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20 September 2009

Online at <https://mpra.ub.uni-muenchen.de/19169/>
MPRA Paper No. 19169, posted 13 Dec 2009 11:45 UTC

Financial crises and cyclic development according to the approach of Paolo Sylos Labini

Marcella Corsi and Giulio Guarini¹

Abstract

In his “Le prospettive dell’economia mondiale” (“Prospects for the world economy”) of 2003 Paolo Sylos Labini analyses the real and financial factors of the American economy and expresses pessimistic forebodings on the future economic trends in the USA and other parts of the world which, in the light of the events occurring as from 2007, can now be seen to have been justified. The aim of this paper is to provide his ideas with a place in the present debate on the American financial crisis and, to this end, the paper is divided into three parts. To begin with we will delineate the approach taken by Paolo Sylos Labini in examining the links between the financial system and economic system, highlighting the classical, Schumpeterian and Keynesian elements contained in it. We will then turn the focus on the four key elements of financial crisis according to Sylos: income distribution, innovation, market forms and debt sustainability. Finally, we will recall some considerations by Sylos on the three themes central to the present debate on the American crisis, namely the rate of interest in monetary policy, the role of the managers, and expectations.

Keywords: Paolo Sylos Labini, financial crises, cyclic development

JEL code: G01, B50, O10.

1. The main characteristics of cyclic development

All Paolo Sylos Labini’s considerations on the origins of financial crises are formulated within the theoretical/empirical framework of analysis of economic development. He defines his as an “integrated approach” (micro-macro),² since it emerges from an original combination of classical, Keynesian and Schumpeterian elements.

Cycle and development

Sylos applies the Schumpeterian term *cyclic development* to indicate “ economic development whose dynamics follow cyclic trends” (Sylos Labini, 1984a). According to Sylos “for Schumpeter «the cycle is the

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² This original operation of synthesis appears by no means obvious, nor immune from possible questioning; in fact, Sylos himself writes: “Thus we have much to gain if we combine certain elements of Keynesian analysis of effective demand with some parts of the Schumpeterian analysis of technological progress and cyclic development of the economy. If we reread the fiercely critical review of the *General Theory* that Schumpeter wrote shortly after its publication (1936) and if we reconsider the reason why Schumpeter rejected the aggregate analysis in the *Business cycles* (pp. 43-4 e 144), a thesis such as we offer here may seem surprising. Let us remember, however, that after the Second World War Schumpeter toned down his criticism considerably” (Sylos Labini, 1984a, p.107). In a note he adds “In the course of economic theory which I followed in 1949 when I was at Harvard as researcher, Schumpeter dedicated two lectures to the models of Keynesian derivation based on interaction between the multiplier and accelerator; he illustrated them taking a cool but not hostile attitude; indeed, he appeared to consider them analytically useful, albeit only at an auxiliary level, to account for short cycles (Kitchin), as proposed by Metzler in 1941.” (Sylos Labini, 1984a, p.107)

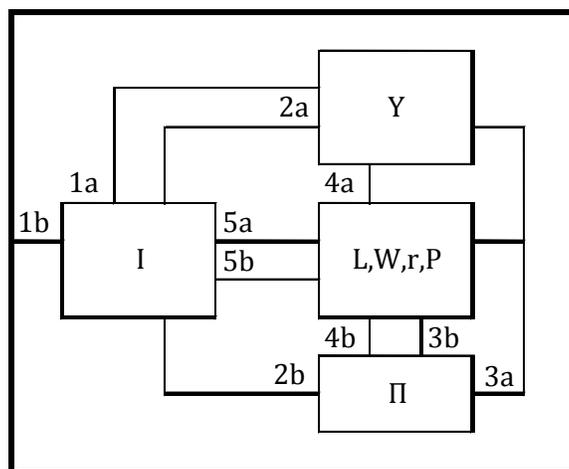
form that economic development takes on in the age of capitalism»” while “ models of Keynesian derivation, .. concern the cycle as such.” (Sylos Labini, 1983).

“[There is need for a] far more vigorous revival of the Schumpeterian construction, thus gradually contributing to a change in the incredible situation of economic theory, where the static approach still predominates, in a period that sees all sorts of technological and organisational innovations creating constant upheavals in economic life.” (Sylos Labini 1990, p. 458)

The key elements affecting cyclic development are, according to Sylos, innovations, forms of markets and income distribution, which condition the dynamics of the main economic variables, i.e. productivity, income, employment, prices and wages.

Let us analyse cyclic development starting from a general, summary scheme in which the variables shown are investments I , income Y , wages W , rate of profit r , prices P , labour productivity Π and employment L . The scheme assumes oligopoly as the market form predominating in the economic system.

