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An Essay on the Crisis of Capitalism - *à la* Marx ?

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An Essay on the Crisis of Capitalism - *à la* Marx ?

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Abstract

The essay argues that a crisis of collective agency is at the root of the global economic crisis we face today. The secret of prosperous capitalism, the so-called *golden age*, was the ability of the state to uniformly impose welfare enhancing market restrictions that made it possible to husband and invest in common pool resources. This ability has waned during the neoliberal era and the result has been a resurgence of forces of competition, what Marx called the law of value, generating long term collective costs that go increasingly unaddressed. This is reminiscent of classical capitalism's main weakness with respect to organizing corrective collective action, making a couple of Marx's point resonate today. One is his view of competition as a war like process and how that militates against coordination (not to mention cooperation) among individual capitalists. The second point is the very basis of Marx's main gripe with capitalism: the two different ways for accounting for economic performance, one, based on profits and the other on human welfare can become deeply divergent. The failure of collective agency ties together the two points. What is profitable at the micro level ends up being at variance with human welfare as well as the long term collective interest of capitalists, because *coordination failure* is not only endemic but a defining characteristic of capitalist competition.

Keywords: collective action club goods, welfare state, financial crisis, Marx

JEL Classification: P16, O16, D70

According to Marx what is unique about capitalism is its capacity for self-regulation, i.e., its ability to self-organize around the economic imperative as dictated by forces of competition. In anything that came before in history organization of economic life had to rely heavily on collective action of one sort or another and that invariably meant some form of organized coercion. Social choice was exercised by the powerful few and invariably in a despotic way. The rise of capitalism limited the scope for collective action at least within the economic sphere, and thus direct forms of coercion could be the exception rather than the rule.

For classical liberalism rallying around individual freedom against despotism and the advocacy of *laissez-faire* basically came to the same thing. Since collective action was thought synonymous with despotic coercion and the market system could function without it, putting the two together, *laissez faire* had to be an essential part of the fight against *tyranny*. Unsurprisingly, the new age found its mantra in Adam Smith's *invisible hand* according to which the individual by acting solely on his self-interest not only helps himself but the society as well. That meant that he no longer had to be sacrificed in the name of the common good.

Marx of course would have disputed that the rise of capitalism brought about the end of coercion by organized political power as such, but wholeheartedly agree that an important difference nonetheless had emerged. Back breaking hard labor was no longer coerced from the worker by the whip of the master but by the cold calculus of a dire circumstance he found himself in. The dire circumstance resulted from a lopsided distribution of what he called *means of production*, and the *property relations* that brought it about had to be maintained at all cost if the system were to remain viable. Once the monopoly of *haves* over economic resources was safeguarded, the dependence of *have-nots* on the labor market for survival went a long way in making *self-regulation* a fact of life.

In this view, capitalism did not eradicate coercive collective action but simply pushed it to the background. As 'coercion-by-force-of-circumstance' replaced direct coercion at the realm of work, the threat of direct coercion had to be kept in store and used as needed in quelling any challenge the *have-nots* posed to their exclusion from the means of production. That meant the *haves* faced a common cost that had to be discharged through some form of collective action. This for Marx was the very *raison d'être* of the capitalist state. Organized coercive power was required not only to thwart challenges that defied private property from below, but also to discipline those on top so that none of their members could free ride on the collective expense. There also had to be a check

on predatory and opportunistic practices on the part of the rich and powerful to prevent the undermining of ideological legitimacy, for legitimacy greatly reduced the cost of enforcing private property.

Yet, the decentralized nature of capitalism, the very source of its historical claim for fame, made it an uphill struggle to carry out effective collective action. Overcoming the inherent free rider problem among the *haves* often required that collective costs were palpable enough, posing a clear, immediate danger if they went unaddressed. But, otherwise, classical capitalism entailed little capacity to organize corrective collective action for the costs it externalized, and, arguably, owed its vibrancy to this very fact. In fact, its dynamism rested on its ability to wager its future on borrowed time. By the time collateral damage from production on human and environmental landscape reached calamitous levels, threatening its very viability, the system had to have produced resources at a much higher scale, making it potentially feasible to tackle these collective costs and negative externalities it had generated in its wake. While necessary this was not however sufficient for effective corrective collective action. The right constellation of political forces was the other prerequisite, and that often needed the midwife of a deep crisis to emerge.

