

A Crisis of Capitalism

(not neoliberalism, “financialized capitalism,” or low wages)

To be presented at “The Economic Crisis and Left Responses” conference,
Pace University, New York City, November 6, 2010

Andrew Kliman, October 18, 2010. Revised version: October 27, 2010.

Introduction

On the Left, a popular view of the underlying causes of the latest economic crisis and slump holds that

- there has been a substantial recovery of the rate of profit since the early 1980s;
- this recovery has been brought about by “neoliberal” (free-market) policies and especially by a fall in workers’ real pay and decline in their share of national income;
- yet economic growth has been sluggish, and the rate of capital accumulation (productive investment as a share of advanced capital) has fallen, because a new regime of “financialized capitalism” has arisen, in which the massive profits have been used to acquire financial assets, not invested in production; and
- the latest crisis and slump are rooted in this process of financialization, and in the buildup of debt that papered over the sluggish growth and falling pay.

This paper will show that the first three points are factually incorrect. *The rate of profit never recovered from the fall it experienced in the late 1970s and early 1980s. Workers’ real pay has increased and their share of national income has been stable. And the rate of accumulation fell because the rate of profit fell, not because portfolio investment increased at*

*the expense of productive investment.*¹ Thus the fall in the rate of profit is a key indirect cause of the sluggish growth, debt buildup, and the crisis.

The political implications of this controversy are profound. If “neoliberal” policies and increased exploitation have led to a substantial recovery of profitability since the early 1980s, a persistent fall in profitability is not among the underlying causes of capitalism’s latest economic crisis and the Great Recession. Thus, the crisis and recession are *irreducibly* financial phenomena, caused by the “financialization” of capitalism and macroeconomic difficulties resulting from it, as well as by more immediate disturbances in the financial sector.

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, activist fiscal and monetary 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 now taking place may also delay the day of reckoning by providing temporary artificial stimulus to the economy, it promises to make the next crisis worse when it comes.

¹ The rate of accumulation is the growth rate of the capital that is invested, i.e., current investment (minus depreciation) as a percentage of the total amount of capital invested in the past (minus depreciation). Since the rate of profit is profit as a percentage of the total capital invested in the past (minus depreciation), the rate of accumulation is equal, by definition, to the rate of profit times the fraction of profit that is invested. The rate of profit is therefore a key determinant of the rate of accumulation. If the fraction of profit used for investment is roughly constant, the rate of accumulation will rise and fall by roughly the same percentage as the rate of profit. It is therefore reasonable to expect the rate of accumulation to track the rate of profit.

My analysis will focus on the U.S., since data for other countries are nowhere nearly as complete, and they are often not very reliable. The claims made by those with whom I take issue in this paper are also based largely on the U.S. experience. Since the U.S. is the epicenter of the crisis—since, in other words, the crisis erupted elsewhere because it first erupted in the U.S. and then spread—the relative lack of discussion of other economies does not reduce the adequacy of the paper’s analysis of the long-term economic difficulties underlying the crisis.

The Rate of Profit and the Rate of Accumulation

Relative economic stagnation since the mid-1970s, in the U.S. and elsewhere, set the stage for a massive debt buildup and the latest crisis (see Kliman 2010a). But what caused the relative stagnation? The most *obvious* explanation, and therefore the explanation that is *prima facie* the most *plausible*, is this:

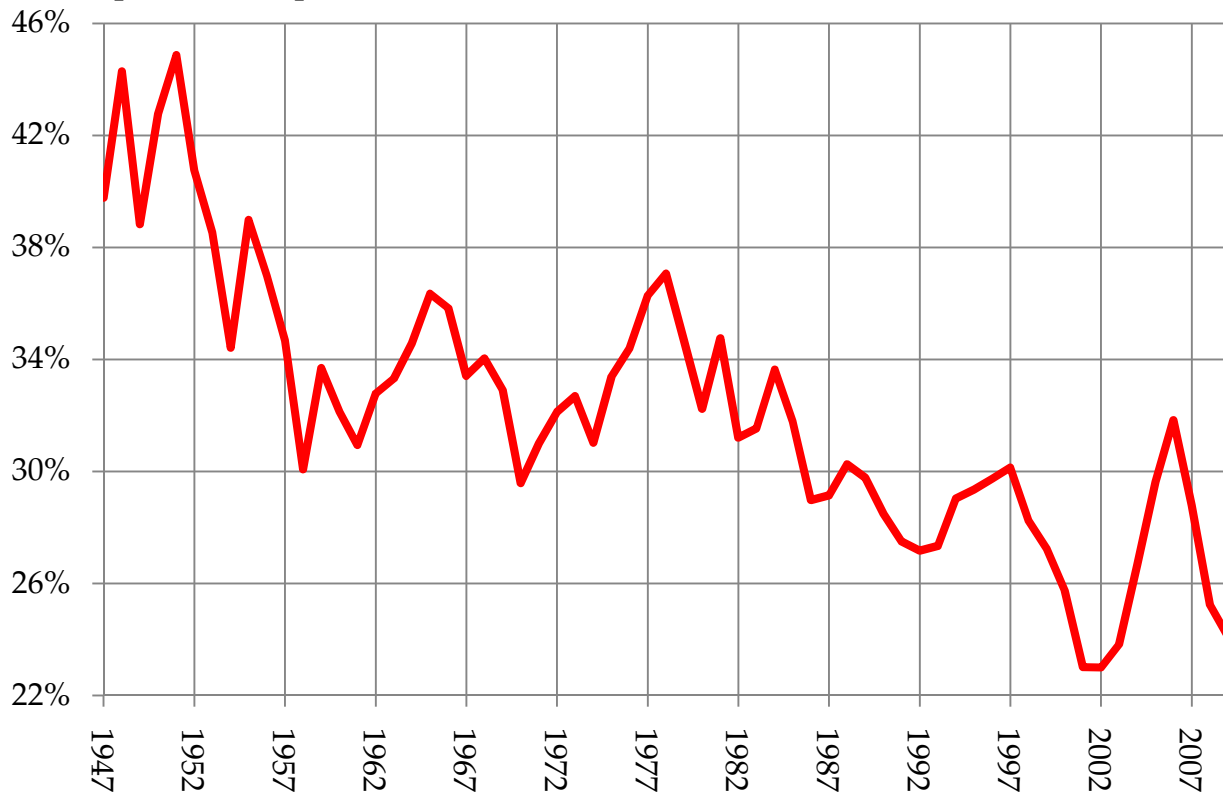
- A. the rate of profit fell and failed to rebound significantly following the recessions of the mid-1970s and early 1980s;
- B. the persistent fall in the rate of profit produced a persistent fall in the rate of capital accumulation; and
- C. the fall in the rate of accumulation led in turn to sluggish growth of per capita GDP, corporations’ output, and compensation of employees, as well as to rising debt burdens, and so on.