Figure 1



(1) The theoretical starting point of the process is represented by investments, which are the main force for development. According to Sylos, from the point of view of causes, investments can be *autonomous (a)*, or *induced (b)* if made under economic pressures arriving from increase in income.

(2) From the point of view of effects, investments as aggregate of two components, one “of development” in the sense of acting mainly to increase productive capacity and so, according to the multiplier principle, to generate income **(a)**, the other “of efficiency” insofar as they serve to save labour and so specifically to increase productivity **(b)**.

(3) Sylos’s productivity function combines the principal forms of secondary innovations (as compared with Schumpeterian innovations) as he conceived of them. The increases in productivity derive from impulses exogenous to the economic system (A) and from endogenous impulses due to income (Y) through the static and dynamic economies of scale (*Smith effect (a)*), absolute cost of labour (cost of labour per unit of product, B) which gives rise to organisational innovations (*organisation effect (b)*), and the relative cost of labour (difference between wages and prices of machinery, D) which induces efficiency

investments in machinery (*Ricardo effect*) **(b)**.³

$$(i) \hat{\Pi} = A + \alpha\hat{Y} + \beta\hat{B} + \delta\hat{D} + I$$

(4) Increases in income and productivity have contrasting effects on the labour market: the former driving in the direction of increased employment and so more power to the unions **(a)**, while the latter, reducing employment, tend to weaken the workers' bargaining power driving towards reduction in wages **(b)**. In this phase the fundamental variables are the cost of labour per unit of product and prices. To clarify this line of reasoning further, let us consider an equation and two identities. The first equation concerns the formation of prices – according to the principle of full cost – in industry, which is the sector Sylos takes for reference since its dynamics condition the development process of the entire economy.

$$(ii) P = v + \mu v$$

in which P is price, v is the component of variable costs (cost of labour per unit of product, cost of raw materials, cost of energy) and μ is the proportional margin applied to cover the fixed costs and obtain profit. The first identity refers to the functional distribution of income

$$(iii) 1 = \left(\frac{W}{\Pi} \frac{1}{P} \right) + (A + Z),$$

where W is the money wage, Π is labour productivity, Z is the share of profits and A is the share of costs other than labour (fixed costs and variable costs such as raw materials, energy, etc.). The second identity is based on the decomposition of Z

$$(iv) Z = \frac{K}{Y} r$$

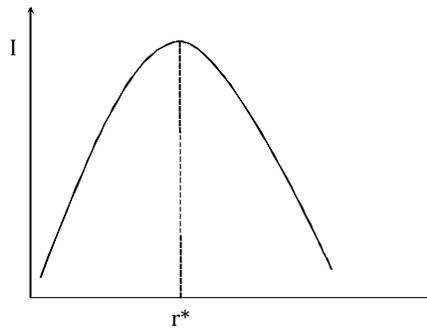
where K is the nominal value of the capital advanced and r is the rate of profit, or in other words the ratio between profits and capital.

In general pursue objective $\hat{W} < \hat{\Pi}$ to increase profits of the share of profits, while the unions aim at having $\hat{W} > \hat{P}$ (which may entail $\hat{W} > \hat{\Pi}$) to increase purchasing power for consumption goods. Sylos analyses the trend in the rate of profit starting from the rate of optimal wage.

(5) The wage rate has a twofold effect on investments: a “demand effect”, in that growing wages stimulate consumption thereby, thanks to the accelerator principle, encouraging investments **(a)**, and a “profits effect” in that, *ceteris paribus*, increasing (decreasing) wages limit (raise) profits **(b)**. Taking into consideration the cost of labour per unit of profit and thus $[(W/\Pi)]$, then the wage rate is optimal for development when the CLUP is stable; in this way consumption increases thanks to growing real wages and increase is also seen in the investments introduced by the steady share of profits. Thus we have a compromise between the demands of the unions and the demands of the employers.

³ For further discussion of Paolo Sylos Labini's productivity equation, see Corsi and Guarini (2007).

Figure 2



Thus the *optimum* turns out to be $\hat{W} = \hat{\Pi}$ since the positive effect on investments is maximised thanks to increased consumption with minimisation of the negative effect that a drop in the share of profits might have on investments maintaining a steady rate of growth in the share of profits, with final positive effect on aggregate demand. There are, however, exceptions to the *optimum* $\hat{W} = \hat{\Pi}$: it is possible to have an *optimum* (from the point of view of the equilibrium affect on aggregate demand) with $\hat{W} > \hat{\Pi}$ if the other factors of costs are reduced (A) and with $\hat{W} < \hat{\Pi}$ if foreign demand and/or public expenditure increase. With $\hat{W} = \hat{\Pi}$ we have steady share of profits Z and this entails, capital-gains ratio being equal, a steady rate of profit r (equation *iv*). Thus, for development the need is to maintain profits at an optimal level, with neither positive nor negative excesses.

