<u>The Great Recession: a Marx, not a Minsky moment</u>

The Great Recession is often portrayed as a Minsky moment when excessive debt and the financialisation of the US economy led to a global financial crash in 2008. Some conjunctural phenomena like 'financialisation' in the last 30 years or neoliberal policy regimes may seem to be the cause of crises, but they are not alternative causes, but are themselves explained by, Marx's law of profitability. The Great Recession was not a Minsky moment of financial instability leading to a collapse in the productive sector; but in contrast, due to a crisis of profitability in the productive sector, eventually forcing the financial sector back into line with the law of value and profitability in the productive sector, in other words, a Marxist moment.

Supported by empirical evidence, this paper attempts to show that the Great Recession of 2008-9 was not caused by excessive 'financialisation,' but was (ultimately) the result of falling profitability in the productive sector of the capitalist economy, leading to a switch of investment into financial assets and fictitious capital. The fictitious nature of the profits in real estate and finance was eventually exposed in the global financial crash.

The financialisation thesis

According to many in the world of heterodox economics, the Great Recession was really a product of a new development in capitalism, the growing dominance and 'autonomy' of the financial sector from the rest of capitalism. This process of 'financialisation' had been operating with increasing intensity over the last 30 years and culminated in the collapse of the financial sector in 2007 that triggered the recession. The global financial crash of 2008 and the corresponding Great Recession of 2008-9 were the result of the rise of an uncontrolled and speculative financial sector and excessive credit/debt, leading to a 'Minsky moment', so the argument goes.[1]

This view of the cause of the Great Recession contrasts with the classical Marxist explanation of crises under capitalism based on Marx's law of the tendency of the rate of profit to fall. According to Marx, individual capitalist businesses compete with each other to sustain and increase profits. To do so, they use new technology to boost the productivity of labour, which reduces the time taken to produce a commodity. But this process is capitalism's Achilles' heel.

In Marxist theory, only labour can create value, so the new value and (the surplus value within new value) generated by capitals investing in new methods of production begins to fall *relatively* to the stock of capital. On the other hand, capitals applying technology are more efficient and so produce a greater output per labour time. So these capitals can gain a surplus profit at a given market price, while the more technologically backward capitalists gain less. The former appropriate a share of the surplus value produced by the latter. So their rate of profit rises but that of the technologically less efficient capitals falls. Competition forces all capitalists to apply new technologies. But in doing so, then average profitability falls. Eventually, the mass of profit falls as well and the least profitable may go bankrupt. A crisis ensues. This is the 'Marxist moment'. 2

Which theory best explains the Great Recession? In answering that, let us consider more closely what the term 'financialisation' means in this context. The wide definition mainly quoted by the financialisation school was first offered by Gerald Epstein. Epstein's definition was "financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies."[3] But as Epstein says: "some writers use the term 'financialization' to mean the ascendancy of 'shareholder value' as a mode of corporate governance; some use it to refer to the growing dominance of capital market financial systems over bank-based financial systems; some follow Hilferding's lead and use the term

'financialization' to refer to the increasing political and economic power of a particular class grouping: the rentier class; for some financialization represents the explosion of financial trading with a myriad of new financial instruments".

For Greta Krippner (who first used the term – MR), the term refers to a "pattern of accumulation in which profit-making occurs increasingly through financial channels rather than through trade and commodity production".[4] Krippner takes financialisation into new territory where profit can come from other sources than from the exploitation of labour. Now finance is the new and dominant exploiter, not capital as such. And it is the instability and speculative nature of finance capital is the real cause of crises in capitalism, not any fall in the profitability of production of things and services, as Marx's law of profitability had argued.[5]

Hyman Minsky, the radical Keynesian economist of the 1980s, posed that the finance sector is inherently unstable because "the financial system necessary for capitalist vitality and vigor, which translates entrepreneurial animal spirits into effective demand investment, contains the potential for runaway expansion, powered by an investment boom."6 A modern follower of Minsky, Steve Keen, puts it thus: "capitalism is inherently flawed, being prone to booms, crises and depressions. This instability, in my view, is due to characteristics that the financial system must possess if it is to be consistent with full-blown capitalism. [7]

Connected to this thesis is the view that that modern capitalist crises are the result of rising inequality and excessive household debt, leading to financial instability and have nothing to do with the failure of profitability in productive investment.[8] Mian and Sufi argue that "Recessions are not inevitable – they are not mysterious acts of nature that we must accept. Instead, recessions are a product of a financial system that fosters too much household debt".[9] John Milios argues that finance had always been at the centre of the circuit of capital.10 Capital has a Janus head, namely one side was the capitalist as a functioning productive investor extracting value from labour power; and on the other side was the capitalist as a lender of money for investment. In the neoliberal period, the latter half of Janus had now become dominant or both sides had merged. This has bred instability, inherent in finance: "it was the financial crisis in the Great Recession that led to the fall in profitability", not vice versa.

The role of credit

Marx recognised the role of credit and financial speculation.[11] Credit is necessary to lubricate the wheels of capitalist commerce, but when the returns from the exploitation of labour begin to drop off, credit turns into debt that cannot be repaid or at serviced. Crises always appear as monetary panics or financial collapses, because capitalism is a monetary economy. But that is only a symptom of the underlying cause of crises, namely the failure to make enough money!

For Marx, the capitalist economy is a monetary economy; and it is an economy with credit as a key constituent. Capital exists either in liquid form i.e. as money, or in fixed form as means and materials of production. Credit in all its forms increasingly substitutes for money in the general circulation of capital and commodities. Marx used the term 'fictitious capital' to define investment in financial assets like stocks and bonds (and in modern times, the derivatives of these). This 'fictitious capital' is "a kind of imaginary wealth which is not only an important part of the fortune of individuals" (but also) "a substantial proportion of bankers' capital". For Marx, financial instruments, both credit and equity, are entitlements to present or future value "We have previously seen in what manner the credit system creates associated capital. The paper serves as title of ownership which represents the capital. The stocks of railways, mines, navigation companies, and the like, represent actual capital".

