The Unliquidated Crisis of Capitalism

May 29, 2010

THIS RECENT WORK BY the late Chris Harman is an application of the "permanent arms economy" theory, a hallmark of the British Socialist Workers Party, to the current economic crisis. This analysis is borrowed in part from the American writer T.N. Vance who argued in the presses of the Independent Socialist League of the early 1950s that the much anticipated reversion to the "unliquidated" crisis conditions of the 1930s was averted at the close of World War II through an application of military Keynesianism. "Imagine," Vance asked, "what would have happened to capital accumulation and to production if war outlays had returned to the negligible level of 1939 or before! In one sentence, the prophets of postwar depression would have been correct." Keynes, one might recall, admonished " 'To dig holes in the ground,' paid out of savings, will increase, not only employment, but the real national dividend of useful goods and services. It is not unreasonable, however, that a sensible community should be content to remain dependent on such fortuitous and often wasteful mitigations when once we understand the influences upon which effective demand depends."

Vance gave the theory a Marxian gloss. "War expenditures accomplish the same purpose as public works, but in a manner that is decidedly more effective and more acceptable (from the capitalist point of view)." Vance, like such actual socialist prophets of postwar depression as Fritz Sternberg (*The Coming Crisis of Capitalism*, 1947), apparently ascribed the crisis tendencies of capitalism to market scarcity owing to the restricted consumption of the working class. This lack of effective demand required, if not as its permanent antidote then as a palliative, the "necessity for state intervention to immobilize excess accumulations of unpaid labor…" through the increased diversion of industrial resources to waste production, output that cannot be reapplied directly or indirectly to the expansion of economic capacity. It required, as Keynes had also suggested, capitalism "borrowing from the techniques employed by the more static class societies of slavery and feudalism," of burying capital, in effect, in an economic ditch.

Vance argued that this permanent war economy, as he called it, would lead initially to a burst of employment and profits, freeing capital to accumulate rapidly. But the cost of hiving off industrial capacity to armaments must, Vance argued, inevitably come at the cost of the wage goods sector and ultimately economic stagnation. The increasing demand for capital goods — buildings, resources, machinery, raw materials — to expand both the capital goods producing sector needed to reproduce both itself and the armaments sector dictated, in effect, economizing solely where there was slack to economize with, namely the growth capacity for consumption goods. Money wages, at full capacity employment, would rise in excess of actual wage good production leading to an irresistible tendency to permanent inflation. Full employment would therefore be purchased at the costs of the relative and — ultimately — at the absolute impoverishment of the working class. The short-term cyclical nature of the economy would be ironed out without providing the working class with increased security. As such, Vance held, the material basis for revolutionary politics could be preserved even in the context of full employment.

The problem with this theory was twofold. First, it did not seem to describe American capitalist reality of the 1950s and 60s. While an increase in arms spending was indeed a seemingly intransigent feature of Cold War capitalism and economic crises seemed to be an historical relic, working class living standards nevertheless thrived and high levels of economic growth proved capable of flourishing within a context of relatively low inflation. When, in the early 1970s, things began to unravel, leading both to stagnation and inflation, the crisis tendencies of capitalism also began to reassert themselves in the recognizable forms of unemployment, profit erosion, and a fiscal crisis of the state — the very combination which seemed to be precluded by Vance's theory.

Second, and equally important, the underlying theory proved too much. As Vance presented the case, capitalism itself seemed economically impossible without the ongoing "immobilization" of profits. "The ruling class is impaled on the horns of a most serious dilemma: to allow those growing and mature accumulations (of capital — BF) to enter into economic circulation means to undermine the very foundations of existing society (in modern terms, depression); to reduce or eliminate these expanding accumulations of unpaid labor requires the ruling class or sections of it to commit hari-kari (in modern terms, the capitalist must cease being a capitalist or enter into bankruptcy)." In other words, Vance suggested that capital accumulation cannot internally sustain the level of demand needed to maintain the rate of profit in the absence of a state generated market for waste production.

