‘The Failure of Capitalist Production’ by Andrew Kliman
Sam Williams, 2013

Part 1

First, I must say I liked this book. I think it is a major contribution to the debate about the nature not only of the latest crisis but of cyclical capitalist crises in general.

This book is a continuation of Kliman’s earlier book “Reclaiming Marx’s Capital” (Lexington Books, 2006), which deals with the so-called “neo-Ricardian” critique of Marx. But “The Failure of Capitalist Production” (Pluto Press, 2012) is more than that. In this book, Kliman deals with crisis theory, the main subject of this blog. He therefore casts a far wider net than he did in the earlier work.

Though Kliman builds on his earlier book, the main target of his critique shifts from “neo-Ricardians” to the “underconsumptionist” school of crisis theory and its main contemporary representative, the Monthly Review school.

Two main schools of crisis theory

I have explained that there are two main theories of the origins of capitalist crises vying with one another among present-day Marxists, both in print and online. (1) One is the theory of underconsumption. The underconsumptionists see the cause of the periodic economic crises under capitalism as lying in the “excessive” exploitation of the workers. In Marxist terms, underconsumptionism attributes crises and capitalist stagnation to a rate of surplus value that is *too high*.

That is, too high not only from the viewpoint of the workers but even from the standpoint of the interests of the capitalists themselves. According to the underconsumptionists, the capitalists are appropriating plenty of surplus value, but they cannot find enough buyers for the vast quantity of commodities they are capable of producing with the workers they are “excessively” exploiting.

The result is either acute economic crises at periodic intervals or long-term economic stagnation with many workers and machines lying idle, or some combination of both. The giant of underconsumption theory in the last century was the celebrated American Marxist economist Paul Sweezy. Sweezy founded and edited the socialist magazine Monthly Review, from which the Monthly Review school takes its name.

The underconsumptionist school’s main rival attributes periodic crises to Marx’s law of the tendency of the rate of profit to fall. This school sees the cause of crises as being the exact opposite of what the Monthly Review school and other underconsumptionists claim it is. The falling rate of profit school holds that it is an *insufficient* rate of surplus value that leads to acute capitalist economic crises and longer-term stagnation. Too little surplus value is produced, not too little from the viewpoint of the workers, of course, but too little relative to the needs of the capitalist system.

The best-known inspirer of the present-day “too little surplus value” school is the Marxist economist Henryk Grossman (1881-1950), who can be seen as the “anti-Sweezy.” The two men were opponents during their lifetimes, and they remain so after their deaths. Kliman does not mention Grossman in this book. However Kliman definitely belongs to the not-enough-surplus-value school of crisis theory. (2)

As I have explained, these two schools of crisis theory are completely opposed to one another. That is, as stated they both can’t be true. I believe that Kliman very much shares this assessment.

This is not just of academic interest, since the two theories lead to quite different *political* conclusions. The underconsumption theory implies that if a more equal distribution of the national income can be achieved under capitalism—in Marxist terms, a lower rate of surplus value—the problem of crises and chronic mass unemployment can be more or less overcome *within* the capitalist system.

Bleak prospects for bourgeois democracy

The not-enough-surplus-value school view, in contrast, implies that the only way out of a capitalist crisis is through an increase in the rate of exploitation of the workers. Here, too, the crisis problem might in theory be overcome within the framework of capitalism but only by greatly *increasing* the rate of surplus value. This, however, implies an explosive intensification of the class struggle with the implication that things either move towards socialist revolution or toward fascist-type dictatorships. If the falling rate of profit school of crisis theory is correct, the prospects for social reform and bourgeois democracy are bleak indeed.

Underconsumptionist theory offers hope for bourgeois democracy

In contrast, the underconsumption school implies a policy of reformism that aims not at overthrowing capitalism, at least not immediately, but rather at social reforms aimed at reducing the degree of capitalist exploitation. The underconsumption school sees a real possibility of reducing class contradictions within the framework of capitalism and therefore tends to take a far more optimistic view of the prospects of preserving bourgeois democracy for a considerable historical period to come.

Kliman versus Sweezy

In his new book, Kliman quotes from an article Paul Sweezy wrote at the very close of his long career as a Marxist economist ("Reminiscences," Monthly Review, May 1995):

"If my analysis of the performance of the U.S. economy during the last sixty years is accepted, to what policy conclusions does it point? … public ownership of the means of production and planning to meet the needs of all the people [won't be] a serious option … any time soon. The question should therefore be reformulated: what could be done within the framework of the private-enterprise system to make it work better?" …

"The second indispensable change needed to make the private-enterprise economy work better is a redistribution of wealth and income toward greater equality. We live in a period in which an unprecedented and growing share of society's income accrues to corporations and wealthy rentiers, while the share of the underlying population stagnates or declines. This implies a permanent imbalance between society's potential for adding to its stock of capital and its flagging consumer power … Would the capitalist class as a whole, in extremis, be willing to give up half of what it has to save the other half? I have a feeling that the fate of the private-enterprise system may depend on the answer to this question." (Kliman, p. 200)

This, squeezed into a couple of paragraphs, is indeed a brilliant summary by Sweezy of his entire life's work. According to Sweezy, more and more of society's income—in Marxist terms, surplus value plus wages—is going to the capitalists in the form of surplus value. The result is a growing gap between society's ability to produce and its ability to consume. The inevitable outcome, according to Sweezy, is either growing economic stagnation in the form of a chronic unemployment of workers and machines or sharp periodic economic crises, or some combination of both.

This argument was developed by Sweezy in his early work "The Theory of Capitalist Development" and upheld later in "Monopoly Capital," which he co-wrote with economist Paul Baran and defended over the decades in the many articles he wrote for Monthly Review magazine.

Sweezy's intellectual opponent Henryk Grossman would, if he had been alive, have answered that a more equal distribution of wealth—that is, a lower rate of surplus value—will not lead to a better performance of the private-enterprise system, as Sweezy calls it, but to a *far worse* performance. A lower rate of surplus value will lead to acute economic crisis and soaring unemployment—that is, to a severe social crisis.

Sweezy pessimistic about prospects for socialism in advanced capitalist societies

Sweezy wrote the lines that Kliman quotes at a time of political reaction. The Soviet Union had just collapsed a few years before, and the media and mainstream bourgeois economists were glorying in the sun of the recovery—unimpressive though it was—of the U.S. economy from the crises of the

1970s and early 1980s. Though the Democrat Bill Clinton was in the White House, the Clinton administration was continuing the "neo-liberal" policies—called the "Washington Consensus"—most closely associated with the administration of Ronald Reagan. (3)

But Sweezy's pessimism about the prospects for socialism in the United States and other highly developed capitalist countries did not simply reflect the dismal political climate of the 1980s and 1990s. At no time during his long life as a socialist economist, which began in the 1930s, had he ever seen a socialist transformation of U.S. society as a realistic possibility in the foreseeable future.

What Sweezy did hope for was a struggle for a renewal of the New Deal policies and politics that are associated with the Franklin D. Roosevelt administration. However, as the "Cold War" set in after World War II, Sweezy saw even such a renewal as increasingly unlikely. Back in the 1930s, left-wing New Dealers, who included in their ranks the young Paul Sweezy, had aimed to reduce the rate of surplus value by encouraging unionization, establishing unemployment insurance and having the government directly hire the unemployed the capitalists were unwilling to hire.

Reconciling the classes through increasing monetarily effective demand

The left-wing New Dealers believed that these measures would not only provide a way out of the Depression but would also reconcile, at least to some extent, the capitalists to the cause of New Deal-type social reform. Under the influence of Keynes, the left-wing New Dealers believed that if they achieved a fairer overall distribution of the national income by putting money into the hands of the workers and poor farmers, who would be expected to spend it rather than save it, there would be a rise in effective monetary demand.

Therefore, the social reformers believed, though the capitalists would be paying the workers higher wages, they would achieve *higher* rather than lower rates of profit because they would now be able to find buyers for the commodities they were capable of producing. The unemployed workers would benefit by finding jobs and the already employed workers would enjoy higher wages. Both the capitalist class and the working class would be the winners.

Rising class contradictions during the 1930s threaten bourgeois democracy

As the social crisis deepened in the 1930s, more and more people saw the choice narrowing down to either a dictatorship of the proletariat on the model of the Russian Revolution or a fascist dictatorship such as Hitler's Germany. In contrast, the supporters of New Dealism were trying to salvage bourgeois democracy by reducing the intensity of the class struggle, thereby avoiding the extremes of either the Soviet or fascist types of dictatorship.

Though Sweezy like many other left-wing New Dealers was a supporter of the Soviet Union, he still hoped for a relatively peaceful democratic transition to socialism in the United States and other advanced capitalist countries. He believed that socialism would be the end product of a prolonged period of New Deal-type social reforms and not revolution and civil war on the Russian model.

Sweezy puts his hopes for socialism in the Soviet Union and then China

As Cold War reaction set in, Kliman explains, Sweezy put his hopes for socialism in other countries, first the Soviet Union and then Maoist China. Under the influence of Maoism in the 1960s, Sweezy became increasingly disillusioned with the Soviet Union, even calling it a new type of exploitative class society. However, Sweezy—unlike Mao and also Kliman himself (who is, however, no Maoist)—did not believe that the Soviet Union was "state capitalist."

Sweezy lived to see the restoration of capitalism—private capitalism, not "state capitalism"—under Gorbachev and Yeltsin in the now former Soviet Union as well as China's sharp turn toward capitalist economic development—again private capitalism and not "state capitalism"—under Deng Xiaoping and his successors. Sweezy was, of course, bitterly disappointed by these developments.

As readers of this blog or students of Sweezy himself know, Sweezy was influenced not only by Marx but also by John Maynard Keynes. From the 1930s onward, Sweezy had wrestled with the question to what extent the economic theories of Marx and Keynes are compatible.

Sweezy did not expect Depression after World War II

Unlike many members of the Communist Parties and the rival Trotskyist movement, Sweezy did not expect to see a return of the Depression after World War II. He assumed that the capitalist governments could—and in the future always would— increase government spending sufficiently to avoid that kind of debacle from ever happening again.

What disappointed Sweezy was not the absence of Depression leading to a socialist revolution but the fact that the greatly increased spending by the U.S. federal government—compared to the pre-World War II years—was not directed to New Deal- type social reforms leading to a more equal distribution of the national income but rather towards the building up of a vast permanent war machine that was used against any movement of national liberation not to speak of any attempt to build socialism.

The economic crises of the 1970s did shake Sweezy's confidence somewhat in the ability of Keynesian policies to head off increasingly severe economic crises. In the final period of his life, Sweezy became fascinated with the phenomena of "financialization" and the related formula for interest M—M', where money appears to increase its value without the intervention of the process of production, as opposed to the basic formula for capitalism M—C—M', which implies the production of surplus value in the amount C' minus C.

But Sweezy himself complained in his final years that he couldn't quite bring it all together, something he blamed on old age. He clearly hoped that the new generation of Marxists would be able to accomplish this.

The historic events of 2008

The year 2008 is notable for two historic events. One was the election of the first African American president of the United States—an event long considered unthinkable considering the U.S.'s long history of African slavery, segregation and other forms of racism. The other event was the financial panic of that year. The two events are in fact closely connected.

In the American summer of 2008, polls indicated that the Republican candidate, John McCain, would probably be elected to succeed George W. Bush. This would confirm the continued dominance of neo-liberalism. As the 2008 presidential campaign began, the U.S. economy was mired in stagnation or mild recession, as it had been since the credit market crisis that began in August 2007.

That crisis broke out when Wall Street finally began to realize that a huge amount of mortgage-backed securities was in fact backed by mortgages many of which simply could not be repaid. But it was still widely assumed the U.S. Federal Reserve System would prevent an old-fashioned panic, much like it had done during earlier financial crises such as the stock market crash in 1987 and the collapse of the Long-Term Capital Management hedge fund in 1998.

Then, in mid-September 2008, suddenly and unexpectedly talks to rescue the crisis-ridden Lehman Brothers investment bank broke down. At the same time, Merrill Lynch—run by the folks who were bullish on America—was forcibly merged with the Bank of America, and the insurance giant AIG had to be virtually nationalized as were the government-sponsored mortgage discounters Fanny Mae and Freddy Mac. Credit froze up like it hadn't done since the banking panic of 1933 just before Roosevelt assumed office.