Consider education. That it was a privilege of the rich was fine as long as the general level of technology required the average worker to be anything but literate. However, once economic sophistication reached a certain level the potential productivity gains from workers with a basic level of education became palpable, turning the dismal condition of the working class into a badly mismanaged *common pool resource*. But, better management required putting in place a generalized system of public education and that involved a political challenge as it meant among other things the curtailment of child labor. Even the rise of central banking, again the outcome of an effort to address a mounting collective cost as periodic bank panics and failures dotted the landscape at the turn of the previous century, required a political struggle despite its direct benefit to the propertied classes. Whether it was the reduction of the length of the workday or workers' collective bargaining rights, when reforms involved the realm of work the political opposition was even stiffer. It is telling that it took a severe depression and deft political maneuvering by FDR to pass the Wagner Act of 1935 which lent federal legal protection to collective bargaining. Even then, the bill ignored share croppers and other agricultural workers because Roosevelt was afraid the southern Democrats and their constituency the large landlords would derail the bill in the US Senate.

The broader implication of all this is that serving the common interest of the classes the state represents required it to rise above them to be able to impose uniform restrictions on market forces potentially beneficial to all. It was crucial that market restrictions could be imposed uniformly. Because any capitalist who could skirt them could acquire a competitive advantage, the state had to be able to cajole or otherwise discipline wayward members of the *haves* out to benefit at others' expense. Ironically, the emergence of organized labor and universal suffrage has made this easier by increasing the urgency of attending to the collective class interest on the part of the *haves*. In the same vein, the Great Depression and later the Cold War became significant catalysts in the historical rise of the big state. Each in its own way enhanced the state's power to tower above the propertied classes and sectional interests when the long term class interest it represented called for it. This was in a nutshell the dynamic that eventually produced the welfare state and the so-called "mixed economy."

The class truce that made it possible gave rise to a new dichotomy, demarcating two disparate spheres with different logics of their own. "Render unto Caesar the things which are Caesar's, and unto God the things that are God's," Jesus is supposed to have said. In a similar manner now the market had its realm and the State its. Akin to the power drive Caesar symbolized the profit motive of the market was the force that moved the rivers and the mountains, while the State replaced Religion as the steward of public conscience and beneficence, taking on the responsibility of safeguarding human welfare. The dichotomy afforded a policy space to address the common good, supporting a new sense of civic engagement that seemed to transcend class interest. Collective action was no longer synonymous with despotism, but, on the contrary, an exercise in democracy. Workers, who acted as the true guardians of their respective nation-states in both world wars, could now fancy themselves as middle class citizens rather than the dispossessed workers they before were. Citizenship mattered and that was no mere false consciousness. The social wage accounted for a good part of the drastically improved living standard workers enjoyed, comprising a whole array of public services that became their birth right as citizens. More importantly, *voice* bred *loyalty* and *loyalty* supported civil engagement, and that in turn made acting on opportunistic self-interest, at least potentially, a political liability.

In more technical terms, the public investments and services the welfare state used to manage the nation's *common pool resources* were in the nature of *club goods*. The system presupposed a *polity* capable of exercising collective agency, setting out rules that not only restricted behavior that could harm the *commons* but also those that enabled coordination across members. Both voluntary compliance and apportioning the

cost of investing in the *commons* called for a social compact, placing civic constraints on members' access to common resources while excluding outsiders for whom the compact did not apply. A clear demarcation between members and non-members was thus essential, necessitating tight national borders and a strong sense of citizenship which only a deepening democracy could inculcate. Because *club goods* worked - resulting in enhanced labor productivity, economic growth, ideological legitimacy, reduced enforcement costs, etc. - it also paid off handsomely to invest in them for the rich and powerful once the collective action problem was disposed of by the *activist* state. The tacit social accord of the era had the *haves* receive the lion's share of economic gains, but also saddled them with a disproportionate share of the taxes that financed the *club* goods. In retrospect, this was indeed the golden age of capitalism – no one complained about high taxes or big government.

It began to unravel when it no longer paid off to invest in these public services. That was mainly the result of two broad causes. One, the increasing complexity of the international economy rendered the system of financial regulation put in place in the 1930s - another *club good* designed to regulate systemic risk - increasingly cumbersome. Piecemeal deregulation was the easy response in a world where capital's ability to evade national restrictions increased with its international mobility. The alternative called for a much more challenging internationally coordinated revamping of regulation at which the liberal political elite failed – perhaps, for not having tried hard enough. Once deregulation proved politically expedient after Reagan and Thatcher, it quickly snowballed culminating in a cycle of market liberalization and further deregulation that eventually gave rise to globalization as we now know it. But, once national borders became increasingly irrelevant for capital and porous for labor *club goods* could no longer be an effective solution. In a world where it made economic sense to offshore blue collar jobs *en masse* taxes on profits soon became a net burden as the cost of public investments could no longer be recouped easily in profits. The era that managed to reconcile profits and public investment in human welfare was coming to an end. The economic basis of the *club* was no more.