However, Michel Husson (2009, 2010), Gérard Duménil and Dominique Lévy (2004), and other radical and Marxist economists have rejected this explanation. They have argued that the “neoliberal” phase of capitalism has a distinctive “regime of accumulation” that has supposedly favored diversion of profits away from productive investment and into financial speculation. But as I will now show, using official U.S. government data, their view is not

supported by the facts. The evidence indicates that *the most obvious and plausible explanation is in fact correct.*

Point C is not controversial—Husson and Dumenil & Levy largely agree with it—so I will limit myself to discussion of points A and B. Figure 1 depicts movements in corporations’ rate of profit. The measure of profit used here, which I call “property income,” is a proxy for what Marx meant by “surplus-value.” It is the share of corporations’ output (net value added) that their employees do not receive. It has continued to fall since the early 1980s. And the same result holds true when other measures of profit (net operating surplus, before-tax profits) are used.²

Figure 1. Property Income as Percentage of Historical Cost of Fixed Assets, U.S. Corporations (depreciation valued at historical cost)



² The after-tax rate of profit has also trended downward, but only slightly. See note 2, below, for definitions of these variables. See the Appendix for data sources and discussion of computations.

Adjustment for inflation does not substantially affect this conclusion. After adjustments for inflation are made, the rate of profit continues to trend downward after 1982, just as its unadjusted counterpart does (see Fig. 2).

Figure 2. Property Income (with depreciation at historical cost), as Percentage of Historical Cost of Fixed Assets, U.S. Corporations

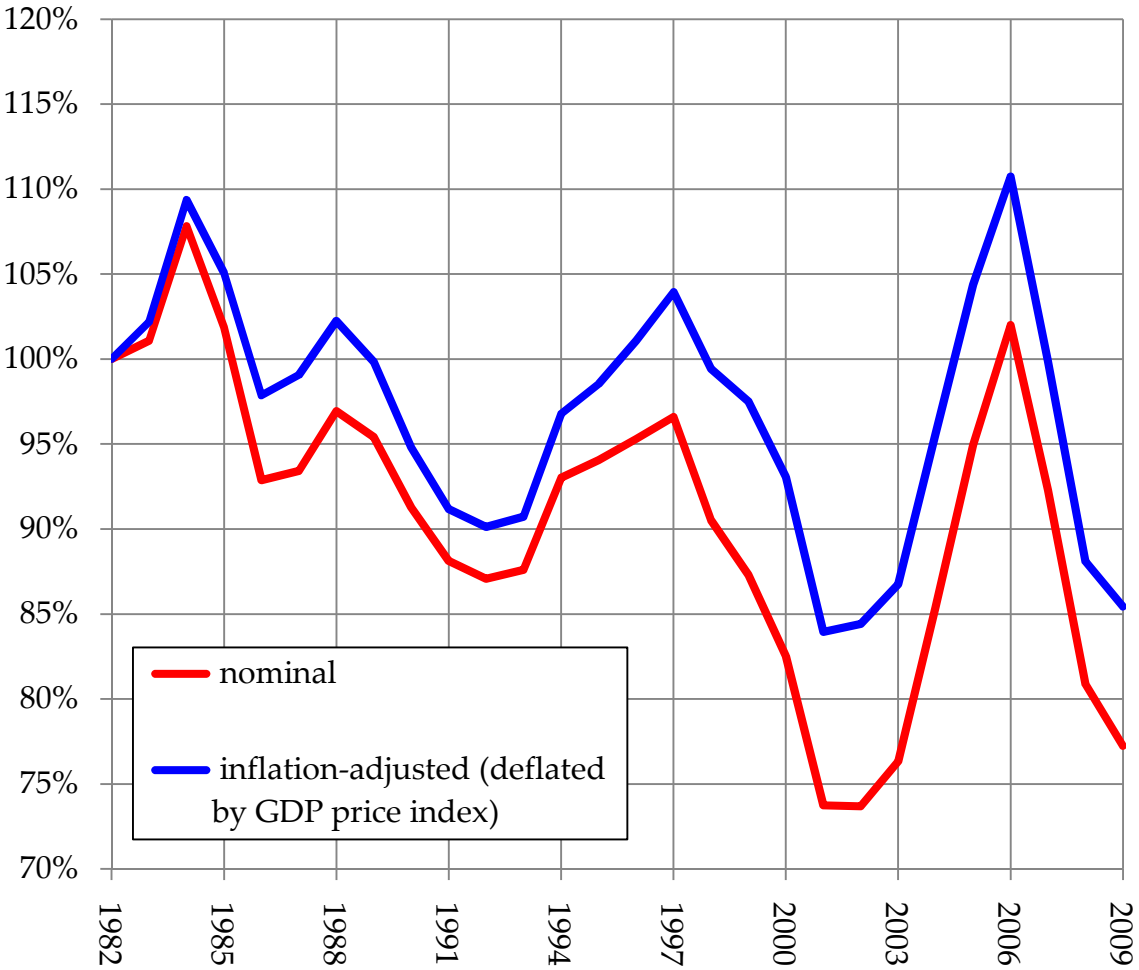
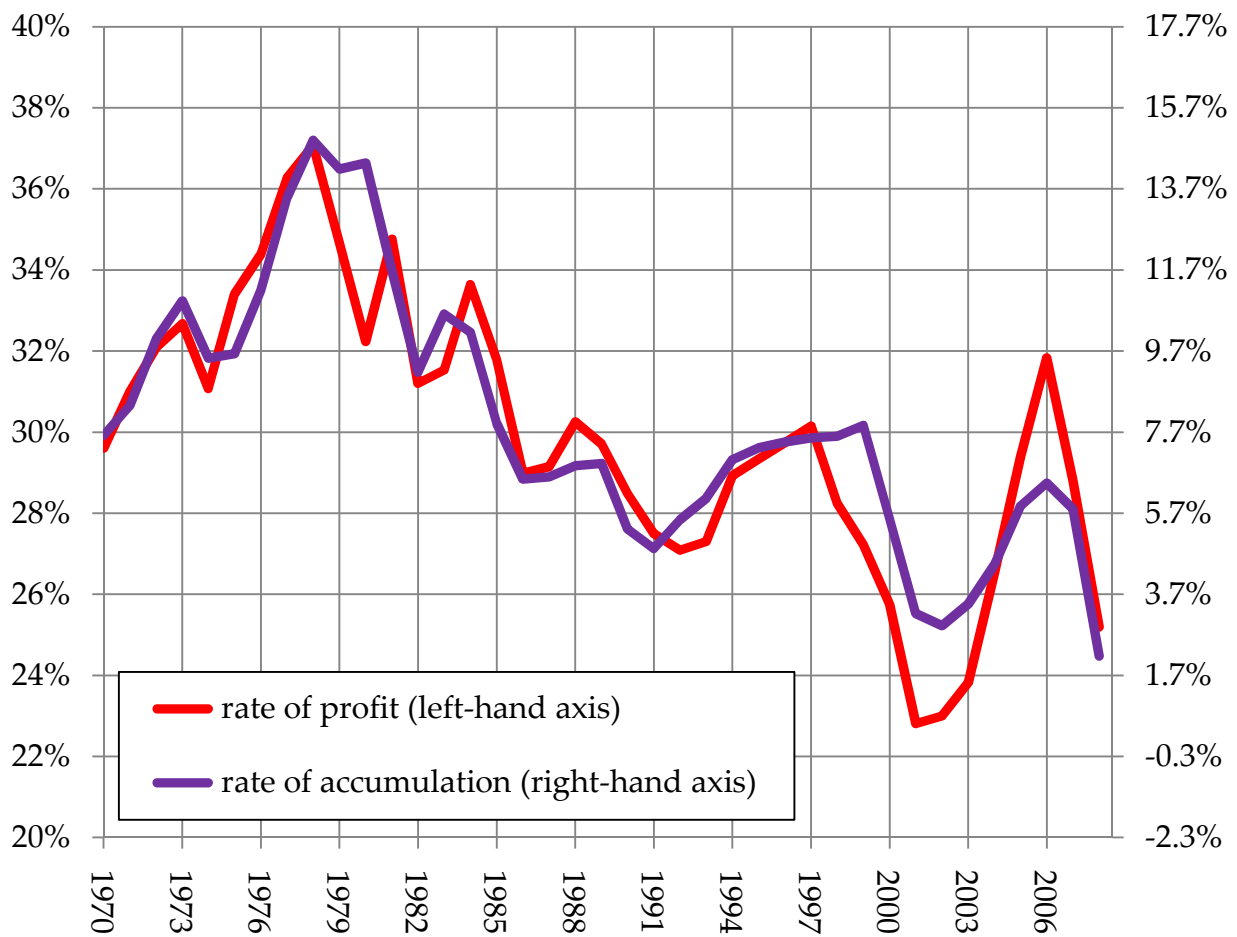


