

Political Implications of the Economic Crisis

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I recently wrote a book on the causes of the crisis and Great Recession. In the course of doing so I discovered, to my surprise, that some of what has been said about the underlying causes is factually incorrect. According to a *common* view on the left, the neoliberals lowered workers' share of income and real pay, and this caused the rate of profit to recover, starting in the early 1980s. They say that there was extra profit that *could* have been invested in production, making the economy grow rapidly. But, they say, it didn't happen because the "neoliberal" phase of capitalism is unique; it favors the diversion of profits away from productive investment and into financial speculation. And slow growth led to rising debt and other problems that set the stage for the financial crisis and Great Recession.

But looking at official US government data, I found that

- *The rate of profit never recovered from the fall it experienced in the late 1970s and early 1980s.*
- *The rate of accumulation fell because the rate of profit fell, not because financial investment increased at the expense of investment in production. (The rate of accumulation is new investment in production as a percentage of advanced capital.)*
- *Workers' share of national income has been stable, and their real pay has increased, during the last 40 years.*

The political implications of this controversy are profound. If "neoliberal" policies and increased exploitation have led to a substantial recovery of profitability, a persistent fall in profitability is not among the underlying causes of capitalism's latest economic crisis, and the crisis is then an *irreducibly* financial one, caused by the "financialization" of capitalism and macroeconomic difficulties resulting from it, and by more immediate financial-sector phenomena.

This thesis implies that we can prevent the recurrence of such crises by doing away with "neoliberalism" and "financialized capitalism." It is unnecessary to do away with the capitalist system of *value production*. It also implies that what the crisis has put on the agenda is the need for financial regulation, Keynesian policies, and perhaps nationalization, not a change in the character of the socio-economic system.

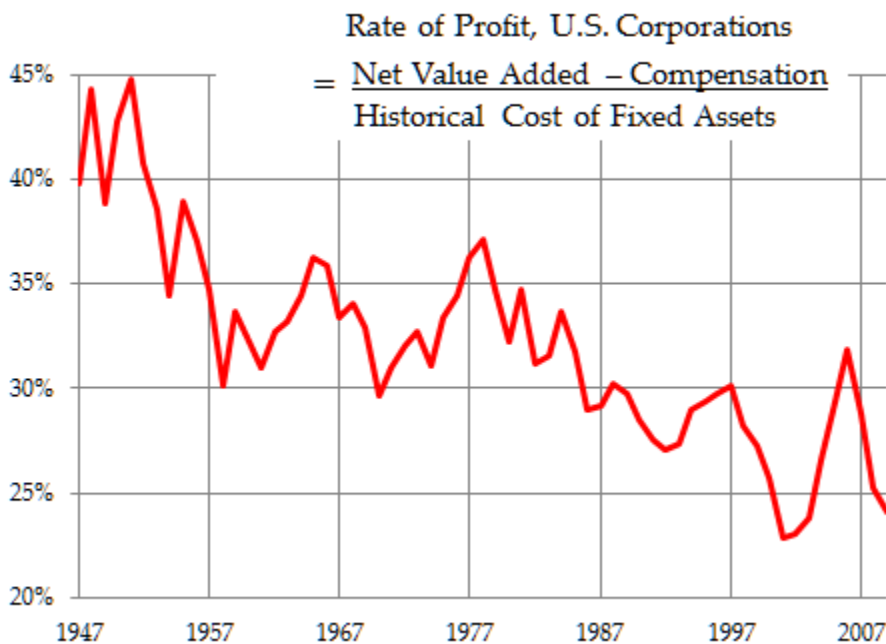
If, on the other hand, the crisis is instead a systemic crisis resulting from the underlying tendency for the rate of profit to fall, then such reforms will at best only delay the next crisis. Moreover, while the immense buildup of government debt that has taken place has delayed the day of reckoning, by providing temporary artificial stimulus to the economy, it promises to make the next crisis worse when it comes.

Both sides of the controversy agree that a sharp decline in the growth of output and GDP

began in the mid-1970s and has more or less persisted ever since. And there's general agreement that this relative economic stagnation, in the U.S. and elsewhere, set the stage for a massive debt buildup that in turn contributed to the length, severity, and continuing effects of the Great Recession.