The existence of these fictitious capitals imparts flexibility to the economy, but over time they become an impediment to the health of the economy. The more fictitious capital distorts the price signals, the more that information about the economy disappears. Decisions about production become increasingly unrelated to the underlying economic structure. Pressures build up in the economy, but they are not visible to those who make decisions about production. Fictitious capitals retain values that would evaporate if participants in the market were fully aware of the future. They also serve as collateral for a growing network of debt. In effect, the financial system becomes increasingly fragile.

John Bolder writes[12]: "up until the early 1980s, credit was used mostly to finance production of goods and services. Growth in credit from 1945 to 1980 was closely linked with growth in incomes. The incomes that were generated were then used to amortize and eventually extinguish the debt. This represented a healthy use of debt; it increased incomes and introduced negligible financial fragility." But from the 1980s, "credit creation shifted toward asset-based transactions (e.g., real estate, equities bonds, etc.). This transition was also fuelled by the record-high (double-digit) interest rates in the early 1980s and the relatively low risk-adjusted returns on productive capital*".*[13]

But, as Bolder hints, it is the drive for profit in the capitalist sector that is behind the expansion of credit. Irving Fisher put it: "overindebtedness must have had its starters. It may be started by many causes, of which the most common appears to be new opportunities to invest at a big prospective profit, as compared with ordinary profits and interest". But prospective profit eventually gives way to "an expansion of the speculative element" and enterprises keep up an appearance of prosperity by accumulating debts, increasing from day to day their capital account."[14]

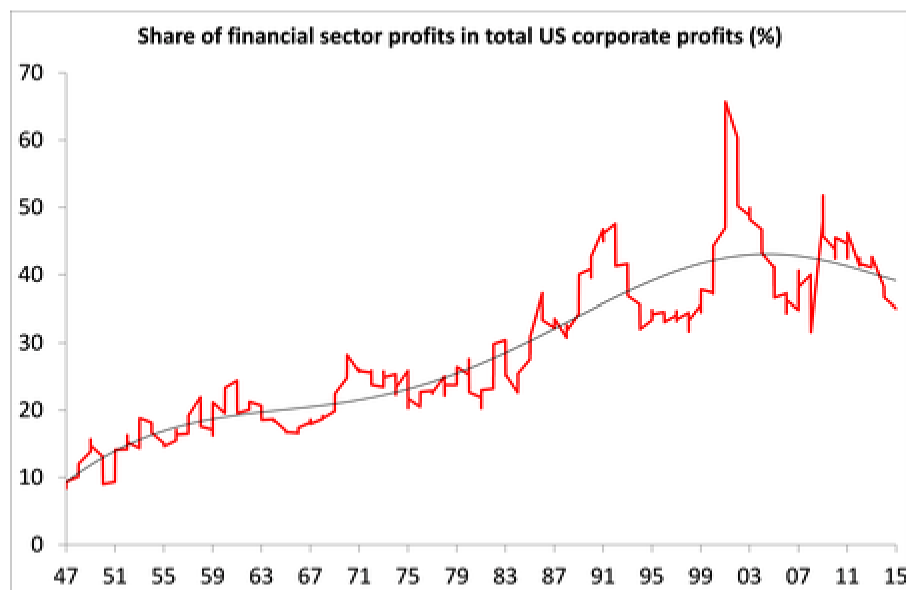
Fictitious values accumulate during extended boom periods and are subsequently shed in the course of the bust. This shakeout "unsettle[s] all existing relations." (Marx). As Paul Mattick put it, "speculation may enhance crisis situations by permitting the fictitious overvaluation of capital, which cannot satisfy the profit claims bound up with it." [15]

So for Marx: "The credit system appears as the main lever of overproduction and overspeculation in commerce solely because the reproduction process, which is elastic by nature, is here forced to its extreme limits, and so is forced because a large part of the social capital is employed by people who do not own it and who consequently tackle things quite differently than the owner, who anxiously weighs the limitations of his private capital in so far as he handles it himself. This simply demonstrates the fact that the self-expansion of capital based on the contradictory nature of capitalist production permits the free development only up to a certain point, so that it constitutes an imminent fetter and barrier to production, which are continually broken through by the credit system. Hence, the system accelerates the material development of the productive forces and the establishment of the world market. It is the historical mission of the capitalist system of production to raise these material foundations. At the same time credit accelerates the violent eruptions of this contradiction -- crises -- and thereby the elements of the disintegration of the old mode of production."

A debt or credit crisis is really a product of a failure of the capitalist mode of production as a monetary economy. "In a system of production, where the entire control of the reproduction process rests on credit, a crisis must obviously occur when credit suddenly ceases and cash payments have validity. At first glance therefore, the whole crisis seems to be merely a credit and money crisis." (Marx).

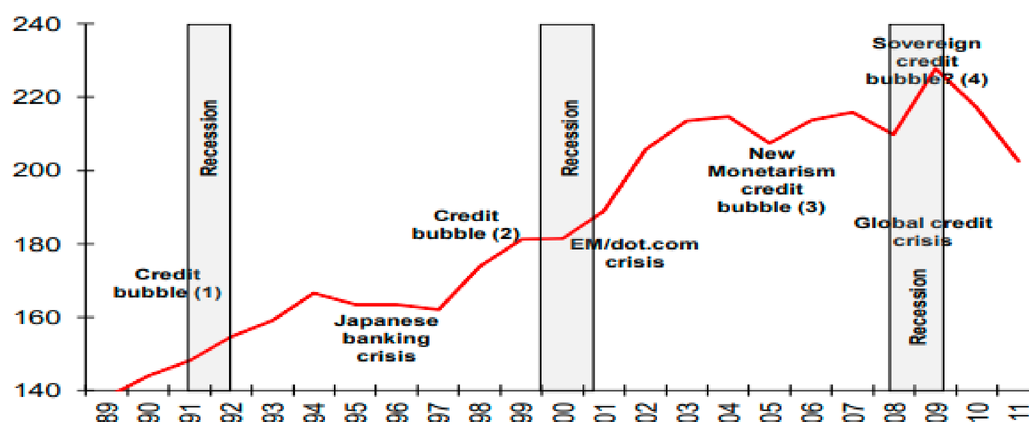
The rise of finance

Financial profits have claimed an increasing share of real profits throughout the whole post–World War II phase.