Figure 3 indicates that point B of the most obvious and plausible explanation is correct—the persistent fall in profitability led to a persistent fall in the rate of accumulation. The rate of accumulation has tracked the rate of profit very closely. *Variations in the rate of profit account for 82% of the variations in the rate of accumulation of the next year.*³

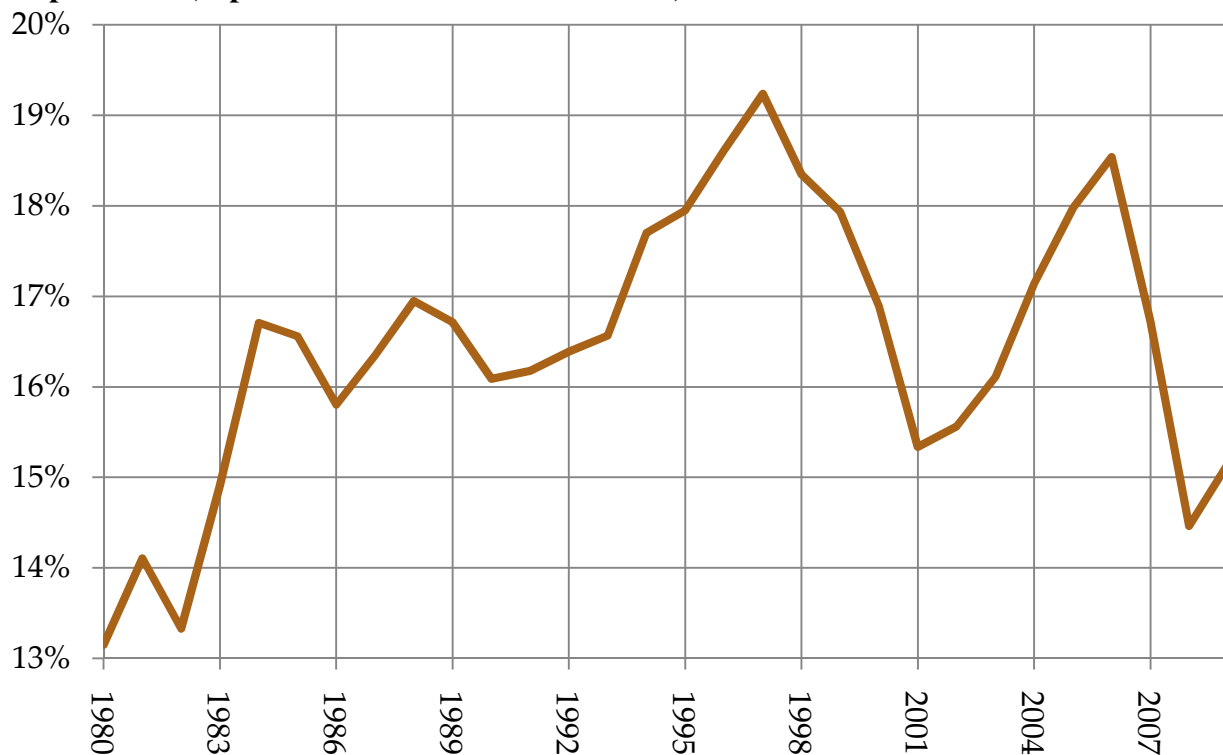
Figure 3. The Rate of Profit and Next Year’s Rate of Accumulation, U.S. Corporations
 (Profit = property income; accumulation = net investment in fixed assets. Both are expressed as percentages of historical cost of fixed assets. Depreciation is valued at historical cost.)



