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THE DISTRIBUTION OF SURPLUS VALUE AND THE TRANSFORMATION FROM VALUES INTO PRICES OF PRODUCTION

The Limits to Capital, 2006 [1982] p.61-74

Marx felt that one of the 'best points' in his work was the 'treatment of surplus value independently of its particular forms as profit, interest, ground rent, etc.' (*Selected Correspondence* (with Engels), p. 192). The theory of surplus value explains the *origin* of profit in the exploitation of labour within the confines of the production process under the social relation of wage labour. The theory of distribution has to deal with the conversion of surplus value into profit. Marx attached great importance to such a step. 'Up to the present time,' he wrote, 'political economy . . . either forcibly abstracted itself from the distinctions between surplus value and profit, and their rates, so it could retain value determination as a basis, or else it abandoned this value determination and with it all vestiges of a scientific approach.' In the third volume of *Capital* (p. 168), Marx claims that 'the intrinsic connection' between surplus value and profit is 'here revealed for the first time'. This is a strong claim, which would bear some examination even if it had not been the focus of an immense and voluble controversy.

Marx's argument concerning the relation between surplus value and profit is broadly this. Surplus value originates in the production process by virtue of the class relation between capital and labour, but is distributed among individual capitalists according to the rules of competition.

In considering how surplus value is distributed among capitalist producers in different sectors, Marx shows that commodities can no longer exchange at their values – a condition that he assumed to hold in the first two volumes of *Capital*. They must exchange according to their 'prices of production'. We would do well at the outset to eliminate a potential source of confusion. These prices of production are still measured in values and are not to be confused with monetary prices realized in the market. Marx still holds to socially necessary labour time as a measuring rod. What he now shows is that commodities no longer exchange according to the socially necessary labour time embodied in them.

In order to follow Marx's argument, we must first lay out some basic definitions and notations. The time taken to produce a completed commodity is called the 'production period'. The time taken to realize the value embodied in the commodity through the exchange process is called the 'circulation time'. The 'turnover time' of capital is the time taken for the value of a given capital to be realized through production and exchange – it is, then, the sum of the production period and circulation time. The 'capital consumed' is the total value of raw materials and instruments of production used up in the course of one production period. Since fixed capital may be fully employed during the production period but not fully used up, the capital consumed during a production period will be equal to or less than the 'capital employed'. We may treat the 'constant capital', c, either as the capital consumed or the capital employed, depending upon what it is we are seeking to show. The 'variable capital', v, is the value of labour power consumed in a production period. The 'rate of surplus value' (or 'rate of exploitation') is given by the ratio of surplus value to variable capital, s/v. The 'value composition of capital' is defined as c/v. The 'rate of profit', p, is $s/(c + v)$ which, when reformulated, becomes:

$$p = \frac{s/v}{(c/v) + 1}.$$

Notice that all of these measures are expressed in *values*.

We now assume a competitive process which equalizes the rate of profit across all industries and sectors. What then becomes clear is that the exchange ratios are affected by differences in the value composition of capital. Consider the following example. An economy has two industries. The first employs 80 units of constant capital and 20 units of variable capital and creates 20 units of surplus value, while the measures for the second are $20c$, $80v$ and $80s$. The total capital advanced in both industries is exactly the same. We define these as the 'costs of production', $c + v$. The rate of exploitation, s/v, is the same in both industries. We also assume an identical production period. But we now notice that the rate of profit in the first industry (with high value composition) is 20 per cent while in the second industry (of low value composition) the rate of profit is 80 per cent. The rate of profit is not equalized.

Let us now suppose that the two industries are of equal weight and that the average rate of profit, p, is 50 per cent. The effect of equalizing the rate of profit is to change the exchange ratios of the two commodities. Each commodity now exchanges according to the ratios indicated by $c + v + p$, instead of $c + v + s$. The first of these measures is called the 'price of production'. It is, we emphasize once more, measured in values not money prices. Under competition we can expect commodities to exchange according to their prices of production rather than according to their values.