Despite an unprecedented bailout of the banks at the expense of the taxpayers, the U.S. economy along with the world economy as a whole promptly went into a tailspin. Under these extraordinary conditions, the tide of the election swung sharply towards the Democrats. Keynesian economics was suddenly back in fashion and the Democratic Party—the party of Roosevelt's New Deal—found itself in control of both houses of the U.S. Congress as well as the White House. Progressives believed that the long nightmare of "neo-liberalism" was finally over.

Was the reign of neo-liberalism really over?

Monthly Review called for a revival of the economics not of Karl Marx but of John Maynard Keynes. Though the prospects of a socialist transformation of U.S. society seemed as distant as ever to the Monthly Review editors, a new New Deal appeared to be finally at hand. The years that followed have been years of bitter disappointment for both the editors of Monthly Review and anybody else who had hoped for a revival of New Deal politics in the U.S.—especially those who viewed the New Deal through rose-tinted glasses.

Since the election of Obama, there has only been the most feeble recovery of the U.S. economy—far less than the one between 1933 and 1937 in the days of Roosevelt's original New Deal. While Obama did launch a "stimulus program," it did not include any WPA-style direct hiring of the unemployed by the federal government. (4)

While the midterm election of 1934 under Roosevelt's original New Deal saw historic gains for the Democratic Party, the election of 2010 put the Republicans back in control of the U.S. House of Representatives, increased their representation in the Senate, and seemed to position the GOP to take back the White House in the election to be held later this year.

Only two years into Obama's administration, American politics seemed to be returning to the neo-liberal groove that they have been stuck in since the election of Ronald Reagan in 1980.

In response to the disappointment with both the Obama administration and the Democrats in Congress, beginning in September 2011—the third anniversary of the panic of 2008—the Occupy Wall Street movement was born. Young people particularly were disgusted that the 2008 election had apparently done nothing after all to shake the dominance of the 1 percent.

Keynesian Marxist narrative

The followers of the Monthly Review school—which I have described as Keynesian Marxist, because they combine, or attempt to combine, the ideas of Marx and Keynes—have increasingly contrasted the prosperous years after World War II with the "stagnation" of the neo-liberal years from the 1980s onward. Their story goes something like this.

The Roosevelt administration, partly under pressure from below, broke the back of Wall Street's "finance capital" that dominated U.S. capitalism during the 1920s. Under Roosevelt, a coalition of industrial corporations, labor, and African American organizations—strongly supported by the U.S. Communist Party—saw to it that the Roosevelt administration followed a path of Keynesian demand management that made recovery from the crisis of 1929-33 possible at all.

Then the massive war spending of World War II, acting as a giant Keynesian stimulus program, finally restored genuine economic prosperity. After World War II, the above coalition—without the Communist Party—was able to keep various U.S. administrations, Democratic and Republican alike, on a path of Keynesian demand management that enabled the U.S. economy to operate at near "full employment."

In this "golden era," largely freed from the yoke of Wall Street and "finance capital," the industrial corporations made the high profits that the strong demand for their products made possible, and the workers benefited from the near to full employment and a considerable rise in wages and social insurance. It wasn't perfect—there was far too much reliance on military spending, for example—but it was a lot better than either the Depression or what was to follow the "golden era."

Unfortunately, as this narrative goes, the forces of Wall Street "finance capital" regained control of the U.S. government, perhaps beginning in 1980 with the election of the ultra-right-wing Republican candidate Ronald Reagan, and completed their takeover with the repeal of the Glass-Steagall Act in 1999 under the Clinton administration.

Turning their backs on the Keynesian program that worked so well in reconciling the interests of the capitalist class and the working class, Keynesian "full employment" policies were ditched and "tight money" policies were imposed that enriched the financial sector at the expense of all other sectors of society, including much of the rest of the capitalist class.

The result of these policies has been growing economic stagnation and finally the "Great Recession" of 2007-09 with little real recovery since. But, the "underconsumptionists" argue, there was and is nothing economically inevitable about these policies and the resulting stagnation and financialization under present-day capitalism. If the "income redistribution" policies of the New Deal and early post-World War II period can be restored by an alliance of industrial corporations and a revived trade union movement, the African American movement and the new Occupy movement—presumably achieved in the U.S. through the Democratic Party—the economy can be restored to the "approximately" full employment of the post-World War II years.

This wouldn't be socialism, but the "private-enterprise system" would work far better for the industrial capitalists and the workers alike than it has over the last 40 years of neo-liberalism. (5)

It is this narrative that Kliman subjects to devastating and I believe quite convincing criticism in his book. Kliman shows that the U.S. economy began to deteriorate in the 1970s before the "neo-liberals" won their decisive initial political victory with the election of Reagan in 1980. Indeed, as Kliman explains in his book, it was the failure of Keynesian-inspired policies to deal with the growing economic crisis of the 1970s that led to Reagan's victory in the first place.

Failure of Keynesian economics

Keynesian economics is based on the claim that under capitalism you can have inflation—demand exceeding supply at full employment—or stagnation—unemployment of workers and machines—but you *cannot have both at the same time*. According to Keynesian theory, if you have stagnation the government and central bank should move to increase effective demand by having the central government run deliberate deficits while the central bank—or monetary authority—expands the quantity of money to lower interest rates.

If you have inflation, the government and central bank should do the opposite. That is, the government should move to reduce the extra demand that is driving inflation by running budgetary surpluses, and the central bank should raise the rate of interest by reducing the rate of growth of the quantity of money.

During the post-World War II "boom"—or more strictly series of booms—the Keynesian economists "explained" that while there had been "great" economic booms under capitalism, this "boom" was different because it *had not* emerged from the natural operations of the "business cycle"—what Marx called the industrial cycle. Unlike in the past, the new prosperity came about because the capitalist governments had finally learned from Keynes how to control, and just maybe eliminate, the "business cycle" altogether.

Marxism 'refuted' by postwar boom

Therefore, the Keynesian economists claimed, unlike past booms the post-World War II boom could be expected to last effectively forever—and so would capitalism. Through the work of Keynes, the Keynesian economists argued, Marxism had finally been refuted. The author of "Capital," the Keynesians claimed, had overlooked or simply not foreseen the possibilities of Keynesian "demand management." This was indeed the prevailing "orthodoxy" by the 1960s, the years of my own youth.

A gentler and kinder capitalism?

As we saw above and elsewhere in this blog, Sweezy did not really challenge this view. Indeed, he accepted its basic assumptions. He claimed, however, that government spending was being directed toward war—like the war against Vietnam in the 1960s—and other forms of "waste" rather than constructive New Deal-type social programs that would benefit the working-class majority.

Not only Sweezy but many other Marxist economists accepted to varying degrees the basic validity of Keynesian economics. Yes, Keynesian capitalism was still capitalism and it was still at the end of the day based on the extraction of unpaid labor—surplus value—from the working class. But it was a kinder and gentler form of capitalism compared to the capitalism of the pre-Keynes era.

In the future, these types of post-World War II Marxists explained, capitalism would still experience "recessions," since "demand management" wasn't perfect and government and central banks would still make "mistakes" and fail to create sufficient demand.

This would be especially likely if the voters made the mistake of electing right-wing rather than liberal or social-democratic governments. But even the most right-wing government, these Marxists assured us, would turn to the anti-crisis Keynesian demand-management "tool chest" and see to it that no really "grave" economic crisis would occur.

Then, in the years after the collapse of the Bretton Woods international monetary system, starting with collapse of the "Gold Pool" in 1968, came accelerating inflation, declining rates of growth, and severe recessions with their associated mass unemployment. The combination of soaring inflation and mass unemployment—held impossible in Keynesian theory—led to the first fall in real wages in the United States since the "bad old days" before World War II.

Right wing blames 'government central planning' not capitalism for the crisis

In light of what the post-World War II Marxists like Paul Sweezy were writing, Marxism appeared to many as simply the left wing of the dominant Keynesian school. The political and economic right wing saw its chance. It proclaimed that "government planning" inspired by Keynes—and Marx—rather than any internal contradictions of the capitalist economy had caused the 1970s economic crisis. Or as Ronald Reagan put it, "government is not the solution to our problem; government is the problem."

The followers of Milton Friedman explained away the Great Depression by claiming that this earlier capitalist crisis had also been caused by "government central planning"—in the form of the blundering policy of the U.S. Federal Reserve Board—a government agency. If only "the Fed" had not stupidly reduced the money supply by one-third—but then what can you expect from government "bureaucrats"—there would have been no Depression, the right wing claimed.

The Friedmanites argued that in the 1920s the U.S. economy had been in great shape with low unemployment, no inflation and strong productivity growth. Minus the government interference in the form of the Federal Reserve Board, the "neo-liberals" claimed, there would have been no Depression, and prosperity would have continued.

The Keynesians—and Keynesian Marxists—had trouble answering these arguments. Friedman gained great authority by pointing out the obvious fact that the soaring inflation was caused by the inflationary policy of the Federal Reserve Board, while the Keynesians either claimed that inflation was caused by "strong trade unions" that were driving up money wages, or tried to explain it away by special factors such as the rise in oil prices brought on by the "OPEC cartel." [see posts on Keynes]

Voters, seeing that the Keynesian-inspired "left" had no solution to the crisis, turned instead to the right, which claimed that it *had* a solution. As a result, politics swung far to the right and the world entered a period of prolonged reaction that it is struggling to emerge from today.

Kliman fears that if the left once again puts forward a program that amounts to little more than warmed over New Dealism and Keynesianism, the way will be opened to a new era of extreme reaction. This time, Kliman warns, it might not take the form of "Reaganism" but something more like the European fascism of the 1930s.

The influence that the ultra-right followers of Texas Republican congressman Ron Paul—a man who rejects *all forms of democracy* including bourgeois democracy— have gained in some sections of the Occupy movement illustrates Kliman's point. We can ignore Kliman's warnings only at our extreme peril.

Today, Keynesians, including many Keynesian Marxists, seem to have forgotten that there even was an economic crisis in the 1970s. Instead, they pretend—or perhaps even believe—that the crisis of 2007-09 was the first real economic crisis since the Great Depression. Unlike the 1970s, the latest crisis was not accompanied by the soaring inflation rates of the 1970s—that may yet come at the next stage—and the Keynesians feel they are back on familiar ground.

Left Keynesians, backed up by Keynesian Marxists, are saying that governments should step up their spending and borrowing and the central banks should further expand the money supply until something like “full employment” returns. Until that point is reached, Keynesians and Keynesian Marxists argue, there is no real danger of inflation.

Kliman’s alternative explanation of the recent crisis

According to Kliman, it was a falling rate of profit bought on by a rise in the organic composition of capital that brought the postwar boom to an end in the 1970s. However, Kliman does agree that Keynesian economic policies did manage to prevent a *full-scale* repeat of the 1930s Depression in the 1970s and early 1980s and again during the recent “Great Recession.” Now, that is better than nothing, isn’t it?

The problem, according to Kliman, is that it is exactly through the destruction of capital that the rate of profit is restored after a prolonged period of a declining rate of profit brought on by a rise in the organic composition of capital preceding the crisis. Kliman indeed *does not* believe that the long-term trend in the rate of profit is downward and even claims that this was also Marx’s view.

According to Kliman, if I understand him correctly, the specific function of crises is to restore the rate of profit through the destruction of capital and therefore to prevent the rate of profit from falling over the long run. Therefore, if Keynesian-type economic measures succeed in limiting the amount of capital that is destroyed during a crisis, the economy will fail to fully recover from the crisis.

I believe, contrary to Kliman, that Marx did indeed believe that the rate of profit would fall—and indeed already had fallen compared to what it had been in early capitalism before his own day—but that this fall manifested itself only over long periods.

A weakness in Kliman’s book, in my opinion, is that he makes no attempt to examine the pre-1929 crises. Kliman is correct to point out that no crisis since World War II has been as severe as what I call the super-crisis of 1929-33. But it is also true that no crisis *before* that crisis came close to equaling the crisis of 1929-33. Kliman seems to think that 1929-33 was a typical capitalist crisis. But if it wasn’t—and virtually all statistical analysis of pre-1929 capitalism indicates that it wasn’t—how did capitalism stave off the fall in the rate of profit before the crisis of 1929?