The other problem that contributed to its eclipse, spurring on neoliberal globalization was the squeeze rising labor costs and bargaining power, the result of two decades of high employment, exerted on profits. Along with the diminished threat of unemployment and a strong safety net the market's ability to discipline workers also waned. With increased economic power labor unions' political influence grew. That combined with the rising aspirations of the lower classes pushed to transform the state into an agent of social welfare, generating escalating claims on wealth owners' purse

and causing them to sour on the activist state. The oil price shock and rising cost inflation drew deeper the wedge between the two opposing class interests, making it increasingly harder for Keynesian aggregate demand management to bridge over them. When the Fed wavered in the face of rising price inflation, reluctant to sacrifice employment at the high altar of *sound money*, it lost the confidence of financial markets. That, in turn, rendered monetary *fine turning* all the more ineffective and detrimental to price stability. The ground was set for a political backlash from wealth owners who made the *activist* state their main scapegoat. The *policy ineffectiveness doctrine*, coined at the time by academic economists adept in reading the shifting political winds, captured the new mood and gave it a cloak of scientific respectability. The political shift to the right worked in conquering inflation and helped the Fed regain the confidence of financial markets. It broke the wage-price spiral by cutting organized labor to size, and that in turn provided a fix for the problem of inflationary weakness of the dollar. International policy coordination, the very challenge liberals failed at, ceased to be an issue once the US led Europe in abrogating the post WWII social compact that made it hard to discipline labor. The monetary tightening and fiscal stimulus under Reagan produced a strong dollar and ballooning trade deficits. Yet, unlike before rising US trade deficits no longer undermined confidence. The political reconfiguration that broke the back of labor unions provided all the backing the dollar needed as the increased threat of unemployment proved a better anchor than gold. The crisis of confidence was over. Still, it took about a decade for the new neoliberal world order to come into its own. Eventually, advancing globalization and the triumphalism that ensued after the fall of the Berlin Wall clinched the trend the political shift to the right had set in motion the decade before. As the strong dollar and trade deficits returned in the mid 1990s it became abundantly clear that there was no going back.

As capitalism galloped past the activist state towards globalization in search of its vibrant past, the *common pool resource* problem began to emerge anew. The substitution of private goods for public services now became the preferred alternative solution, eclipsing *club goods*. As the *club* began to fragment, the 'winner take all' ethos of markets also clashed with that of 'social solidarity' inherent in the notion of citizenship, contributing to the steady erosion in the ability to address collective costs and concerns through the normal political process. The basic infrastructure of democracy as embodied in the political machinery bequeathed from the welfare state was still intact, yet it was proving increasingly ineffective in protecting society from the deleterious effects of market expansion. No longer economically functional, democracy was going through a transformation from within driven by the political elite's reinvention of itself as the agent of market reform. Calling its abdication the 'end of

ideology,' the political elite arrived at a new consensus that held that trying to constrain or overrule market forces to attain social ends not only does not work but is counterproductive. The more rewarding alternative was now thought to be a market friendly approach to statecraft that respected the discipline markets imposed. That could also give the government, the liberal elite believed (hoped?), freer hand at promoting public beneficence.

As we now know all too well the tilt toward markets paid off only for those on the very top, neither trickling down much nor benefiting the public purse. But, just as the gap between *haves* and *have-nots* was widening to a level unprecedented since before the Great Depression, the state was at the same time losing its power to discipline wayward sectional interests out to gain at others' expense. More importantly, that also meant that the rich and powerful were progressively losing their ability to exercise collective agency to safeguard their long term collective interests. An adverse dynamic was thereby set in motion that made the pursuit of short-sighted, narrow self-interest the "winning" strategy, despite its long term harm on common interests.

Consider the financial crisis and ponder what interest that was served by the steady removal of regulatory constraints on leverage. In retrospect, we can identify a few fateful decisions that had a decisive effect on the way to financial implosion - such as the prohibition on regulation of over-the-counter financial derivatives like credit default swaps in 2000, among others - and study their idiosyncratic circumstances, but the salient fact remains: each of these were a part of a long process of financial deregulation whose purpose was to enable financial institutions to migrate onto unregulated enclaves so that they could earn higher profits by taking on greater risk. Taking on higher levels of risk became very profitable in part because financial institutions did not have to bear its cost in full. The (private) risk they bore was only a part of the overall risk they took on, the difference being the systemic risk born by the society as a whole. The celebrated revolution in finance worked its magic by making an ever smaller base of short term liabilities support an ever larger volume of long term debt in the financial system as a whole. The inherent higher risk to society this entailed was ignored in the name of market efficiency. Since financial deregulation made the market the arbiter of who bore the risk, the argument ran, it was diversified more efficiently. While it is true that risk was diversified much more broadly than ever thought possible, it took a severe crisis to expose like a bad check the fiction that market liberalization effectively privatized systemic risk.

