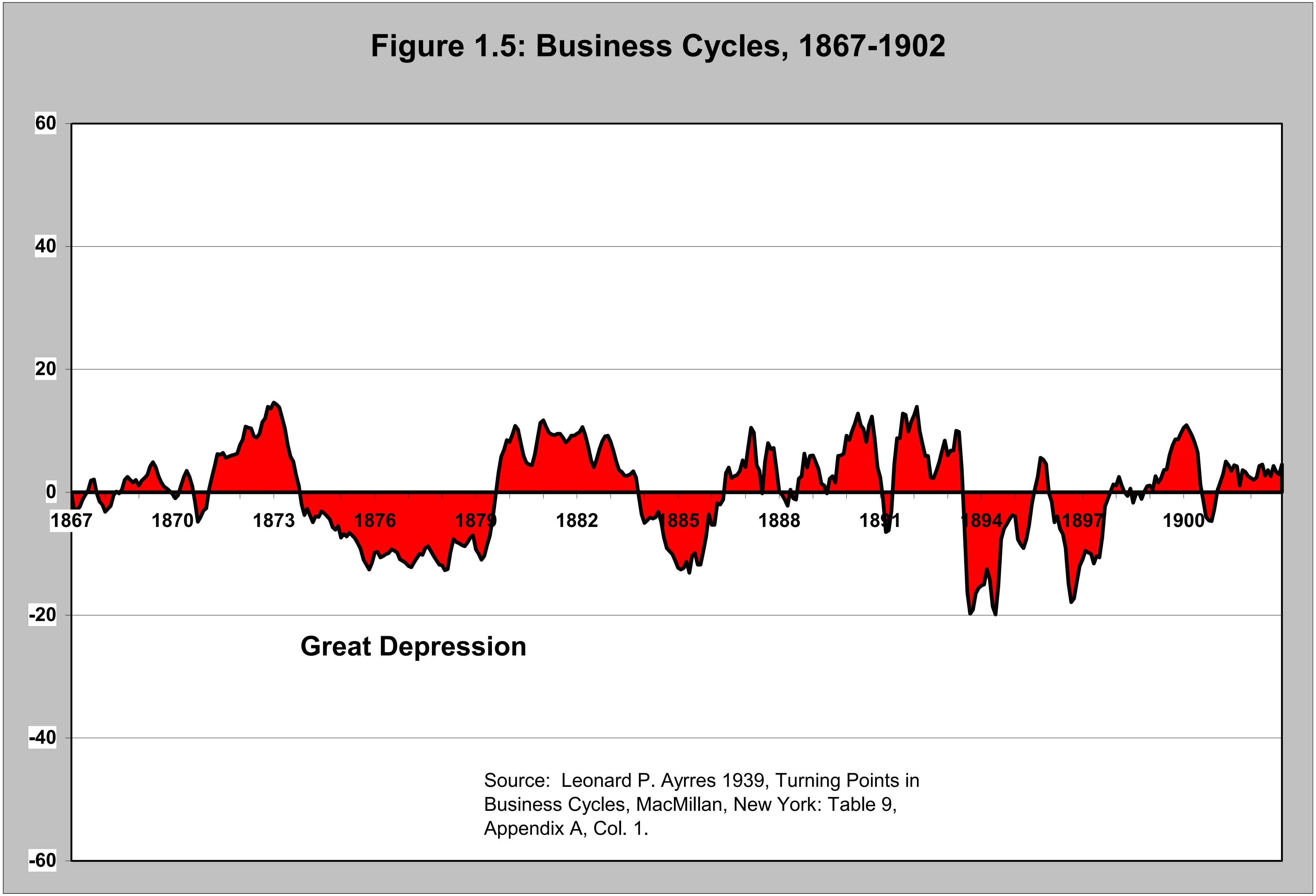


Figure 1.5: Business Cycles, 1867-1902
60
40
20
0
-20
-40
-60
1867
1870
1873
1876
1879
1882
1885
1888
1891
1894
1897
1900
Great Depression
Source: Leonard P. Ayrres 1939, Turning Points in
Business Cycles, MacMillan, New York: Table 9,
Appendix A, Col. 1.