We can construct an identical argument with respect to capitals having different turnover times. Marx did not do so directly, but we should also acknowledge the importance of turnover time in forming exchange ratios. Since the capitalist is interested in profit over an average time period (an annual rate of return on capital, for example), capital that turns over many times in a year will earn a much higher rate of return compared with capital that turns over only once (assuming similar value compositions and identical rates of exploitation). Capital and labour will tend to be reallocated from sectors with lower turnover times to those with higher until the annual rates of return are equalized. Relative prices will be affected, and we have an additional reason why commodities will no longer exchange according to their values.

What Marx is doing here is implementing his general rule that production determines distribution but that the former cannot be considered independently of the distribution included in it. Marx's transformation procedure in fact plays upon a double sense of 'distribution'. It is the distribution of the capital among the different industries in accordance with the general rate of profit that leads to the formation of prices of production, which have the effect of distributing the surplus value differentially according to the value compositions and turnover times of the different capitals.

The general distributive effect can be quite simply stated. Each capitalist contributes to the total aggregate surplus value in society according to the labour power each employs, and draws upon the aggregate surplus value according to the total capital each advances. Somewhat facetiously, Marx called this 'capitalist communism' – 'from each capitalist according to his total workforce and to each capitalist according to his total investment' (*Selected Correspondence* (with Engels), p. 206). More specifically, this means that industries with low value composition ('labour-intensive' industries) or rapid turnover time produce greater surplus value than they get back in the way of profit, while the opposite is the case for industries with high value composition (so-called 'capital-intensive' sectors) or low turnover time. This is an important result. It provides the basis for some erroneous Marxist interpretations of imperialism – countries dominated by industries with low value composition will give up surplus value to countries dominated by high value composition.[17]

So why all the controversy? Marx's own strong claims, together with some provocative comments by Engels in his prefaces to the second and third

[17] Emmanuel (1972); the error arises because when proper solutions to the transformation problem are derived they do not necessarily show a transfer of value from sectors with low value composition to sectors with high composition.

volumes of *Capital,* served to focus attention upon what is indeed a key feature in Marxian theory: the relation between surplus value and profit. Unfortunately, the solution Marx proposes is either in error or incomplete. Bourgeois critics have pounced upon what they see as a fundamental error and used it to discredit the whole Marxian theory of production and distribution, insisting, all the while, that distribution must be restored to the rightful place from which Marx sought to dislodge it. Let us consider the nature of the supposed 'error'.[18]

Marx sets up a tableau for five industries of varying value composition in order to illustrate how prices of production will be formed when the profit rate is equalized through competition (*Capital,* vol. 3, ch. 9). He assumes, for purposes of exposition, that capitalists purchase commodities at their values and sell them according to their prices of production. He also assumes that the average profit rate is known and that this can be calculated in advance by giving an equal weighting to each of the five sectors and averaging surplus value production in relation to total capital advanced.

We can spot two problems immediately. If all commodities exchange according to their prices of production, then this applies as much to inputs as to outputs. Capitalists buy at prices of production and not, as Marx sets it out in his schemas, according to values. Marx is perfectly well aware of this, but considered that 'our present analysis does not necessitate a closer examination of this point' (*Capital,* vol. 3, pp. 164–5). Secondly, as capital is redistributed from sectors with low to high value composition, so the total output of surplus value changes and this alters the rate of profit. Clearly, the transformation procedure Marx devises is incomplete. It is, at best, an approximation. Marx did not emphasize that this was so, and Engels went on to confuse matters greatly by triumphantly proclaiming in his preface that Marx had established *the* solution to the problem, which would confound and silence his critics for ever more.

Böhm-Bawerk (1949) promptly pointed out the defects in Marx's procedure, treated them as fundamental errors, and derided the whole Marxian scheme of things to great effect. Far from silencing the critics, Marx's solution to the transformation problem provided them with abundant ammunition to use against him.

The transformation problem assumed its current guise with mathematical attempts to correct for Marx's error. von Bortkiewicz was the first to provide a mathematical solution in 1907. He used a simultaneous equation approach and showed that it was possible to solve the transformation problem under

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certain rigorously defined conditions. The problem then becomes one of identifying and justifying the conditions for the solution.

