The debate on the rate of profit (yet again)

Michael Roberts, 2011

Did the US rate of profit trend upwards from 1982 and when did it peak? The debate/argument continues among Marxist economists. And behind this debate about the facts is the analysis. If the rate of profit did rise from 1982 onwards, how can Marx's law of the tendency of the rate of profit to fall play any role in explaining the financial crisis and the Great Recession of 2007-9?

First, did the rate of profit in the US rise from 1982? The evidence is pretty conclusive: it did. In a paper on this presented last summer to the Association of Heterodox Economists ("The profit cycle and economic recession"), I summarised all the recent studies on this question along with presenting empirical evidence of my own. Let me quickly run through what I found.

Measuring the rate of profit (ROP) by closely as possible to the Marxist categories of surplus value and constant and variable capital (what Dumenil and Levy call "a la Marx" – see G. Duménil, D. Lévy, "*The Crisis of the Early 21st Century: General Interpretation, Recent Developments, and Perspectives*", 2011), Simon Mohun found that [1] "*US capitalism is characterised by long secular periods of falling profitability and long secular periods of rising profitability and crises are associated with major turning points".* Mohun's turning points seem to be a 1946 trough in profitability, a 1965 peak, a 1982 trough and a 1997 peak – similar to mine.

Li Minqi, Fenq Xiao and Andong Zu [2] looked at the movement of the profit rate and related variables in the UK, the US, Japan, and the Euro-zone. According to them, since the mid-19th century there have been four long waves in the movement of the average profit rate and rate of accumulation. They find a peak at 1997 in the ROP for the US.

David M Kotz [3] uses an after-tax rate of profit measure of the nonfinancial corporate business sector as a percentage of net worth. Kotz finds that the US ROP rose rapidly to 1997. Then it peaked and fell sharply thereafter. Anwar Shaikh [4], using another measure of ROP as profits of enterprise, which excludes rent, interest and taxes, finds that the US ROP peaked in 1997. George Economakis, Alexis Anastasiadis and Maria Markaki [5] measure the Marxist rate of profit by the net product less employee compensation divided by net fixed capital of US non-financial corporates, which is very close to my broader measure. They find that the ROP rose from 10.6% in 1946 to a peak of 19% in 1966, falling back to 9.6% in 1983 and then rising to a peak of 18.2% in 1997, before dropping back again remaining under the peak of 1997 thereafter. They also find that adding the financial sector into the equation makes no difference to the turning points or trend of the ROP. And Erdogan Bakir and Al Campbell find that US after-tax profit rate peaked in 1997 at about 7.5% before falling back and the next peak in 2006 was still below that of 1997 [6].

Some disagree and reckon that a new peak was reached in 2006. They include French Marxist economist Michel Husson [7] who reckons that the US rate of profit did not peak in 1997 but went higher (I consider his measurements in the AHE paper). More recently, Deepankar Basu and Ramaa Vasudevan from two American universities concluded that the US rate of profit rose from 1982 and peaked either in 1997 or 2006, depending on how you measure it (see my post, The rate of profit again!, 31 August 2011). As we can see, these studies found that the rate of profit in the US (*a la Marx)* rose from 1982. And most agree that it peaked in 1997 and subsequent peaks have not surpassed the level of 1997. But all agree that the rate of profit began to fall from 2006, well before the credit crunch descended on the economy in mid-2007. Indeed, the mass of corporate profits started to fall in 2006 too.

Those that disagree that the rate of profit rose significantly after 1982 either claim that the rise was not significant or that the measurement of the rate of profit was incorrect. The measurement issue is complicated, but mainly depends on whether you measure surplus value against the stock of fixed assets on an historic cost basis or on a replacement cost basis. Most of the studies above reckon that using replacement costs is okay, even more correct. Andrew Kliman [8] is adamant that it must be historic costs. However, my own study shows that it really does not make a big difference. There is still a rise in the rate of profit after 1982 up to 1997 at least.

In a recent critique of a new book, Global Slump by David McNally, Joseph Choonara takes McNally to task on his claims of a rise in US profitability after 1982 (see Once more (with feeling) on Marxist accounts of the crisis). Choonara says that McNally's claim of a doubling in the rate of profit from 1982 to 1997 is incorrect. He quotes both Mohun's and Shaikh's data as above. Well, the US rate of profit may not have doubled, as McNally claims, but the rise was anywhere between 45-65% – reasonably significant, I think.