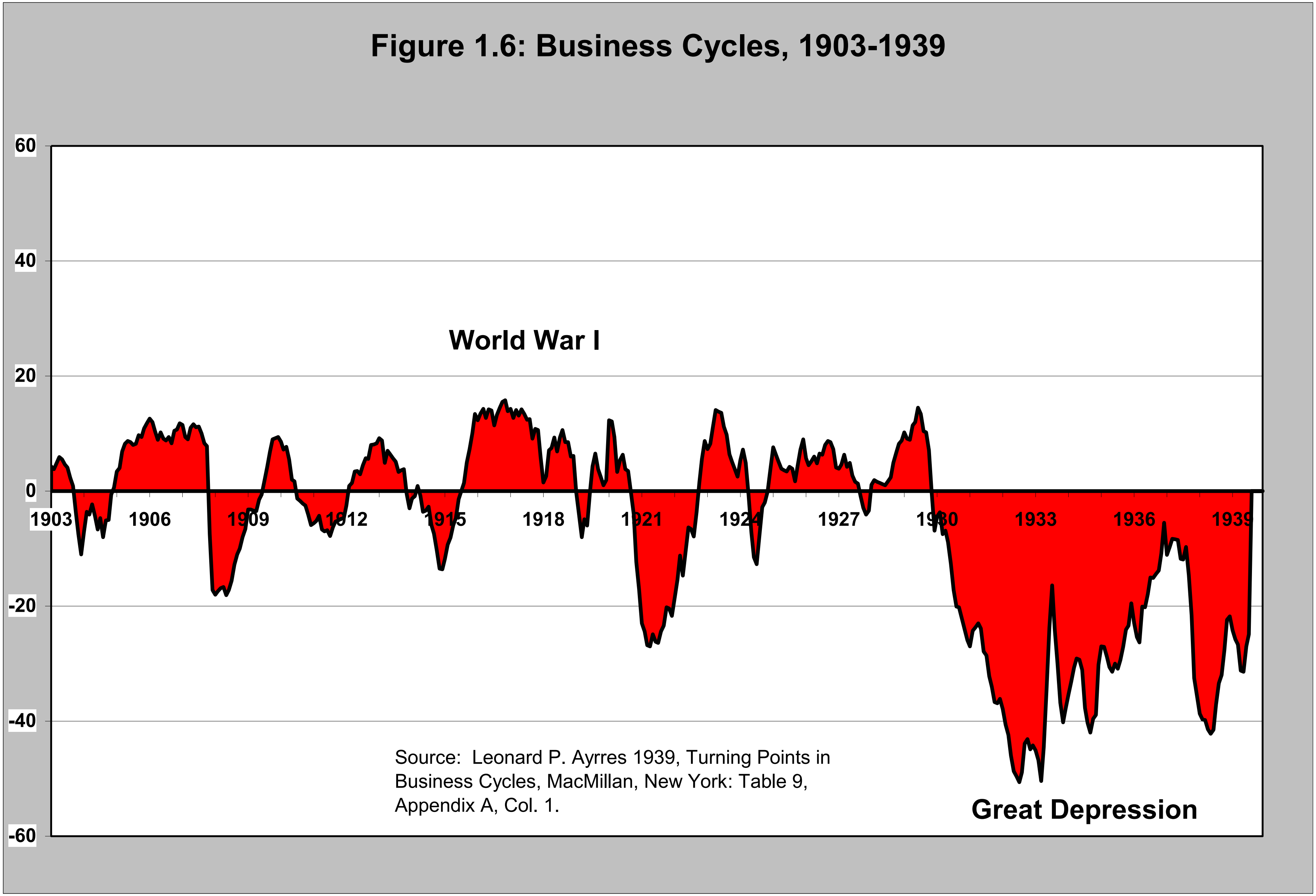


Figure 1.6: Business Cycles, 1903-1939
60
40
20
0
-20
-40
-60
1903
1906
1909
1912
1915
1918
1921
1924
1927
1930
1933
1936
1939
World War I
Great Depression
Source: Leonard P. Ayrres 1939, Turning Points in Business Cycles, MacMillan, New York: Table 9, Appendix A, Col. 1.