That capital accumulation cannot itself sustain at length the level of demand needed to maintain the consistency of the profit rates, may be true enough. But Vance rejected out of hand the possibility of capitalism coexisting with a falling rate of profit, which is the alternative outcome to the process that he described. To do so would be "like asking capitalists to accept a 3 percent rate of profit, because if they make 6 or 10 percent they … destroy the economic equilibrium." Yet as long as capital accumulates faster than the rate at which profitability falls, the fall in the rate of profit would be compensated by a rise in the mass of profits. Insofar, and only insofar, as that process can be sustained — the very elusive possibility of economic "equilibrium" that Vance so vehemently denied, would in fact be supportable. Conversely, because the state markets no commodities, it has no independent source of income beyond its ability to tax and borrow, which is itself simply a form of deferred taxation. The creation of a market for arms can eliminate the problem of excess capital capacity, were it to exist, and can therefore increase the mass of profits by bringing unused private resources into play. But the state can accomplish this only by annexing idle liquidity, with the promise of future repayment with interest, and recycling this liquidity to the market in the form of government contracts. What appears in the short term as an injection of profitability due to government intervention can be sustained only by the expropriation and redistribution of capitalist income once full capacity is again attained. The arms economy would then, in the context of full capacity, be able to expand only by squeezing the profits of the private sector. This makes it all the more difficult to support the pace of accumulation needed to further raise the mass of profits in the reproductive sectors against the renewed pressures of declining profitability and stagnation.

THIS IS WHERE HARMAN TAKES OVER in the further development of the theory of the permanent arms economy. Harman's political associate Tony Cliff drew directly from Vance's analysis and was unable to bring any new insights into the mix except in one critical detail. Cliff argued that the tendencies identified in western capitalism also applied to the "bureaucratic state capitalisms" of the Soviet bloc. That is, Cliff and his associates argued that competition with the West induced tendencies within the Stalinist economies that paralleled the workings of market capitalism. Michael Kidron, writing in the 1960s, supported the permanent arms economy theory but on an entirely different footing. Where he and now Harman were to differ from Cliff and Vance is that both came to see arms production primarily as a countertendency to a falling rate of profit, rather than as an offset to the rather primitive "underconsumptionism" that underscored previous versions of the theory. The central dynamic of "closed capitalism" was in Kidron's words this: "(S)ince unpaid labor is the sole source of profit and the outlay on labor power a constantly declining part of all investment outlays, profit as a proportion of total investment is bound to decline." Therefore a rapid buildup of capital combined with "even the most marginal rise in real wages would precipitate bankruptcy and slump."

But Kidron believed he had discovered a loophole to the falling rate of profit in the work of neo-

Ricardian theorists who were gaining academic traction in the 1960s. Questioning the adequacy of Marx's price theory, the neo-Ricardians argued that the rate of profit was determined solely by the conditions of production in the capital and wage goods industries, those industries that contributed to the material reproduction of the system as a whole, rather than by the all-sector competition to divide the pool of profits collectively created in the economy. Since armaments were not part of the reproductive sectors of the economy, shunting excess capital into waste production seemingly shielded the economy from the effects of a falling rate of profit. Kidron never argued that the ruling classes had any great neo-Ricardian insights into the workings of capitalism, but rather that capitalism fell into this virtuous trap through the political necessities of Cold War rivalry. The problem is that he no longer could really make a convincing case for revolutionary working class politics. It is true that Kidron would argue that the rising technological intensity of the arms industry could create stubborn structural pockets of unemployment, and that the price to pay for ironing out the business cycle was likely a moderation in the tempo of growth. But this is no longer a capitalism lacking the economic fat to continuously add to the economic security and well being of its working classes through rather modest redistributive concessions.

That is not to say that workers' struggles would disappear. After all, the forms of hierarchal social organization at the workplace remain rigid and oppressive. Working arrangements, rules and discipline, the intensity of labor, the dignity of labor on the shop floor and in the working environment are all issues that cannot be eliminated by economic stability. Still the question remains as to how to translate fragmentary concerns and particular issues into larger social movements and political networks for comprehensive change when the crucial underlying necessity for sweeping change — wholesale economic insecurity — is lacking.