Choonara goes on to argue that just looking at cyclical rise in US profitability from a trough in 1982 to a peak in 1997 leaves out the secular downward trend that is evident in the US rate of profit in the post-war period. Choonara is right, but that does not deny the cyclical upturn. The debate now seems to be bogged down between those who say the rate of profit fell because there was secular downward trend from 1946 and those who say it rose (cyclically?) from 1982. It seems to me that both are right and wrong. There is a secular downward trend but it is broken up by cyclical up phases that can last some time, decades.

Yes, those of you who have read this blog regularly know what comes next. I now going to put forward my interpretation of the evidence on profitability; namely there is a secular downtrend and there is also a profit cycle in the US capitalist economy that lasts from trough to trough about 32-36 years. I reckon that the peak year of 1997 sets the marker for the end of the up phase from 1982. The down phase then began to exert pressure on the US capitalist economy. It forced an even bigger switch from productive investment in manufacturing, transport and communications into financial and property sectors to maintain profits through the expansion of what Marx called fictitious capital, or credit. That laid the basis for the crisis in 2007 and the ensuing major slump. In that sense, Marx's law of profitability did operate to cause the crisis. The great upphase in profitability after 1982 had finished in 1997, some ten years before the Great Recession. The downphase is still here and will last for at least another three to seven years.

Choonara's criticism of McNally on this score seems harsh. McNally was not suggesting that the rise in the rate of profit after 1982 meant that Marx's law played no role in the crisis. On the contrary, McNally in a recent paper refers to the fact the mass of profits in the US rose only 6% from 1997 to 2007 and then fell absolutely in 2006 (quoting my post, *Profits and investment in the economic recovery*, 29 December 2010 by the way!). As he says *"underlying the crisis was a peak in business profits which then turned into a classic expression of the contradictions of capitalist accumulation, which rendered the system vulnerable to a dramatic financial shock"*. McNally

McNally says that some Marxists have become obsessed with the Golden Age of capitalism from 1948-65, regarding it as an exceptional period that eventually gave way to the long-term reality of secular decline. In contrast, McNally points out that the period from 1982 can hardly be called a period of decline for US capitalism if profitability and growth are the criteria. Profitability rose and so did economic growth compared to the period of falling profitability from 1965-82. I have made this same point in my book, *The Great Recession*, when I showed that when profitability rises, so does economic growth under capitalism and when it falls, growth is generally slower. It is what you would expect when an economy is driven ultimately by profitability. Choonara seems to want to deny this by arguing that growth was slower from 1982 to now compared to the Golden Age. But that is an unfair comparison, as growth was faster between 1965-82 but is now much slower in the downward phase of profitability since 1997.

The rise in profitability between 1982-97 also confuses other Marxist economists in different ways. Gerard Dumenil has argued that the rise shows that the crisis was not caused by a fall in profitability but by 'structural changes' in capitalism under a neoliberal regime that promoted 'uncontrolled credit' because of the hegemony of the financial sector (see my post, *The crisis of neoliberalism and Gerard Dumenil*, 3 March 2011). Also, Left Minsky-Keynesians like Steve Keen and Riccardo Belliofiore (see my post of 7 October 2011) and even Marxists like Fred Moseley have argued that the financial crash was a product of the collapse of excessive debt.

But if Marx's law of profitability is still 'behind the crisis' (as Guglielmo Carchedi would put it) then what is the mechanism that explains this cycle of profitability and boom and slump? Marx himself recognised the important role of credit crises but he also said that *"the superficiality of political economy shows itself in the fact that it views the expansion and contraction of credit as the cause of periodic alternation of the industrial cycle, whereas it is a mere symptom of them* [and] *effects becomes causes in their turn and the various vicissitudes of the whole process take on their own periodicity"* (Marx, Capital, 1991).

Marx's law of the tendency of the rate of profit to fall included a series of countervailing factors that could dominate and so create conditions for a rise in profitability for at least some time. Marx said that the most likely conditions for such a rise in the rate of profit were when *"a rise in the rate of surplus value was coupled with a significant reduction in the value of the elements of constant capital and fixed capital in particular."* This was precisely the conditions of accumulation from 1982 onwards. The two deep economic slumps of 1974-5 and 1980-2 had sufficiently reduced the value of constant capital. At the same time, the slumps had driven up unemployment and weakened the ability of the labour movement to protect wages (the cost of variable capital). The productivity of labour rose as new techniques, and hi-tech ones at that, were introduced to many sectors of the economy while wages were not allowed to rise as much. The wage share in the US economy plunged. The rate of surplus value rose. At the same time, constant capital fell in value relative to variable capital.