Kliman’s analysis

Returning to Kliman’s analysis, Keynesian policies both in the 1970s and during the most recent crisis prevented the destruction of capital on a scale such as to restore the rate of profit sufficient to make possible a return to full-blooded capitalist prosperity. The result, he argues, has been, in effect, to transform the law of the *tendency* of the rate of profit to fall into the law of the falling rate of profit—at least for a certain historical period beginning in the 1970s. This is the nub of Kliman’s analysis of the current long-term crisis of capitalism. (6)

Kliman believes that from the 1970s onward, there have only been very slight and short-lived recoveries in the rate of profit and provides statistical data that he believes proves this. As a result, there has been no return to post-World War II-style capitalist prosperity. Until there is a destruction of capital on a scale comparable to that of the 1930s—or even the 1930s plus the additional destruction of capital during World War II—there will be no real capitalist prosperity.

Future prospects

Kliman believes that there are two possibilities for capitalism’s future. One is that Keynesian policies continue to prevent a full-scale repeat of the Depression. The rate of profit fails to recover and low growth continues, interrupted from time to time by severe recessions.

Or, eventually, there will be a crisis on the scale of the Depression of 1930s or maybe even worse that finally destroys capital on a sufficient scale followed by a recovery in the rate of profit. In that case, a new era of capitalist economic prosperity will set in, a new rise in the organic composition of capital will occur and the rate of profit will again fall leading to a new crisis sometime in the future.

However, Kliman fears that before such a crisis, through the mass destruction of capital and consequent recovery in the rate of profit, leads to a new prosperity, the crisis in the absence of a socialist transformation will likely lead to an extreme political reaction that might resemble 1930s-type European fascism more than it resembles the policies of Ronald Reagan and Margaret Thatcher, bad as they were.

The only way out of this impasse is to replace capitalism with socialism. Therefore, "capitalist production has failed." Monthly Review-style Keynesian Marxism with its false perspective of a new New Deal to once again save bourgeois democracy is a dangerous diversion.

Unlike the Monthly Review's hopes, Kliman's analysis provides *no hope* Keynesian demand management will be able to restore the prosperity of the post-World War II period—or other periods of great capitalist prosperity—and on that basis reconcile the conflicting interests of the working class and the capitalist class. The only real way out is to replace capitalism with socialism.

Marx's law of the tendency of the rate of profit to fall

Marx's law of the tendency of the rate of profit to fall is therefore at the center of Kliman's analysis. This would explain why before he wrote the current book he devoted a separate volume to refuting the "neo-Ricardian" claim that Marx's law of the tendency of the rate of profit to fall was invalid. Kliman's current book on crises can therefore be seen as Volume II of a single work.

Let's briefly review Marx's law of the tendency of the rate of profit to fall. Marx called it the most important law of political economy. In Volume III of "Capital," Marx showed that assuming the rate of surplus value—the ratio between paid and unpaid labor—remains unchanged, the rate of profit will fall as the organic composition of capital rises. Marx assumed that workers work half of the work day for themselves—reproducing the value of their labor power—and the other half free of charge producing surplus value for the capitalists.

Marx showed that a rate of surplus value of 100 percent can express itself in many different rates of profit depending on what Marx called the organic composition of capital. The organic composition of capital is the ratio of what Marx called constant capital, which includes all the productive capital except for the purchased labor power of the workers. The purchased labor power of the workers is the variable capital that actually produces the surplus value.

Marx made several assumptions for reasons of simplification—not because he believed that this was true in reality: that all commodities find buyers (there are no realization problems), the rate of turnover of (variable) capital is fixed, and all commodities sell at their prices of production. The sum total of the prices of production is assumed to be identical to the sum total of their direct prices. The rate of profit measured in terms of value—or what comes to exactly the same thing, in terms of embodied abstract human labor—is assumed to be identical to the rate of profit in terms of prices of production.

Marx demonstrated that assuming the ratio of constant capital to the variable capital rises—every other variable remaining unchanged—the rate of profit will decline. Marx then explored various forces that counteract the fall in the rate of profit. The most important of these are a rise in the rate of surplus value and the cheapening of the elements of constant capital—auxiliary and raw materials plus fixed capital such as buildings and machines. These and other offsetting factors transform the law of the falling rate of profit into the law of the tendency of the rate of profit to fall.

However, the lowering of the value of constant capital due to a fall in the labor value of the constant capital—called moral depreciation by Marx—is a double-edged sword. To the extent that the constant capital experiences a moral depreciation, a portion of the value of the constant capital will not be transferred to the final commodity product but is destroyed. These losses must be taken into account when calculating the actual rate of profit.

Marx separated these contradictory effects by assuming that after the organic composition has risen, it then stops rising. He shows that once the organic composition has risen and all the *transitional effects* brought on by the moral depreciation of capital have been fully absorbed—assuming that the rate of surplus value is still 100 percent—the rate of profit will be lower than before. It is important to realize that Marx is assuming a constant rate of surplus value—or value of the commodity labor power—and not a constant *real wage* like the authors of the neo-Ricardian Okishio's theorem do.

The naive falling rate of profit crisis theory

The most naive form of the falling rate of profit crisis theory is that the rate of profit progressively falls within each industrial cycle as the organic composition of capital rises until the rate of profit has fallen so low that the capitalists cut back their rate of investment, since the low rate of profit no longer justifies the risk and bother of investing in new factories and equipment and hiring more workers. The period leading up to a crisis, according to the supporters of the naive falling rate of profit school, is therefore not a period of the overproduction of commodities but rather a period of falling rates of profit.

Eventually, as the rate of profit keeps falling, there are fewer fields of investment that yield the minimum rate of profit that the capitalists are willing to accept. Hence, there is an overaccumlation of capital relative to the fields of available investment that yield the minimal acceptable rate of profit. Once investment starts to fall, an overproduction of commodities does appear, but according to the naive falling rate of profit school this overproduction of commodities is the *result*, not the cause, of the crisis.

Kliman does not hold to the naive version of the theory. He notes that the rate of profit actually rose just before the crisis of 2007-09 broke out, for example, something it should not have done according to the naive falling rate of profit theory. What Kliman believes happens is that as the rate of profit falls within a particular industrial cycle, the economy becomes more vulnerable to crisis. More and more businesses are operating at the edge, making barely enough profit to survive. These growing difficulties are papered over by the growing inflation of credit.

But the inflation of credit can only go so far. Eventually, the bubble bursts and the crisis is on. The immediate cause of the crisis, therefore, is a crisis in the credit system. Of course, the chain of payments, like any chain, will break at its weakest link. In the crisis of 2007-09, the weakest link was in the area of residential mortgage credit.

But according to Kliman, the crisis of the credit system was not the real cause of the crisis, nor was the overproduction of commodities the real cause. The real cause of the crisis was the relentless fall in the rate of profit brought on by the rise in the organic composition of capital during the preceding boom.

This, by the way, if I understand him correctly, is why Kliman does not believe the rate of profit has actually fallen over the history of capitalism. If it had, capitalism, according to his logic, would have never fully recovered from its very first crisis. If we apply Kliman's falling rate of profit theory to the first modern capitalist crisis—the crisis of 1825—in the period preceding that crisis, the rate of profit was already so low that capitalism could barely function.

As a result, in 1825 all it took were some problems involving gold drains and the credit system to trigger capitalism's first modern economic crisis. If the rate of profit had drifted even lower in the coming decades, capitalism would have effectively been crippled. But as Kliman demonstrates, capitalism continued to develop with great vigor—despite its periodic crises—in the years after 1825, only showing signs of getting bogged down from the 1970s onward. Therefore, Kliman quite logically draws the conclusion that there is no actual lasting downward movement of the rate of profit—at least before the 1970s.

How should we measure the rate of profit?

In Kliman's analysis, the rate of profit is therefore the crucial variable that determines the fate of capitalist production. But how exactly should we measure the rate and mass of profit? The answer to this question, as Kliman explains, is not as straightforward as it may seem. Here Kliman's latest book represents a continuation of his earlier book against the "neo-Ricardians."

If you ask an ordinary businessman how he measures his profit, he will answer that this is very easy to explain. Why we businessmen measure profit in terms of money. At the beginning of the year, I know my total capital is a certain value measured in terms of money. By value I mean my estimate of the amount of money I would get if I decided to sell all my assets—factories, machines, stocks of raw materials, and inventories—for money and decided to lay off all my workers rather than spend the money I lay aside for payment of wages to provide employment for my workers. My accountants then come up with a monetary figure that represents the value of my capital at the beginning of the year.

At the end of the year, our businessman explains, I have used up a portion of the value of my capital. This includes the wages I have paid my workers, the raw materials I have used to make my products, plus my electricity expenses, and so forth. In addition, I have to make allowances for depreciation on my fixed assets— factory buildings, machines and so on. My accountants will estimate for me the amount of capital I use up in a year including the amount of money I spend on labor. When I sell my products, their prices must cover these expenses plus an additional sum that I must add on that represents a reasonable profit. If I don't make such a profit, I won't be able to stay in business and provide continued employment for my workers.

So, we ask our businessman, you measure profits in terms of money. Yes, that is exactly what I do, he answers. But what exactly is the money that you measure your profits in terms of? Well, our businessman scratches his head, isn't it that stuff produced by the Federal Reserve System—it's green with pictures of dead presidents on it. Or maybe it is also the bank accounts. Yes, I think the economists say money is also the accounts created by the commercial banks through their loans.

Frankly, our businessman continues, I never really did understand that economic stuff. I am only a practical man. The only thing I know is that I must make money or go out of business. That is something that those who complain about the "greed" of us businessmen refuse to understand. Running a business is hard enough without having to worry about philosophical questions such as what the nature of money is. I leave that to the economists whose job it is to concern themselves about such matters.

The naive Marxist

Now let's ask a naive Marxist. You know the type, a young person who has joined a socialist group, attended a few classes in Marxist economic theory and assumes that he or she has now fully mastered the subject. (7)

Our young socialist explains that Marx said labor alone creates value. Therefore, profit is simply the unpaid labor produced by the working class. Since prices are determined by value, money merely reflects the values of commodities. Therefore, when your businessman—I would call him a capitalist exploiter—explained that he measures profits in terms of money, what he is really saying is that profits are measured in terms of labor, which is measured in terms of time. Your businessman is really measuring profit in terms of the unpaid labor that he has forced his workers to perform, whether he knows it or not.

The neo-Ricardian professor of economics

Now let's introduce into the discussion a radical professor of economics of the neo-Ricardian—or "physicalist," as Kliman calls them—school. Our "physicalist" says to our young socialist, you know I am very much in favor of socialism just like you are. But is your socialist organization still teaching you the labor theory of value? Don't they know that Marx's—and Ricardo's—theory of labor value has long since been refuted by us radical economists. We have shown that the rate of profit in terms of labor is not the same as it is in terms of money.

These results have been mathematically proven beyond all doubt. The rate of profit is not determined by the surplus value divided by the total value of capital times the turnover period of variable capital, as Marx believed, but by the real wage plus the physical conditions of production. Therefore, profits are really measured in terms of the physical product that is produced by capitalist industry.

You will understand this, our neo-Ricardian professor of economics explains to our young socialist, when you master mathematics rather than waste your time with an introduction to Marxist economics class taught by well-meaning but ignorant socialist organizers. Math, our young socialist answers, why I hate math and anyway I am far too busy organizing!

Notes Part 1

1 Historically, there was one other school of crisis theory, the school that claims that crises are brought on by disproportionate production. At present, the disproportionality theory of crises appears to have little support.

2 Kliman is a follower of the American Marxist Raya Dunayevskaya (1910-1987). Dunayevskaya was born in the Ukraine of Jewish parents and was brought to the United States by her parents as a young girl in 1920. During her teenage years, she became an enthusiastic supporter of the Russian Revolution, the Third International and the American Communist Party. In 1928, however, she broke with the leadership of the Comintern and the U.S. Communist Party and became one the first Americans to take up the cause of Leon Trotsky.