Global credit accelerated in the late 1990s and after a pause in the mild recession of 2001, liquidity took off again up to the point of the start of the global credit crunch mid-2007.

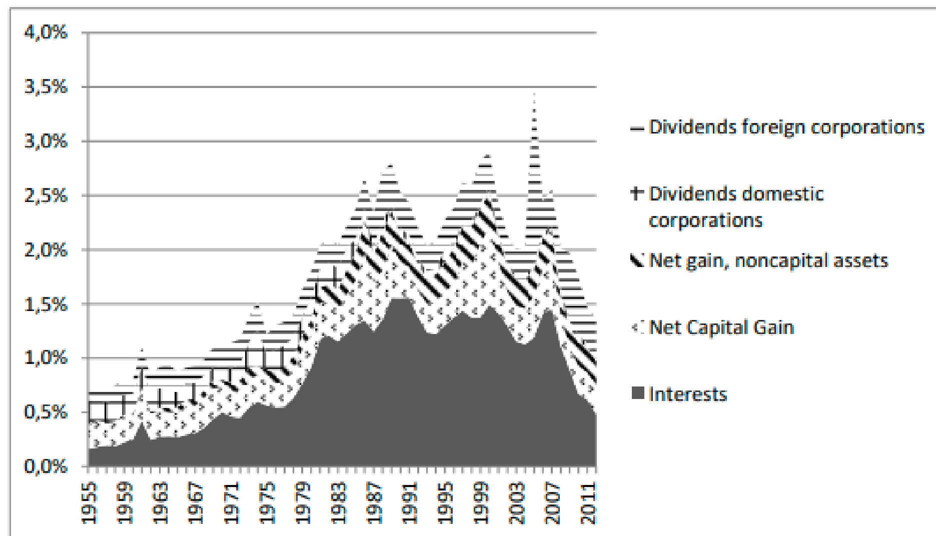
Figure 3. Global credit to GDP and the bubbles



Source. Roberts M, op cit.

However, this does not mean that the productive and financial sectors of modern economies have merged or that the major multi-nationals are now really just large financial institutions, as is claimed by some in the financialisation school. Indeed, the empirical evidence is to the contrary. Joel Ranovitch finds that "contrary to the financial rentieralization hypothesis, financial income averages 2.5% of total income since the '80s while net financial profit gets more negative as percentage of total profit for nonfinancial corporations. In terms of assets, some of the alleged financial assets actually reflect other activities in which nonfinancial corporations have been increasingly engaging: internationalization of production, activities refocusing and M&As."[16]

Figure 6. Financial Income as percentage for total income, NFCs, 1955-2012. Source: IRS.



Source: Rabinovitch

Durand and Gueder offer several causes for the gap between profitability and investment from a financialisation perspective[17]: "the revenge of the rentiers narrative (rising interest rates); a change in management preferences in favour of financial investment at the expense of domestic productive investment— (the financial turn of accumulation narrative); the possible substitution of foreign investment at the expense of domestic productive investment and increased cost mark-up thanks to cheaper inputs form low-wages countries—(the globalisation narrative)." They find all these factors contribute to varying degrees. But what is missing from this narrative is what was happening to the profitability of productive capital to cause companies to switch into financial investment or go abroad to invest.