“Profits are the petrol of the capitalist car: without them, the car stops, but it also stops if there is too much petrol as the engine gets flooded” (Sylos Labini 2004a, p.89)

Actually, the optimal rate of profit is to be seen rather as the range of rates since every sector has its own specific optimal value: “[...] in some activities it can even be zero, since these activities would not be performed at zero profit and the means of production used in the activities could be put to more advantageous uses for the economy as a whole.” (Sylos Labini 1984a, p.245) In this case the optimal is of a dynamic type since it relates to processes of development and thus quite distinct from static optimum analysis in mainstream studies.

“Economists have long discussed a series of «optimums» of a static type – beginning with the issue of the optimal allocation of resources (for the economy) or of specific means of production (for a firm); far more important than the these, however, are the «optimums» of the dynamic type”. (Sylos Labini 1984a, p.246)

Key elements

The elements characterising cyclic development are, according to Sylos: innovation, market forms and income distribution. The various interactions between these elements generate the various dynamics of development and decline.

What emerges from the scheme in Figure 1 is a development that by its very nature is cyclic precisely because of the alternation of phases in which, from the point of view of investments, the development effect prevails **(2a)** and, from the point of view of wages, the demand effect **(5a)**, and phases in which, due to the possible detriment to profits in the previous phase, there prevail efficiency investments **(2b)** and the profit effect of wages **(5b)**.

There are two important aspects to the interaction between innovations and income distribution. The first has to do with the way the fruits of technological progress are distributed: with $r < r^*$ they go mainly into wages, while with $r > r^*$ they are absorbed into the profits. On the other hand, with $r < r^*$ the innovations are mostly in the fields of technology and labour organisation, when in a prolonged $r > r^*$ situation the innovations become primarily of a financial type. With regard to the interaction between forms of market and innovation we may also add that a social division of labour works in the direction of product innovations that entail the formation of differentiated oligopolies, while a technical division of labour tends towards process innovations with consequent formation of concentrated oligopoly. Finally, the interaction of forms of market with income distribution entails diverse trends in the real CLUP. According to Sylos, the prevailing situation in a competitive goods market is $r \leq r^*$, while a situation with an oligopolistic market of goods and weak unions (prices and wages rigidly low) entails $r > r^*$.

The various forms of markets can also influence the effects of productivity increase on the other economic variables. Broadly speaking, in competition the increase in productivity reduces the price and so $\left(\frac{W}{\Pi} \frac{1}{P}\right)$

remains constant, while in oligopoly, if productivity increases due to the introduction of plant or machinery accessible only to the big firms, these firms do not cut their prices and thus increase profits and/or wages, while if there is only an increase in prices, then the big firms can maintain their privileged position investing yet more, thereby obtaining ever greater rates of growth in productivity. In both competition and oligopoly the increase in productivity boosts the real gains, the former with a reduction in prices, the latter with an increase in the growth rate of the nominal income. Closely bound up with the question of oligopolistic markets is the of price dichotomy issue: according to Sylos, the most competitive sectors (the sectors of agriculture and raw materials) exhibit greater elasticities than the oligopolistic sectors (the secondary and tertiary sectors), and in the field of labour, where increasing skills see a differentiated oligopoly taking form, the elasticities decrease.⁴

To sum up, in his approach Sylos combines classical, Schumpeterian and Keynesian elements.

	Keynes	Schumpeter	Sylos Labini
Theoretical Pillars	1. Expectations 2. Consumption propensity 3. Liquidity preference	1. Invention 2. Entrepreneur 3. Banker	1. Innovation 2. Market forms 3. Income distribution

Cyclic development is characterised by the forces of development and decline, with the rate of profit as their key point. The classical economists consider this variable to be essential for an understanding of the dynamics of economic development, since it underlies accumulation. As Sylos points out, Smith concentrates his analysis on surplus profit as an example of the absence of that free competition that would work in the direction of uniformity in the profit rate. In different contexts, Ricardo points out how deficiency in the rate of profit limits capitalistic development.