Moreover, Kidron, with his concentration on runaway waste production, nonreproductive commodities of which armaments are a special case, raised issues more conducive to a far different approach to socialism. The picture which Kidron paints — but which he failed to pursue — was one of a capitalism increasingly confronted with ecological barriers, which it cannot overcome. In order to overcome them, economic development and growth must be made in a rational, democratically planned and controlled way – which, no doubt, is incompatible with capitalism. But the problems that confront society primarily facing an ecological barrier do not summon the working class, except as individual members of a larger outraged public, to play a key strategic role.

How did Harman and Kidron come to accept the neo-Ricardian approach that denies the non-productive sectors' influence on the overall profitability of capital? The argument, such as it is, has been presented this way by Piero Sraffa, the principle theorist of the Ricardian revival. "If an invention were to reduce by half the quantity of each of the means of production which are required to produce a unit of a 'luxury' commodity of this type, the commodity itself would be halved in price, but there would be no further consequences; the price-relations of the other products and the rate of profits would remain unaffected." But what Kidron and Harman forget is this: Sraffa's conclusions only hold true under the hypothetical assumptions maintained in the Sraffaian model that is "concerned exclusively with properties of an economic system as do not depend on changes in the scale of production or in the proportion of 'factors.'" That is, the neo-Ricardian critique operates under the assumptions common to mainstream neo-classical economists of a system without capital accumulation. It is specifically designed to challenge the conclusions of mainstream economists on their own turf.

Once that crucial assumption is discarded, as it must be, to examine the actual workings of an economy in motion, very different conclusions arise. Under a dynamic system, inventions that lower production costs by diminishing the capital intensity of the production process increase profitability, regardless of the sphere of production involved. The increase in profitability under such circumstances in any sector draws investment to it, thereby allowing it to expand relative to all other spheres. This drives down the average level of capital intensity. As a result, a dollar's worth of capital investment becomes coupled with a growing level of profit-yielding employment. It is associated, in other words, with a system-wide increase in profitability.

Similarly, productivity gains that coincide with an increase in the investment of capital relative to wages ultimately tend to attract to them additional investment in search of profit differentials. But to quite different ends. By drawing investment disproportionately to capital-intensive sections, the overall capital intensity of the system grows. However, now a dollar's worth of investment is associated with a diminished level of profit-yielding employment and — therefore — a falling rate of profit. In an expanding economy, changes that affect the direction of profitability do not distinguish between "reproductive" and "nonreproductive" spheres of investment. Consequently, the distinction that the neo-Ricardians and Kidron-Harman prize as so noteworthy are effectively devoid of any real world applicability.

Where the distinction between "reproductive" and "nonreproductive" investment becomes crucial is, as we shall argue, in the pace or rate at which the system as a whole can expand.

This is the theoretical problem that Harman inherited. Unfortunately, he makes a regular hash out of this challenge. Harman above all seems intent on proving his Marxist orthodoxy — which, in his case, means rejecting the once fashionable neo-Ricardian fancies — while retaining the crucial neo-Ricardian corollary that armament production offsets the falling rate of profit. In other words, Harman is out to rescue his political tendency from the theoretical and historical problem that it is ill-equipped to explain: the return of the capitalist business cycle of rampant unemployment and the decades long erosion of working class living standards.

Harman contends that the resumption of capitalist crises coincided with the reduction of the relative weight of the armaments sector within the world economy. "The very success of low arms spending economies began to put pressure on the high arms spenders to switch resources away from arms and towards productive investment. For only then could they begin to meet the challenge they faced in market competition from Japan and West Germany." But this begs the question: Why were low arms spenders more successful, if success is measured by profit rates, in the post-war decades when the entire theory seems to suggest — if not predict — the very opposite? Why was Japan, where military expenditure is about .8 percent of GDP, in a decades-long slump commencing in the 1990s, despite being a low arms spender? Conversely, why didn't Germany experience the wild gyrations of the business cycle based on its relatively low armaments expenses (1.5 percent of GDP) throughout the post-war years? Can the collapse of the bureaucratic "state capitalist" economies be based on their retreat from arms productions or was their retreat a byproduct of their general economic collapse? Is China's and India's relative success to be attributed to their increasing expenditure on military production (now attaining 4.3 percent and 2.5 percent of GDP respectively) or does their relative economic success permit such (modest) increased expenditures?