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”.

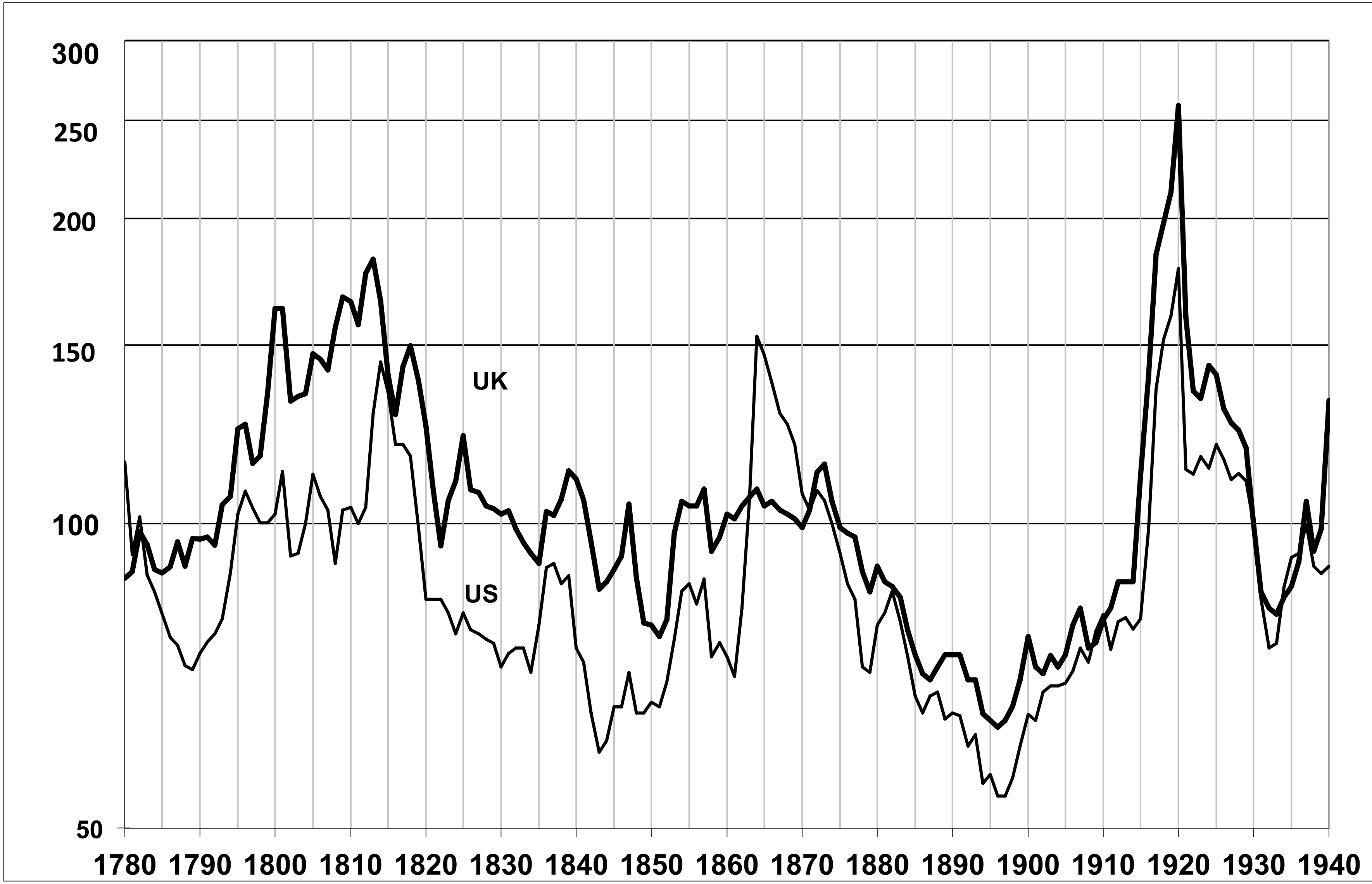
- His own research led him to *also* believe in long waves as intrinsic patterns of capitalist development