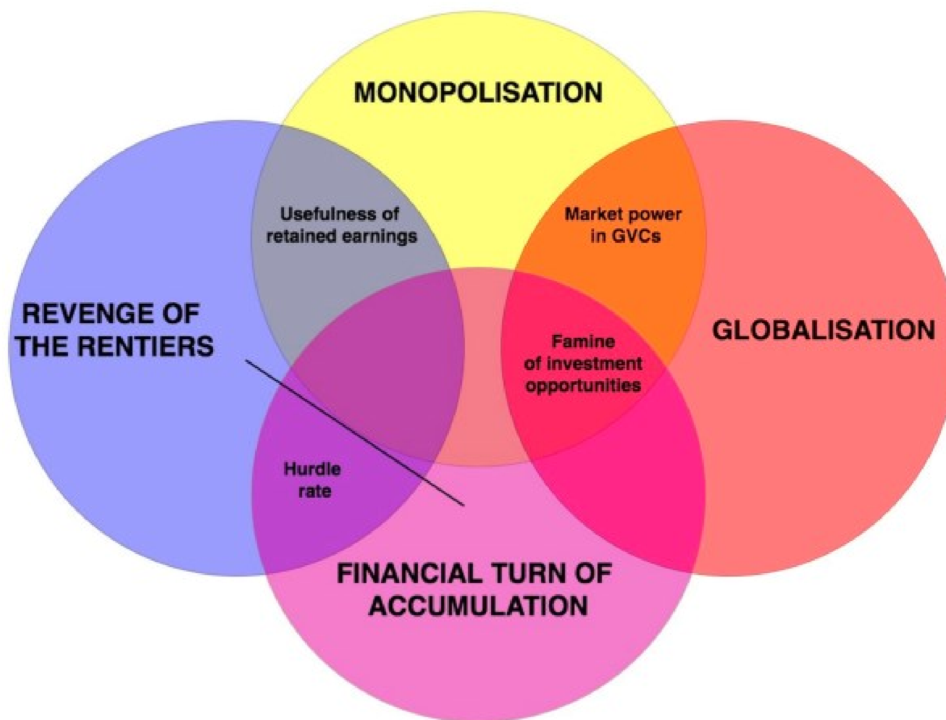
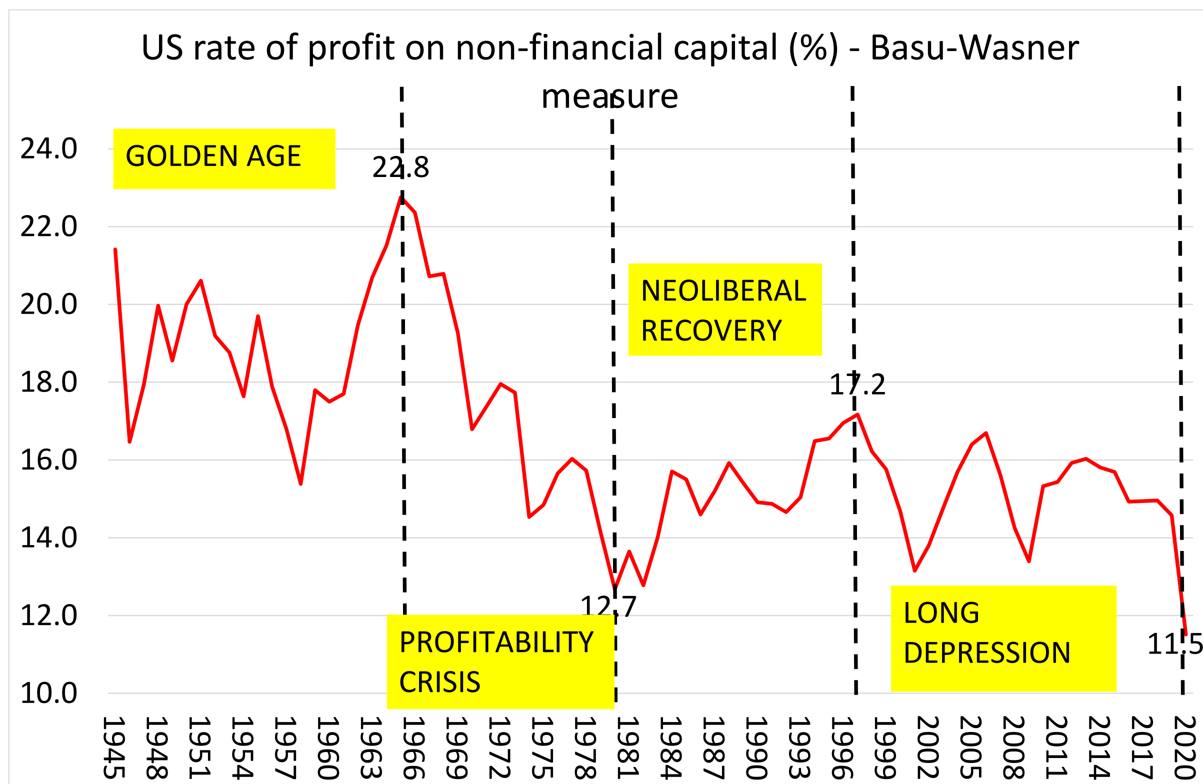


Figure 20. The conundrum of the relaxation of the profit–investment relation.

What caused the Great Recession?

Supporters of the financialisation thesis claim that the classical Marxist explanation of the Great Recession is wrong for several reasons. *First,* the rate of profit in the major economies was not falling before the crisis and indeed had not been falling but rising since the early 1980s.18 *Second,* the rise in profitability was mainly due to a fall in the share of value going to the labour force compared to the capitalist class. The share of profit rose and so did the rate of profit did – contrary to Marx's law of profitability and was not due to Marx's classic law of a rising organic composition of capital (which expresses the 'capital-bias' in capitalist accumulation).19

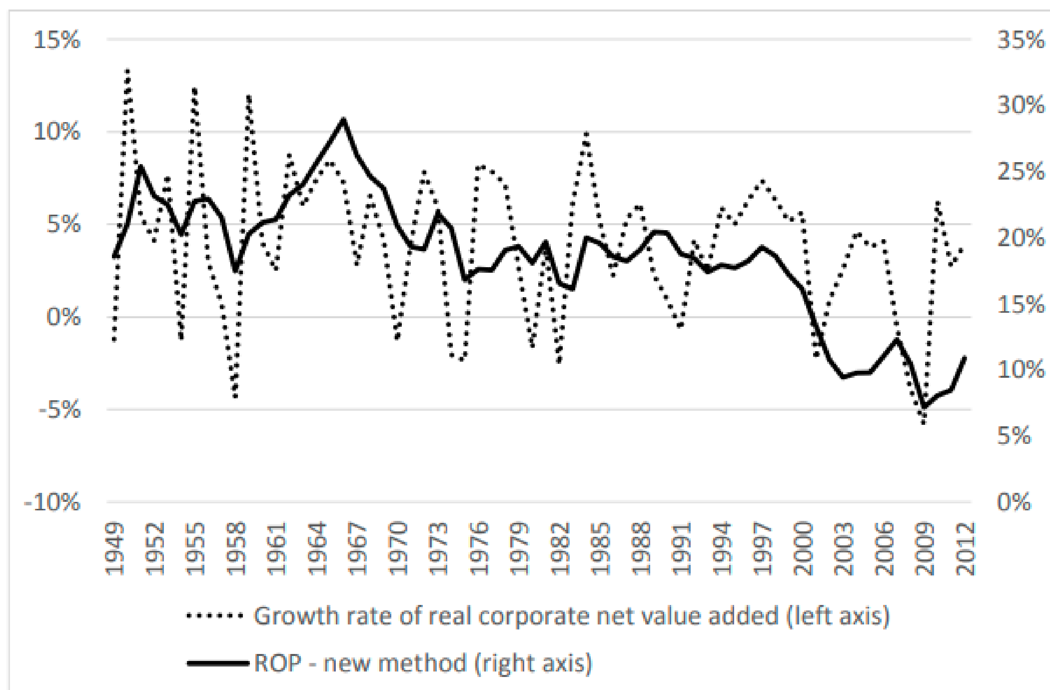
Let us consider the evidence for these assertions. The global financial crash and the Great Recession started in the US. So the US economy provides the basis for evidence. It is true that the US rate of profit on capital started to rise from a deep trough from the early 1980s. However, non-financial sector profitability peaked in 1997. There were two deep falls around the slumps of 2001 and 2008-9 and the recovery between these two recessions was not sufficient to surpass the 1997 peak.