The formal mathematical problem arises because it is necessary, given the simultaneous equation approach, to hold something invariant between the value structure and the price of production structure if a solution is to be identified. Since Marx himself argued that the sum of the prices of production should equal the sum of the values, and that the total surplus value must equal the total aggregate profit, these two have most commonly been chosen as the invariants. The trouble is that these two conditions cannot hold simultaneously given this particular mathematical representation. Consequently, a whole host of different mathematical solutions have been proposed, each using a different invariance condition.[19]

This allows Samuelson (1971) to argue that, since there is no logical reason to choose one invariant over another, Marx's transformation from values into prices of production is not a mathematical transformation in any real sense at all, but simply a process of erasing one set of numbers and replacing them with another set. The price of production analysis in the third volume of *Capital* has no necessary logical relation to the value theory proposed in the first volume. The latter, then, can be viewed either as an essay in metaphysics or 'an irrelevant detour' *en route* to the more fundamental price theory of the third volume. Since price theory has been 'revolutionized' since Marx's time (principally through the marginalist 'revolution', which lies at the basis of contemporary neoclassical theory), Marx can, as far as his contribution to price theory is concerned, be relegated to the history books as a 'minor post-Ricardian'. Thus does Samuelson joust with the Marxian ghost.

One line of response to Samuelson has been to accept his mathematical contribution and then to argue that, although he may be 'a crackerjack mathematical economist', he is a 'terrible political economist'. Laibman (1973–4) thus chooses the rate of exploitation as the invariant on the grounds that class struggle and the social tension between capital and labour is the qualitative hallmark of the capitalist mode of production. True as the latter may be, this implies that the balance between wages and profits in a capitalist economy is set by class struggle and by nothing else – a proposition we denied earlier. This is far too high a price to pay to get past Samuelson's objections.

A second line of defence requires treating the transformation problem as an historical problem. Under this interpretation, commodities did indeed exchange at their values under conditions of simple commodity exchange among independent producers not subjected to the rule of capital. With the rise of capitalist relations of production, the value relations become obscured and ultimately buried under prices of production. This interpretation finds

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some justification in Marx's comment that 'the exchange of commodities at their values . . . requires a much lower stage than their exchange at their prices of production, which requires a definite level of capitalist development.' It is, therefore, 'quite appropriate to regard the values of commodities as not only theoretically but also historically *prius* to the prices of production' (*Capital*, vol. 3., p. 177). Engels opined that, 'had Marx had the opportunity to go over the third volume once more, he would doubtless have extended this passage considerably (*Capital*, vol. 3., p. 896). And so Engels set about elaborating on the idea for him, and in his '*Supplement*' to *Capital* (vol. 3) wrote out a lengthy historical version of the transformation problem. A number of more restrained versions of it have been since advanced by writers such as R. L. Meek (1977, ch. 7).

There are two problems to this historical approach, even though it sounds very Marxian to appeal to history to resolve a logical dilemma. We note, first of all, that this account runs entirely contrary to the argument we set out earlier, namely, that values cannot be fully established in the absence of capitalist relations of production. It contradicts the idea of an integral relation between the value theory and the capacity to produce surplus value. Furthermore, as Morishima and Catephores (1978) document in great detail, Marx's general approach indicates that what he was 'looking for in the labour theory of value was not the abstract description of a pre-capitalist period from which he could derive developed capitalism genetically, but rather the theoretical tools which would allow him to get to the bottom of capitalist economic relations.' The historical version of the transformation problem – even in its more moderate and sophisticated renditions – must, therefore, be rejected.[20]

Since we cannot appeal either to class struggle or to history to solve the problem, we have to revert to treating the transformation as a 'static, atemporal, analytical device' for dissecting the social relations of capitalism. We are obligated to find a reasonable mathematical technique for dealing with the problem. Rather late in the day, Shaikh (1978) has proposed to follow the technique that Marx used and designed iterative solutions which, at each round of the iteration, adjust input costs and the profit rate until equilibrium prices of production are identified. According to this view, Marx simply performed the first calculation in this sequence and didn't bother with the rest because it did not seem as important to arrive at the correct mathematical solution as to draw the important social conclusion. Morishima (1973), with his customary mathematical ingenuity, shows that, if the transformation procedure is treated as a markov process, many of the difficulties that arise when it is treated in terms of simultaneous equations disappear – the equality between the sum of the prices of production and the