6. **Long Waves and Great Depressions**

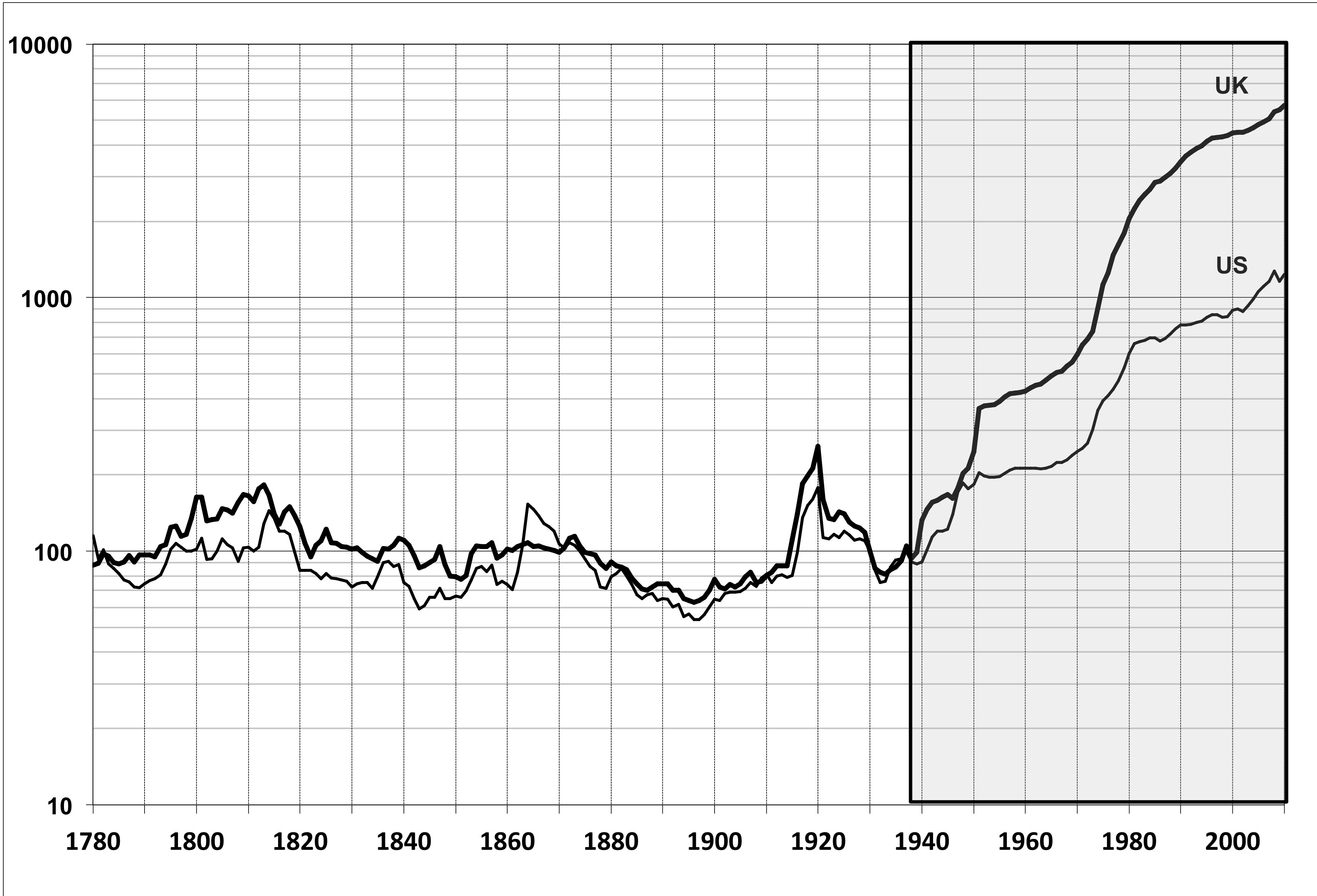
Kondratieff believed that Depressions were linked to Long Waves

