

## Karl Marx

Karl Marx, a converted Lutheran, was born in the German Rhineland to moderately wealthy Jewish lawyer. At 17 Marx entered the university and would soon come to be influenced by the ideas of the philosopher Hegel. Hegelian ideas motivated the critical position taken by Marx, a position which prevented him from securing a university post and would eventually force his move to Paris.

In Paris, Marx interacted with many revolutionary socialist and communist thinkers. During his short time in Paris, Marx developed a friendship with the capitalist Frederick Engels who would later serve as Marx's primary benefactor.

Engels's *The Condition of the Working Class in England* (1844) would become an invaluable source for Marx. In 1848, a politically tumultuous time in Europe, Marx and Engels drafted a statement of principles which they titled *Communist Manifesto*. In the years immediately following its publication Marx moved several times, not always by his own choosing and would ultimately take refuge in London.

It was in London, utilizing the resources of the British Museum, that Marx would draft volume I of *Capital*. Volume II and III were pieced together by Engels posthumously.

## Background for Marxian economics

### Socialist thought

*Capital* sets forth Marx's theory of the development of the capitalistic system. The analysis draws on the social reform movement of the Enlightenment— society can be nurtured to promote the best interests of its members. However, there were two broad views on how this reconstruction might occur.

Continuing the tradition of classical liberalism, one approach maintained that the best interest was served by promoting individual freedom. The other approach drew upon the socialist-anarchist movement. The socialist element contrasted with the classical liberalism on the view of ownership and specifically with regards to ownership of the means of production. The anarchist element shared a view with the liberals on the role of the government— it should be minimal. However, each approach had different motivation for their view on the role of government. The anarchist considered government to be the outgrowth of private property, particularly as an instrument of domination to preserve the political and economic power of the wealthy.

Saint-Simon and Fourier were two influential thinkers of the social-anarchist tradition that emerged in France in the early 19<sup>th</sup> century, both of whom did not support abolishing private property. Proudhon disagreed, asserting that "property is theft."

Robert Owen was a socialist thinker who stepped outside the intellectual arena and attempted to put into practice the principles of a socialist society. Owens purchased two communities for his socialist experiment, New Lanark, Scotland and New Harmony, Indiana. While success was short-lived for both communities, they are interesting examples for what Marx would refer to as utopian socialism.

While Marx agreed with many of the early socialist thinkers on many points, one major point of disagreement was on the ability to bring about a social transformation by appealing to reason. It is not difficult to understand that the wealthy would reject the socialist ideas, but even the workers, according to Marx, were not ready for such a radical shift. It would not be until the evils of the present system

worsened the position of the working class, a process that Marx saw as inevitable, would they be ready for the revolution.

### Hegel's philosophy of history

Hegelian dialectic has its origins in ancient Greek philosophy and later became an important tool of the Scholastics. The basic idea is two people engage in debate, modifying and correcting their arguments until arriving at a third view which incorporates elements of both. Controversy leads to corrective argument and modification until a synthesis emerges in which thesis and antithesis are reconciled. Hegel expanded upon the Greeks by extending the dialectic to a process which motivates change in the universe, not just between individuals. Applying the Hegelian approach to history leads to the following conclusion: knowledge of the past is necessary to foresee and influence the future.

### Ricardian economics

Ricardo's labor theory of value serves as the third source of inspiration for Marx's analysis. According to Ricardo's labor theory of value, a commodity that possesses utility, which is not considered by him to be a cause or measure of value, derives its value from scarcity and the quantity of labor required in its production. While Ricardo stated that scarcity and labor determine value, scarcity matters most when the commodity is not reproducible. Combining Ricardo's assertions that rent is a differential surplus and fluctuations in wages and profits do not affect value combined with his recognition that most commodities are products of labor and can be reproduced, Ricardo concludes that commodities are exchanged in proportion to the labor used in production.

While Smith and Ricardo both relied upon a labor theory of value, Marx differed in that he remained hostile to the system of *laissez faire* and competitive capitalism that his predecessors supported. The labor theory of value was used by Marx as the foundation in his argument on labor exploitation and eventual destruction of the capitalist system.

## The origin, nature, and functioning of capitalism.

### Economic interpretation of history

Marx sought to "lay bare the economic law of motion of modern society." Changes in the mode of production drives social change.

The mode of production in material life determines the general character of the social, political and spiritual processes of life. It is not the consciousness of men that determines their existence, but on the contrary, their social existence determines their consciousness. At a certain stage of their development, the material forces of production in society come in conflict with the existing relations of production, or what is but a legal expression for the same thing, with the property relations within which they had been at work before. From forms of development of the forces of production these relations turn into their fetters. Then comes the period of social revolution. With the change of the economic foundation the entire immense superstructure is more or less rapidly transformed.