It might however be misleading to attribute any causal significance to the arguments that gained currency in support of deregulation and market liberalization beyond their role in whitewashing what was happening. It rather appears that the process of deregulation was driven by the opportunities it afforded financial institutions to gain privately at the collective expense, which also incentivized the exertion of undue influence on the political process to speed up deregulation and further weaken public oversight. This is not however the usual story of *moral hazard* where slackened market discipline causes private agents to stray from the economic imperative and their long term self-interest. Because, the lack of market discipline here was not the problem. In fact, what arguably made profit seeking banks to stray from their enlightened self-interest by taking on excessive risk was the economic imperative market discipline imposed on them. Their practices served a broader economic function as well. Stagnant wages and skewed income distribution made borrowed funds from wealth owners through financial intermediation a means by which working class households could escape falling living standards. Financial deregulation facilitated the steady accumulation of debt this process implied, greatly reducing the cost and easing the terms of borrowing for the deficit units. In other words, the market responded quite efficiently to the demand for cheap loans (and for better yielding safe securities on the part of the investors), while competition made it possible to produce them even cheaper over time.

Nor is this an argument of *state capture* by a group of financial oligarchs who enriched themselves by managing to override market forces through political means. While bankers definitely succeeded in enriching themselves and even corrupting the political process, these did not necessarily translate into greater power over, or freedom from, market competition. On the contrary, in the age of ascendant capitalism individual bankers, just like individual corporate leaders, have seen their power *vis a vis* markets erode. The point has been aptly noted by the ex-Labor Secretary Robert Reich: corporate leaders wielded so much more political power over market forces during the era of the welfare state when compared to their pliant subservience to them today. In the era of rising markets the *bottom line* has notably been the real emergent force, compelling each individual capitalist to stick closely to his own narrow, short-term self-interest lest any deviation from it caused his downfall. This has strong implications as it signifies a growing inability on the part of capitalists to act as a class in safeguarding their long-term collective interests. For enlightened self-interest is pushed out of reach when capitalists (and bankers) fail at collective agency, which in turn is the price they have to pay when everyone acts on his short-term, narrow self-interest. Yet, they are

compelled to continue acting myopically as long as they cannot credibly expect others to behave otherwise.

The broader point is that when the potentially harmful effects of market forces on collective interests cannot be proscribed through some form of collective action competition ends up having a pernicious effect exactly when it is working. A downward spiral is then set off when the dismantling of regulation exposes a *common pool resource* to over-extraction (as has been the case with excessive risk taking), where competitive advantage accrues to those who can extract from it more and faster. In more technical terms, deregulation gives rise to a dominant strategy which produces a new socially sub-optimal Nash equilibrium that is characterized by a negative network externality. The mutual restraint that previously prevented this outcome is no longer attainable because whoever continues to self-restrain when others no longer do is in an unviable position. This implies that the supply inducing effect of deregulation works through a social subsidy it provides private producers in the form of freed access to a common resource, the cost of which to society escalates over time however by its progressive degradation. It is then possible that a negative feedback eventually hinders the normal functioning of the system.

One can also alternatively think that the effect of deregulation is to dismantle a rule/sanction designed to prevent some negative 'network-externality-causing' *coordination failure*. Consider the following analogy: as better technology (diversification) makes cars much safer all speed limits are discarded (lifting of constraints on leverage), giving rise to a strong demand for faster cars (cheaper loans and higher debt) which become more profitable to produce. After a brief interval when both consumers and producers seem to be enjoying driving and producing faster cars accidents begin to escalate, locking in everyone in a high risk environment including the remaining cautious drivers whose caution no longer pays off. In this process, the effect of competition is to speed up the traverse to the new sub-optimal Nash equilibrium created by the *coordination failure*, but until that point is reached the temporary improvement in performance can mistakenly be attributed to gains from market efficiency. Once the new equilibrium is reached however there is little escape from its deleterious effects (negative network externalities) unless (or until?) some form of collective action alters the rules and thus the structure of interaction.