³ The *p*-value is 2.31083E-15, which is less than 1/400 trillion. This means that, if there were no *actual* relationship between the rates of profit and accumulation, there would be less than one chance in 400 trillion that the *observed* relationship between them would be as strong as the one we see here.

However, the radical and Marxist economists who contend that the rate of profit has recovered substantially since the early 1980s do not accept that the rate of profit fell—point A of the most obvious and plausible explanation. They are proponents of the so-called current-cost (or replacement-cost) “rate of profit,” profit as a percentage of the amount of money that businesses would currently need to *replace* their productive capital assets (means of production). 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. Movements in these two rates have differed substantially since the early 1980s (see Fig. 4). Whereas, as we saw above, the historical-cost rate of profit continued to decline, the analogous current-cost “rate of profit” did rebound to some degree.

Figure 4. Property Income as Percentage of Current Cost of Fixed Assets, U.S. Corporations (depreciation valued at current cost)



But this leaves proponents of the current-cost “rate of profit” with a serious problem. Because they deny that the rate of profit has fallen, they must also deny that the fall in the rate of accumulation is due to a fall in the rate of profit. They then have to try to account, somehow, for the extremely curious fact that nothing else—the rate of accumulation, corporations’ output, etc.—rebounded in response to the recovery in the “rate of profit.”

Now the most obvious—and, *prima facie*, the most plausible—way to account for this curious fact is that the current-cost “rate of profit” is just a theoretical construct, a figment of these economists’ imagination:

- It is not what businesses and investors seek to maximize.
- It fails to accurately measure their *actual* rates of return, profits as a percentage of the original amount invested.
- It fails to accurately measure their expected future rates of return.
- It bears no clear relationship to the actual rate of capital accumulation.
- Finally, although Husson and Duménil have recently defended the use of the current-cost rate on the ground that it adjusts for inflation, it does not do so in a proper manner. What it adjusts for is actually not inflation—a general, economy-wide increase in the price level—but rather increases in the prices of each type of capital asset. As Figure 2 showed, when one adjusts for changes in the *general* price level, there is no substantial difference between the movements in the inflation-adjusted rate of profit and the movements in the unadjusted rate since the early 1980s.

Given all this, it is no longer surprising that the rate of accumulation has declined even as the current-cost “rate of profit” has risen.

Instead of embracing this obvious and plausible explanation, proponents of the current-cost “rate of profit” imagine that a distinct “neoliberal” “regime of accumulation” emerged in the early 1980s. They argue that the rate of accumulation fell, not because of a lack of profit, but because this new regime of accumulation was one in which profits were diverted away from productive investment and into financial markets. And this is the reason why they contend that the latest crisis of capitalism is an irreducibly financial one, rather than a crisis rooted in underlying profitability problems.

For instance, Duménil and Lévy (2004, p. 65) write,

Why was the restoration of the rate of profit not coupled with a parallel resumption of growth ...? The key to this enigma [... is] the specific dynamics of neoliberalism. ... the structural crisis is over[; we can] blame neoliberalism for poor accumulation rates.

