Module 2

Lecture 15

Topics

2.14 Karl Marx IV

2.14.1 Marx's Analysis of capitalism

- Marx's analysis of capitalism is based on a the following assumptions:
    1. Labor cost theory explaining relative prices
    2. Neutral money
    3. Constant returns in manufacturing
    4. diminishing return in agriculture
    5. perfect competition
    6. a modified version of wage fund doctrine

- Marx and classical political economists especially Ricardo had a lot of elements common in their economic models. It is important to understand the difference between them. Marx was critical of the capitalist system and his objective was to analyze the transition from capitalism to socialism.

- Ricardo on the other hand was concerned about the distribution of income within the capitalist system. Below we are discussing some of the basic features of Marxian economics.

2.14.2 The reserve army of the unemployed

- In classical analysis population growth plays an important role in determining level of profit.

- With rising capital accumulation, the demand for labor rises which leads to rising wages.

- Malthus argued that population would rise with rising real income of the labor class creating extra labour supply that would prevent real wage from rising and profit from falling. Hence, Malthusian theory explained why profit does not vanish in the long run in the capitalist system.

- Marx rejected Malthusian theory of population. Instead he proposed the existence of reserve army of labor to explain why capitalist profit does not go down to zero.

- According to Marx, excess supply in labor market always exists which depresses the wages and makes profit positive.

- Young people finishing school, women looking for job and people losing jobs because of labor saving technology add to the reserve army of labor.

- In the Marxian system, wages, profits and employment varies with phases of the business cycle. During boom period, capital accumulation and wage increase, and reserve army shrinks. This ultimately depresses profit and capitalists responds by replacing workers with machine by restoring profits again.

- The concept of reserve army of labor is a radical idea which runs contrary to the orthodox theory. Ricardo admitted that there could be unemployment but it would be of temporary in nature. If the labor market is competitive then wage should go down to clear market.

- Marx also claimed that labor market is perfectly competitive. Then how could he defend unemployment in equilibrium in the long run?

- There are various ways the Marxian position can be defended. We will discuss this in detail in the chapter on the critique of general equilibrium theory how market can stay in disequilibrium in the long run. For now, we provide brief outline of the arguments.

- The simplest way to explain the Marxian position is that workers are paid just enough money to buy their subsistence consumption bundle. Hence, wages cannot go lower than that level even if there is excess supply in the long run.

- Another way of reconciliation is to look at the labor market in dynamic framework rather than the static framework that classical-neo classical tradition usually uses for analysis. In a dynamic set up unemployment exists in the market due to search cost -- it is costly to match job seekers with the appropriate employers. However, search theorists would argue that excess supply of labor indicates that more than competitive equilibrium wage exists in the labor market.

- Tracking down` reserve army of labor empirically is quite tricky. Usually, unemployed people are defined as people who are looking for jobs but cannot find it. But how do such people survive? In developed countries, unemployed people are easy to identify from unemployment doll records. In less developed countries, people often work in family farms or businesses but not employed meaningfully which means that the farms' output won't fall if these people are removed. This concept is known as disguised unemployment. These people should be part of the reserve army but it is difficult to measure the number of such people.

- Also, people working part time to search for better jobs are also part of the reserve army.

- Besides the problems involved in measuring the size of reserve army, it is a difficult task to statistically show that reserve army depresses wages or for that matter, finding the size of the reserve army that will depress wage.

2.14.3 Falling rate of profit

- The idea that the rate of profit would fall over time is an important element of the classical writing. Marx's contribution was to explicitly linking it with the demise of capitalism.

- Marx maintained that the drive for profit would induce the capitalists to accumulate more capital which would bid up the wage and reduce profit.

- Capitalists would responds to it by employing more machinery that would displace labor. Marx argued more employment of machines would reduce rate of profit. In order to understand the argument it is imperative that we take a look at the value-profit calculus of Marxian economics.

- Marx divided capital in two components: constant capital (c) and variable capital (v). Constant capital consists of expenditure on physical capital such as machines and factory building. This is referred to as the constant because the labor embodied in these is fixed. Variable capital on the other hand is wage bill. This is called variable because this is amenable to negotiation between the trade unions and the management.

- Rate of profit in the Marxian scheme is defined as $\rho = \frac{s}{c+v}$ where s is the surplus value.

- The rate of surplus value (alternatively called the rate of exploitation) is defined as $e = \frac{s}{v}$. The organic composition of capital is given by $y = \frac{c}{v}$

- Hence, ρ can be rewritten as
  $\rho = \frac{e}{1+y}$ (1)

- With capitalists replacing workers with machines y will go up reducing the rate of profit given that all other parameters are constant.