But as Marx argued: *"In practice, however, the rate of profit will fall in the long run"*. These countervailing influences cannot last forever and eventually the law of profitability will start exert its downward pressure on profits. The rate peaked in 1997 with the exhaustion of the gains of new technology in the productive sectors. US capitalism only sparked onwards through rising profits in the financial sector and a huge expansion of 'fictitious capital' not backed by increased value in the productive sectors. The collapse of the US housing market from 2006 exposed imaginary nature of financial profits and triggered the eventual collapse of the banking sector that relied on them.

That this interpretation of the facts on the Great Recession seems right to me is backed up by work done by David Laibman recently (*"Capitalism, Crisis and Renewal", Science and Society*, July 2010). Laibman asked the counterfactual question: what if there had not been a 'neoliberal turn' from 1982 and wages had kept pace with productivity so there was no rise in the rate of surplus value? Would there still have been a crisis? Remember the arguments of many in this debate is that it was low wages, leading to more borrowing, that eventually caused the crisis, not a fall in the rate of profit. Laibman shows that if the 1980 wage-profit ratio had been sustained through to 2006, the rate of profit would have fallen by 15%. Wages would have risen by 7% a year in real terms and would have made a significant dent in profitability. Far from higher wages boosting growth and keeping profits up, so avoiding a crisis, they would have eventually triggered it anyway, because the rate of profit would have fallen due to rise in the organic composition of capital – Marx's law. Low wages were not the ultimate cause of the Great Recession; it was low and eventually falling profitability.

Michel Husson has argued that we must distinguish between the cyclical ups and downs of profitability which apparently have nothing to do with Marx's law and the secular decline which does (see his key paper, Husson on the rate of profit). But surely, it is unnecessary to divide the two aspects of profitability. Marx's law explains both if we realise that the countervailing factors are what brings about a cyclical effect and the 'law as such' is what brings about the secular trend. As I put it in my AHE paper, *"The causes of both the cyclical and secular movements in profitability are broadly two - fold. The first is driven by the change in the organic composition of capital (or capital productivity). This change is brought about through crisis and the destruction of the value of accumulated capital. The second is driven by the change in the share of unproductive to productive labour and a long term tendency for the organic composition of capital to rise. A rising organic composition of capital will eventually lead to a fall in the rate of profit and vice versa. A rising share of unproductive to productive labour will lead to a fall in the rate of profit and vice versa"*. So it is perfectly possible to accept that there was a rise in profitability from 1982 to 1997 and still argue that the financial crisis and the Great Recession can be explained best by Marx's law of profitability.

All this debate has been based on the experience of the US capitalist economy. But what was happening in other major economies? And there is another countervailing factor to the decline in the rate of profit in any one capitalist economy: making higher profits abroad. Profitability in the emerging capitalist economies is much higher and clearly US and other advanced capitalist corporations can compensate there for falling profitability at home by investing overseas. That factor was not unimportant after 1982. But I'll return to the question of overseas profits and the profitability of other capitalist economies on another occasion.

[1] Simon Mohun, The present crisis in historical perspective, November 2010, Historical Materialism conference.

[2] Li Minqi, Feng Xiao, Andong Zhu, Long waves, institutional changes and historical trends: a study of the long-term movement of the rate of profit in the capitalist world economy, 2007, Journal of World Systems Research

[3] David M Kotz, Accumulation and crisis in the contemporary US economy, June 2007, Review of Radical Political Economics

[4] Anwar Shaikh, The first great depression of the 21st century, Socialist Register 2011

[5] Economakis, Anastasiadis and Markaki, An empirical investigation on the US economic performance from 1929 to 2008, Critique 2010

[6] Erdogan Bakir and Al Campbell, Neoliberalism, the rate of profit and the rate of accumulation, Science and Society July 2010.

[7] M Husson, Taux de profit 2009, the debate on the rate of profit, July 2010

[8] A Kliman, The persistent fall in profitability underlying the crisis, March 2010