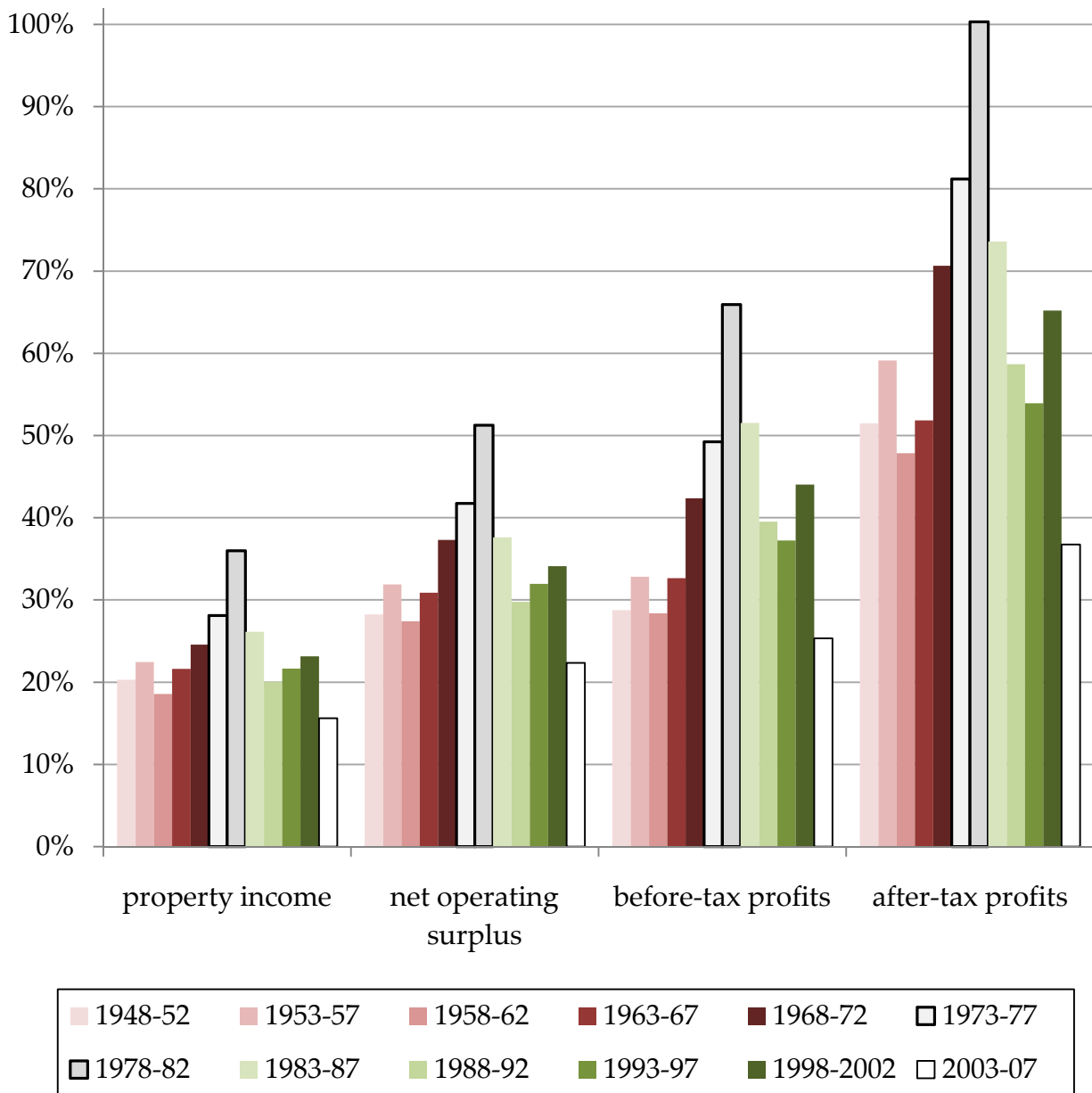
Similarly, Husson (2008) contends that

[the] decrease of the wage-share has allowed a spectacular recovery of the average rate of profit from the mid 1980s. But ... the rate of accumulation has continued to fluctuate around a level lower than that before the crisis. In other words, the drain on wages has not been used to invest more. ... The difference between the rate of profit and the rate of investment is a good indicator of the degree of financialisation.

If it were in fact true that, during an entire quarter-century of capitalism, the rate of productive accumulation has failed to respond to a substantial rise in the rate of profit, it would be extremely peculiar. As Husson (2008) acknowledges, such a disconnect between the rates of profit and accumulation is “more or less unprecedented in the history of capitalism.”

But it just isn't true. At least, it isn't true of the last quarter-century of capitalism in the U.S. As we saw above, the fall in the rate of accumulation closely tracked the fall in the rate of profit from the late 1970s through the early 2000s. Moreover, as Figure 5 shows, the average share of profits devoted to net investment was actually somewhat greater between 1983 and 2002

Figure 5. Net Investment in Fixed Assets, as Percentage of Profits, U.S. Corporations (depreciation valued at historical cost)



than between 1948 and 1972. This result is very robust; it holds true across all four measures of profit.⁴

The reason why I find no long-term decline in the fraction of profit devoted to productive investment, while proponents of the current-cost “rate of profit” contend that such a decline has occurred, is *not* that I consider investment figures in which depreciation is valued at historical cost while they consider figures in which it is valued at current cost. When one values depreciation at current cost, one obtains the same conclusions.

Now, it is true that, if one examines *only the period since 1980*, as Husson (2009) does in a recent critique of my empirical work on the rate of profit, one finds that there’s been a fall in the share of profit that is invested. This is clear from Figure 5. But that is only because the share of profit that was invested was abnormally and unsustainably high in the early 1980s. It has nothing to do with any distinctive and unprecedented neoliberal “regime of accumulation.”

What happened is this: The rate of profit fell sharply during the mid-1970s through the early 1980s, while the decline in the rate of accumulation was at first slower and more modest. Consequently, net investment as a percentage of after-tax profits rose, to more than 80% between 1973 and 1977, and to *more than 100%* between 1978 and 1982 (see Figure 5). Thus, U.S. corporations were investing more of their after-tax profits than the after-tax profits they actually had! That situation clearly could not persist. So the relationship between net investment and

⁴ As noted above, what I call “property” income is net value added minus compensation of employees. Net operating surplus is property income minus “taxes on production and imports less subsidies.” (Taxes on production are mostly sales taxes.) Before-tax profit is net operating surplus minus “net interest and miscellaneous payments” and “business transfer payments.” Business transfer payments include fines, settlements of claims, and other items. After-tax profit is before-tax profit minus “taxes on corporate income.”

profit that had existed earlier was restored. But through 2002, at least, there was no long-term decline in the percentage of profit that was accumulated.⁵

Pay and Workers' Share of Income

John Bellamy Foster and Fred Magdoff, two writers for *Monthly Review*, a left-Keynesian underconsumptionist publication, have recently fused the view that the economic crisis is an irreducibly financial one with an underconsumptionist explanation of the origins of “financialized capitalism”:

It was the reality of economic stagnation beginning in the 1970s ... that led to the emergence of ‘the new financialized capitalist regime,’ ... whereby demand in the economy was stimulated primarily ‘thanks to asset-bubbles.’ ... But such a financialized growth pattern was unable to produce rapid economic advance for any length of time, and was unsustainable....

A key element in explaining this whole dynamic is to be found in the falling ratio of wages and salaries as a percentage of national income in the United States. Stagnation in the 1970s led capital to launch an accelerated class war against workers to raise profits by pushing labor costs down. ... Chart 3 shows a sharp decline in the share of wages and salaries in GDP [gross domestic product] between the late 1960s and the present. [Foster and Magdoff 2008]

⁵ The very rapid rise in profits during the mid-2000s led to a temporary decline in the percentage of profit that was accumulated. Then the economic crisis and slump led to a massive decline in investment, and this reversed the rebound in the accumulation-to-profit ratio that was taking place. It is too early to tell whether a long-run change in the relationship between profit and accumulation has occurred.