According to Sylos Labini, the pillars of the Keynesian approach are expectations, consumption propensity and the liquidity preference, and from this approach he draws upon the multiplier principle and the accelerator principle, the “demand effect” of wages (according to which real wages raise income through consumption) and the important role played by public investments and the unions. On the other hand, he criticises this approach in that it takes as secondary Sylos’s three pillars, namely innovation, forms of market and income distribution, while from the Schumpeterian approach it is precisely the idea of cyclic

⁴ Sylos observes that this point does not appear in Keynes’s analysis, where these elasticities are homogeneous in every market with free competition fundamentally prevailing.

development and the role of innovation which he looks to. According to Sylos, Schumpeter's pillars are invention, the entrepreneur and the banker, with the perception that "the inventor is a man of great intelligence, even a genius, but not necessarily a scientist; the entrepreneur is the innovator, the man who realises the potential of an invention and implements it; the banker is the person who finances the whole operation" (Sylos Labini 1984a, p.74). In the case of innovations, there are certain lexical-conceptual differences between Schumpeter and Sylos Labini: the former defines innovations as autonomous (induced) if they are original (improvements in previous innovations), while the latter defines them as exogenous (endogenous) if generated by non-economic (economic) impulses.

Sylos criticises Schumpeter for identifying solely in innovation the *primum movens* of a cycle without considering the driving role of demand and in particular of the role of the State, which are at the basis of Keynes's analysis and which, in Sylos's terms, are defined as public autonomous and private induced. In fact, Schumpeter defines only the innovative firms as "motors", while for Sylos the "motors" exhibit the following characteristics:

"[...] (a) production and productivity increase more rapidly than in the other industries, to the extent that the relative prices tend to diminish; (b) the relative incomes — especially wages and profits — tend to grow; and (c) employment tends to increase more than in other industries". (Sylos Labini 1991, p.320)

The Schumpeterian scheme has to be readjusted to account for the scenario in the aftermath of the Second World War, with dominant positions growing in the markets.⁵ Nevertheless, a form of competition remains within oligopoly where the agents are large firms and the competitive tools are increasingly complex.⁶

2. The real dynamics of the financial crisis

According to Sylos, financial crises find a place in the process of development in that they represent the main consequence of the persisting inequality $r > r^*$. We will go on to construct an analytic scheme stylising the major mechanisms that can bring about a financial crisis, and consequently economic crisis, within cyclic development. This scheme seems to us to have general validity since, although the main references are to the crisis of '29 and the present crisis, which Sylos analysed in depth, and they are crises which, again according to Sylos, also have features in common with the Asian crises of the 1990s.

Similar phenomena [to the crisis of '29] occurred in Japan as from 1993; the crisis had serious repercussions in various countries of Asia, including Indonesia and the so-called Asian tigers, with the exception of Taiwan, which had deliberately put a brake on the growing relations with Japan to avoid tensions with China. The main preconditions of crisis were similar: progressive rise in profits, wholesale

⁵ "The third stage of capitalism is defined by the Marxists as the stage of monopolistic capitalism and by Schumpeter as the stage of trustified capitalism. Personally I prefer to define it as the stage of oligopolistic capitalism. In this stage the Schumpeterian triad loses importance: the individual inventor is ever more frequently replaced by a scientist or group of scientists working in the laboratories of big companies and in public laboratories; the function of the banking system changes, due also to pressures of public spending and the expansion of government securities; and as a rule the innovations do not come in with a host of imitators, but are ever more often implemented by firms already existing. Entry is more difficult" (Sylos Labini 1984a, p.78).

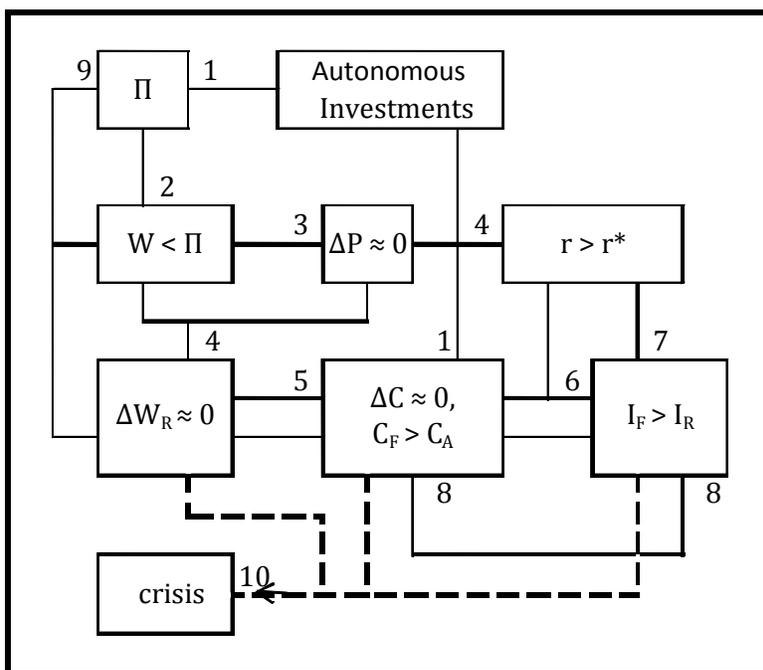
⁶ "This does not mean that competition disappears: what does tend to disappear, outside agriculture, is atomistic competition; on the other hand, the "competition that counts" is growing ever keener than it used to be; it is «the competition created by new goods, new technologies, new sources of supply of raw materials, new types of organisation (for example, the large control unit)» (Schumpeter, 1942, p. 84; trad. it., p. 80). According to Schumpeter, in our times the innovating firm can be large or small but, given the superiority of the large firm in terms of financial resources and the possibility to organise research laboratories, "the competition that counts" tends increasingly to be that of the large firms, while the small firms are increasingly driven to the sidelines. (Sylos Labini 19901, p.449)