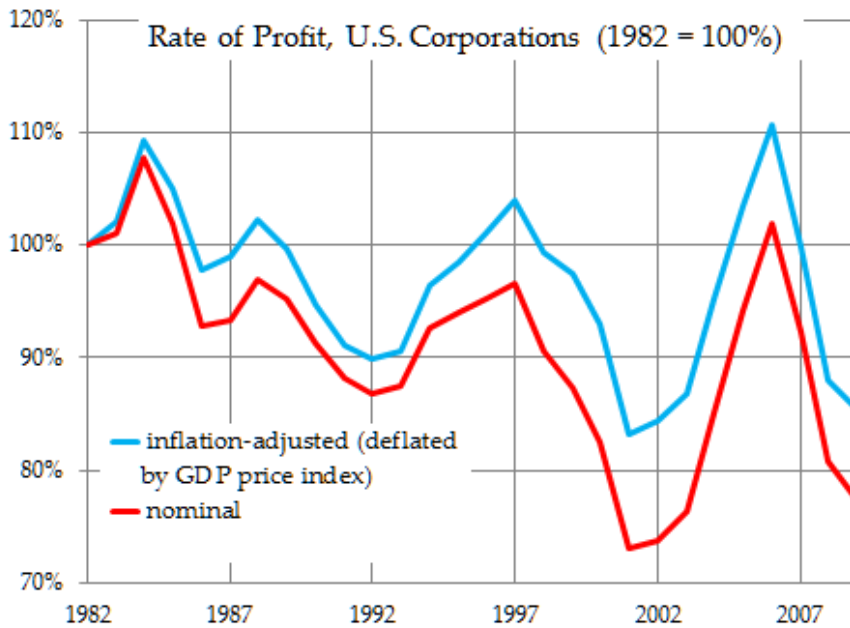
But what caused the relative stagnation? The most **obvious** explanation, and therefore the explanation that is *prima facie* the most **plausible**, is that the rate of profit fell and failed to rebound significantly after the early 1980s; the persistent fall in the rate of profit produced a persistent fall in the rate of capital accumulation; and the fall in the rate of accumulation led to sluggish growth, rising debt burdens, etc.

Evidence for the United States indicates that this obvious and plausible explanation is in fact correct.

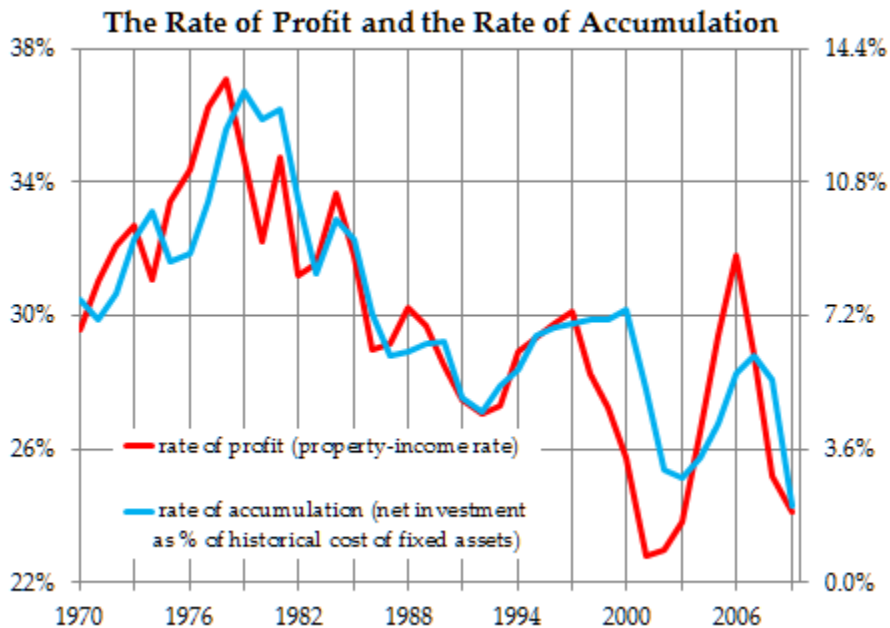


This graph shows movements in U.S. corporations' rate of profit. A broad measure of profit is used here--the share of corporations' net value added that their employees do not receive. This rate of profit has continued to fall since the early 1980s.