- "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



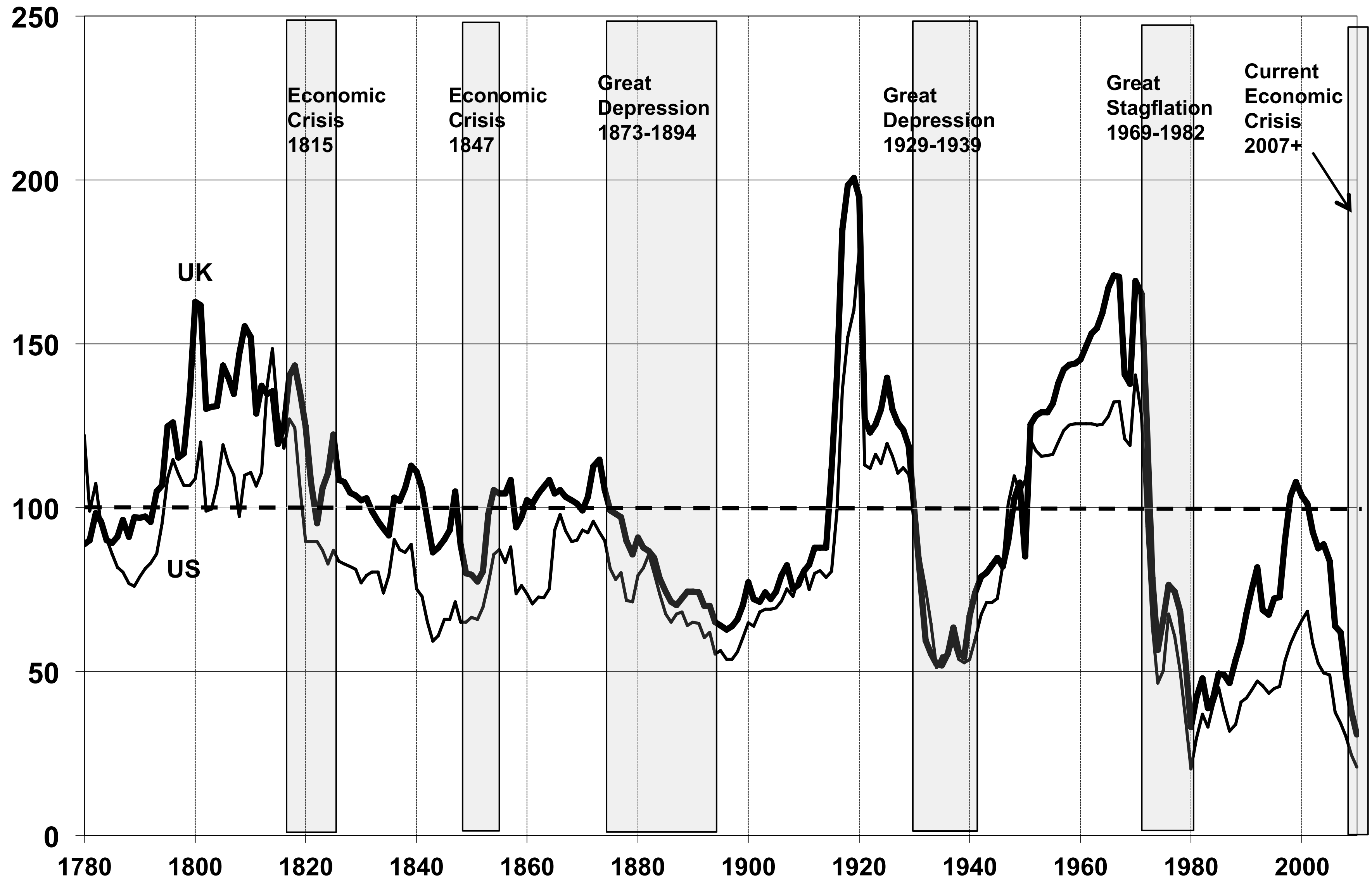
Disappearance of Kondratieff Price Waves after 1940