Source: Basu-Wasner, https://dbasu.shinyapps.io/Profitability/

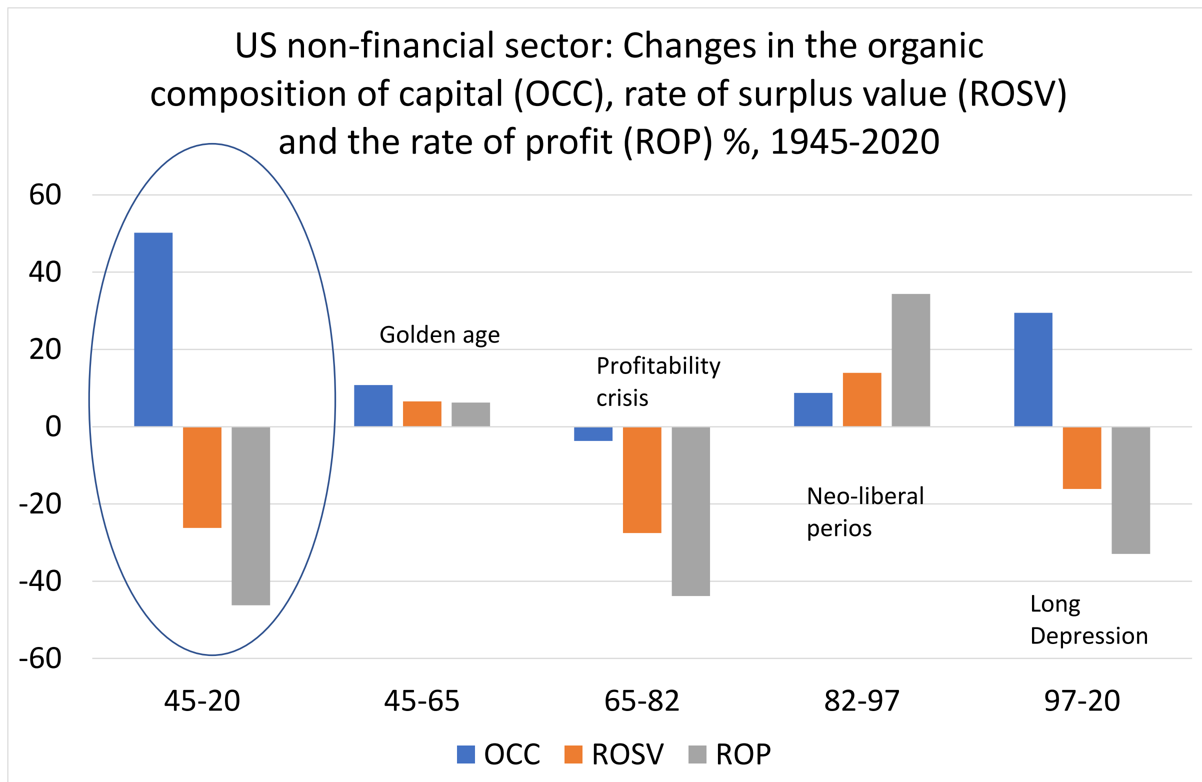
Above, I choose the rate of profit on non-financial capital because it excludes financial profits, much of which are fictitious, as defined above. Peter Jones has attempted to measure the rate of profit excluding fictitious profits. His measure shows a sharp fall in the US rate of profit on non-fictitious productive capital from the end of the 20th century right up to the Great Recession. So the profitability of the productive sector (creating new value) of the US economy was falling well before the global financial crash and the Great Recession began.

Figure 7: ROP using non-fictitious corporate profit vs growth rate of corporate NVA