real estate and stock exchange speculation, and eventually a great crisis revolving around the banking system; [...] The crisis also hit South America and the developed countries, but not too hard, thanks also to the financial interventions of the governments of Japan and the United States, and indeed of the International Monetary Fund. Effectively, having been halted in time, financial crisis did not degenerate into lasting real crisis. (Sylos Labini 2000, pp.76-77)

The basic idea is to trace out some schematic relations that encapsulate Sylos' ideas on financial crises, his aim being to offer not definite forecasts but, rather, theoretical bases upon which assessments of probability might rest:

“[...] in economics, unlike astronomy, precise forecasts are not possible, were it only for the fact that certain variables depend on decisions that cannot be predetermined; we can only formulate previsionsal hypotheses or assessments of probability, indicating the bases upon which such assessments are made”. (Sylos Labini 2002a, p.1).

Figure 3



(1) As we have seen, autonomous investments raise labour productivity and by virtue of the multiplier drive income and consumption upwards: in '22, the first of the years leading to the crisis of '29, they involved electricity, automobiles, radio and the press, and in '93, the first of the years leading to the present crisis, they involved information technology, electronics and telecommunications.

(2) In terms of dynamics, bargaining weakness on the part of the unions leads to a rate of wages falling increasingly lower than the rate of productivity. In the case of the '29 crisis, according to Sylos, the weakness of the unions resulted from the anti-union policies then pursued:

“it was only in the time of Roosevelt, in 1933, that the right to strike was recognised and subsequently, in 1935, with the Wagner law, full union freedom; after 1933 wages

became rigid on the downward side and flexible on the upward” (Sylos Labini 2004a, p.90)

In the case of the present crisis, on the other hand, Sylos attributed the weakness of the workers in Western countries to international competition and excessive labour flexibility.

“[...] in years of weak development or stagnation a high level of flexibility means a falling level of real wages, with negative effects on the growth of consumption. A...] the very high level of flexibility in that country [the United States] tends to generate contrasting drives harming all. (Sylos Labini 2004a , p.135)

(3) Oligopolistic firm positions keep the prices of industrial goods steady, and the prices of agricultural goods and raw materials slightly decreasing due mainly to a reduction in demand. According to Sylos prices today are in general more rigid on the downward side than at the time of the '29 crisis, since oligopolistic positions have been reinforced in all the sectors while the public support for agricultural prices is particularly strong.

(4) All this entails two effects: a rate of profit above the optimal $r > r^*$ and stable real wages. The above normal profits of the large oligopolistic firms are in part transformed into

“very high salaries which the executives award to themselves. In a world dominated by great oligopolistic complexes these salaries do not serve simply to reward the performance of people endowed with considerable or even exceptional capacities, nor indeed are they correlated with «marginal productivity» aspects of their performance; actually, these salaries incorporate part of the surplus profits of oligopoly and serve to qualify the “status” of the executives: thus they become almost, as it were, a «necessity» of the system. If all the big corporations follow a – from this point of view – collusive line of behaviour, then the share of oligopolistic surplus profits channelled this way can grow large indeed”. (Sylos Labini 1992, p.269-270)

(5) Lack of growth in purchasing power and a decreasing quota of wages hamper growth in consumption and fiscal policy has hardly proved helpful. In fact, with reference to both crises he points out that “with regard to consumption, we must recognise the fact that distributive inequality has grown thanks to fiscal policy favouring the rich; and while military expenditure increased, social spending decreased.” (Sylos Labini, 2004b, p.18)

According to Sylos, increasingly unfair income distribution has been supported not only by fiscal policies, but also by a cultural process thus inclined, that has made the situation socially possible.