[20] Morishima and Catephores (1978) provide detailed, and in my view quite correct, arguments for why they think Marx would have rejected such an historical approach.

sum of values can happily coexist with the equality of surplus value and total profit, as Marx insisted it should. What is truly surprising, in Morishima's view, is how close Marx came to solving the problem in spite of its inherent difficulty and his extremely limited mathematical technique.[21]

Several interesting insights into the transformation problem have, in fact, come from the non-Marxist camp. Both Baumol (1974) and Morishima (1973) have had much to say that is positive and germane to the problem. Baumol correctly argues, for example, that Marx's fundamental concern was to establish a theory of distribution and that the actual transformation from values into prices of production is a side issue.[22] Morishima likewise defends the view that Marx was striving for social insights rather than for mathematical exactitude, and that, from this standpoint, what Marx set out to do he did quite well.

So what is the social meaning for which Marx was searching? He lays out his conclusions forcefully, by comparing the effect of the transformation with that produced by the capitalist appropriation of relative surplus value:

> With the development of relative surplus value . . . the productive powers . . . of labour in the direct labour process seem transferred from labour to capital. Capital thus becomes a very mystic being, since all of labour's social productive forces appear to be due to capital, rather than labour as such, and seem to issue from the womb of capital itself. . . .
>
> All this obscures more and more the true nature of surplus value and thus the actual mechanism of capital. Still more is this achieved through the transformation of . . . values into prices of production. . . . A complicated social process intervenes here, the equalization process of capitals, which divorces the relative average prices [of production] of the commodities from their values, as well as the average profits in the various spheres of production . . . from the actual exploitation of labour by the particular capitals. Not only does it appear so but it is true in fact that the average prices [of production] of commodities differ from their value, thus from the labour realised in them, and the average profit of a particular capital differs from the surplus value which this capital has extracted from the labourers employed by it. . . . Normal average profits themselves seem immanent in capital and independent of exploitation. (*Capital*, vol. 3, pp. 827–9)

The fact that profit has its origin in the exploitation of labour power is no longer self-evident but becomes opaque to both capitalist and labourer alike. 'Disguised as profit, surplus value actually denies its origin, loses its character, and becomes unrecognizable.' This leads in turn to the 'utter incapacity of

[21] Morishima (1973), Shaikh (1978) and Desai (1979) are all helpful here.

[22] Baumol (1974) seems best to have captured what Marx was trying to do with the transformation, and repays careful reading. Dostaler (1978b) provides a similar account and tries to reconcile the issues within the framework of the sort of value theory we are here adopting.

the practical capitalist, blinded by competition as he is, and incapable of penetrating its phenomena, to recognize the inner essence and inner structure of this process behind its outer appearance' (*Capital*, vol. 3, pp. 167–8). And to the extent the theorists of capital reflected this confusion, they too failed to penetrate to the secrets that were concealed by the phenomena of competition. And it is these secrets Marx claims to have revealed fully and effectively for 'the first time'.

The fetishism that arises out of the transformation from values into prices of production plays a crucial role in Marx's argument. It performs an obvious ideological and apologetic function at the same time as it mystifies the origin of profit as surplus value. Such a mystification is dangerous for capital because the reproduction of the capitalist class depends entirely upon the continuous creation and re-creation of surplus value. But even if the capitalists could penetrate beneath the fetishism of their own conception, they would still be powerless to rectify a potentially serious state of affairs. Competition forces them willy-nilly to allocate social labour and to arrange their production processes so as to equalize the rate of profit. What Marx now shows us is that this has nothing necessarily to do with maximizing the aggregate output of surplus value in society. We find in this a material basis for that systematic misallocation of social labour, and that systematic bias in the organization of the labour process, that lead capitalism into periodic crises. Competition necessarily leads individual capitalists to behave in such a way that they threaten the very basis for their own social reproduction. They so behave because the logic of the market forces them to respond to prices of production rather than to the direct requirements for the production of surplus value. This is the crucial insight that arises out of a study of the transformation problem. It is a result we shall pursue to its bitter logical conclusion in subsequent chapters.