A Trotskyist during the 1930s, Dunayevskaya broke with Trotsky in 1939 over his support of the Soviet Union in the Soviet-Finnish winter war of 1939-40. She supported a breakaway group from the Trotskyist movement that refused to support the Soviet Union in any way whatsoever. The majority of these breakaway "Trotskyists"—Trotsky himself disowned them—claimed that the Soviet Union represented a new kind of class society unforeseen in Marxist theory, which they dubbed "bureaucratic collectivism." However, Dunayevskaya, working with the far better-known West Indian Marxist CLR James, developed a theory that the Soviet Union represented "state capitalism."

Dunayevskaya argued that since the Soviet state was engaged in competition with other capitals on the world market, it represented a single capital that brutally exploited the Soviet workers. Therefore, she reasoned, though there was little private ownership, the Soviet economy was fully subject to the operations of the law of value, and the Soviet economy was a capitalist economy in the full sense of the word.

But because the Soviet state owned most of the means of production, Dunayevskaya called the Soviet economy "state capitalism" to distinguish it from traditional capitalism where private ownership of the means of production predominates. Dunayevskaya believed that the Soviet economy was simply the most extreme example of a general evolution of capitalism from private capitalism to "state capitalism."

Dunayevskaya, along with CLR James, briefly rejoined the main wing of the U.S. Trotskyist movement—the one that had been supported, though not without some friction, by Trotsky himself—but then split with it a second time forming their own group. Shortly thereafter, James and Dunayevskaya split and Dunayevskaya formed what she called the Marxist-Humanist current. She became increasingly critical of not only Trotsky but Lenin as well, coming to reject Lenin's idea of a vanguard party of the working class that leads the working class to power.

Over the years, Dunayevskaya wrote many articles on politics, philosophy, problems of women's liberation and economics including on crisis theory. Dunayevskaya like the far better-known Grossman strongly defended the view that crises stem from the tendency of the rate of profit to fall due to the rising organic composition of capital. Kliman's views, though similar to Grossman's, draw their immediate inspiration from Dunayevskaya, not Grossman.

3 Reagan, a professional movie actor with a political bent was himself a strong supporter of FDR's New Deal and his Democratic Party. However, during the witch hunt in the late 1940s, Reagan "named names" in order to save his acting career. Having thus burned his bridges with the "progressive wing" of U.S. politics, Reagan then quickly evolved to the right and became a supporter of the extreme right wing of American capitalist politics. Reagan, who had been a strong "liberal" in the American sense of the world, ended up an extreme "neo-liberal," or in American parlance an extreme conservative.

4 The WPA—short for Work Projects Administration—was a New Deal program that hired the unemployed directly and put them to work on many useful public works projects, many of them still in use today.

5 In its December 2011 issue, Monthly Review published an article by Richard Preet, professor of geography at Clark University, Worcester, Massachusetts, along these lines. “Resolving finance capitalism’s dilemmas,” Preet concludes, “would require state redirection of income distribution, investment, and economic development.”

While Preet calls this a “stronger version of democratic socialism,” he means a stronger form of New Deal or Popular Front-type reformism designed to break the power of finance capital over the U.S. and world capitalist economy and not a socialist revolution in the traditional Marxist sense of the world.

The now very small U.S. Communist Party is also strongly committed to achieving a new New Deal through electing as many Democrats as possible, which is seen as a step towards a gradual democratic evolution toward socialism in the U.S. The party has long since repudiated the idea of leading a Russian-type revolution in the United States.

The U.S. Communist Party shares Professor Preet’s view that finance capital lost power under Roosevelt but regained power under Reagan and used its regained power to ditch Keynesian-type economics in favor of the neo-liberal policies that led to the recent crisis.

6 By long-term crisis of capitalism, I mean that long-term period of reduced growth that began in the 1970s and not short-term periods of absolutely falling production and employment such as occurred in 2007-09 that represent short-term cyclical crises or “recessions” in the industrial cycle. Still, even Kliman makes some distinction between the “Great Recession” proper and what he calls the “failure” of capitalist production that began in the 1970s.

7 These are the kind of people for whom the expression a little knowledge is a dangerous thing was invented.

Part 2

Measuring the mass and rate of profit

As Andrew Kliman correctly emphasizes, the rate of profit is the most important economic variable under the capitalist mode of production. Capitalist production is production for profit and only for profit.

But exactly how do we define profit, and in what medium is profit measured? As we will see, there is no general agreement among present-day Marxists on exactly what profit is and how it should be measured. And if we lack a precise definition of profit, we will obviously have difficulties in understanding the significance of the law of the tendency of the rate of profit to fall and the role that this historical tendency plays in real-world capitalist economic crises.

Should we use historical or current prices in calculating the rate and mass of profit?

Kliman strongly supports the use of historical prices rather than current prices to measure the rate of profit. But other Marxists believe that profits are more meaningfully measured in terms of current prices, or what comes to the same thing, replacement costs.

Suppose after an industrial capitalist has purchased the means of production that are necessary for him to carry out the production of his commodity, a sharp fall in prices of the means of production occurs. If we measure profits in terms of historical prices, we may find that our industrial capitalist has not made a profit at all but rather a loss.

However, since the purchasing power of money has risen relative to the means of production used by our capitalist, he will be able to purchase a greater quantity of the means of production than before. Therefore, in *real terms* he will be able to carry out production on an *expanded* scale. In that case, hasn't our capitalist made a profit after all?

Suppose the fall in the level of prices reflects a fall in labor values of the commodities that make up the means of production. In terms of value—abstract human labor embodied in commodities measured in terms of time—he will be in possession of *less* value than when he started. In value terms, he will have made a loss, but in terms of material use values he will have made a profit.

As we know, capitalists are forced under the pressure of competition among themselves to maximize their accumulation of capital and not means of personal consumption, nor in terms of means of production used to produce means of personal consumption. Instead, each individual capitalist, according to Marx, is forced to maximize the accumulation of capital in terms of value.

Therefore, if an industrial capitalist is losing wealth as measured in value terms, won't he be losing capital, not accumulating it? And if this continues, won't he lose all his capital? That is, at a certain point won't he cease to be a capitalist? Kliman, if I understand him correctly, would strongly agree with this argument.

However, not all economists would agree. For example, the "neo-Ricardians"—or "physicalists" as Kliman likes to call them—claim that labor values have no relationship to prices. The physicalist economists therefore deny that labor value has any importance at all to the capitalist economy. According to these economists, the accumulation of capital cannot therefore be measured in terms of labor values; it must be measured in terms of the accumulation of material use values.

Our physicalists would argue—and the physicalists here include not only "neo-Ricardians" but economists of the neo-classical and Austrian persuasions—that once the effects of deflation—falling prices—have been taken into account, our industrial capitalist has indeed made a profit. (1)

Profits are measured in terms of money

However, despite the claims of the physicalists of all schools, as far as actual capitalists are concerned profits are measured not in terms of physical means of production but in terms of money.

We often hear that the shares of a given corporation soared—or declined—on the stock exchange because the company "beat its numbers"—or fell short of the "Street's" expectations. For example, a given company might "beat its numbers" by 25 cents a share or fall short of expectations by 25 cents. We don't read that the company beat its numbers or fell short of them by 0.001 lathes per share, or 0.004 industrial robots per share or 0.005 employed workers—labor power—per-share.

Ask any businessman and he will tell you his aim is to make *money*—not increase the quantity of factory buildings, lathes, industrial robots or number of workers at work in his factories or other productive enterprises.

But wait a minute! In order to make money, isn't it necessary for industrial capitalists to increase their factory buildings, lathes, industrial robots and number of workers employed and thus increase the overall wealth of society? Any physicalist economist will explain that the real purpose of a "free market economy," as they prefer to call capitalism, is to increase the wealth of human society to the maximum extent possible.

Profit measured in terms of dollars and cents—money—is simply the way real wealth is measured, according to the physicalists. The real purpose of a "free market economy" is to increase as much as possible the wealth of society measured in terms of utilities (use values) that are desired by the members of society.

This is, however, not the way the capitalists engaged in the day-to-day struggle of capitalist competition see it. From the viewpoint of the capitalists themselves, the making of money is indeed the end, and any increase in material wealth that results from this is merely an unintended *side* effect.

If a capitalist can make the same amount or even a greater amount of money by lending money at interest (M—M'), for example, this is just as legitimate as far as the "bottom line" is concerned as making the same amount of money by building a new factory that produces medicines to fight childhood diseases.

The aims and historical significance of capitalist production

According to the Marxist theory of historical materialism, the justification of the capitalist mode of production, with its cruel exploitation, is precisely the vast increase of the material wealth of society in terms of the use values of commodities. It also brings about a vast increase in the productive powers of labor as well as the creation of a class of wage workers that has both the material interest and potential to transform exploitive capitalism into a classless society.

Remember, historical materialism teaches us that any conception of socialism without the huge accumulation of material wealth that has occurred during the era of capitalist production is a pipe dream. So what is a mere side effect for the capitalists themselves is actually the most important historical result of capitalist production.

How the capitalists measure their wealth

Publicly traded corporations are obliged to issue two types of financial reports: income statements and balance sheets. The income statement more or less honestly—and sometimes not so honestly—measures the mass and rate of profit. The balance sheet attempts—again more or less honestly or not so honestly—to measure the wealth of the corporation as a whole.

The balance sheet will actually list the material elements of the wealth of the corporation in use value terms, though often the details are quite skimpy. Each listed material element of wealth is, however, assigned a monetary value. We may see a factory employing thousands of workers busy night and day producing automobiles, clothes, iPads, medicines and so forth, but the men—and nowadays a few women—who run the corporations see a definite sum of money, measured in terms of dollars, euros, yen or yuan as the case may be.

Whether it is a worker at work—variable capital—or a machine, or a stock of yet to be sold finished goods—commodity capital—each material element of wealth is valued by capitalists and their accountants in terms of a *definite quantity of money*.

While a typical industrial capitalist—or corporate officer—will have trouble defining exactly what money is if you try to pin him or her down, he or she does know that money is infinitely divisible and that a given unit of money—for example, a U.S. dollar, is equivalent to another U.S. dollar. Therefore, unlike the use values that make up material wealth that differ qualitatively from one another, money is made up of some sort of uniform substance. Different quantities of money are *qualitatively* identical and differ only in *quantitative* terms.

Our industrial capitalist—especially nowadays—is also aware that the same thing is true across currency units. At any given point in time, assuming that a euro is worth say $1.30, a euro represents the same exact quantity of wealth measured in terms of money as one U.S. dollar and 30 cents. Behind dollars, euros, yuan, and yen there is hiding the common substance called money. Every active capitalist knows—or if he or she doesn't they won't remain a capitalist for very long—that this money substance must be increased as much as possible at the pain of ruin.

At the end of the day, the corporations—and non-corporate capitalists as well—will commit any crime—even risk life on earth itself (2)—to increase this all-important substance called money, which represents social wealth in general but not wealth in the form of specific means of production or means of personal consumption.

Only a portion of the total capital is money capital

It is sometimes claimed that the capitalists' aim is to increase the quantity of money capital—that is, capital existing in the form of money. This, however, is not true. While a certain portion of the wealth of capitalist society must exist in the form of money—for example, dollar, euro, yuan, yen and so forth bills you carry in your wallet—the vast bulk of the wealth in capitalist society most certainly *does not exist in the form of money*.

The aim of capitalist production is not to maximize the quantity of money itself—this is where a capitalist differs from a miser—but to increase the quantity of wealth *measured in terms of money*. Most of the "money" here is actually imaginary money or what Marx called money of account.

Kliman is a Marxist who unlike the "neo-Ricardians" upholds the law of labor value. He like all Marxists who accept in some form the Marxist theory of value knows that behind this mysterious substance called money there lies a social substance called value. Money, virtually all Marxists who concern themselves with questions of economic theory would agree, represents value.

But what is the actual relationship between wealth measured in terms of money—dollars and cents—and value measured in terms of abstract human labor? Here things can get tricky.

Monetary expression of labor time, or MELT

Kliman measures capitalist wealth through what he among other Marxists call the monetary expression of labor time, or MELT. This seems reasonable. But exactly what is the relationship between value—embodied labor time—and its monetary expression?

If prices directly equaled value, things would be quite simple. If a factory is worth $10 million, this would be just another way of saying that this type of factory on average takes x number of hours of abstract human labor to construct. Using dollars rather than hours would be simply a convenience.