If we look at the actual figures, the Kidron-Harman theory seems to have little explanatory value. World military expenditure in 2008 is estimated to have reached $1.464 trillion in current dollars (just over $1.2 trillion in 2005 constant dollars). This represents a 4 percent increase in real terms since 2007 and a 45 percent increase over the 10-year period since 1999. Of course, the lion's share of that increase must be attributed to American military spending, whose military expenditure now accounts for just under half of the world total, at 41.5 percent. Yet it would be hard for anyone to argue that this increased expenditure is a boon to the American economy or its working class, beyond those directly and indirectly employed in those sectors.

WHAT HARMAN SHOULD HAVE BEEN in the position of asking, were his theory coherent, is why the success of high arms producers, such as the United States, did not pressure low arms producers to abandon international competition and channel investment into armaments or other waste goods so that their economies might be shielded from cyclical effects of the falling rate of profit? That is, one should have expected the exact opposite question from that which Harman actually poses. After all, one could, following Kidron's and Harman's logic, ask why excess capacity — or over-production of capital relative to profitability — exists at all, since it should quite "easily" be mopped up by adapting idle capacity to waste production? The point is this: No worker consumes armaments and no capitalist uses military hardware as machinery. To the extent that values are capitalized into nonreproductive goods, they are lost to the process of accumulation. And it is not just their profits that are lost, but the entire value of the output of such goods that are lost, assuming — not unreasonably — that the incidence of taxes needed to buy arms falls primarily on the capitalist class. The maximum potential rate of accumulation is thereby diminished. To sustain the pace of investment needed to raise the mass of profits, increasing downward pressure must be continuously placed on the living standards of the working class. This is especially true if, as is often the case, the political process guarantees arms manufacturers a higher rate of profit than that which prevails in the overall economy. Rather than "rescuing" capitalism from the falling rate of profit, enlarging the nonreproductive sectors — even by the relatively modest measure of according them a higher rate of profit than the prevailing rate in times of economic contraction — reinforces the tendencies to stagnation.

Harman's observation is therefore correct — competition from low arms producing nations did squeeze the economies of high arms producers. But, as we have argued, it did so for very different reasons from those adduced by the "permanent arms economy" theory. It did so by making immanent the drag that nonreproductive sectors impose on the pace of accumulation and manifested itself anew in the demand for diminished taxation by the wealthy on corporations and on claims to profits.

How then in broad terms can the relative golden decades of the 1950s and 60s be explained within a context of a growing arms sector? The theory of the falling rate of profit is reasonably enough grounded. New technologies are applied to existing lines of production not when they are absolutely cheaper than prevailing techniques, but rather when they are relatively cheaper. As long as the savings on wages exceed the increased costs of new production processes, capital expands by introducing techniques that raise the capital intensity of production. If real wages are able to rise with productivity, the rate of profit would decline. But the opening of new avenues of consumer products in the post-war era continuously offset the rising capital intensity in existing production lines. This ongoing expansion of light industry, once established, is subject, of course, to the same tendency towards increased capital/labor thresholds over time. The onset and expansion of "consumer capitalism," however, extended a decades-long reprieve from the falling rate of profit because capitalist lines with relatively low capital to wage ratios were cropping up and outstripping the pace at which existing lines of production were deepening their levels of capital intensity. As long as this fortuitous condition continued, capitalism was able to expand both its reproductive and armaments sector without the tendency towards stagnation, which such waste expansion might otherwise entail.

