

Economic crisis

An economic crisis is a situation in which the reproduction of an economic unit is suddenly compromised, typically when it is unable to meet its contractual obligations. A crisis may be generalised from one unit to the system as a whole, with the crisis being transmitted through a breakdown of the financial system as one failure provokes others and undermines the confidence of investors.

For the economist, an economic crisis is essentially a subjective phenomenon, arising when rosy expectations of the future prove faulty. A general crisis is typically the culmination of an economic boom, during which agents are optimistic about the future and credit is cheap and easily available. Minor failures can be absorbed by the system, but a chain of failures may undermine optimism, leading to a withdrawal of credit and cuts in spending, which provoke a generalised crisis and subsequent depression. In retrospect, the waves of optimism and pessimism underlying the business cycle seem irrational, but at the time the expectations of economic agents are self-fulfilling and so their mood appears entirely realistic. The economists' theory of crisis may be complemented by social psychological accounts of the swings of 'market psychology', but leaves little space for sociological explanation.

Sociological contributions to the theory of economic crisis have been almost entirely confined to the Marxist tradition, in which economic crisis has been seen not as an irrational eruption on the surface of capitalism, but as an expression of the inherent contradictions of the capitalist mode of production. While orthodox economists believe that competition ensures that supply and demand adjust smoothly to one another as capitalists adapt their production plans to expected market conditions, Marx and Engels believed that competition drives capitalists to expand the forces of production without limit, so that capitalism is marked by an inherent tendency to overproduction, which underlies the periodic economic crises through which production is brought back within the limits of the market. However, Marx's own writings on crisis are fragmentary and inconsistent so that the Marxist theory of crisis has been an area of intense debate, emphasising now one and now another aspect of Marx's theory.

The traditional Marxist theory of crisis, propounded by Kautsky, derived from Engels and referred somewhat vaguely to the 'anarchy of the market', within the context of the secular tendency to overproduction, as the source of crises. This theory was challenged in the 1890s by Eduard Bernstein, who denied the necessity of crisis, arguing that cartels would overcome the anarchy of the market. Bernstein's arguments challenged the Marxist assumption of the necessity of socialism, so the theory of crisis became the lynchpin of Marxist orthodoxy. Against Bernstein, Rosa Luxemburg proposed an 'underconsumptionist' theory of crisis, while Rudolf Hilferding proposed a 'disproportionality' theory. Hilferding's theory was compromised because it seemed to imply that corporatist regulation could ensure the proportionality of the various branches of production, so 'underconsumptionism' became the dominant Marxist theory of crisis, endorsed by the ideologists of the Soviet Union. However, 'underconsumptionism' was compromised in its turn by the 'Keynesian revolution', which suggested that state fiscal regulation could overcome any threat of a crisis of underconsumption.

The post-Second World War boom appeared to vindicate the critics of Marxist crisis theory, because it seemed that Keynesian macroeconomic regulation was indeed able to secure sustained economic growth. Nevertheless, the recurrence of crisis tendencies and the failure of Keynesian regulation from the late 1960s provoked a renewed interest in the Marxist theory of crisis. One feature of the renewed crisis tendencies was a marked fall in the rate of profit in the metropolitan centres of capitalist accumulation and Marxist crisis theory now came to focus on the explanation of crisis as a result of this fall in the rate of profit. During the 1970s, Marxist debate raged between those who believed that the fall in the rate of profit was the result of the erosion of profits by rising wages and increasing state social expenditure, as an expression of the

intensifying 'class struggle', and those who linked it to Marx's 'law of the tendency for the rate of profit to fall'. As capital came to prevail over labour in the struggle over wages and social spending during the 1970s, it was the 'law of the tendency for the rate of profit to fall' that emerged as the canonical Marxist theory of crisis, although this was more often invoked as a rhetorical device than as a systematic theory.

Before the 1970s, the 'law of the tendency for the rate of profit to fall' had not played a significant role in the explanation of economic crises in the Marxist tradition. If it played any role in Marxist theorising, it was as a long-term secular tendency, which might make capitalism more vulnerable to a crisis, but was not itself the cause of the crisis. The sharp fall in the rate of profit in a crisis was seen as the result of the crisis, not as its cause, which was found elsewhere. The Marxist debates in the 1970s and 1980s focused on the issue of whether and in what sense Marx established a necessary tendency for the rate of profit to fall, with much less attention being paid to the question of whether and why such a tendency should find its necessary expression in a crisis.

The theory of crisis has played a central ideological role within Marxism because the necessity of crisis supposedly establishes the inevitability of socialism. However, even if the necessity of crisis is established, this ideological role is undermined by two counter-arguments, which Marx and Engels themselves fully recognised. First, a crisis marks not so much the destruction of capitalism as the means of its regeneration. In the wake of the crisis, archaic production capacity is destroyed, while the surviving capitalists are able to force down wages and intensify labour, preparing the ground for a renewal of capitalist accumulation on the basis of an increased rate of profit. Second, the period of depression following a crisis is by no means conducive to the mobilisation of the working class, so that an economic crisis will only provoke a revolutionary political crisis if the organised working class is already politically and ideologically prepared to take power.

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Further Reading:

Clarke, S. (1994) Marx's Theory of Crisis, Basingstoke and London: Macmillan, and New York: St Martin's.

Engels, F. (1987) Anti-Dühring, in K. Marx and F. Engels, Collected Works, Volume 25, London: Lawrence and Wishart.

Howard, M.C. and King, J.E. (1989 and 1992) A History of Marxian Economics, 2 volumes, Basingstoke and London: Macmillan, and New York: St Martin's.