Their Chart 3 shows that wages and salaries fell from about 52% of gross domestic product in 1960 and 53% in 1970 to about 46% in 2007. It looks convincing—unless you also look at the government’s categories and realize that Foster and Magdoff have left out big and growing chunks of working people’s incomes. Data for these other components of workers’ incomes are readily available. In fact, they’re reported in the same table that Foster and Magdoff used to get their wage and salary figures.

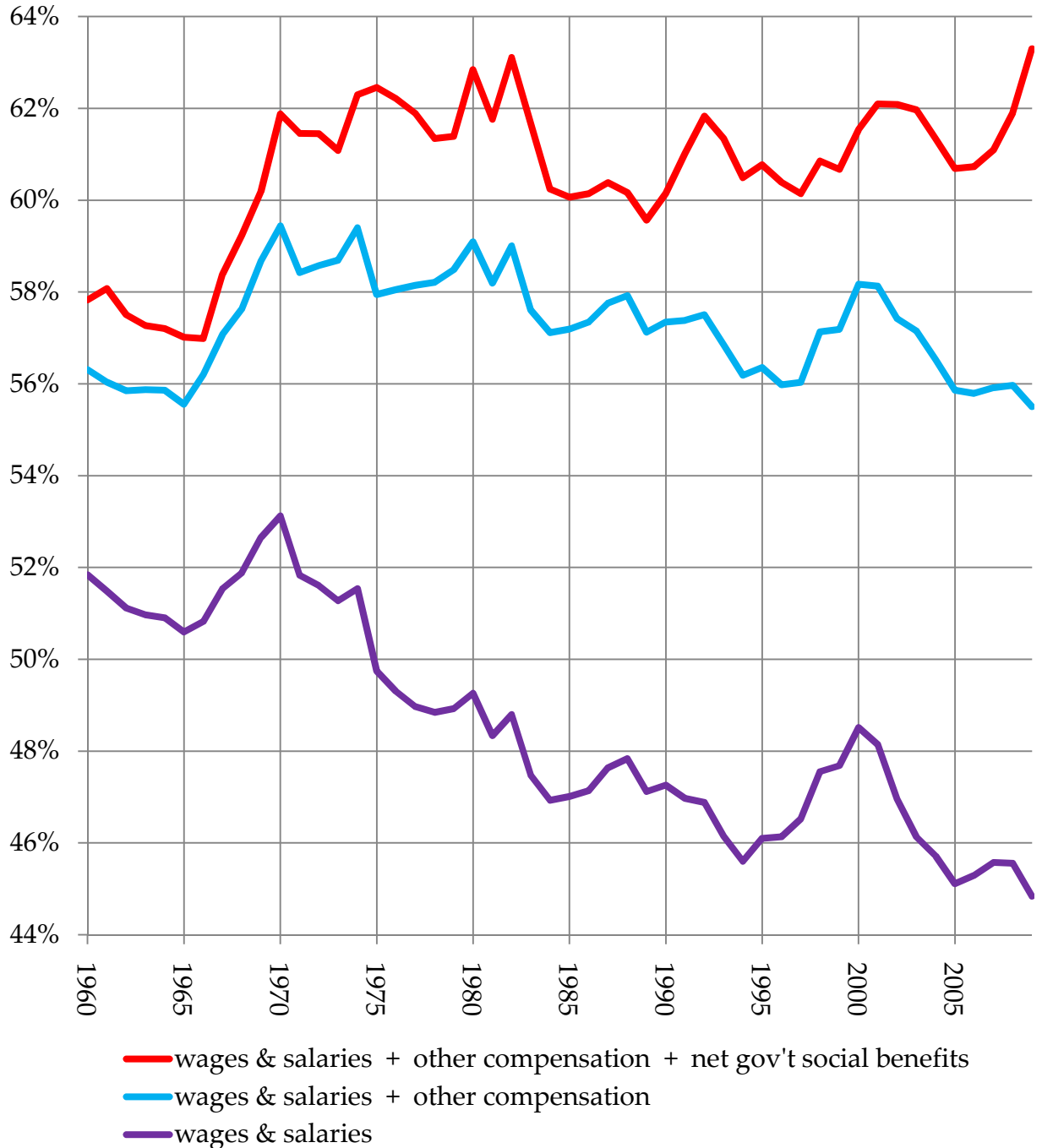
What is left out when one restricts one’s attention to wages and salaries alone? First, many employers pay health and retirement benefits, and employers pay Social Security and Medicare taxes. All this is part of employees’ “total compensation.” Since the U.S. population is getting older and living longer after retirement, and since health-care costs are rising especially quickly, these additional components of total compensation have increased twice as fast as wage and salary income since 1970. In effect, workers are drawing less of their total compensation now, and saving more of it for when they’re older.

Second, the government pays people, especially the working class, a lot of “social benefits”: Social Security and Medicare benefits, veterans’ benefits, welfare assistance, unemployment insurance benefits, etc. As the population has gotten older and as more people have come under the Social Security system, these social benefits have also increased as a share of GDP. Net social benefits (the benefits minus the tax contributions that partly pay for them) have increased almost four times as fast as wage and salary income.

Figure 6 compares Foster and Magdoff’s results with the results we get when we look at total compensation and when we also add in net social benefits. Between 1960 and 2009, the wage and salary share of GDP fell by 7.0 percentage points, but the total compensation share fell by only 0.8 points, and the total-compensation-plus-net-benefits share *rose* by 5.5 points. Between

1970 and 2009, the wage and salary share of GDP fell by 8.3 percentage points, but the total compensation share fell by only 3.9 points, and the total-compensation-plus-net-benefits share rose by 1.4 points.

Figure 6. Components of Workers' Incomes as Percentages of GDP, U.S.