Indeed, this this is exactly what Marx himself did when he explained surplus value on the basis of the exchange of commodities with other commodities of equal value in Volume I of "Capital." Indeed, Marx insisted that surplus value *cannot be explained without this assumption*. So, for certain problems, including the most important question in all economics, the origins and nature of surplus value, the concept of MELT is quite useful.

But Kliman knows that real-world market prices are constantly deviating from values. The real problem is exactly how we relate the world of prices to the world of human beings engaged in production and exchange. In other words, what is the relationship—if any—between wealth measured in money and wealth measured in labor value?

Since the end of the Ricardian era, the (bourgeois) economists, whether they are Austrians, neo-classicals or neo-Ricardians, deny that wealth measured in terms of (labor) value and wealth measured in terms of money have any meaningful relationship to one another. Therefore, these “physicalist” economists claim that the concept of MELT is meaningless. They instead make a kind of shortcut, directly connecting wealth in terms of utilities, or use values, with wealth measured in terms of money.

MELT, in contrast to the physicalist theories of the neo-Ricardians—and other bourgeois economists—attempts to connect monetary value and value based on abstract human labor directly. The idea behind MELT without a money commodity is that a dollar, a euro and so on represents a definite quantum of value—abstract human labor—that is not embodied in any particular commodity but rather reflects the value embodied in commodities as a whole. While the supporters of MELT agree that individual prices can and indeed do deviate from values, the sum of prices will equal the sum of values.

As we saw when we examined Kliman’s earlier book “Reclaiming Marx’s Capital,” to the supporters of MELT the sum of the prices of production equals the sum of direct prices, and the rate of profit calculated in terms of values will exactly equal the rate of profit in terms of both direct prices and values. Marx himself made these assumptions, though he noted as we will see below that these equalities were only approximate, not exact.

These equalities, if they are treated as exact as opposed to approximate, will inevitably lead to contradictions that open the door to the neo-Ricardians. The neo-Ricardians have no difficulty showing that except under unrealistically restrictive assumptions, the rate of profit in terms of value and in terms of money will never be exactly equal.

The neo-Ricardians then jump to the conclusion that the rate of profit in terms of value is meaningless. The neo-Ricardians profoundly “explain” that the decisions made by real-world capitalists have nothing to do with the value rate of profit. After all, real world capitalists neither care about the value rate of profit nor know what the value rate of profit is. This is certainly true as far as it goes.

Faced with what appears to them to be contradictions in Marx’s theory of value, the neo-Ricardians give up and retreat from value theory altogether to the “commonsense view” that profit simply consists of the growing mass of material use values produced by capitalist industry minus the means of consumption the workers get to consume in exchange for their labor. The neo-classicals and Austrians reply to the neo-Ricardians: We told you so all along.

If you accept these arguments of the neo-Ricardians, you naturally will tend to agree that it is more meaningful to measure profits in terms of current prices—taking into consideration the effects of either inflation or deflation, as the case may be—as opposed to historical prices. After all, just as the workers are ultimately more concerned with real wages—what their wages actually buy—aren’t the capitalists also more concerned with their real profits—what their profits buy in terms of material use values as opposed to their purely nominal money profits? (3)

From the classical economists to Marx

While today’s bourgeois economists are all “physicalists,” this was not the case with the classical economists. Though the French school of the Physiocrats were physicalists in the sense that they confused surplus value with the biological fact that if you plant a certain quantity of corn seeds, at the end of the growing season you will possess more corn seeds than you began with. This is why the Physiocrats saw only agricultural labor as productive of surplus value. Though naive, this view was still a great advance over the view that surplus value arises in the sphere of circulation and not the sphere of production.

It was the English school of classical political economy—England and Scotland being the countries where capitalist production was most advanced—that developed the distinction between what they called value in use—use values—and value in exchange that is produced only by human labor.

The distinction of English classical economy between use value and exchange value was the starting point for Marx. Nobody was ever born an accomplished Marxist economist, not even Marx. In the beginning, Marx was the student of the classical economists. He did not become a fully fledged

“Marxist” economist all at once. Inevitably, therefore, Marx’s early writings are mixture of “Marxism” and classical political economy. (4)

However, by the time he wrote “Capital,” Marx described not two but three types of “value.” In addition to use value and exchange value, the distinction he inherited directly from classical political economy, Marx distinguished between value and the *form of value*—exchange value. Why did Marx introduce this distinction that was unknown to the classical economists? Was he simply showing off his philosophical education? Remember, Marx was a philosophy major in college and held a doctorate in philosophy.

Since Marx did not fully develop the distinction between value and exchange value until relatively late in his career and didn’t make this distinction in his earlier writings, many modern Marxists, who often lack a proper philosophical education, remain confused on this question. The very concept of “forms,” after all, takes us back to the world of ancient Greek philosophy. What do the old Greeks who lived thousands of years ago in a slave—not capitalist—society have to do with the economics of modern capitalist society (5)

I believe that without understanding the distinction between value and the form of value, we not only fail to fully grasp Marx’s theory of value—at best, we have an understanding of value that is somewhere between that of Ricardo and the mature Marx—we cannot fully understand either capitalist crises or the evolution and fate of modern capitalist society.

What is this “form of value” and how does it differ from “value.” According to Marx, the form of value is *exchange value*. Exchange value arises because value, after the earliest phases of barter, cannot express itself directly as hours of labor but must express itself through the ratio in which a commodity of one use value exchanges with a commodity of another use value.

Let’s take an example that Marx himself used in “Capital.” Suppose a coat of a given quality is exchanged for a given number of yards of linen. How would a merchant measure the amount of coats he has in inventory? He would measure the coats in discreet units—by how many physical individual coats he has in inventory. Why does he measure coats this way? Because it is in the nature of coats as a material use value that two coats can never be combined into one coat. Also if you cut a coat in half, the coat will lose its entire use value as a coat.

Linen, by contrast, has a completely different unit of measure, some unit of length. Marx uses the old English measure of length called a yard, which consists of three old English feet. These old English units of measure are still used in the United States, but most of the rest of the world uses meters. A yard is roughly the old English equivalent of a modern metric meter. If Marx was writing “Capital” today, he would probably have used meters rather than yards. But old English yards and metric meters have one thing in common, they are both measures of length. Therefore, the use value of linen is measured in some unit of length.

Notice that the use value of our two different commodities, coats and linen, are measured in totally different units. In contrast, their (labor) *values* are measured in a common unit of measure, the quantity of abstract human labor measured in units of time. The unit of time may be hours, minutes or seconds just like we can measure the *lengths* of linen in terms of either meters or yards.

Suppose I am the maker of the coat and barter it for linen. I am interested in what the value in exchange of my coat will be in terms of linen—measured in yards or meters. This brings us to the *distinction* between value and exchange value. In the above example that I borrowed from “Capital,” the value of the coat is measured in abstract human labor—that is, in some measure of time. In contrast, the exchange value of the coat is measured in terms of units of linen measured in some unit of length.

Therefore, value and exchange value are two distinct relationships. However, the fact that the coat and a given quantity of linen are being exchanged implies that they have something in common. But what is it? Marx finds that what they have in common is that they are both products of abstract human labor. Not the specific human labor that produces a coat nor the specific human labor that produces linen, but what the human labor that produces coats, linen, gold, iron and so on have in common.

When the value of the coat corresponds directly to the value of linen it exchanges for, the coat represents the same quantity of *abstract* human labor that the linen does. This relationship, however, includes the possibility, and, in the real world as Marx makes clear, the overwhelming probability, that the coat and linen will exchange at some ratio other than the one that exactly expresses the coat's labor value.

Indeed, Marx explains again and again that exchange value virtually *never* expresses value exactly. The distinction between exchange value exactly expressing value—the rare exception—and exchange value not exactly expressing value—almost always the case—causes any concept of MELT *without a commodity like linen that measures the value of a coat in terms of its own use value* to break down.

Marx explains that the exchange value relationship where the exchange value of a coat is measured in terms of a given quantity of the use value of linen contains in embryo the money relationship. In order to arrive at the money relationship of production, we simply have to generalize the relationship between the coat and the linen. Instead of measuring the exchange value of only a coat in terms of linen, we can measure the exchange value of all commodities—except linen—in terms of linen. In that case, linen would serve as money. Alternatively, we can replace linen with a more suitable commodity—a precious metal such as gold.

To return for a moment to the coat-linen example, Marx calls the coat—the commodity whose value is being measured—the *relative form* of value and the linen—the commodity that serves as the unit of measure of exchange value—the *equivalent form* of value. Of course, in a simple barter exchange we could just as well use coats to measure the exchange value of linen. In that case, we would call the coat the equivalent form of value and the linen the relative form of value.

But this ceases to be true once a commodity establishes itself as the universal equivalent. Why do we need a universal equivalent? When only a few products of human labor are exchanged, we really don't need a *universal* equivalent. However, this changes once hundreds and then thousands of products—still far less than the millions of types of commodities that are exchanged today—are exchanged. Indeed, if we did not have a universal equivalent, every commodity would have many thousands of prices, or as many prices as there are commodities with distinct use values and qualities—minus one, the commodity whose value we are trying to determine.

This problem is easily solved if we simply set one commodity aside and use its use value to measure the exchange values of all other commodities. In "Capital," Marx gives an example where linen serves as the universal equivalent and calls it the general form of value because linen is not really a very good money. He then gives another example where gold replaces linen as the universal measure of value. We have arrived at the stage of money where gold serves as the universal equivalent, or money commodity.

Price is shown to be the measure of the value of a commodity—value must always be measured in terms of its value form, exchange value—as a given weight of the precious metal gold. The value of a commodity can never be measured directly in terms of quantities of abstract labor but only through the *form* of exchange value. Once gold has established itself as the universal equivalent, the values of all commodities, all the wealth of capitalist society, are measured in terms of weights of gold—that is, in terms of prices.

Whatever commodity serves as money, whether gold, silver or some other commodity, is not determined by any individual, government or "monetary authority" but rather by a process akin to natural selection. Some commodities, due to their material use values—such as gold, for example—make better potential monies than other commodities with different use values, such as linen.

Gold is superior to linen as a money commodity because it contains a much greater quantity of value in a smaller physical mass, it does not deteriorate with time as linen does, and it is divisible down to its atomic level. Gold therefore approximates the (in principle) infinite divisibility of embodied abstract human labor much better than the physical divisibility of linen. Also, unlike linen, different quantities of gold can be easily recombined by melting down different physical pieces of gold and recombining them.

For example, gold coins can be melted down and forged into a bar of bullion, which is the purest form of money. A bar of bullion can also be melted down and minted into many gold coins. Currency units can then be defined as specific weights of gold, and gold then becomes the standard of price. Prices then become physical quantities of gold measured in terms of a given unit of weight. In this way, all the wealth of the capitalist world can be measured in terms of weights of gold.

Why can't we use embodied labor to directly measure wealth?

But why do we need to measure value—embodied abstract human labor—indirectly though the value form of exchange value rather than directly? Why can't we measure value directly in terms of labor time? Wouldn't this be far superior to the system of using exchange value, which introduces the possibility, neigh the inevitability, of value being measured imperfectly?

In the 19th century, a whole series of reformers, including the Ricardian socialists and the French anarchist-socialist Pierre-Joseph Proudhon proposed just such a reform. These proposed reforms involved the setting up of a labor bank that would assess the value of every commodity presented to it in terms of the quantity of labor it took on average to produce. In exchange for the commodity, it was proposed by the reformers, the bank would issue a unit of currency that would represent the value of the commodity in question in terms of the labor that was necessary to produce it.

This "labor money" would then be exchangeable by its owner for any other commodity that represented the same quantity of labor as determined by the labor bank, whose employees would presumably be experts in determining the quantity of labor it takes on average to produce a given commodity of a given use value and a given quality.

The champions of labor money believed that such a system would be vastly preferable to the system of measuring the values of commodities indirectly through exchange values—or under modern conditions—the price system, because it would eliminate unequal exchanges between commodity users.

Pre-Marxist socialists such as the Ricardian socialists believed that by eliminating the unequal exchange of commodities, surplus value would be eliminated thus rendering the existence of a class of wealthy non-workers who live off the unpaid labor of the working class impossible.