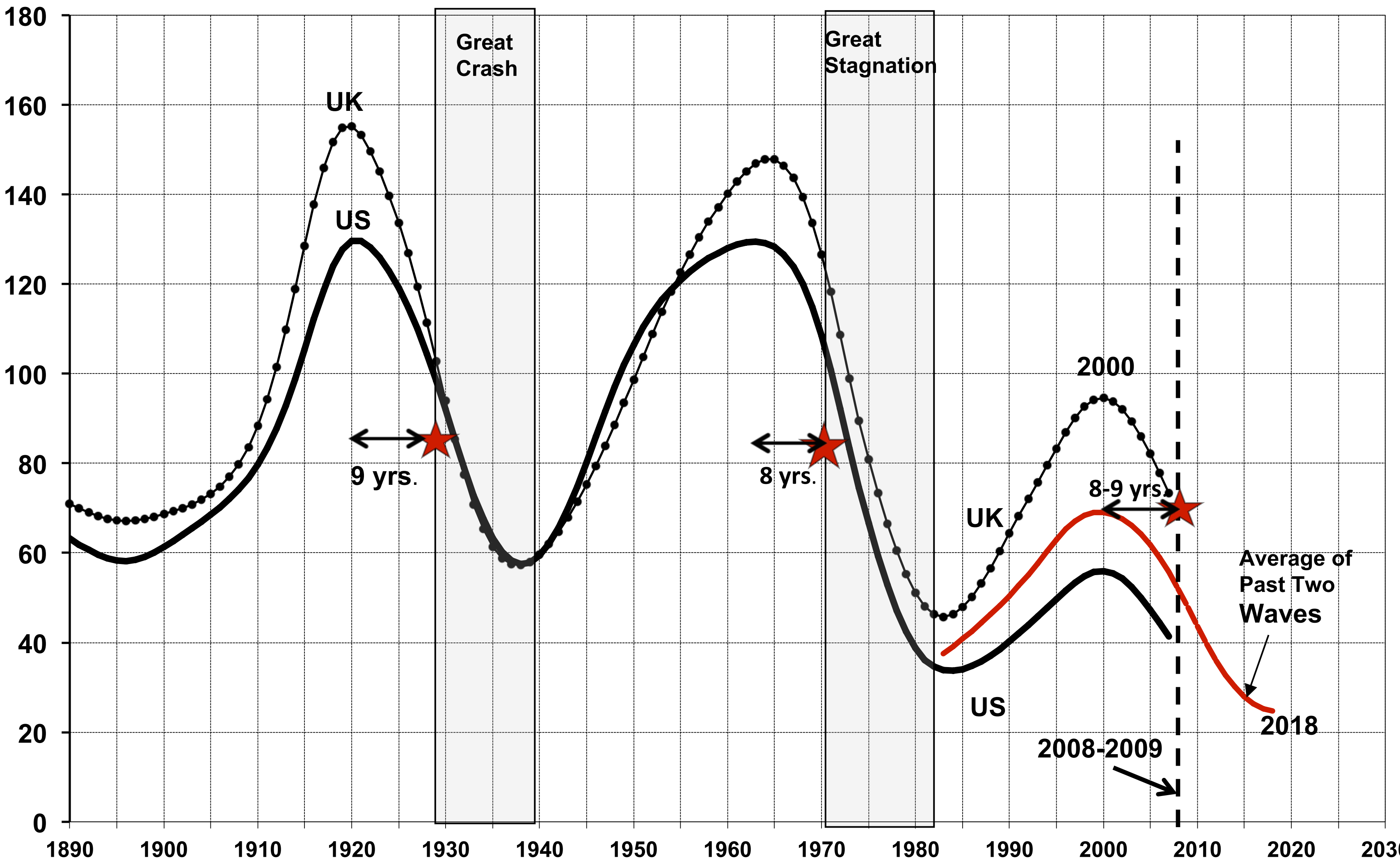
7. Kondratieff had *two* forms of price data

- 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 (Kondratieff, 1984, Table 1 pp. 134-135).
- 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