The stability of the capital-output ratio over in the 1950s and 60s has given rise to the belief that the incidence of capital deepening and capital saving innovations are roughly the same. But this is largely attributable to the aggregation of economic statistics that fail to disentangle the impact of new product lines with lower capital/labor thresholds with actual innovations in the means and methods of production. Capitalist investment in productivity enhancing technology, as opposed to product innovation, generally exhibits, as we have argued above, a capital using, rather than savings bias. “Neutral” technological bias is largely incompatible with capitalism because it would force capital to adjust its growth path to that of labor force. Product innovation, on the other hand, is technologically random in its impact on the capital output ratio. But statistics do not properly distinguish between product innovation and process innovation and therefore tend to blur the distinction.

By the early 1970s the reprieve had, in any case, played itself out and the normal laws of accumulation reasserted themselves through a prolonged economic malaise. This could not be attributed simply to the oil shock of 1973. It is true that the oil companies ran record profits, largely at the expense of all other sectors. But this only obscured the underlying fact that, as economist William Nordhaus observed, “by most reckonings corporate profits have taken a dive since 1966,” record oil profits notwithstanding. And, he continued, “The poor performance of corporate profits is not limited to the United States. A secular decline in the share of profits has also occurred in most of Western Europe.”

This gave rise to the celebrated belief, both among business and even far left economists, that labor militancy was the cumulative cause of profit erosion. And Harman is quite right in dismissing this explanation. But he does so by appealing to a statistical dodge, that wage shares only appeared to have increased because proper consideration had not been given to taxes and capital appreciation. Why then are wage demands so feared, if merely so much froth? Though statistically true, this explanation fails to explain the actual mechanics of wage increases within the context of capital accumulation. The rise in money wages impacts capitals of different compositions, of different capital to wage ratios, in a way that further exacerbates the tendency for profit rates to fall. Investment flows from spheres with high wage components towards spheres with relatively low wage components, to compensate for the profit differentials opened up across the board by increases in worker compensation. Moreover, within each sector, more capital-intensive methods of production — unprofitable at lower wage rates — are now introduced to compensate for the profit squeezing threat of higher wages. The net effect of an increase in wages is therefore a thoroughgoing round of capital deepening, of ever higher ratios — in other words — of capital to labor, as capital seeks ever more ferociously to free itself from the constraint of wage costs. This is how a still expanding capitalism provisionally reorganizes itself to check the rise in wages. But this reorganization is itself contradictory in that it hastens along a different path the very consequence it seeks to avoid. By diminishing the mass of labor activated by the additional dollar of capital invested, the system undermines its ability to extract a volume of profits commensurate with the level of accumulated capital.

The crisis in the mid 1970s rocked the system. The breezy confidence of the post-war era that the business cycle had been vanquished evaporated overnight. Unions that had grown accustomed to partnering with capital — to the extreme point of providing a reserve lobby for sectoral business interests — in return for a steady growth in incomes and benefits, were caught flatfooted. Having long abandoned confronting business on behalf of mass society, it had grown comfortable and respectable by explaining to its rank and file the orderly limits of capital. Yet even the weak forms of resistance that the housebroken American labor movement was still able to muster, proved too much for Reagan. An all out assault was launched against the remaining pretensions that labor was ever a coequal partner in society.

Where Keynesian intervention, the supposed savior of the 1930s, became discredited both in academia and in public life, the ideological trend swung to its seemingly opposite extreme. It was the market itself, which would restore the conditions of profitability and revive the system. And in order for the market to reign supreme, statist deregulation became the principle function of conservative governments from Carter and Reagan to Clinton. The overriding purpose of government became to delink itself from the economic process. That is not to deny that deficit spending in the form of military Keynesianism under Reagan halted the spiraling contraction of the system. Still the low point for profit rates was reached in the early 1980s and the actual revival of business activity was to wait until rampant cost cutting measures, the purging of excess capital through bankruptcy, the concentration of remaining capital into fewer hands, and, above all, the slashing of working class wages and living standards could all churn through the system. The thorough reconfiguration of the production structure, in short, was required before conditions of profitability could be restored.