These early socialist champions of labor money lived before Marx demonstrated that surplus value arises not through the unequal exchange of commodities but on the basis of the equal exchanges of commodities of a given value. This becomes apparent as soon as we distinguish between the labor performed by the workers and the ability of the worker to work (labor power), which is the actual commodity that the worker sells to the capitalist. Therefore, even if a system of labor money could actually work, it would not eliminate surplus value. Its only merit would be that it would make surplus value transparent rather than hidden behind equal and apparently voluntary exchanges by two equal contracting parties such as is the case under the money price system.

But could such a system of labor money work, at least in principle? Marx explained that it could not under a capitalist or indeed any other form of commodity production. Why is this? Because if every commodity producer was guaranteed the sale of his or her commodity at its value regardless of whether or not its use value actually met any real need, there would be no mechanism whatsoever to see to it that the use values would be produced in anything like the proper proportions. Social production would disintegrate entirely unless the labor bank was a "despotic ruler of production," as Marx put it in "The Grundrisse," and determined the proportions in which the use values were actually produced. (6)

In those circumstances, we would no longer have commodity production—a market economy—and without commodity production we would no longer have capitalist production because capitalist production is simply generalized commodity production where labor power itself has become a commodity.

Commodity producers know that they are producing too much of a commodity of a given use value and quality precisely when its price falls below its value, and they know that they are producing too little when the price of the commodity in question rises above its value.

Since the competitive relationship among commodity producers *forces* them to adjust the amounts they produce to maximize their appropriation of value as measured in money, the endless fluctuations of prices around the axis of values makes possible the production of material use values in approximately the right proportions. It is the price mechanism that makes the existence of commodity producing societies including capitalist society possible in the first place.

Therefore, what at first appears as a grave defect in the money-price system—the fact that it measures the values of commodities imperfectly—turns out to be *absolutely necessity* for the existence of the whole system of commodity production and *therefore no defect at all*.

Real money versus money of account

Since money must exist in the form of an actual commodity, it is possible to actually possess exchange value in a material form. Marx described metallic money such as gold bullion as the *independent* form of exchange value. Though I can't carry around units of unchanging "real purchasing power" in my pocket, I can literally carry exchange value around in my pocket in the form of gold coins, or in the form of tokens, such as paper dollars, that represent the money commodity and are exchangeable for the money commodity.

IOUs payable in real money—credit money—or monetary tokens that are convertible on the "free market" into gold bullion can serve as money substitutes but *only to the extent that they are convertible into real, that is commodity, money*. Therefore, in addition to possessing real capital—capital that consists of material use values other than money—a capitalist has to possess a certain amount of wealth, even if only a small portion, in the form of money—either in the form of actual money—gold bullion—or in the form of money substitutes that represent real money such as token money, or credit money—for example, a checking account at a commercial bank.

The quantity of money substitutes that can be created by the "monetary authority" and the banking system, measured in terms of weights of real money without depreciating against real money, will ultimately be limited by the amount of real money in existence.

Money of account

In addition to real money—and its representatives such as token and credit money—there is also the purely imaginary money that capitalists use to value the commodity elements of their real capital. This type of imaginary money used for valuation Marx called money of account.

With this in mind, let's take another look at the question as to whether profit should be calculated on the basis of historical costs, as Kliman insists it should, or current costs. The formula for capitalist production is M—C..P..C'—M'. Our industrial capitalist must start with a definite sum of money M—called "seed money" in business terminology. He can invest the money in a business in the *hope* of making a profit *in terms of money* or he can for the time being hold onto wealth in the form of money. If the capitalist chooses the latter course, he will forgo the opportunity of making a profit. In this case, he won't strictly be acting as a capitalist just yet but rather as a miser.

Since our man wants to be a capitalist and not a miser, he will if at all possible use his money to create a business that realizes a profit in terms of money. But under certain conditions, such as a crisis, he will be well advised to postpone the founding of a business until favorable conditions for profit-making return. In the wake of a crisis—like the present—there are widespread complaints that the capitalists—corporations and banks—are sitting on huge sums of accumulated money. Why are they seemingly so irrational?

In reality, they are waiting for the prospects for profit-making to become more favorable. When these prospects become favorable enough, they will indeed invest the money and keep on investing and then borrowing money in ever greater quantities until the market is again flooded with unsold commodities and profits again collapse.

In order to grasp this, let's tell a story of two would-be capitalists. Each of our capitalists starts with an equal amount of money. Exactly how they got the money—whether through inheritance, winning the lottery, theft, or some other way—is of no concern here. One of our would-be capitalists correctly senses that a crisis is approaching and expects a sharp fall in prices that will preclude any possibility of realizing a profit *in terms of money* in the immediate future. He decides to hold onto his money until the approaching crisis runs it course.

Capitalist number two wrongly expects that prosperity will continue and goes ahead and invests his money by setting up factories and purchasing raw materials and labor power. The crisis arrives and prices fall exactly as capitalist number one expected. In money terms, our first capitalist has neither made a profit nor a loss. (We assume he has some other source of income to keep himself alive as he waits for the crisis to bottom out.) He has exactly the same amount as wealth, all in the form of money, that he had before.

Our second capitalist has made a loss in terms of money but due to the rise in the purchasing power of money, he is in a position to actually expand the scale of his operations. In terms of historical prices—the way Kliman calculates profit—our second capitalist has made a loss but in terms of current costs he has made a profit.

Now let's assume that the crisis has run its course. Prices have bottomed out and are set to rise. In terms of money, which capitalist possesses greater wealth? Our second capitalist has lost wealth in terms of money though he has increased his wealth in real terms—that is, in terms of accumulated material use values. Our first capitalist has neither gained nor lost wealth in terms of money, since all his wealth is in the form of money, but he too has gained in terms of real wealth because the purchasing power of his money is greater than it was before the crisis caused prices to fall.

The first capitalist who has kept his wealth in money has two advantages over the second capitalist. First, he has a greater mass of wealth in terms of money. Second, since all his wealth is in the abstract form of money, he can convert his money wealth into any specific form of wealth he wants to. Since it is his intention to act as an industrial capitalist, he enters the market as a buyer and buys up means of production, raw and auxiliary materials, and labor power. He now has a greater mass of real capital than our first capitalist. He also has the advantage of having not only more machines but the latest models that are more efficient than the older models possessed by our second capitalist.

Since our first capitalist's cost prices are lower and he can undersell our second capitalist as well as produce on a greater scale, he drives our second capitalist out of business depriving him of all his capital. Very likely he will be in a position to buy our second capitalist's means of production at bargain basement prices and add it to his own means of of production. The fact that our second, now ex-capitalist made a profit in terms of current costs is small consolation to him.

Therefore, Kliman is absolutely correct on the need to calculate profits from historical costs, not current costs. Profits have to be calculated in terms of the amount of money capital that the capitalist actually advanced when he bought his means of production, raw materials and labor and not the costs that the means of production and labor power would have cost him at the present time. If these have fallen, so much the worse for him.

MELT and the relationship between prices and values

The most naive theory of the relationship between values reckoned in hours of abstract human labor and prices reckoned in weights of gold bullion is that prices always equal values. More precisely, since hours of abstract human labor are not really the same thing as weights of gold bullion, the gold serving as the money commodity always exchanges for a quantity of commodities that embodies exactly the same quantity of labor that the gold did. However, as we have seen, this is ruled out *even in theory*, since if it were true, there would be no mechanism in a commodity-producing economy to allocate the labor available to society to carry out production in the proper proportions.

Still, as we have already noted, making the assumption that prices are indeed directly proportional to labor values is absolutely necessary for solving some problems including the *most important problem* in all economics, the origin and nature of profit—surplus value.

A somewhat less naive theory would be that while individual prices of commodities deviate from their values, the sum total of all prices always equals the sum total of the direct prices of all commodities. Under this assumption, the total sum of the prices of production will always equal the total sum of direct prices. We can then show that the total quantity of surplus value equals the total quantity of profit—surplus value—measured in terms of exchange value or physical weights of gold, assuming gold serves as money, both in terms of the mass of profit and the rate of profit.

Used correctly, this a powerful abstraction. It is absolutely necessary for solving certain problems such as the transformation of prices that are directly proportional to values into prices of production that ensure that equal quantities of capital yield equal profits in equal periods of time. It allows us to understand the division of the total social surplus value between the capitalists working with capitals of different organic compositions, as well as the nature of ground rent. Finally, it is necessary to explain the law of the tendency of the rate of profit to fall—the most important law of political economy according to Marx.

However, we have to keep in mind the limitations as well as the power of this abstraction. When we talk about the total sum of the prices of commodities, we are not actually talking about all commodities, because we are always leaving one commodity out—the commodity whose use value serves to express exchange value. We cannot forget that the total sum of commodities N *does not equal* N–1, the total sum of commodities minus the commodity that functions as money and serves as the "yardstick" that measures in its own use value the values of all other commodities. This inevitably transforms the exact equalities of prices and values—or direct prices—into *approximate* equalities. (See this previous post for a more in-depth discussion of the transformation problem.)

By failing to grasp this, many of our post-Marx Marxists have left the door open for the "neo-Ricardians"—who seek to replace Marxist economics with vulgar economics, or to the extent that the "neo-Ricardians" are socialists, replace scientific socialism with vulgar socialism.

MELT, paper money and metallic money

For the purpose of explaining surplus value, the concept of the monetary expression of labor time—MELT—is adequate, even if we do not need to understand that non-commodity money is impossible. We do not need Marx's full theory of value to understand the most important problem in all economics, though we *will need* it later to defend Marx's discovery on the origin and nature of surplus value against the "neo-Ricardian" attack.

But when it comes to examining the world of ever-fluctuating market prices, MELT *without a money commodity* will not do. We have to understand that market prices are virtually never equal to direct prices, whether of individual commodities or of commodities as a whole. Here we need to understand what laws really govern the movement of market prices.

As prices of commodities as a whole rise above their direct prices, as they do during an economic boom, the capitalists indeed make a higher rate of profit in money terms than they do in value terms. This is exactly what present-day neo-Keynesian economics—and its echo in the Keynesian-Marxist school that Kliman rightly polemicizes against—bases itself on. The Keynesian-influenced policy makers figure that as long as they ensure that there is a gradual rise in the general price level—called inflation targeting—they will ensure that business will always be profitable. However, we know that extra profits made by capitalists due to a rising general price level that does not reflect changes in values or a rise in the rate of surplus value are *temporary*.

Such price movements have no lasting effect on the rate of profit. Inevitably, such a rise in prices will set in motion forces that will lower them once again—at least when prices are calculated in terms of the use value of the money commodity—weights of gold.

Inevitably, the extra profits made by capitalists due to such a rise in prices above values will be offset by losses that will occur when prices inevitably fall once again to a level that is below the direct prices of commodities. When this happens, forces will be set in motion that will again raise prices. In the long run, therefore, the rate of profit calculated in terms of the use value of the money commodity—weights of gold—will fluctuate around a level that *approximately* corresponds to the value rate of profit, just like the prices of individual commodities fluctuate around an axis that *approximately* equals the direct prices of the commodities in question.

In only one sense are "physicalists" right when they claim that profit must be measured in terms of physical quantities. Profit must indeed be measured in a physical quantity but only the physical quantity of the use value of the commodity that serves as the *universal equivalent*, or money, commodity. If linen serves as the universal equivalent—like it does in Marx's coat-linen example—profits would have to be reckoned in yards or meters of linen. If gold serves as the universal equivalent, profits have to be calculated in terms of weights of gold—metric tons.

The measure of profit since the end of the gold standard

Under a gold standard, the rate of profit in terms gold bullion and the rate of profit in terms of currency are identical. This is because currency units—dollars, pounds and so on—are defined in terms of specific weights of gold bullion. The last time a gold standard prevailed—during the Bretton Woods system—the U.S. dollar was defined as 1/35th of a troy ounce of fine gold.

However, under a system of token money, currency units like dollars have no *fixed* definition in terms of gold. This gives rise to the illusion that currency somehow serves as tokens of value directly and therefore acts as non-commodity money as opposed to mere money substitutes. This is the mistake the supporters of MELT make. They imagine that the value of the coat can be measured by tokens that directly represent value as opposed to being measured by the use value of linen. But Marx proved this to be impossible.