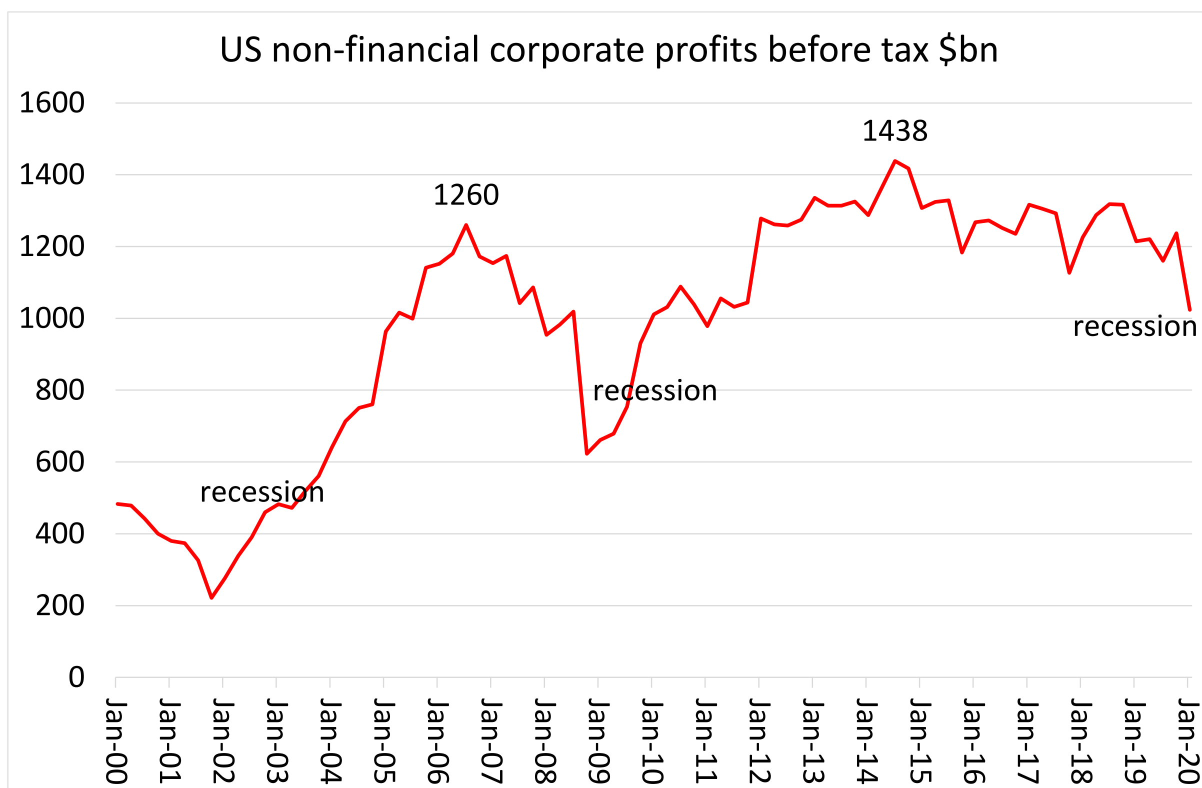


Source: http://gesd.free.fr/jonesp13.pdf

The second claim of supporters of financialisation as the cause of the Great Recession is that the rise in profitability and profits was not due to a falling organic composition of capital (OCC) but to a rising rate of exploitation. Stagnant wages led to increased household debt which eventually provoked the property crash and the global financial crash (Mian and Sufi et al). But if we decompose the contributions of the Marxist categories to the US rate of profit in the post-war period, we find that the most important driver of the falling rate of profit since 1945 has been a rising organic composition of capital. Indeed, the rate of surplus value in the non-financial sector fell over the 75-year period. Only in the so-called neoliberal period did the rate of surplus value rise faster than the organic composition of capital, thus sufficiently counteracting the downward impact of the latter on the rate of profit.

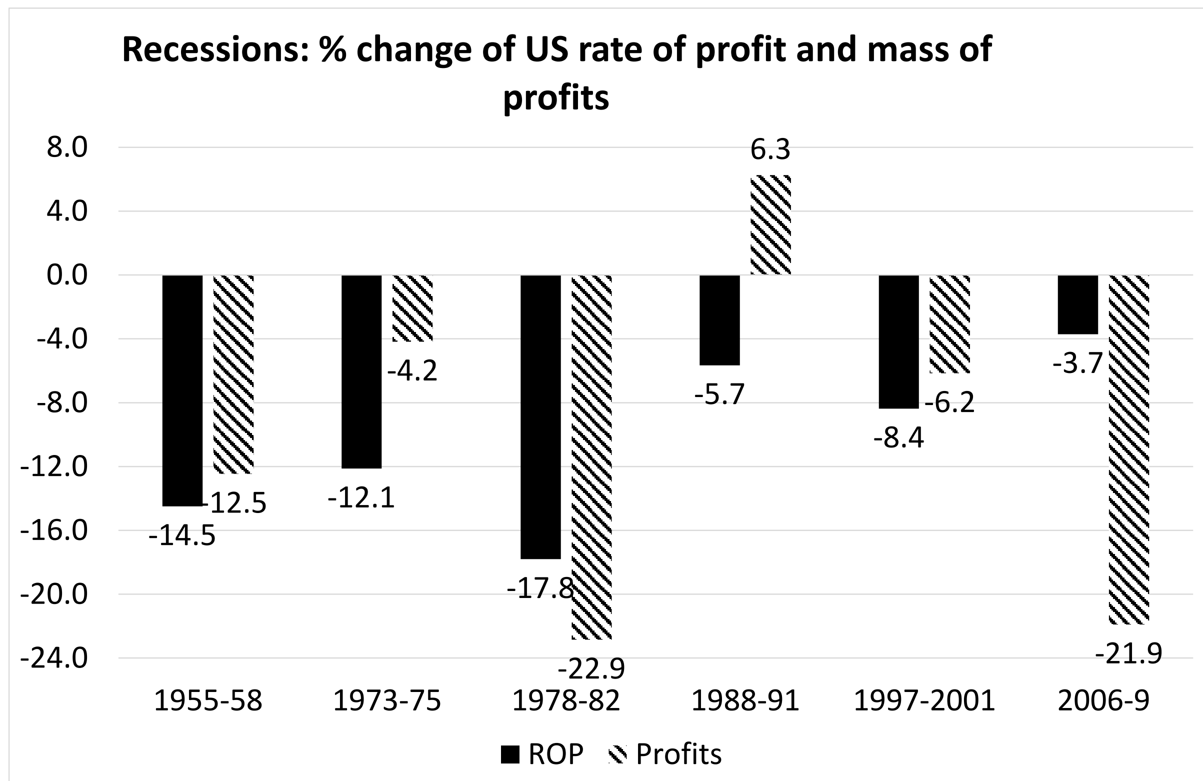


As for the mass of profit, the evidence of the last 20 years is that the rate and mass of profit fell leading to a fall in business investment and when that fell, a recession ensued. That applies to the Great Recession and the Pandemic slump.