IV INTEREST, RENT AND PROFIT ON MERCHANTS' CAPITAL

Given the sound and fury of the debate over the reduction and transformation problems, it is somewhat surprising to find that the other components of Marx's theory of distribution have sparked so little controversy. This can be explained, in part, by the appallingly muddled state in which Marx left his theories of rent and interest and the failure of Marxists to come up with cogent and agreed-upon clarifications of the mess Marx left behind.

Since each of these aspects of distribution will be examined at length in later chapters, I shall at this stage limit myself to a few general comments on the direction in which Marx seemed headed and the reasons he provides for heading there.

The theory of surplus value, recall, stands on its own independently of any theory of distribution apart from that most fundamental of all distributional arrangements, which separates labour from capital. The surplus value is converted into profit through the social process of competition. Profit is in turn split into the components of profit on merchants' capital, interest on money capital, rent on land and profit of enterprise. The task of any theory of distribution is to explain the social necessity for, and the social processes that accomplish, this distribution of surplus value.

The sequential manner of presentation – moving from surplus value production to distribution – should not deceive us into thinking that distribution relations have no importance for understanding production. Since Marx argues that production cannot be considered apart from 'the distribution included in it', we have to consider the very real possibility that rent and interest play important roles as conditions of production.

Indeed, I shall later seek to show that fixed capital formation – and in particular the creation of the physical infrastructures in the built environment – cannot be understood independently of the social processes that regulate distribution. Distribution relationships therefore affect the conditions of production. Marx plainly does not deny this. But he does insist that, however significant these impacts might be, they could never explain the origin of surplus value itself.

Marx opened up a perspective on the underlying logic dictating distribution relations by examining the general process of circulation of capital. He depicts the process of expansion of value as passing through a sequence of metamorphoses – changes of state. The simplest way to look at it is as a process in which money is thrown into circulation to obtain more money. Money is laid out to purchase labour power and means of production, which are together shaped through production into commodities to be sold on the market:

$$M - C \begin{pmatrix} LP \\ MP \end{pmatrix} \ldots P \ldots C' - M' \text{ (etc.)}.$$

The money at the end of the process is greater than that at the beginning and the value of the commodity produced is greater than the value of the commodities used as inputs. The two phases M–C and C'–M' are transformations brought about through buying and selling, whereas P, the production process, involves a material transformation in the product and the embodiment of socially necessary labour.

The circulation process that begins with money and ends with money (plus profit) is the paradigm form of circulation of capital. But when we look at circulation as a never-ending process, we find that we can dissect it in a number of different ways. We could look at it as beginning and ending with the act of production or with capital in a commodity state. We can create three separate windows to look in on the overall characteristics of the can expand the surplus value realized by the producer through accelerating the turnover of capital and reducing the necessary costs of circulation.

2 *Money capital and interest*

When capital takes on the money form and becomes *money capital,* it manifests itself as capital in its purest form – as exchange value divorced from any specific use value. The paradox, of course, is that it cannot retain its character as capital without being put into circulation in search of profit. The normal process of circulation under the capitalist mode of production entails the use of money capital to create surplus value through production of commodities. This implies that the *use value* of money capital is that it can command labour power and means of production, which can then be used to produce greater value than that money originally represented. The capacity to produce surplus value then appears to be a power of money capital itself. Money capital, as a consequence, becomes a commodity like any other. It possesses a use value and an exchange value. This exchange value is the rate of interest.

'Interest-bearing capital' Marx observes, 'is the consummate *automatic fetish* . . . money making money, and in this form it no longer bears any trace of its origin' (*Theories of Surplus Value*, pt 3, p. 455). '[To the] vulgar economist who desires to represent capital as an independent source of value, a source which creates value, this form is of course a godsend, a form in which the source of profit is no longer recognizable.'