Because labor under any system of commodity production, including capitalist production, is private, it can only express its social nature by exchanging for another commodity with a different use value. Except for the earliest stages of barter, the abstract labor embodied in a particular commodity having a particular use value with a particular quality must prove its convertibility into a given quantity of the money commodity measured in the unit appropriate for the use value of the money commodity. This is necessary to demonstrate that the abstract human labor embodied in it is actually a fraction of the total *social* labor. In contrast to all other commodities, the labor embodied in the money commodity, Marx explained, is *directly* social.

The effects of the depreciation of token money

During the 1970s, the currency price of gold—the exchange rate of dollar monetary tokens with the money commodity gold bullion—rose so rapidly that hoarding gold was more profitable than most lines of business. While prices were rising in terms of U.S. dollars and other currencies linked to the U.S. dollar under the dollar system, prices calculated in terms of gold bullion fell rapidly, in fact so rapidly that profits in terms of gold bullion were wiped out. This did not mean that surplus value wasn't being produced—it was—but the surplus value wasn't being realized in terms of the use value of the money commodity—gold bullion.

However, though paper money was losing purchasing power against commodities, real rates of profits—after inflation was taken into account—profits measured in terms of commodities in general were still high enough to make possible continued expanded reproduction in physical terms. Therefore, virtually all bourgeois economists and most Marxists assumed that production was still profitable since in physical terms the capitalists were proceeding with expanded reproduction—even if at a somewhat reduced pace.

Most economists would agree that nominal profits were somewhat overstated in the 1970s due to inflation. In a period of high inflation like the 1970s, if we calculate prices in terms of current costs as opposed to historic costs, the rate of profit will be considerably lower. What is often not realized is that we have to distinguish between a rise in prices *in terms of gold* and a rise in prices produced by the depreciation of the paper currency against gold. For example, the high inflation during World War I in the U.S. is an example of inflation of the former type, while the high rate of inflation during the 1970s is an example of the latter type.

In the U.S. economy during World War I, it was not simply prices in terms of gold that rose independently of value, it was profits in terms of gold as well. But precisely because the movements of prices and profits did not reflect real changes in underlying labor values, they proved unsustainable. The profit bonanza of World War I was ultimately paid for by the huge losses that the capitalists incurred in the early 1930s. This played no small role in the origins of the the Great Depression. This was the market's way of balancing things out so that in the *long run*, the rate of profit in value terms and the rate of profit in gold and currency terms were pretty much in line with the value rate of profit.

But what about the 1970s when the movements of not only prices but also profit measured in terms of depreciating U.S. dollars diverged sharply from prices and profits measured in terms of gold bullion. Under the influence of Keynes, during the 1970s Washington policy assumed that by tolerating a rather high rate of inflation in dollar terms they were successfully staving of a situation where falling prices would cause profits to disappear entirely for a number of years like happened in the early 1930s.

The pragmatic policymakers reasoned that practical businessmen were governed by profit in terms of official legal tender currency, not profits in terms of gold bullion. Washington—echoed by Keynesians and the supporters of Milton Friedman as well—claimed that gold was being "demonetized" and that in the future a "pure" fiat currency would act as the measure of value directly without any help from gold or any other commodity.

It is true that except in the final stages of extreme hyper-inflations, practical businessmen will measure their profits in terms of official legal tender currency, though there was a general feeling during the 1970s that the official rates of profit in terms of paper dollars were being considerably overstated. If inflation was taken into account, the mass and rate of profit would be lower, both bourgeois and Marxist economists alike reasoned. (7)

However, the same practical businessmen are always looking to move their capital into the areas where they earn the highest rate of profit in terms official legal tender currency. During the 1970s the most "profitable" area to invest capital was to purchase and hoard gold bullion. Of course, if we measure profits in terms of gold the mere hoarding of gold by definition bears no profit. Leaving aside the costs of storage you simply break even. If, however, we combine Marx's analysis of value and exchange value as the form of value while never forgetting that capitalism cannot *exist* for very long without a *positive rate* of profit, we draw the conclusion that a situation like the 1970s where profits remain positive in terms of paper money but are strongly negative in terms of gold bullion is *unsustainable*.

Why the 'Volcker shock' was necessary to save capitalism

Most radical Keynesians and Keynesian-Marxists argue that the Volcker shock was either a horrible mistake or, as the Keynesian-Marxist Doug Henwood argues, a move to lower real wages by the Federal Reserve System. (8) It would have been possible, they argue, to avoid the horrible "Volcker shock" recession and the reactionary policies of the Reagan presidency that followed if only the U.S. policymakers of the time had been willing to tolerate a little more inflation or a somewhat higher real wage.

However, in reality the only real alternative to the Volcker shock would have been a *socialist revolution*. Any attempt to maintain the situation where the rate of profit was positive in terms of paper money but negative in terms of gold bullion would have been incompatible with the continuation of the capitalist system. A continuation of Keynesian-type stimulus polices under the conditions of the late 1970s and early 1980s was simply not an option. Under pain of complete economic collapse, a positive rate of profit in terms of gold bullion had to be restored.

Of course, it is unlikely that practical policymakers such as Paul Volcker understood this in the above terms. So how did the necessity of stabilizing the dollar in order to restore a positive rate of gold profit impress itself on their practical minds?

In 1979, the Federal Reserve System, like it generally does in "normal times," had been targeting interest rates. As inflation accelerated, interest rates—in terms of paper dollars—rose. Since the Federal Reserve System was attempting to hold interest rates down in an attempt to maintain prosperity, it responded to the rising interest rates by issuing more token dollars—which led to still greater depreciation of the U.S. dollar, higher inflation and higher nominal interest rates.

Finally, between August 1979 and January 1980, the dollar price of gold rose from around $300 in August to $875 at one point in January. Within a period of only five months, the U.S. dollar had lost considerably more than half its gold value. If the Federal Reserve System had attempted to continue to hold interest rates down, it would have had to more than double the quantity of U.S. token dollars at a time when there was a run out of, not into, the U.S. dollar—like there was in the last quarter of 2008. The stampede out of the dollar and its satellite paper currencies into gold would have rapidly intensified. (See this and this earlier post on the stagflation period.)

If the Fed had continued to fight the rise in nominal interest rates by creating ever more dollar token money at an accelerating pace, the result would have been true hyper-inflation, where the capitalists would have stopped calculating prices and profits in terms of paper dollars altogether and instead would have increasingly calculated them directly in terms of weights of gold. If inflation had continued to increase, they would have refused to sell commodities for paper dollars and demanded gold instead. Under these conditions, the government would have been unable to enforce the legal tender laws. The system of paper currency and the credit system built on top of it would have been wiped out entirely.

At this point, it became clear to practical policymakers such as Volcker that the Keynesian "cure" was worse than the disease.

How we interpret the "Volcker shock" has important *political* implications. Keynesian demand management policies at a certain point inevitably run into a blind alley—or the "metal barrier," as Marx called it in Volume 3 of "Capital"—in the form of a runaway demand for gold. Though Keynesian-Marxists are right when they say that there is a realization problem, they are utterly wrong when they believe that this problem can be solved by government deficit spending and currency inflation.

Kliman and other Marxists who think like him, while they tend to ignore the realization problem, are ultimately correct when they explain that the rate of profit cannot be altered by manipulating monetarily effective demand or simply by creating, as Marx wrote in "Theories of Surplus Value," "profits upon alienation" (buying cheap and selling dear).

Therefore, contrary to the hopes of our Keynesian reformers, the interests of the capitalist and working classes *cannot be reconciled* through Keynesian-style "demand management." Any such attempt will inevitably run into the currency rate of profit being negated by the underlying value rate of profit.

After the Volcker shock

The Volcker shock did not actually restore the gold standard. Instead, under Volcker the Fed simply refused to further accelerate the rate of growth of U.S. dollar token money. Over the next 20 years, though the value of the U.S. dollar continued to fluctuate against gold, the overall dollar price of gold declined from a peak of $875 to well under $300 by 2001.

Unlike the 1970s, the rate of profit was positive during the 1980s and 1990s not only in terms of of dollars but—what really counts—in terms of real money, gold bullion. This was because the dollar was gaining gold value—thus simply hoarding U.S. Federal Reserve notes actually "earned" the owner a positive rate of interest in terms of gold—and therefore prices in gold terms were rising more rapidly than in dollar terms. The rate of profit in gold was not only positive during the 1980s and 1990s, it was actually *higher* than the rate of profit in terms of U.S. dollars. On its own terms, the Volcker shock was not a tragic mistake but a tremendous success!

This brings out another economic law. While the rate of profit in terms of token money units and the rate of profit in terms of gold can deviate dramatically in the short run, as they did in the 1970s, in the long run the basic laws that govern the capitalist economy will cause them to converge toward the value rate of profit.

What left-Keynesian economists, supported by the Keynesian-Marxists, really hope to achieve is to replace profits based on surplus value—that is, exploitation—with profits based on buying low and selling dear and on this basis reconcile the interests of the working class and the capitalist class. This is a pure utopia!

Therefore, I believe Kliman's basically correct argument against Keynesianism and Keynesian-Marxism would be greatly strengthened if he acknowledged the impossibility of non-commodity money. There are some indications in "The Failure of Capitalist Production" that he may be moving in this direction.

For example, he correctly links the sharp rise in the dollar price of oil in 1973 to the dramatic depreciation of the U.S. dollar against gold when he comments: "Although the Arab-Israeli war of 1973 was the immediate event that caused OPEC … to cut production, the consequent rise in the price of oil served to accomplish OPEC's longer-term objective: reversal of the decline in revenues in terms of gold." (p. 59) Quite correct.

Kliman also writes: "As the volume of outstanding government debt mounts, confidence in its ability to guarantee debt and repay its own debt—with real money, not printing-press money and a depreciated currency—will move in the opposite direction." (p. 207) What can real money be except gold bullion, the money commodity?

Next month: The tendency of the rate of profit to fall in crises and the evolution of the rate of profit from the stagflation of the 1970s to the Great Recession.

Notes Part 2

1 A massive deflation in nominal prices across the board has not occurred in the lifetime of most people alive today for reasons that should be well known by regular readers of this blog. However, such massive deflations have occurred historically—for example, in 1920-21 and 1929-33.

2 An example of this is the huge campaign against the reality of global warming being waged by fossil-fuel capitalists. In waging this campaign, they are acting like "good" capitalists. They are subordinating the long-term continued existence of life—on this planet at least—to the *higher*—for the capitalists—end of increasing their wealth measured in terms of money.

3 The modern bourgeois economists, unlike their classical ancestors, deny that there is any real difference between capitalists and workers. While it is true that both workers and capitalists are interested in the quantity of material use values they get to consume, the capitalists are also concerned with the accumulation of capital. This makes all the difference.

4 Back in the late 1960s when I was young, there was a great deal of discussion of who was more relevant, the "young Marx" of the "Economic and Philosophical Manuscripts" written around 1844 when Marx was just getting started in his study of political economy, or the "old Marx" of "Capital." There was a whole school who defended the "young Marx," who wrote about "alienation," against the "old Marx" of "Capital," who wrote about surplus value. Looking back, I find this a little silly. It would be like defending the "young Einstein," who was just mastering the physics that had been handed down to him by Newton, Faraday, Maxwell and other physical scientists against the "old Einstein" of the special and general theories of relativity.

5 It is almost like asking, what do the old Greek philosophers have to do with the "high tech" revolution of the last few decades? Actually, quite a lot since today's "object-oriented programming" is largely rooted in the categories developed by ancient Greek philosophy.

The Greek schools of idealist philosophy—above all Plato—saw "forms" as the most important element in reality. In contrast, materialism recognizes that "forms" are products of the human mind that help us in distinguishing the different elements of reality from one another. Unlike the idealists, materialists in the final analysis realize that reality is always concrete.

For example, in a computer program what actually counts when the computer executes the machine language instructions is not the form of the object in a high level programming language—this merely helps human programmers understand the program—but the manipulation of the actual data by the computer's instruction set.

Therefore, every object-oriented program can be rewritten without the objects—or the forms—though this might well make it harder for a human programmer to understand the code.