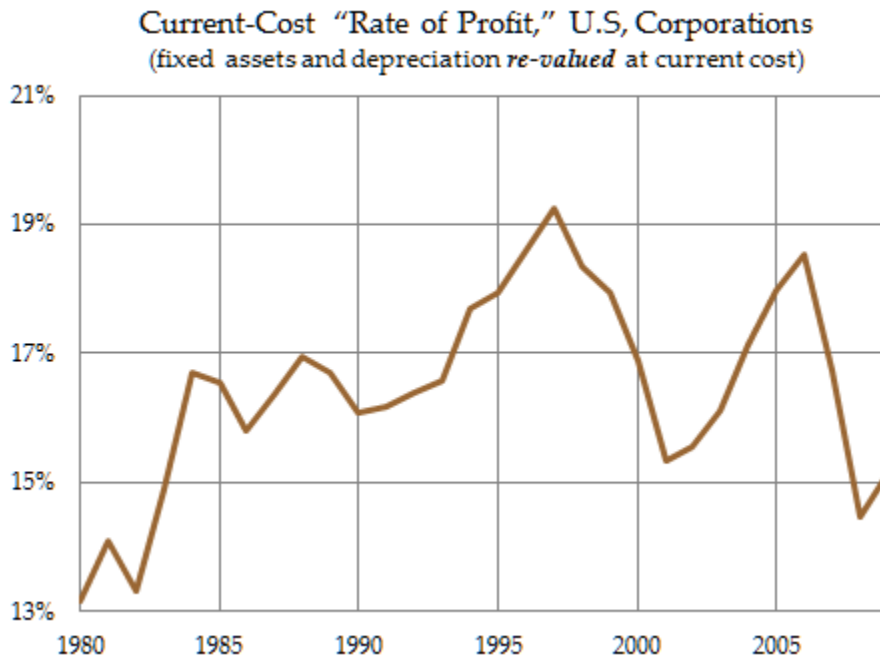
The next graph shows that this conclusion remains true even after adjustments for inflation are made.



And here's an extremely important graph. It shows that the rate of accumulation fell **because** the rate of profit fell. Over the last 40 years, the rate of accumulation has tracked the rate of profit quite closely. Changes in the rate of profit account for 82% of the changes in the rate of accumulation. The relationship between them is clearly no fluke. There's been a relative decline in **investment** of profit in production because there's been a relative decline in the **generation** of profit.



One reason why these conclusions contradict some common beliefs on the left is that some economists use the term “rate of profit” to refer to something that **isn’t** a rate of profit in any **normal** sense. They compute the so-called current-cost (or replacement-cost) “rate of profit,” which is profit as a percentage of the amount of money that businesses would currently need to *replace* their capital assets. However, what almost everyone else—businesses, investors, Marx—means by “rate of profit” is the historical-cost rate, profit as a percentage of the amount of money actually invested in the past to purchase the capital assets (their historical cost), minus depreciation. That’s what business people care about, how much extra they get back compared to what they actually invested in the past.

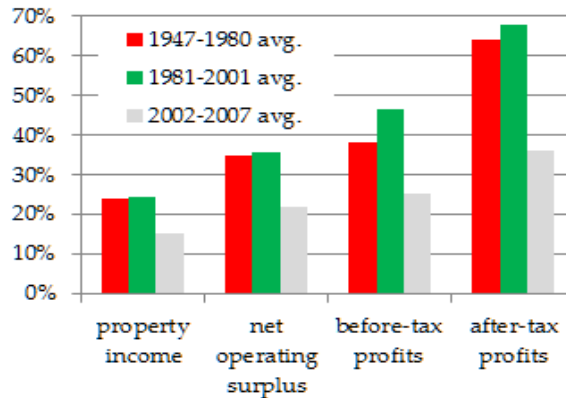


Whereas, as we saw above, the actual rate of profit continued to decline, the analogous current-cost “rate of profit” did rebound to some degree. But it’s not a rate of profit in any real sense, so the fact that it rose doesn’t matter. And the fact that it rose *while the rate of accumulation fell* is strong evidence that it doesn’t function like a rate of profit; businesses investment decisions aren’t based on it.