The important point is whether the argument can perhaps be generalized to the other salient cases of deregulation in the neoliberal era involving the relaxation of labor and environmental standards. For the ability globalization afforded capital to skirt nationally

proscribed 'welfare-enhancing' restrictions had in a similar manner the effect of drawing a wedge between private and social cost. The broader significance of this divergence for environmental degradation, epitomized by the two dollar T-shirt at Wall-Mart, is usually better understood as it relates to pressing issues such as the effect carbon consumption has on global warming. What is perhaps not as well recognized is the broader connection between financial risk, the environment and labor – for in each case freed up competition has had the effect of lowering the *supply price* by externalizing internal costs, i.e., by making over-extraction of some *commons* possible. Put differently, in all three cases there is some element of a *common pool resource* that is impossible to fully privatize through market reform, and thus deregulation runs the risk of exposing them to over-extraction. This was arguably Polanyi's main insight and the reason why he argued that these common resources which he called *fictitious commodities* required social protection from market expansion which threatened their long term viability.

Clearly, how long it takes for the adverse feedback from an impaired *fictitious commodity* to exert its influence, and how immediate a threat that poses, widely differ. For instance, an unstable regime of financial risk implodes relatively fast as we have just seen, and its effects are swift enough to convince even the most skeptical that they are real. In the case of labor, they might not even be noticeable for a considerably longer period. Notwithstanding their adverse effect on aggregate demand, the divestment in people on the lower rungs of the workforce and the erosion of labor standards in advanced countries might have little immediate economic downside for individual capitalists because of the large reserve army of labor that has opened up with globalization. The chronic shortages of highly skilled labor that is now being felt in some sectors in advanced economies is perhaps a possible exception, not unrelated to the adverse effect increased market uncertainty has on any long term investment in specialized skills. The more consequential impact however appears to be political in the form of the mounting anger among the downwardly mobile population. It remains to be seen if and how much longer the political class will be able to continue channeling this anger into support for further dismantling of the *club* through more market reform, given that the effect is only to ratchet up the popular sense of frustration over time.

Of course, nothing brings to sharp relief the problem of collective agency in the face of an escalating adverse feedback effect from a degraded common resource as does the environmental crisis. How long it would take before a political consensus emerges acknowledging that the ongoing damage we inflict on the environment is not sustainable? When would "normal" life as we know it become impaired in a "palpable" way in the absence of a major course correction? Would the adverse feedback effects

involve a slow enough process such that conceivably we could adjust our behavior myopically every step of the way until we have effectively locked ourselves in a course that will destroy life? That these questions remain open is itself a major statement in itself, and the crucial question is what explains the paucity of corrective collective action in the face of such alarming odds. Beyond the usual recriminations against the short-sighted politicians, often blamed is the difficulty of forging international agreements on how to apportion the costs of addressing global externalities and providing public goods among a multitude of wayward sovereign nation states. While that surely is a challenge, the problem at hand might have deeper roots.

For the inability to organize corrective collective action is reminiscent of classical capitalism, that its main strength involving its ability to self-regulate is also its very weakness when it comes to collective action. One is also uncannily reminded of Marx and his analysis of capitalism – two of his central points, especially resonate. One is his view of competition as a war like process, so at variance with “perfect competition” later economists came up with, and how that militates against coordination (not to mention cooperation) among individual capitalists. The idea in Lenin’s grim re-rendition is as vivid as it is dark where capitalists are envisioned as competing among themselves to sell the rope that would be used to hang them. The second point is the very basis of Marx’s main gripe with capitalism: the two different ways for accounting for economic performance, one, based on profits and the other on human welfare can become deeply divergent. The failure of collective agency ties together the two points. What is profitable at the micro level ends up being at variance with human welfare as well as the long term collective interest of capitalists, because *coordination failure* is not only endemic but a defining characteristic of capitalist competition. Thus, for Marx, it is the failure of collective agency that prevents capitalists from changing their “destiny,” explaining why he thought the “internal contradictions” of the system inexorably would snowball into a generalized, system-wide breakdown. The main idea is that collateral damage from what he called the “law of value” (*read* laws of competition) goes unaddressed until it begins to impair capitalist production (and the society) itself.

That resonates today. Arguably, the very breakdown of the capacity for collective agency in the face of escalating problems caused ultimately by unfettered market expansion and competition is fast becoming the leitmotif of our times. Whether it is the crisis of social protection, environmental or the financial crisis, in each case some mismanaged *common pool resource* is involved, inflicting long run collective costs that we cannot help but ignore because our institutional capacity to organize effective collective action is drastically compromised. There was a time when the welfare state

could successfully enforce mutually binding uniform restraints on market competition, effectively preventing negative network externalities from festering. Citizenship was the key building block of the requisite institutional capacity then. What will it be today? Is democracy and capitalism at logger-heads?