- Things are not so straight forward if technological change takes place which changes the rate of exploitation. The rate of exploitation is partly determined by technology and partly by the comparative political strength of workers union and capitalists. So higher productivity may need not necessarily result in higher rate of exploitation. If technological change induces higher rate of exploitation (i.e. more surplus per unit of labor employed) then there are two opposing forces at work there, and the resultant change in rate of profit is theoretically ambiguous -- it becomes an empirical question.

- Given that we don't have a very satisfactory theory of technological development it's impossible to come up with a theoretically unambiguous answer.

- However, Marx maintained the position that rate of profit will decline in the long run and that will bring down the capitalism. Some of the twentieth century Marxist economists such as Paul Sweezy and Joan Robinson contested the idea of falling rate of profit.

2.14.4 Business crises

- Economic depression is clearly the expression of the contradiction between forces of production and production relation of the capitalist system. However, there is no clearly formulated theory of crisis done by Marx himself. Marx detailed several causes of economic crisis but never zeroed on the cause of the crisis.

- Marx's argued that crisis is an integral part of the capitalist system which was a marked departure from the classical theories.

- Classical writers based their theories on Say's law which tells that supply creates its own demand thereby leaving no room for crisis. Marx thoroughly denounced Say's law saying that it presents distorted view of capitalism.

- Marx said that in a simple barter economy production is carried out for consumption only and there commodity is exchanged for commodity. Say's law holds in this situation. Even if money is introduced in the simple commodity production as a mere medium of exchange nothing changes and the doctrine that “money acts as a veil" can hold in this case.

- Capitalism however, is a more complex economic system where surplus value is produced.

- Marx said that crisis can be understood by analyzing how capitalists investment decision responds to changes in rate of profit.

- Marx suggested the following mechanisms for crisis:

- Cyclically recurring fluctuations: In this mechanism technological innovation triggers a boom, capital accumulation rises and wages rise too. As a result surplus value and rate of profit will fall over time. This would induce capitalists to invest less causing economic depression. In depression wage rate will fall creating greater profit opportunity.

- As a result capital accumulation will start again creating upward swing of the cycle.

- Disproportionality crises: The Marxian theory of crisis is mostly a supply side theory. Disproportionality crisis brings in the elements of demand side analysis in Marxian theory of crisis.

- Disproportionality crisis refers to the problem associated with the problem of resource allocation among various sectors. Marx questioned the ability of markets to allocate resources in a decentralized fashion. Classical and neo classical answer to this is that over or under production if any will be reflected in rising or declining prices and market output will adjust correspondingly to bring back the equilibrium. Problem of disequilibrium in classical view is only a temporary phenomenon.

- Marx, on the other hand that unemployment created in one sector would spread to other sectors creating wide spread unemployment. Whether Marxian theory is true depends on how big is the industry where unemployment is happening and skill specificity of the workers in that industry. If automobile sector is shrinking and software is booming then it will not be easy to relocate the resources from automobile to software as these two industries require different types of resources and skill. Also if the shrinking sector is comparatively large relative to the size of the economy the crisis would be long term and acute. Recent banking crisis of Iceland constitutes such an example as the banking sector was really big in Iceland and hence the contagion effect within Iceland was quite large.

2.14.5 The concentration of capital

- Although the Marxian model assumes perfectly competitive market, Marx was aware of rising concentration of wealth and monopolization of industries. Large firms would out compete smaller firms by exploiting scale of operation.

- Marx predicted that with more and more concentration of wealth and emergence of big corporations.

- This will be followed by a separation of ownership and control along with a number of undesirable social consequences such as corporate fraud and stock price manipulation.

- For Marx this was another expression of the contradiction between forces and relations of production.

2.14.6 Increasing misery of the proletariat

- Another contradiction of capitalism that would lead to its destruction was *increasing misery of the proletariat*.

- There are three possible interpretation of this doctrine of Marx:
    1. Absolute misery of the proletariat will increase as real income for the majority of people will decline with capitalism.
    2. Relative misery will increase as share of labor income in national income would fall.
    3. With the advance of capitalism, the quality of life of the laborers would deteriorate.

- Marx subscribed to each of these views at some point or the other.

- The doctrine of absolute misery can be found in his early writing which was abandoned between the publication of communist manifesto in 1847 and the publication of capital in 1867.

- Marx however maintained the third point of degrading life quality under capitalism throughout his writing