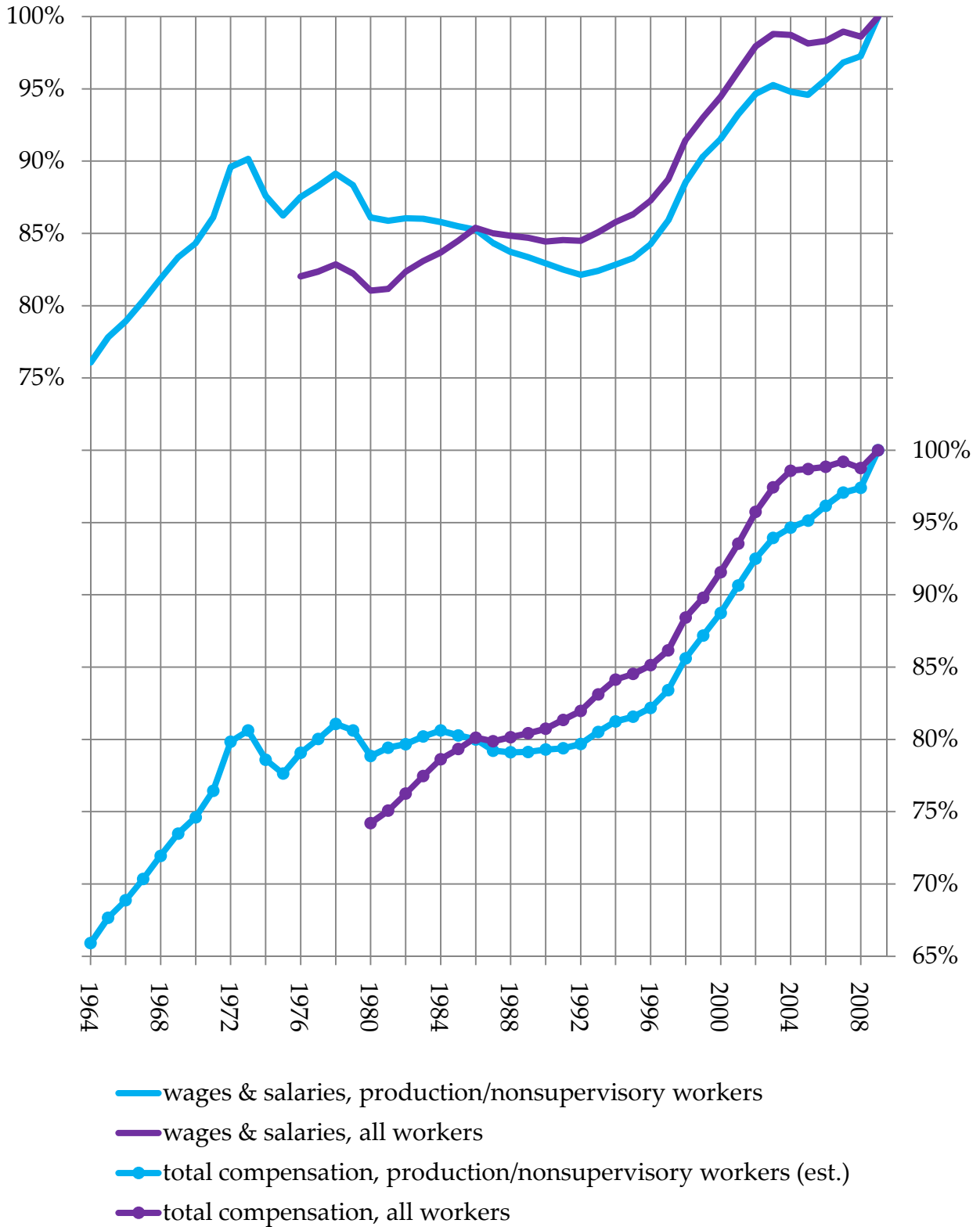
I do not mean to imply that working people are living well. That isn't the case. But the reason they aren't living well doesn't have to do with the alleged but nonexistent decline in the share of national income they receive. It has to do with a sharp decline in GDP growth that began in the mid-1970s and has more or less persisted ever since. Since GDP isn't growing fast and working people are getting a close-to-constant share of it, their incomes aren't growing fast, either.

Foster and Magdoff then write that the fall in the wage-and-salary share of GDP “reflected the fact that real [i.e., inflation-adjusted] wages of private nonagricultural workers in the United States (in 1982 dollars) peaked in 1972 at \$8.99 per hour, and by 2006 had fallen to \$8.24 (equivalent to the real hourly wage rate in 1967), despite the enormous growth in productivity and profits over the past few decades.”

One problem with this statement is that, once again, Foster and Magdoff are looking only at the trend in wages and salaries, not at the trend in total compensation. Another problem is that there are different ways of adjusting for inflation, and they lead to different results, but Foster and Magdoff did not explain this to their readers. A third problem is that they use pay data for “production and nonsupervisory workers” in the private sector. Several years ago, the U.S. government announced that it would discontinue publication of this series (though it later decided not to do so), partly because the category didn't make much sense to the people who answered the government's survey questions.

Figure 7a uses the personal consumption expenditure price index to adjust for inflation. Use of this index leads to the unambiguous conclusion that real compensation has *risen*, not fallen, whether we consider wages and salaries or total compensation, and whether we consider just production and nonsupervisory workers or all private-sector workers. Since 1972, production

**Figure 7a. Compensation Indexes, Private Industry Workers, U.S. (2009 = 100%).
Deflated by Personal Consumption Expenditures price index.**



and nonsupervisory workers' real wages and salaries have risen by 12%, and their real total compensation has risen (according to my estimate) by 25%. Real wages and salaries of private-sector workers as a whole have risen by 22% since 1976, and their real total compensation has risen by 35% since 1980.