As the system contracted and profits dissipated, the funds left to business were used to setting up production in low wage areas in both the South and abroad. Existing assembly lines were sped up in attempt to boost the productivity of a diminished labor force. Overhead costs embodied in occupational safety measures, pension plans, and health benefits were dialed back or eliminated. Excess inventories were purged by computerized "just in time" controls. Energy was conserved through a new generation of efficient-usage innovations. Office space, equipment, and factories were purchased at fire sale prices as a wave of mergers and acquisitions streamlined, in part, the production process. Production became lean and tight. The Information and Computer Technologies (ICT) revolution opened up new lines of investment, with far-ranging productivity boosting and labor cost savings applications. Profit rates began to revive, though not, according to Robert Brenner, to the past glories of the long post-war boom.

HARMAN THEREFORE RAISES A STRONG and insightful point that the crisis period of the 1970s was never fully liquidated. He rightfully points out that investment in the major capitalist nations remained historically low for the past two decades. And he correctly noted that "world capitalism would not have become dependent on the bubble had profit rates returned to the levels of the long boom."

Deregulation most famously cleared a path for the creation of new financial instruments such as derivatives, swaps, and the securitization of various forms of debt, including home mortgages. And "financialization," in Harman's words, "provided a substitute motor, in the form of debt, for the world economy." Derivatives, which are essentially hedging bets against the future price movements of underlying assets, mushroomed to almost three times the value of the assets they were designed to cover. This was massively and continuously fueled by the undervaluation of the Chinese yuan, which kept Chinese export accounts in perpetual surplus, allowing an ocean of recycled dollars flowing back to American banks. A seemingly self-perpetuating cycle had emerged, keeping interest rates low, liquidity fluid, and the American export sector perpetually at a competitive disadvantage with the largest of emerging markets. The brief revival of profit rates, punctuated by a series of dot.com bubbles and stock market gyrations, was also ultimately based on a price structure that was out of all connection to the underlying production structure. Economic expansion came to rest increasingly on debt accumulation, without a corresponding buildup of productive capacity. The state could cover its growing obligations only through massive borrowing; consumers, faced with diminished or stagnant wages, maintained consumption levels by mortgaging and continuously refinancing houses, borrowing against insurance policies, maxing out credit cards, and cashing in 401Ks; corporate borrowing necessarily replaced internal financing owing to inadequate profits; the enterprises consolidated through the mergers boom of the 1980s — financed by debt acquisition — were just as likely to be dismantled for speculative ends as to be productively applied. The massive cost-slashing undertaking that had transpired since the early 1980s, which might have given momentum to the system for a renewed burst of accumulation had it been sufficient to produce a reasonable expectation of acceptable returns, was instead applied to transforming the economy into a gigantic lottery. Financial deregulation gave rise to the illusion that profit making could bypass and make itself independent of the production of values, a project that, as we have seen with dramatic certainty, is ultimately unsustainable. Yet without this “irrational exuberance” stoking the expansion of credit and debt, the vast engine of capitalism would have stalled out long ago.

The merit of Harman’s book, for all its pitfalls and unnecessary dead ends, is that it persuasively locates the current collapse — superficially ascribed in the popular press to lax legislation, financial mismanagement, and greed — on the historical continuum of capitalism. The system, as Harman explains, is caught in a noose. The problems caused by the lack of profitability can be solved only by depression. This is the only massive cost cutting purgative that can eliminate excess capital and labor costs ruthlessly enough to restore profitability and revive production. Depression is the essential internal feedback system and ultimate fallback of the market economy. That certain financial institutions such as AIG, Bank of America and Citicorp are considered “too big to fail” and make room for more efficient entities, represents a justified fear on the part of political elites that triggering the onslaught of a second depression would unloose massive social dislocations with unpredictable and uncontrollable political consequences. Like religious zealots confident in their belief in the afterlife, yet petrified of dying, the ruling class that worshiped at the altar of the market place, trembles in fear of a market place let loose. That fear encapsulates the barbaric obsolescence of the market economy.