“It is to be noted that, as in the 1920s and in the last 10 years in the United States, the watchword in Italy is «enriches vous!»: the paradoxical aspect is that the poorer categories do not seem to have many objections to this trend, or fashion; far from detesting the rich, the poor seem to admire them, fascinated by the idea of becoming rich themselves; and this, I believe, is the only way to explain how fiscal policies favouring the rich have not come up against significant policy objections in any party. Perhaps judgement of income distribution depends not so much on abstract and immutable ethical criteria of fairness, as on the expectations of the people and, in concrete terms, the functioning of the economy”. (Sylos Labini 2002b, p.1)

(6) Real investments are driven solely by profits and not by growing consumption, which means growing importance for financial as opposed to real investments. According to Sylos, the former take the form of “credits to distributors and consumers, money and deposits in the banks, stocks and shares, and credits to partner and subsidiary companies, while the latter go into “plant, machinery, equipment and

stocks". "[Real investments] generate increase in productive capacity, while [financial investments] serve various functions, such as: preparing resources to finance real investments in a subsequent period; enhancing the firm's «security» – or in other words its capacity to get over awkward situations; increasing the capacity to reap gains, in addition to that dependent upon the production of goods" (Sylos Labini 1992, p.210)

(7) Thus we see a financial market developing, fed by speculation and supported also by the central and private banks.

"The interests involved are of such proportions that the central bank and major banks, taking part in the speculation at times, implement a policy of support which may prove of long if not infinite duration. For these reasons the speculative bubbles do not immediately collapse." (Sylos Labini 2003a, p.269)

Thanks to financial activities this market generates considerable profits, reinvested in the same and since "they are activities that give rise to a redistribution and not an increase in wealth" they are "devoid of any economic function" and so "purely speculative and sterile, or even destructive" and can be considered activities that produce "luxury goods", as termed by Sraffa. (Sylos Labini 1984a, p.246). Effectively, Sylos distinguishes between "productive" and "unproductive" profits, in relation to the development in either case. It is a distinction that looks back to the Classical-Sraffian distinction between luxury goods and goods necessary for the perpetuation of the productive process, between productive and unproductive investments, and between productive and unproductive labour.⁷

(8) Debts have a fundamental role: on the one hand they finance consumption, while on the other hand they support firms still investing in the real. However, Sylos's considerations also extend to the State and abroad; in fact, he takes into consideration four types of debt: public debt, debt of families, of firms, and foreign debt. The relative importance of consumption financed C_F by loans as compared with "autonomous" consumption C_A may keep consumption growing, but it also aggravates the fragility of the economic system.

"The importance of real estate speculation lies in that, in America, it has largely boosted the growth of consumption, which has been the motor of the upturn of the last few years and which would on the other hand have been restrained by the sharp increase in the inequality of income distribution. The drive for increasing consumption derived above all from capital gains, real or hoped for, on the strength of which families were able to obtain bank loans. This explains why the bursting of the real estate speculative bubble has rather more serious effects than a stock market crash." (Sylos Labini 2005a, p. 18)

Sylos considers debts a decisive element for modern capitalism: the process of accumulation underlying development would be unimaginable without resort to debt for part or all of the value of the investment, given that internal financing often fails to cover the entire sum needed. If, during periods of development, debt is in fact a means of development, in periods of crisis it becomes a heavy burden weighing on recovery.

"Thus, while in a favourable economic situation debts translate into expenditure, thereby fuelling effective demand, in unfavourable conditions the debts contracted to

⁷ "The distinction between profits favourable or unfavourable to the development process, like the distinctions between goods necessary for perpetuation of the productive process and luxury goods, and between productive and unproductive investments are linked to the distinction between productive and unproductive labour proposed by the Classical economists a proposed anew in original terms thirty years ago by Alberto Breglia in a short but important article (Sylos Labini 1984a, p.246-247). (??) refers to Breglia, A. 1953, 'Profitti sterili e profitto fecondo', *Giornale degli economisti*, March-April.

pay debts coming to maturity entail a reduction in effective demand, which fuels a negative spiral". (Sylos Labini 2003a, p.273)

For Sylos an element taking on a decisive role for the duration of the crisis is the sustainability of the debt conceived essentially as the negative difference between the nominal rate of interest and nominal rate of income growth; a sustainable situation is one in which an economic agent (private or public) faces a loan cost below the benefit obtained from the investments made on the strength of that loan. Thus the problem touching directly on sustainability is to verify whether the investments (private or public) are productive or unproductive. He starts from the relations set out by Pasinetti (1998):

$$S^p / Y - [(i - g)D / Y]$$

where S^p is the primary budget surplus (net of interest), Y is the nominal gross domestic product, i the nominal rate of interest, g the rate of growth in income, and D the volume of the debt. However, he holds that in order to evaluate the sustainability of the debt it suffices to focus on relation $(i - g)$.