And actually, the trend in this so-called “rate of profit” also stopped rising after 1984.

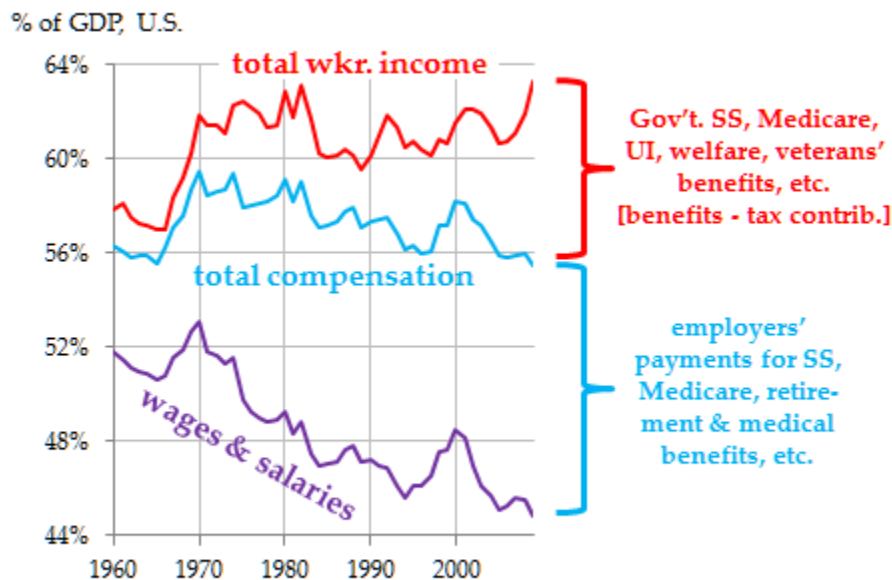
Another respect in which my conclusions contradict some conventional wisdom is that some economists have stressed that the share of profit that has been accumulated, put back into productive investment, has fallen since the 1980s. This is technically correct, but extremely misleading. What happened is that, no matter what measure of profit one uses, the share of profit that was accumulated was actually higher during the 1st three decades of “neoliberalism,” 1981 to 2001, than the share that was accumulated during the earlier part of the post-World War II period.

Capital Accumulation (Net Investment in Fixed Assets), as % of Profit, U.S. Corporations



There was then an abrupt fall in the six years prior to the crisis, which seems to have been caused partly by a huge temporary rise in profits and partly by the fact that there was a lag between this rise in profits and the subsequent rise in investment. In any case, through 2001, at least, there was no neoliberal diversion of profits away from productive investment and into financial instruments.

The third surprising thing I found has to do with compensation of workers. In 2008, John Bellamy Foster and Fred Magdoff published an article in Monthly Review which showed that wages and salaries fell from 53% of gross domestic product in 1970 to about 46% in 2007. But this is very misleading.

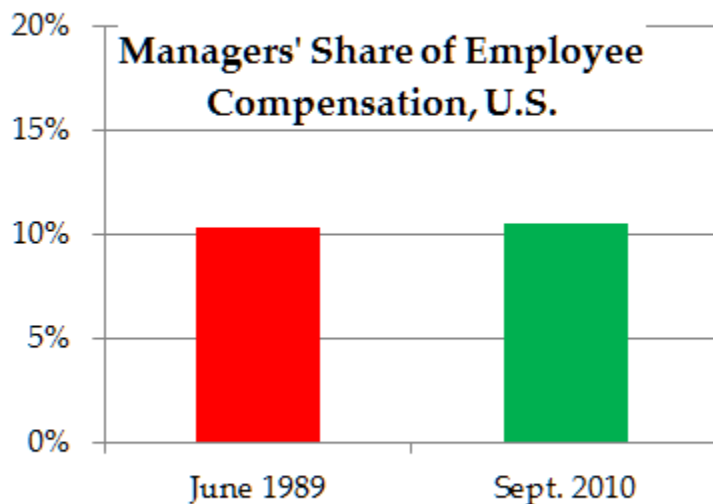


It leaves out the Social Security and Medicare taxes that employers pay, retirement benefits some of them pay, etc. All this is part of employees' "total compensation." Since the U.S. population is getting older and living longer after retirement, and since health-care costs are rising especially quickly, these additional components of total compensation have increased faster than wage and salary income. In effect, workers are drawing less of their total compensation now, and saving more of it for when they're older.