The mode of production also serves as an impetus to social change and reflects social relationships inherent in the ownership and use of the material means of production. Contradictions between the mode of production and social relationships drive social change. Herein lies the Hegelian influence on Marx. However, a major point of departure is that Marx saw the arena of conflict as the material world and the social system that exists within it. The conflicts to be resolved, according to Marx, exist between social classes— ruling class versus exploited class.

The economic source of class conflict was also of interest to classical political economists preceding Marx. Ricardo considered distribution to be primary concern of political economy and focused much of his analysis on the antagonism between landlord and capitalists. Marx focused on the conflict between *the bourgeoisie and the proletariat*, land and rent were of less importance for Marx's analysis of the capitalist system.

In attempting to demonstrate the transitory nature of capitalism, Marx isolated the capital-labor relationship, reducing it to its simplest form— exchange. The commodity exchanged between labor and capital is **labor power**. Labor power is the only commodity that labor has to offer for sale. The mode of production typical to capitalism is best understood from looking at the social relationships: the means of production is controlled by the bourgeoisie and the work is performed by the proletariats.

The mode of production involves the technical aspects of production in addition to the social relationships emerging from the socioeconomic, political, and cultural institutions that accompany the given stage of development. The conflict between this superstructure of society and the mode of production remains a key theme in Marx's work.

### Use value and exchange value

On the problem of value, Marx begins by accepting that every commodity has a use value and an exchange value. Use value remains primarily outside of Marx's concern. The relationship between object and person is not a social relationship and thus resides outside the concern of political economy. Exchanging commodities, on the other hand, involves social relationships because every exchange of commodities is also an exchange of labor.

The insistence that a commodity can only have exchange value if it represent embodied labor leads to a distinction between value and price. Much like earlier thinkers, Marx understood labor is not homogenous; however it can be reduced to a homogenous unit.

“Skilled labor counts only as simple labor intensified, or rather, as multiplied simple labor, a given quantity of skilled labor being considered equal to a greater quantity of simple labor.”

A further caveat is needed: only socially necessary labor time contributes to value.

“The labor time socially necessary is that required to produce an article under the normal conditions of production and with the average degree of skill and intensity prevalent at this time.”

Commodities exchange at a rate that reflects the quantity of socially necessary labor each embodies.

### Simple reproduction and expanded reproduction

Like the Physiocrats before him, Marx recognized that production must convert a part of its product into means of production: it must reproduce itself. Both the Physiocrats and the classicists envisioned a system where producers owned the means of production and exchanged their surplus with others to enjoy consumption.

Extended reproduction characterizes an advanced capitalist system differs in that the owners of the means of production employ labor and production is for sale. The bourgeoisie purchase the labor power of the proletariat as a commodity and direct it towards production for the purpose of generating revenue. The difference between the value of the inputs and the value of the outputs constitutes surplus value which supports accumulation, not consumption.

## Summing up Marx's points

Abstinence by capitalists is not the source of accumulation. Profits received by capitalists are not simply a return for capital advanced.

To establish this refutation of classical views, Marx begins by asserting that the purpose of simple reproduction is to satisfy wants and can be represented by C-M-C'. Under expanded reproduction, the objective is to make profit by appropriating surplus value. The capitalist uses money to purchase labor power. The selling price of labor's product exceeds the cost of purchasing the labor power, the differential constitutes the surplus. Extended reproduction is represented by M-C-M': buying in order to sell dearer.

The working day can be divided into the necessary labor to produce subsistence for the worker's family and surplus labor. Marx's concern with the exploitation of labor led him to focus on rate of surplus value.

Rate of surplus value =  $s'/v$ .

Where  $s$  is the surplus value and  $v$  is variable capital

There are three factors which determine the rate at which surplus value can be created: the length of the working day, the productivity of labor, and the basket of goods that constitutes the worker's real wage. To deal with capital, Marx assumed that depreciation from use in production transfers an equal value to the commodity produced.

## Equalization of the rates of profit

In Volume I of *Capital*, Marx relies on competition to equalize rates of surplus value across sectors. In Volume III, edited by Engels and published posthumously, argues for the equalization of rates of profit instead of rates of surplus value. The rate of profit is defined as the ratio of surplus value to total capital outlay.

Rate of profit =  $\pi' = s/c+v$  where  $c$  is constant capital

While equalizing rates of profit is more realistic, it implies that a commodity will sell at its cost of production rather than its labor value. The problem here is in transforming values into prices, a problem that Marx himself recognized.

"It would seem therefore, that here the theory of value is incompatible with the actual process, incompatible with the real phenomena of production, and that for this reason any attempt to understand these phenomena should be given up."