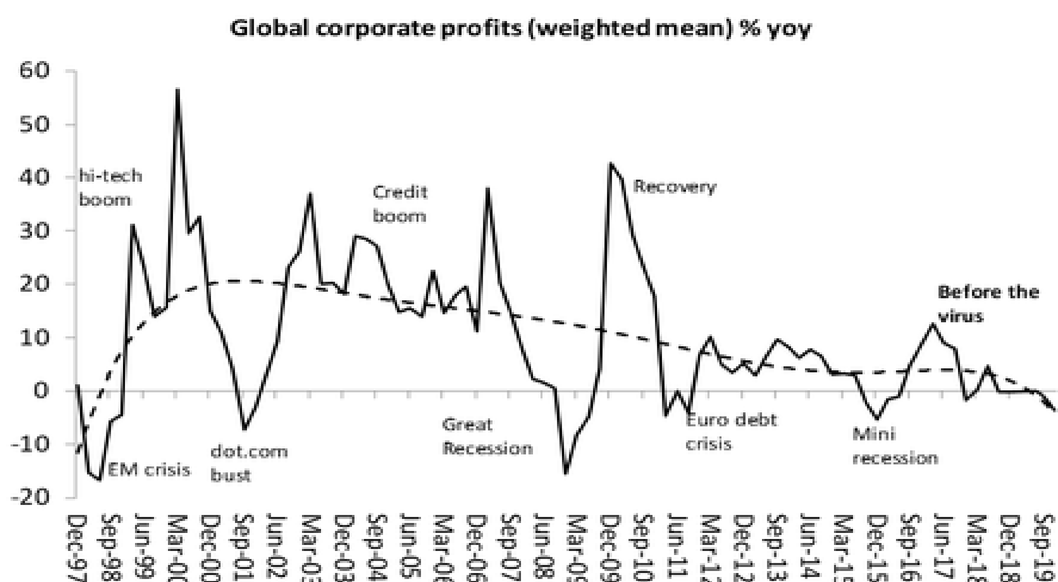
Source: NIPA, authors calculations

Indeed, it applies to every recession in the US in the last 75 years.



Source: NIPA, authors calculations

And for that matter, globally:



Source: Datastream, author’s calculations

Other authors studying the rate of profit and the Great Recession reach the same conclusion. Maniatas and Passas conclude that: "the claims of certain Marxists that the present crisis is not a crisis of profitability seem to be unfounded." 20 Also, Economakis and Markaki: "The Greek crisis resurfaced due to the low profitability of capital, a result of a rising OCC."21. Mavroudeas and Paitaridis conclude that: "the 2007-8 economic crisis is a crisis a-la Marx (i.e. stemming from the tendency of the profit rate to fall – TRPF) and not a primarily financial crisis and this represents the 'internal' cause of the Greek crisis.". And even more recently, Tsoulfidis and Paitaridis: "The falling net rate of profit is responsible for this new phase change, the Great Recession."[22]

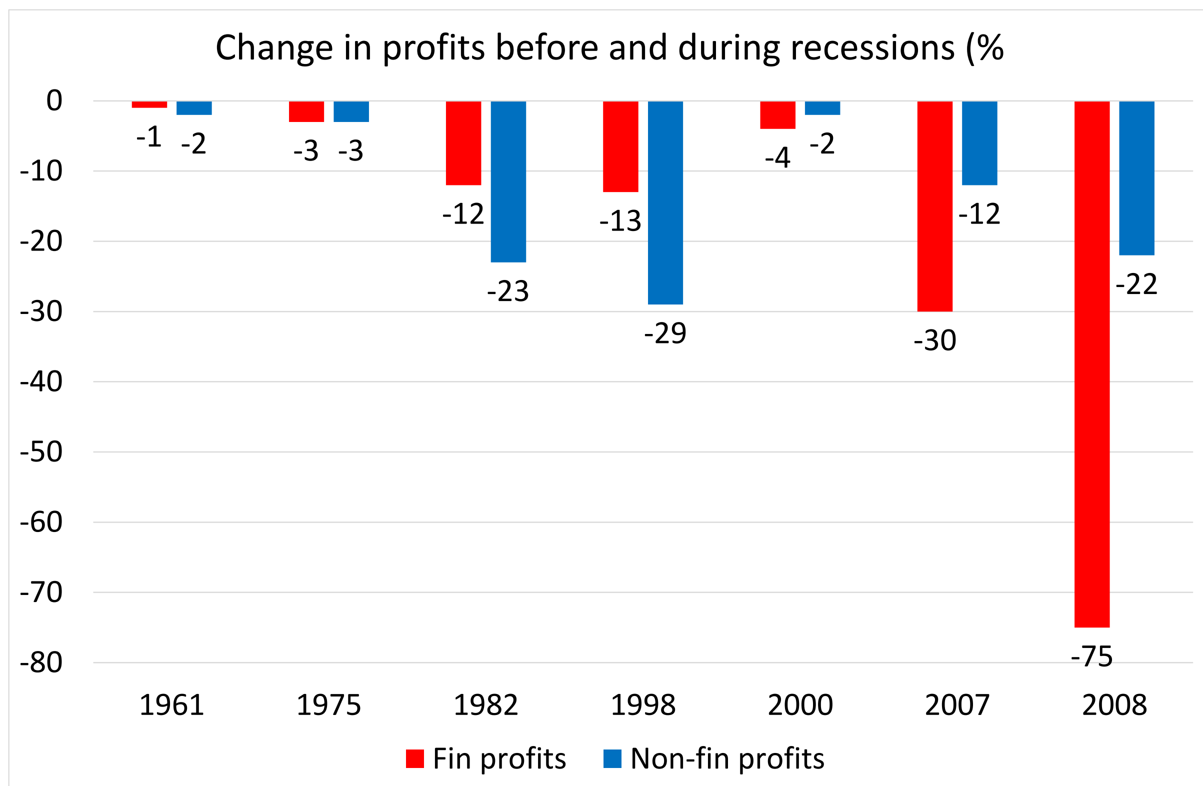
Financial crises and recessions

Carchedi provides compelling empirical support for Marx's law of profitability showing the link between the financial and productive sectors in capitalist crises. From the early 1980s, the strategists of capital tried to reverse the low profitability reached then. Profitability rose partly through a series of major slumps (1980, 1982, 1991, 2001 etc). But it also recovered (somewhat) through so-called neoliberal measures like privatisations, ending trade union rights, reductions in government and pensions etc.