Also, the government pays a lot of "social benefits": Social Security, Medicare, unemployment insurance, welfare, veterans' benefits, etc. The net social benefits (benefits minus the tax contributions that partly pay for them) have increased much faster than wage and salaries.

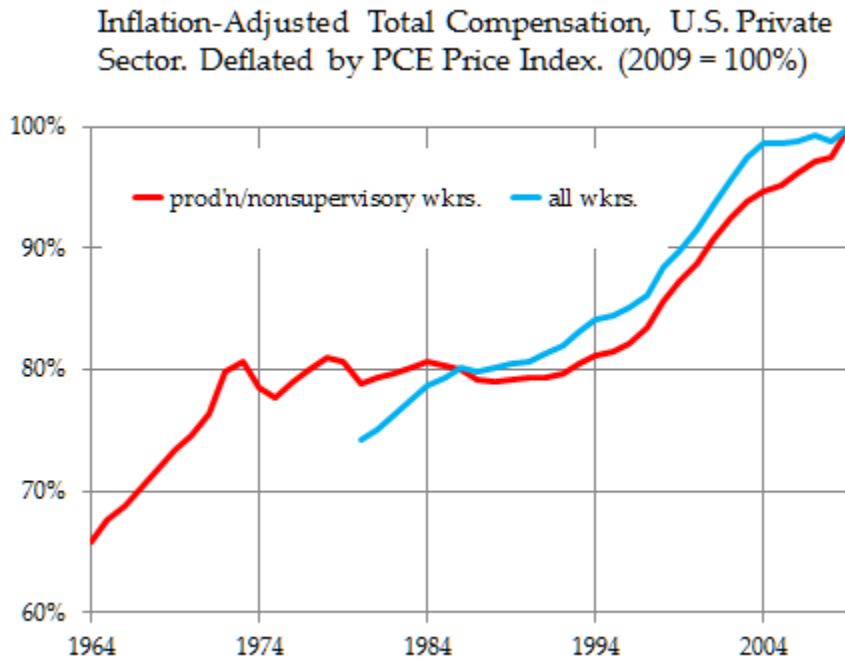
When all this is factored in, we see that employees' share of the country's income has not fallen since 1970, and it's a good deal higher than in 1960.

Now, some of these employees are managers. One might think that compensation of employees has remained a stable share of total income because of huge increases in the compensation that managers' receive, while other workers' compensation has fallen. But this seems not to be the case. My estimates, from U.S. government data, indicate that managers' share of all compensation hardly increased at all during the last 21 years (and the government's categories don't count as managers people like those that McDonald's calls managers but who are involved in the preparation and serving of what it calls food.)