Marx offered a solution as well, the market transforms values into prices that differ from labor values. In the aggregate, at the industry level, surplus value is determined according to the organic composition of capital or what we call capital intensity.

*Organic composition of capital*

$$K = c/(c+v)$$

Let's consider a numerical example to help understand the transformation of values into prices. Assume 5 industries. Total capital across all industries is the sum of constant and variable capital, here it is  $390c + 110v = 500$ . Each industry is assumed to have 100 units of total capital, for example industry 1 has 80

units of constant and 20 units of variable capital. Industries 5 and 4 are the most capital intensive while industries 3 and 2 are the least capital intensive.

All 5 industries have a rate of surplus value ( $s/v$ ) equal to 100 per cent.

Part of the constant capital is used up in production and becomes congealed in the commodity. The value of the commodities is the socially necessary labor time  $c'+v+s$  and is presented in column 6 of table 1 and column 4 of table 2. If each industry sold their commodities at a price equal to values, then they would have different rates of profits as shown in last column of table 1.

Competition ensures a uniform rate of profit and will redistribute the surplus value, totaling 110, across the industries. Redistribution ensures that each industry will receive a uniform rate of profit, which in this example works out to  $110/500=.22$  or 22%.

Profit equalization implies that products will be sold at the **price of production** =  $c'+v+s+d$ . where  $d$  is the deviation of values from prices that yield constant rate of profit and is presented in the final column of table 2. To rescue the labor theory of value, Marx accedes that individual commodity prices may vary from value, but in the aggregate, he notes that, socially necessary labor explains value: summing  $d$  across industries gives a value of 0.

### Capital accumulation and the falling rate of profit.

The rate of profit is more important to capitalists than the rate of surplus value.

The uniform rate of profit will cause prices to deviate from values.

The redistribution of surplus value is determined according to industries stock of constant capital, not variable capital which is the source of value. How capital accumulates, thus, is a relevant question. The original source of capital funds, according to Marx, is what he describes as primitive accumulation. The period of primitive accumulation in England occurred in the 15<sup>th</sup>-16<sup>th</sup> centuries. The demise of feudalism freed the proletariat: freed them to sell their labor.

The spoliation of the church's property, the fraudulent alienation of the state domains, the robbery of the common lands, the usurpation of feudal and clan property, and its transformation into modern private property under circumstances of reckless terrorism, were just so many idyllic methods of primitive accumulation. They conquered the field for capitalistic agriculture, made the soil part and parcel of capital, and created for the town industries the necessary supply of a "free" and outlawed proletariat.

Accumulation continued after the primitive era; however, the source changed to surplus value.

Accumulation brings with it increased mechanization, altering the organic composition of capital. The problem for the capitalists is that the relative reduction in variable capital reduces the rate of surplus value. It is from this recognition that Marx deduces the tendency for a falling rate of profit.

Technological advance displaces labor. Workers who have been freed by machine power constitute the industrial reserve army of the unemployed. The reserve army depresses wages, serving to maintain surplus value.

### Capitalist crisis

Most classical economist assumed away the possibility of crisis by their acceptance of Say's law. Marx rejected Says law, correctly asserting that it only pertained to a barter economy of the C-M-C' variety. In a capitalist economy, money is necessary to start production and getting more of it remains the ultimate goal of capitalist production.

## Monopoly capitalism

Marx's analysis sought to demonstrate that capitalism cannot expand indefinitely. *En route* to the inevitable proletarian uprising and consequent revolution would be the centralization of capital. The expansion of finance enables concentration of ownership of the means of production to a few producers. During this phase, ownership of capital and the entrepreneurial function are divorced. Concentration, according to Marx, intensifies the contradictions inherent in capitalism and strengthens the forces that lead to revolution.

"Centralization of the means of production and socialisation of labor at last reach a point where they become incompatible with their capitalist integument. The integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated."

## Concluding thoughts

Marx built upon Ricardo's labor theory of value and derived political implications of it by utilizing a Hegelian interpretation. At time of its publication, the Austrians were pushing hard for subjective utility theory of value. Moreover, Marx's rejection of the classical paradigm marginalized his contribution, at least until monopoly and unemployment among other contributions became so prevalent, they could no longer be glossed over.

The reliance on socially necessary labor has been criticized heavily and correctly so; however, there is no doubt that the way in which he used the labor theory of value, ascribing economic breakdown to internal insufficiencies was revolutionary.

Marx envisaged a rising organic composition of capital, rising faster than the output of consumption goods. Stable economic growth in the Marxian model requires proportionate expansion of both capital and consumption good industries. Surprisingly, modern growth theorists have recently established a very similar result.