BUSINESS CYCLE THEORY
Selected Texts 1860–1939

Volume II

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Edited by
Harald Hagemann

VOLUME II

Structural Theories of the Business Cycle

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INTRODUCTION

In contrast to the highly aggregated frameworks adopted for theoretical business cycle analysis in the post-Second World War literature, many of the important contributors to the Continental European debate on business cycles in the interwar period chose analytical frameworks which allowed a representation of the interaction between disaggregated production structures of the economy and macroeconomic fluctuations. Seminal work on structural theories of the business cycle had been done by the Ukrainian economist Mikhail I. Tugan-Baranovsky (1865–1919) who took Marx's schemes of reproduction as the major starting point for his work on economic crises and who viewed cyclical fluctuations as an integral part of capitalist development. In his Magister dissertation *Industrial Crises in Contemporary Britain* Tugan-Baranovsky (1894) was the first author to base a theory of cyclical growth on Marx's reproduction schemes, only published (in volume II of *Capital*) in 1885. Tugan-Baranovsky also used Marx's theory to organise his detailed empirical analysis of the crises of the British economy since 1825. Soon after the German edition of *Industrial Crises* was published in 1901 Tugan-Baranovsky's analysis of cyclical fluctuations began to provoke a lively discussion among the leading theoreticians of the Social Democratic Party in Germany, including Rudolf Hilferding and Rosa Luxemburg, and also had a strong impact on economists in Continental Europe, for example Arthur Spiethoff (Germany), Knut Wicksell (Sweden) and Albert Aftalion (France). Its readership grew with each translation, and it to some extent influenced Dennis Robertson in England, who wrote a review article of it after a French translation of the second Russian edition was published in 1913.

We therefore begin this volume with the theoretical core chapters: I, 'The Causes of Crises in the Capitalist Economy' and VIII, 'The Industrial Cycle and the Causes of the Periodicity of Crises', both taken from the German edition which became so influential.[1] This edition is based on the second, fully revised Russian edition (1900), and was written in German by the author, who in his introduction points to the synthesis he intends between the doctrines of classical economics and those of Marx in Volume II of *Capital*. Tugan-Baranovsky first clearly distinguishes between partial

1 Excerpts from Part II (Chapters I, V, and VI) of the third Russian edition (1914) have been translated into English as 'Periodic Industrial Crises', *Annals of the Ukrainian Academy of the Arts and Sciences in the United States*, 1954, pp. 745–802. For a detailed analysis of Tugan-Baranovsky's contributions to economics, see Amato (1984).

and general overproduction and between a barter and a monetary economy. He then demonstrates that a redirection of productive activity across different branches is necessary when a change in the overall rate of economic growth, even with constant technology, takes place. He shows that when technical change is introduced as well (he analyses the case of an increase in the 'technical composition of capital', which amounts to an increase in the degree of mechanisation) the insights obtained from analysing a change in the overall rate of growth with constant technology can be extended to cover the case of changing technology as well. Both unbalanced growth and the distinction of different stages in the adjustment process are established here as an important component of an analysis of the transition to a higher rate of economic growth.

Another important point which was forcefully argued by Tugan-Baranovsky, and for which his analysis became best known, was the relative independence of investment activity from the demand for final consumption goods.

> Comparison of the simple reproduction of social capital with its reproduction on an expanded scale enables us to draw the highly important conclusion that in the capitalist economy, demand for goods is, in a certain sense, independent of the total volume of social consumption: the total volume of social [final] consumption can fall at the same time as total social [final] demand for goods is rising, absurd as this may seem from the standpoint of 'common sense' (Tugan-Baranovsky 1901, p. 25).

Emphasising the Marxian statement that 'the *real barrier* of capitalist production is *capital itself*' (Marx [1867] 1954, p. 250), Tugan-Baranovsky denies the possibility of underconsumption crises (see also 1904, pp. 277ff.). The thesis that 'underconsumption' is the most important cause of economic crisis is decried as 'utterly wrong' (1904, p. 279). According to Tugan-Baranovsky, this holds for all underconsumption theories whether developed by Sismondi, orthodox or revisionist Marxists or contemporary bourgeois economists. Although he also refutes Marx's theory of the falling tendency of the rate of profit, he sticks to the Marxian view that capitalist accumulation is an end in itself. 'Accumulate, Accumulate! This is Moses and the prophets' (Marx [1867] 1954, p. 558), that is, capitalists derive utility from the mere possession of capital and its expansion. Tugan-Baranovsky is thus an adherent of the Marxian (and with some modifications, also of the later Keynesian) view of the accumulation process, in which investment decisions dominate and can be taken as partially independent of individuals' time preferences. This contradicts the neoclassical view according to which the individual saving/consumption decisions dominate the course of events and investment is regarded as a medium for intertemporal distribution of consumption.[1]

The analysis of investment behaviour allows Tugan-Baranovsky to extend Marx's critique of Say's Law into a fully-fledged analysis of a credit economy. In a credit economy, investment gets an element of relative independence from the evolution of social consumption and thus provides the basis for overexpansion of capacities in certain sectors of the economy. Because of relative rigidities in adjusting allocation patterns and productive capacities to the requirements of the disproportionate growth process of an expanding economy, and to adjust to situations where misallocations become apparent, brings with it the possibility – and, indeed, likelihood – of economic crisis. The economic crisis is itself the mechanism which – with economic and social losses – brings about a readjustment of 'proportions' – the adjustment of productive capacities to the pattern of social demand – which, together with adjustments in the financial sphere and in income distribution, provides the basis for renewed capitalist expansion. It should be noted that Keynes (1930, p. 89) found himself 'in strong sympathy with the school of writers ... of which Tugan-Baranovsky was the first and the most original' who based their theories of the credit cycle on fluctuations in fixed capital investment.

Tugan-Baranovsky presents a full and consistent picture of the business cycle in a capitalist economy. A credit economy is prone to instability. The high degree of interdependence of industrial activities and the snowball effects working both through credit links and expectations formation processes could easily lead to a scenario of *general* overproduction. Tugan-Baranovsky, like many other cycle theorists of his time and in later years, relates an upswing to the increased rate of production of new fixed equipment and he observes, again like many others, that there are particularly severe fluctuations in the activity levels of the capital-goods-producing industries.

At the beginning of an expansion, activity is concentrated in the heavy capital goods sector which is characterised by long gestation periods. Economic activity then moves increasingly towards the provision of 'working capital' to utilise the new capacities once they have been installed; finally, and to some extent simultaneously, production in consumer goods industries has to expand to satisfy the increasing demand derived from increased employment levels, and the industries also have to respond to the changing expenditure patterns which result from rising real incomes. Tugan-Baranovsky traces the slowdown of the expansion process and the emergence of first partial and then general overproduction back to the inability of a capitalist economy to adequately undertake the structural adjustment required by the disproportionate industrial growth pattern that is to be followed by the economy in the course of an upswing. In particular, the relative rigidity of fixed capital and long construction periods are the causes of that inability.

1 For an excellent comparison of Tugan's 'bubble' with the conventional neoclassical bubble, putting emphasis on these totally different views of the capitalist accumulation process, see Mainwaring (1995).