"Taking account of the primary budget surplus and the ratios S^p / Y and D / Y means coming closer to reality considering the capacity of the state or private agents to pay interest, but the substance remains the same. Effectively, starting from the evident consideration that the ratio D / Y remains stable when D and Y grow at the same rate, it will suffice to examine the trend in the difference $i - g$ to judge whether problems will arise in the sustainability of debts, whether private or public". (Sylos Labini 2003a, p.278)

(9) When prices do not fall and wages decrease the endogenous impulses to increases in productivity due to the Smith effect, the Ricardo effect and the organisation effect slacken, autonomous investments alone remaining as principal driving force.

(10) For this reason crisis breaks out when the speculative bubble explodes, effective demand collapses and in general the economic system, no longer centred on the real economy, goes awry. The debts become unsustainable: the public debts call for a reduction in spending or a hike in taxes, or indeed new debts, but at ever higher interest rates (thereby aggravating the unsustainability), while the family debts lead to a drastic fall in consumption, and the indebted firms are obliged to cut their investments. The unsustainability of the debts prolongs and deepens crisis:

"The motor of cyclic development consists in innovations: the greater they are, the broader will be the scope they offer investments, and the longer the phase of prosperity. At the same time, however, the speculative waves wax stronger, the managers' errors become more frequent and the debts grow, their volume conditioning the duration of crisis once the phase of prosperity ceases." (Sylos Labini, 2003a p.268)

All this entails falls in income and employment. As an immediate solution, Sylos proposes a recipe aiming mainly at reduction of debts and fostering growth through a trade policy agreed upon with the other partners.

"It is my opinion that Keynes's recipe does not apply today, since funding deficit spending entails the sale of securities, driving interest upwards; moreover, the increase in demand would also swell imports, thus worsening the foreign debt. The need is in some way to lighten long-term debts and agree upon a policy to launch, with the support of the WTO, a series of trade agreements serving to stimulate reciprocal expansion of the markets: exactly the opposite of the policy adopted by the major governments in the 1930s, and the opposite of the course in America has embarked

upon [...].” (Sylos Labini, 2003a, p.15)

3. Sylos Labini’s approach and the recent literature on financial crises

In our last section here we will be looking at certain original elements in Sylos Labini’s approach relating to various themes discussed in the literature on financial crises: monetary policy, the role of the managers and expectations.

Monetary policy

Looming large in the current debate are theories on the type of manoeuvre that the Central Bank must perform on the interest rate in times of crisis. To put it in a nutshell, based on the quantitative theory of money the monetarist approach considers the optimality of shifts in the interest rate in terms of the quantity of money intended to be obtained for the purposes of a particular inflationary targets, while in the post-Keynesian approach the element conditioning the effectiveness of the level of the interest rate lies in the expectations not only of the firms, but also of the banks. Sylos held a measure of monetary policy to be effective if, taking into consideration the principle of debt sustainability, it determines an increase (decrease) in the difference between interest rate and rate of income growth if the aim is restrictive (expansive). On the monetarist approach he has this to say:

“When, to cope with inflation, the central bank decides to raise the short-term interest rate – the official discount rate – it can achieve its aim if it sets the rate of discount over the nominal income growth rate [...]: only thus can it bring about a reduction in investments, employment and the unit cost of labour while at the same time determining a fall in the demand for raw materials and oil. This, and not the line indicated by monetarism, can curb inflation” (Sylos Labini 2004a, p88)

On the other hand, with reference to the post-Keynesian approach and an expansive monetary policy, he writes:

“[...] the difference (i-g) turns our thoughts to reflect on the Keynesian liquidity trap: the analysis departs from the, albeit important, limits of the monetary sphere – banks and firms – to enter the real economy, in that it affects the income trend. In fact, to avoid problems of sustainability, a zero increase in income would logically speaking call for zero interest, while a reduction of income would call for negative interest” (Sylos Labini...)