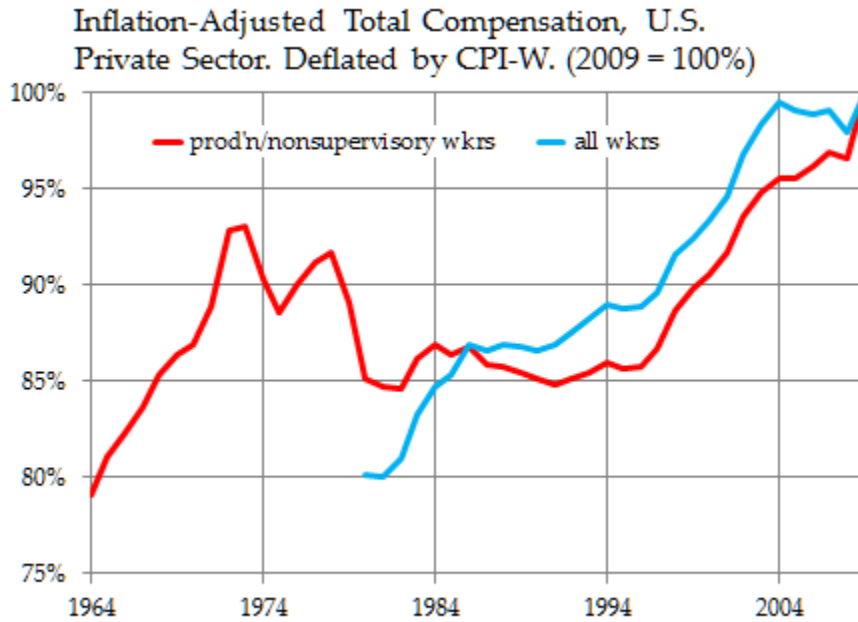


The next two graphs show that if we look at workers' **total** compensation, not just wages and salaries, their real—inflation-adjusted—compensation has **risen**, not fallen. It is higher than at the start of the 1980s, and it's also higher than during the 1970s.

Here's what we get by using the personal consumption price index to adjust for inflation.

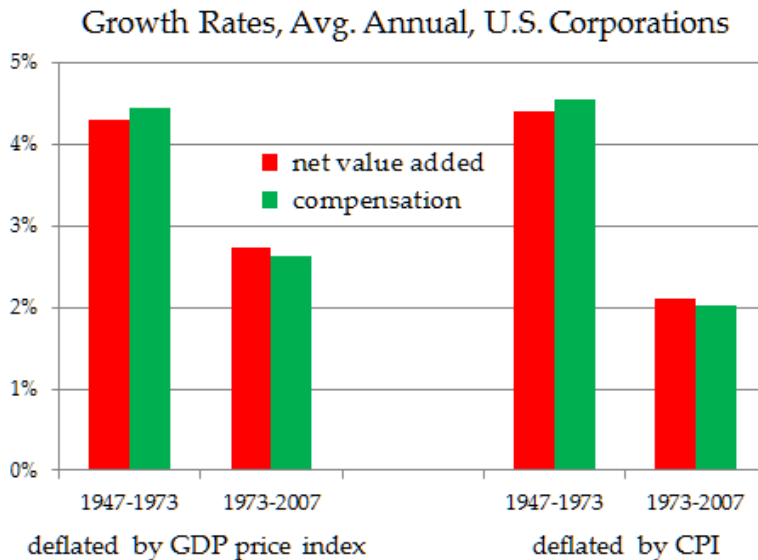


And here's what we get when we use the consumer price index.



I do not mean to imply that working people are living well. They aren't. But the reason they aren't living well doesn't have to do with the alleged but nonexistent decline in the share of national income they receive.

It has to do with the relative stagnation of the economy, the slowdown in growth of GDP and in corporations' contribution to GDP, their "net value added." The degree of slowdown in the growth of employees' compensation is almost exactly the same as the degree of slowdown in the corporations' net value added.



To conclude: As we have seen, the economy has been sluggish for decades, owing to the falling rate of profit and the fall in the rate of accumulation that resulted from it. And these problems—rather than a fall in working people's share of income, are what led to slower growth of pay.

This suggests that "share the wealth" struggles operate under strict limits. During the last several decades, the wealth has not been there to share; and the latest economic crisis greatly exacerbated this problem. Of course, struggles can succeed that protect workers' standard of living. Even struggles to force capitalists to provide pay increases comparable to those that workers' received in the early post-World War II period can succeed. *But they cannot succeed without causing the rate of profit to fall further than it has fallen already.* And if it falls further, the system will be even less stable, even more prone to severe crises and recessions that threaten to turn successes into failures.

Thus, working people need to be aware—and intellectuals need to help them be aware—that when they help themselves by fighting to protect their standard of living, they are hurting the capitalist economy, not helping it. If they are not aware of this, they will not be prepared for the obstacles they will face. Nor will they understand why their efforts to better their lives meet with such fierce and deeply-rooted resistance. It isn't the case that what's good for working people is what's good for capitalist America; and the only way to get beyond this contradiction the only is to replace capitalism with socialism, a people-based socioeconomic system. There are no lasting victories short of this.