Carchedi concludes: "The growth of fictitious profits causes an explosive growth of global debt through the issuance of debt instruments (e.g., bonds) and of more debt instruments on the previous ones. The outcome is a mountain of interconnected debts. …. But debt implies repayment. When this cannot happen, financial crises ensue. This huge growth of debt in its different forms is the substratum of the speculative bubble and financial crises, including the next one. So this countertendency, too, can overcome the tendency only temporarily. The growth in the rate of profit due to fictitious profits meets its own limit: recurring financial crises, and the crises they catalyze in the productive sectors."[23]

But there was also another countertendency: the switch of capital into unproductive financial sectors (that Durand et al noticed). Carchedi: "Faced with falling profitability in the productive sphere, capital shifts from low profitability in the productive sectors to high profitability in the financial (i.e., unproductive) sectors. But profits in these sectors are fictitious; they exist only on the accounting books. They become real profits only when cashed in. When this happens, the profits available to the productive sectors shrink. The more capitals try to realize higher profit rates by moving to the unproductive sectors, the greater become the difficulties in the productive sectors. This countertendency—capital movement to the financial and speculative sectors and thus higher rates of profit in those sectors—cannot hold back the tendency, that is, the fall in the rate of profit in the productive sectors."

Carchedi shows that there have been increasing financial crises since the 1980s, but they did not lead to an investment and production collapse, unless they were accompanied by a fall in productive profits too. As Carchedi points out, "the first 30 years of post WW2 US capitalist development were free from financial crises. Only when profitability in the productive sector fell in the 1970s, was there a migration of capital to the financial unproductive sphere that during the neo-liberal period delivered more financial crises. The deterioration of the productive sector in the pre-crisis years is thus the common cause of both financial and non-financial crises… it follows that the productive sector determines the financial sector, contrary to the financialisation thesis."



Source: Carchedi 2018

Carchedi concludes that: "The basic point is that financial crises are caused by the shrinking productive base of the economy. A point is thus reached at which there has to be a sudden and massive deflation in the financial and speculative sectors. Even though it looks as though the crisis has been generated in these sectors, the ultimate cause resides in the productive sphere and the attendant falling rate of profit in this sphere."24

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[1] Minsky Moment refers to the onset of a market collapse brought on by the reckless speculative activity that defines an unsustainable bullish period. Minsky Moment is named after economist Hyman Minsky and defines the point in time where the sudden decline in market sentiment inevitably leads to a market crash. See https://www.investopedia.com/terms/m/minskymoment.asp

[2] See G Carchedi, Behind and beyond the crisis, http://gesd.free.fr/carchedi11.pdf October 2011

[3] Epstein, G. 2005a. 'Introduction: Financialization and the World Economy.' In Epstein (2005b)

[4] The Politics of Financialization- An Interview with Greta Krippner, https://journals.openedition.org/regulation/12637?lang=en

[5] Mavroudeas: (393982858-QMUL-2018-Financialisation-London) the 'financialisation hypothesis' reckons that "money capital becomes totally independent from productive capital (as it can directly exploit labour through usury) and it remoulds the other fractions of capital according to its prerogatives." And if "financial profits are not a subdivision of surplus-value then…the theory of surplus-value is, at least, marginalized. Consequently, profitability (the main differentiae specificae of Marxist economic analysis vis-à-vis Neoclassical and Keynesian Economics) loses its centrality and interest is autonomised from it (i.e. from profit – MR)."

[6] https://www.tutor2u.net/economics/blog/hyman-minsky-the-financial-instability-hypothesis

[7] Minsky Journal of Finance, Vol 24 1969

[8] http://jwmason.org/slackwire/in-jacobin-a-demystifying-decade-for-economics/

[9] https://thenextrecession.wordpress.com/2014/06/28/its-debt-stupid/

[10] http://users.ntua.gr/jmilios/Milios_Appreciating_P.Gowan.pdf

[11] https://www.panarchy.org/marx/credit.html
[12] https://rwer.wordpress.com/2018/11/26/productive-versus-financial-uses-of-credit/
[13] Note that Bolder recognises that it was a fall in the profitability ('low risk-adjusted returns on productive capital') in productive investment and the rise in interest costs that led to the switch towards financial asset investment.

[14] https://fraser.stlouisfed.org/title/debt-deflation-theory-great-depressions-3596
[15] https://libcom.org/files/Paul%20Mattick%20Economic%20Crisis%20and%20Crisis%20Theory.pdf

16 Joel Rabinovitch: The financialisation of the nonfinancial corporation. A critique to the financial rentieralization hypothesis,

https://www.academia.edu/35761937/The_financialisation_of_the_nonfinancial_corporation_A_critique_to_the_financial_rentieralization_hypothesis

[17] Cédric Durand and Maxime Gueuder, The Profit–Investment Nexus in an Era of Financialisation, Globalisation and Monopolisation: A Profit-Centred Perspective, http://digamoo.free.fr/durandgueuder.pdf

[18] See the assertions of Lapatvitsas among others in Costas Lapavitsas, Financialisation and capitalist accumulation, Research on Money and Finance, February 2010.
[19] At Marxism 2010 in London, this view was expressed verbally by Alfredo Saad-Filho who argued that the Great Recession was a 'bubble-like crisis' centred in the financial sector. Indeed, all recessions since the 1980s have been caused by excessive credit bursting and not by a crisis in accumulation due to a falling rate of profit, said Saad-Filho. Each crisis is special and unique, claimed Saad-Filho and there is no overriding or underlying cause of capitalist crisis as proponents of Marx's law of profitability have argued. Indeed, Marx never really had a theory of crisis anyway.

[20] World in Crisis, Chapter 8
[21] Greek Capitalism in Crisis: Marxist Analyses (Routledge Frontiers of Political Economy) 1st Edition by Stavros Mavroudeas (Editor)

[22] http://digamoo.free.fr/tsoulfidis18.pdf
[23] Carchedi, Chapter 2, World in Crisis
[24] Carchedi op cit