The result is that interest on money capital becomes separate from what Marx calls 'profit of enterprise' – the return gained from engaging in the actual production of commodities. The separation arises because when individual capitalists hold money they have a choice between putting it into circulation as money capital earning interest, or putting it directly into circulation through the production of commodities. This choice is to some degree dependent upon the organization of production itself, because the purchase of large items – plant and machinery, for example – entails either hoarding or a system of capitalist saving and borrowing in order to smooth out what would otherwise be an extremely uneven investment process.

We will deal with the details of the credit system and interest on money capital in chapters 9 and 10. All we are concerned to show here is that the difference between capital in money or productive form ultimately leads to the separation between interest on money capital and profit of enterprise. This distinction amounts to a division of the surplus in two different forms, which may ultimately crystallize into a division between money capitalists and producer entrepreneurs. While both have a common interest in the expansion of surplus value, they do not necessarily see eye to eye when it comes to the division of the surplus value produced.

3 *Rent on land*

Since we will have much to say on the nature of rent in a later chapter, we need to consider it only in the most peremptory manner here. At first sight there appears to be no logical position for rent in the circulation of capital as we have portrayed it. The monopoly power that accrues to landowners through the private ownership of land is the basis of rent as a form of surplus value. The power this privilege confers would come to nought, however, were it not for the fact that land is an indispensable *condition* of production in general. In agriculture the land becomes even a *means* of production in the sense that it is cleared, improved and worked upon in a way that makes the land itself an integral part of the production process.

The circulation of capital encounters a barrier in the form of landed property. The landowner can exact a tribute – appropriate a portion of the surplus value – in return for the use of the land as a condition or means of production. The degree to which this barrier is manifest as the class power of landowners depends upon the historical circumstances. But all the time the power to appropriate a part of the surplus in the form of rent exists, it must of necessity reflect a pattern of social relationships that penetrate willy-nilly into the heart of the production process and condition its organization and form.

4 *Distribution relations and class relations in historical perspective*

With the exception of rent, which rests on the monopoly power of private property in land, the splitting of the surplus value into interest on money capital, profit on productive capital (profit of enterprise) and profit on merchants' capital is implicit in the three circuits of capital and the three fundamental forms capital can assume in the process of circulation. But we are not dealing here simply with the logical relationship between the circulation of capital and the distribution this entails.

Marx, for example, emphasizes that all of these forms of capital – merchants' capital, money capital and rent on land – had an historical existence which stretches back well before the advent of industrial capital in the modern sense. We therefore have to consider an historical process of transformation in which these separate and independently powerful forms of capital became integrated into a purely capitalist mode of production. These different forms of capital had to be rendered *subservient* to a circulation process dominated by the production of surplus value by wage labour. The form and manner of this historical process must therefore be a focus of attention.

These forms of appropriation of surplus value, all of which hide the origin of surplus value, have also to be considered in terms of the social relationships that they both presuppose and sustain. The result is that we have now to modify the notion of the class relations that prevail within the capitalist mode of production. Although there is a certain community of interest among both capitalist appropriators and capitalist producers of surplus value – a community of interest that underlies the overall conception of the bourgeoisie in capitalist society – there are also differentiations within the bourgeoisie which have either to be interpreted as 'fractions' or as autonomous classes. A 'class' of rentiers that lives entirely off interest on their money capital is not to be confused with the industrial capitalists who organize production of surplus value, the merchant capitalists who circulate commodities or the landlord class which lives off the rent of land. Whether or not we use the language of class or fractions or strata does not matter too much at this juncture. What is essential is to recognize the social relationships that must attach to the different forms of distribution, and to recognize both the unity and diversity that must prevail within the bourgeoisie as a result. For in the same manner that the distinction between wages and profits as a generic category cannot be considered except as a class relation between capitalists and labourers, so the distribution relations are social in nature, no matter how hard the vulgarizers might seek to conceal them in terms of the fetishistic notion that money and land magically *produce* interest and rent. Once more we have to recognize that, although these distribution relations enter into and condition production in important ways, it is the study of the production process itself that reveals the secrets of distribution. To pretend otherwise is to fall victim to the world of appearance, which is clouded with fetishisms, and to fail to penetrate 'the inner essence and inner structure . . . behind its outer appearance'.