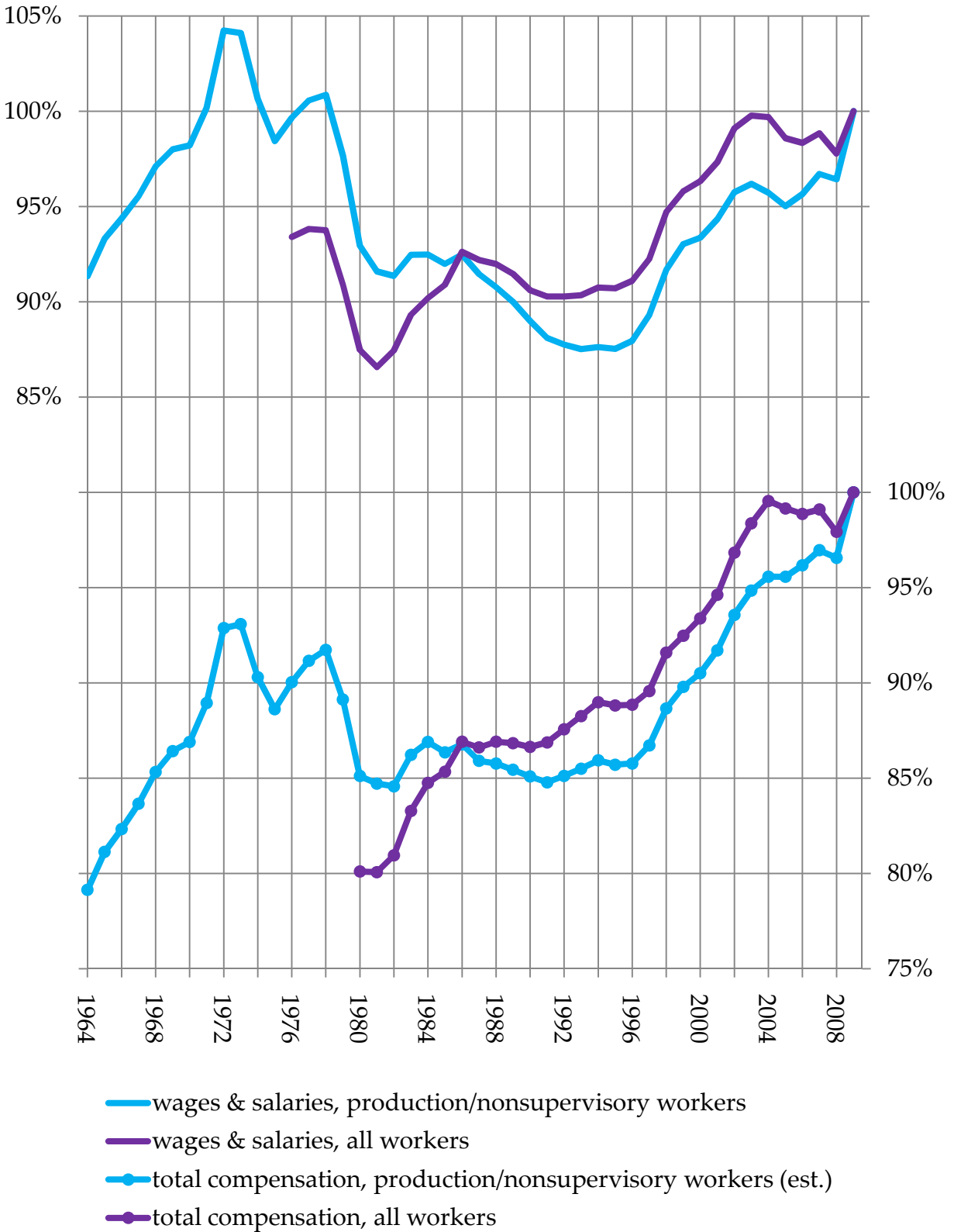
Figure 7b uses the consumer price index to adjust for inflation; this is the method that Foster and Magdoff chose. Once again, when we focus on total compensation, we find that workers' pay has *risen*. Real total compensation of all private-sector workers has risen by 25% since 1980 and (my estimate of) real total compensation of production and nonsupervisory workers has risen by 8% since 1972. Real wages and salaries of all private-sector workers have also *risen*, by 7% since 1976. The only series that declines is the one for the wages and salaries of production and non-supervisory workers, which has fallen by 4% since 1972. This is the series that Foster and Magdoff chose to present.

Conclusion

As we have seen, the economy has been sluggish for decades, owing to the falling rate of profit and the the fall in the rate of profit that resulted from it. And these problems—rather than a fall in working people's share of national 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,

**Figure 7b. Compensation Indexes, Private Industry Workers, U.S. (2009 = 100%).
Deflated by Consumer Price Index for Urban Wage and Clerical Workers.**



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.

Appendix

The following data come from the U.S. Bureau of Economic Analysis, and are available at www.bea.gov:

Corporations' fixed assets valued at current cost: Fixed Asset Table 6.1.

Corporations' fixed assets valued at historical cost: Fixed Asset Table 6.3.

Current-cost depreciation of corporations' fixed assets: Fixed Asset Table 6.4.

Historical-cost depreciation of corporations' fixed assets: Fixed Asset Table 6.6.

GDP price index: National Income and Product Account (NIPA) Table 1.1.4.

Gross value added, compensation of employees, taxes on production and imports less subsidies, net interest and miscellaneous payments, business transfer payments, and taxes on corporate income: NIPA Table 1.14.

Net value added in historical-cost terms is gross value added minus historical-cost depreciation. Net value added in current-cost terms is gross value added minus current-cost

depreciation. Net investment in fixed assets during any year is the change in fixed assets, valued at historical cost, between the start of the year and the start of the next year.

To adjust for inflation in Figure 2, I divided property income by the GDP price index to obtain the numerator of the inflation-adjusted rate of profit. The denominator, fixed assets at historical cost, adjusted for inflation, is the prior year's denominator *plus* the ratio of the new year's net investment to the new year's GDP price index. The initial value of the denominator is fixed assets at historical cost at the start of 1929 divided by the GDP price index of 1929.

Historical-cost rates of profit use start-of-year figures in the denominator. The current-cost "rate of profit" uses end-of-year figures in the denominator.

For sources of the data in Figures 6, 7a, and 7b, and discussion of my computations, see Kliman (2010b).

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