Consistently with his entire approach, Sylos deems it indispensable to accompany monetary policy with structural policies vis-à-vis the real economy. For example, the expansive monetary policy that fostered overdevelopment of the financial market entailed a “doped” recovery of the economy in that a very low interest rate, while rendering debts sustainable, reinforced the debt-dependence of consumers in sustaining consumption, given the increasing inequality of income (Sylos Labini 2004a, p.88)

The role of the managers

With regard to the debate on the excessive power of the managers during the tumultuous development of the financial markets, there is in the first place an incisive indictment by Sylos above all from the social

point of view:

“The rapacity and greed of the big managers of our times make Karl Marx’s most scathing descriptions of the capitalists of his time sound like understatements. Not only economic life, but social life as a whole are contaminated.” (Sylos Labini 2002c, p.1)

Moreover, to prevent situations entailing overweening power for the managers and thus inefficient behaviours, Sylos suggests reconsidering the possibility of implementing worker participation in firms:

“Can worker participation drastically reduce the abuses of the big managers? Yes, and for obvious reasons: worker participation prevents barriers between workers and the board of directors - the workers themselves contribute to managing the firm and thus it becomes hard to commit abuses. In all this the market mechanisms remain intact. [...] Worker participation is a matter for the relatively large firms, organised as public companies. Particular forms of worker participation are conceivable for the medium-sized firms, which are often the most dynamic. For the small and very small firms, prevalent in Italy, worker participation is, as it were, in the very nature of things: in a firm of ten people all the workers have, in one way or another, a part in all the decisions.” (Sylos Labini 2002c, p.1)

Expectations and uncertainty

Another point dealt with in the recent literature is the significant role played by expectations and uncertainty in bringing about the onset of financial crisis, and in this respect it is, by analogy, worth seeing what Sylos Labini had to say with reference to Keynes and the crisis of '29. Here Sylos looks to objective analysis of the events and not subjective factors, and consequently, while recognising the importance of expectations, he criticises the Keynesian approach as being excessively “psychological”.

“The issue of psychological assumptions is closely bound up with the issue of expectations: indeed, the latter is part of the former. To avoid any misunderstandings, I must point out that I certainly do not mean to deny the importance of expectations or, in general, the importance of psychological or subjective factors. Nevertheless, if the economist does not mean to encroach on the profession of the psychologist, and wishes to avoid pseudo-explanations that end up by begging the question, he must clarify *why* certain expectations are formed rather than certain others: only if (and to the extent that) the impulses depart from his field of study can he assume them as given externally. The case for criticism arises when expectations are assumed as *primum mobile* or - and this is the most frequent case - when the reasons underlying expectations or other impulses are indicated in vague and generic terms, and not effectively explained.” (Sylos Labini 1984a, pp.256-7)

Sylos sets out to account for a phenomenon by identifying the objective elements and not describing “psychological” elements without the necessary examination, precisely because introduced by an economist.

“He held these factors to be of a psychological nature, which is undeniable; but the issue is a matter of the origin of speculative waves, and simply to put these waves down to irrational expectations is hardly a real explanation.” (Sylos Labini 1991, p.298)

And this led to a different interpretation of the primary causes of the crisis of '29.

“Basically, the boom did not originate in the American stock exchange, as Keynes suggested, from a wave of irrational expectations, but from a huge shift in income

distribution favouring profits. The financial crash that followed that boom had those extraordinary consequences due to the real variables of the economy that we all know, above all production and employment". (Sylos Labini 1991, p.298)

Conclusions

As we have sought to demonstrate, Sylos Labini's observations on financial crises form an integral part of his analysis of the processes of cyclic development. Thus, according to Sylos Labini, the major causes of every financial crisis have to do with the real economy and in particular with the distribution of income, forms of market and innovation. The Sylos Labini approach is an innovative combination of the Classical, Schumpeterian and Keynesian approaches and can offer an original contribution to the present debate on the American financial crisis with respect to three issues: monetary policy, the role of the managers and expectations. Finally, two further evaluations formulated by Sylos Labini are to be taken into account when analysing this crisis:

1. the crisis offers an important opportunity for an understanding of economic realities,

"Paraphrasing the title of a study that brought fame to the economist Kenneth Arrow (*learning by doing*), I would speak of *learning by suffering* since, perhaps, we learn only by suffering. In other words, the lecture I refer to [*Sylos Labini proposes a new Bretton Woods*] can take place after a period of no minor difficulties. We can only hope that it is not a matter of real upheavals". (Sylos Labini 1984b, p.18)

2. economic analysis should be not only logical-theoretical in nature, but also historical; otherwise, it lapses into mere abstraction,

"The various observations I have brought together in my hypothetical fifth approximation belong to a preliminary study of the cyclic process of development in a given country in a given period: Italy after the Second World War, in this case. I am of the conviction that studies of this kind, in which theoretical analysis is chemically combined with historical research, are essential if our aim is not a flight of fancy but endeavour to understand the realities in which we live." (Sylos Labini 1991, p.321)

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