The essence of value—people engaged in labor and exchange—is the reality and not the "form of value"—coats valued in terms of linen or in terms of money.

6 Marx added that the proportions of production could also be determined by the associated producers as in the case in a socialist economy.

7 For example, there was a tendency for business to shift to LIFO (last in, first out) accounting, which assumes that the last items in inventory to be produced or acquired are sold first, as opposed to FIFO (first in, first out) accounting, which assumes the converse. During periods of rising prices, LIFO-type accounting will show a lower profit than FIFO accounting, since it will eliminate the profits that are earned simply through the rise in the prices of commodities between the time a business acquires its inventories and it sells its inventory—called "inventory profits" by accountants.

8 Capitalists and the organs of the capitalist state, including the central banks, are always trying to increase the rate of profit, and there is no surer way of doing this than by increasing the rate of surplus value. However, the Volcker Fed at the end of the 1970s was faced with a far more urgent problem—the threat of an imminent economic collapse of the capitalist system. They took the only road open to them—since socialist revolution was hardly an option—to prevent it.

Part 3

The evolution of the rate of surplus value

Kliman's discussion of the evolution of the rate of surplus value over the last 40 years is, in my opinion, the weakest part of his book. Most Marxists—and non-Marxists, including the great bulk of U.S. workers—would agree that the portion of income going to the rich—the capitalist class—has risen considerably in the U.S. since the early 1970s. This widespread popular belief is clearly reflected in the rise of the Occupy movement.

Kliman strongly disagrees with this. Using U.S. government statistics, he attempts to demonstrate that the share of the U.S. national income going to the workers has risen at the expense of the share going to the capitalists. Or in Marxist terms, the rate of surplus value has actually fallen. A falling rate of surplus value, even if the organic composition of capital remains unchanged, implies a fall in the rate of profit. If a fall in the rate of surplus value is accompanied by a rise in the organic composition of capital, the result will be a marked fall in the general rate of profit.

Which is right: the general popular perception and the view of the Occupy movement that American capitalism and world capitalism is growing more exploitative, or Kliman's contrary view?

Kliman quotes John Bellamy Foster and Fred Magdoff—leaders of the Monthly Review school: "…wages of private non-agricultural 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." (p. 155)

These figures would seem to clinch the case for a considerable rise in the rate of surplus value in the decades preceding the "Great Recession." It would seem that on the eve of the Great Recession in 2006, a typical U.S. worker got less in use value terms for each hour of labor power she sold to the capitalists than her mother earned for similar work 34 years earlier. Furthermore, the productivity of human labor has hardly stood still over the last 34 years. This means that the commodities that a worker consumed in 2006 embodied a considerably smaller amount of human labor value than was the case in 1972.

This is true for two reasons. First, the worker in 2006 received less use value for every hour of labor power she sold to the capitalists. (1) Second, each unit of use value she did receive in exchange for her sold labor power represented less embodied abstract human labor—value—than it did in 1972.

This would mean that there has been a marked growth in what Marx called relative surplus value when if the total work day remains unchanged workers will be working a smaller amount of time for themselves and a greater amount of time for the capitalists. This can be the case even if the standard of living of the workers actually increases, if the increased number or quantity of commodities the workers get to consume in exchange for their sold labor power represents a smaller quantity of value.

Kliman disagrees. He thinks that if anything the rate of surplus value, at least in the U.S., has fallen over the last 40 years. In attempting to prove this, he quotes economist Martin Feldstein as an authority. Feldstein wrote that it is a "measurement mistake" to "focus on wages rather than total compensation." Feldstein complains that this has "led some analysts to conclude that the rise in labor income has not kept up with the growth in productivity." (p. 153)

Kliman doesn't inform his readers that Martin Feldstein is an extremely reactionary economist who has dedicated his life to defending and prettifying U.S. capitalism, though he does mention that he was the head of the National Bureau for Economic Research. (2)

Marxists, beginning with Marx, have often quoted bourgeois economists when these economists' research exposes some of the truths about capitalism and its exploitation of the workers. When the hired apologists for capitalism are obliged to admit a portion of the truth about the exploitative nature of capitalism, it is especially telling. The more reactionary the particular apologetic economist is the better.

But for a Marxist to quote reactionary economists when they use statistical data in a way that actually strengthens their apologetic views of capitalism is rather unusual, to say the least. While we can't prove that American capitalism has grown more exploitative simply because Feldstein (3) claims it hasn't, Kliman's conclusion is strongly in line with Feldstein's natural ideological bias.

Even if it were true that "non-wage compensation"—such as health insurance, for example—has increased so much since 1972 that real income—hourly wages plus non-wage compensation—has risen for each hour of labor power that U.S. workers sold to the capitalists between 1972 and 2006, it would still remain to be shown that U.S. workers are receiving more value for each hour of labor they perform. Remember, as long as the productivity of labor is growing it is quite possible for the standard of living of workers to rise while they are more exploited than ever. This is what Marx's concept of relative surplus value is all about.

Casting further doubt on Kliman's claim that the rate of surplus value of U.S. workers did not rise in the decades preceding the Great Recession is the fact that the last 40 years have seen a tremendous weakening of the U.S. union movement. "Union membership as of 2010 in the private sector," states Wikipedia, "has fallen under 7%—levels not seen since 1932″—that is, since the days of Herbert Hoover when union membership was greatly depressed during the super-crisis phase of the Great Depression.

It would indeed be remarkable if the rate of surplus value extracted from American workers had actually declined despite this huge weakening of the union movement, combined with the increase in real unemployment, only partially reflected in the official jobless numbers, that has occurred since the postwar economic prosperity ended 40 years ago.

Even if we were to accept Kliman's attempt to demonstrate a fall in the rate of surplus value in the United States since 1972, his problems wouldn't end there. Kliman leaves out, as he himself acknowledges—pleading lack of reliable statistics—the effects of the shift of capitalist production from the United States and other imperialist countries, where wages are relatively high, to countries like China, India, Bangladesh and so on, where wages are dramatically lower. Unlike 1972, the bulk of the profits coined by U.S.-based corporations is increasingly produced by extremely low-paid workers, mostly in Asia but also in Latin America, the Caribbean and Africa.

When this is taken into account, it is hard to draw any other conclusion than that on a global basis—and this is what counts for determining the average rate of profit, especially in today's globalized world—the rate of surplus value has risen dramatically.

Why does a radical socialist economist like Andrew Kliman attempt to prove the opposite, relying on U.S. government statistics—hardly an unbiased source—and the reactionary Martin Feldstein to make his case? The reason is not that Kliman is pro-capitalist, nor does he have any real desire to prettify either U.S. capitalism or world capitalism. Quite the contrary. He is bitterly opposed to the entire system of capitalist exploitation.

The problem lies, rather, in his one-sided crisis theory. Kliman believes that economic crises are caused by a rate of profit too low to sustain capitalist expanded reproduction.

In his "Failure of Capitalist Production," Kliman is attempting to demonstrate the need to overturn capitalism, in direct opposition to the Monthly Review school, which holds that the capitalist system is reformable. In this blog, I myself have strongly criticized the Monthly Review school for what I believe to be its false underconsumptionist crisis—or stagnation—theories and the illusions about the reformability of capitalism that such theories lead to.

In contrast to Kliman, the members of the Monthly Review school blame capitalist stagnation and the Great Recession on the underconsumption that is the result of the increasingly exploitative character of present-day capitalism. The Monthly Review writers hold that if only "the 1 percent" learn to exploit the working class in a more moderate way, both the working class and the capitalist class would be better off. They hold that a lower rate of surplus value would be more than compensated for by the increased possibilities for realizing the surplus value that would still be produced. In this way, the interests of "labor and capital" would be partially reconciled and class antagonisms softened.

In complete opposition to the Monthly Review school, Kliman's theory of crises requires a fall, or at least very little rise, in the rate of surplus value in order to explain the reduced rate of growth of the world capitalist economy since the early 1970s, as well as the Great Recession. In contrast, supporters of the Monthly Review school feel quite comfortable with a rising rate of surplus value, since it bolsters their theory that the Great Recession and sluggish economic recovery were caused by "underconsumption."

If the rate of surplus value has indeed risen over the last 40 years, this doesn't mean that the Monthly Review school—or other versions—of the underconsumptionist theory of capitalist crises and stagnation are necessarily correct. But it does contradict Kliman's crisis theory.

Kliman, Jefferies and the Great Recession

Kliman's theory of crisis has much in common with that of Bill Jefferies. Jefferies, is a British Marxist in the Trotskyist tradition, who is a member of the editorial board of [Permanent Revolution magazine](). Both Kliman and Jefferies see the fall in the value rate of profit as the basic cause of capitalist crises. Both believe that if the rate of surplus value rises sufficiently to prevent a fall in the value rate of profit, severe economic crises will not occur. Where Jefferies differs from Kliman is that Jefferies accepts that the rate of surplus value has indeed risen sharply since the 1970s leading to a rise, not a fall, in the rate of profit.

When the world credit markets first froze up in August 2007 causing a sharp but initially brief drop in share prices on Wall Street, a debate broke out on whether the credit freeze-up heralded a major economic downturn in the global capitalist economy. Marxists as a rule have a natural bias towards predicting crises in the capitalist economy, while bourgeois economists have a bias toward predicting capitalist prosperity. (4)

Bill Jefferies, rather uniquely on the left, went out on a limb and predicted that there *would not* be a major economic downturn. Pointing to the restoration of capitalism in the Soviet Union and Eastern Europe and the vast growth of capitalism in China, combined with the huge setbacks suffered by the trade unions and labor-based political parties in the imperialist countries themselves, Jefferies drew the conclusion that, taken globally, there indeed had been a considerable rise in the rate of surplus value and therefore the rate of profit. (5)

Therefore, despite the storm clouds that were gathering in the global financial markets beginning in July-August 2007, Jefferies predicted that there would not be a world recession. According to Jefferies, only a major recovery in the world workers' movement that would lead once again to a fall in the rate of surplus value and a renewed decline in the rate of profit could cause economic crises on the scale of those of the 1970s to recur.

We now know with the advantage of 20/20 hindsight that Jefferies was wrong. The credit freeze-up in August 2007 did indeed herald the beginning of the biggest global economic downturn not just since the 1970s but since the 1930s. In addition, the recovery that followed has so far turned out to be a mere shadow of the recoveries that followed the 1929-33 super-crisis itself and the 1937-38 "Roosevelt recession."

Even if we assume for the sake of argument that a powerful and sustained capitalist economic expansion sets in beginning in 2012, this would not change the fact that the 2007-09 slump combined with the very slow start of the recovery—and now renewed recession throughout much of Europe—amounts to the most serious period of crisis and depression in the global capitalist economy since the Depression of the 1930s.

The truth is that the Great Recession represents a problem for the whole school of thought to which Kliman belongs. Kliman's school of crisis theory blames capitalist crises on a fall in the value rate of profit brought about by a "too low" rate of surplus value combined with a "too high" organic composition of capital.

The situation today is quite unlike the 1970s. Back then it could be plausibly argued that the rate of surplus value, and even more the rate of profit, had fallen considerably, because the 1970s crises had been preceded by a historic rise in both the hourly wages and the social wage of the productive workers—who were still largely located in the imperialist countries of the United States, Western

Europe and Japan. Despite Kliman's best efforts, it is hard to make the same case for the Great Recession.

In a post on this blog, I explained that in his very mistake Jefferies was showing that there was something missing in the theory that capitalist crises, depressions and stagnations are caused by an insufficient production of surplus value and a too low value rate of profit. What is missing in both Kliman's and Jefferies' theory is the whole problem of the *realization* of surplus value once it has been produced in the form of yet-to-be sold commodities.

The law of the tendency of the rate of profit to fall and the cyclical crises of overproduction

Kliman quotes Marx: "When Adam Smith explains the fall in the rate of profit [as stemming] from a superabundance of capital…he is speaking of a *permanent* [Marx's emphasis] effect and this is wrong. As against this, the transitory superabundance of capital, overproduction, and crises are something different. Permanent crises do not exist." (p. 26) Kliman should ponder the meaning of this quote.

Marx is making a sharp distinction between changes in the rate of profit brought about by changes in the organic composition of capital that are permanent changes and the sharp but *temporary* falls in the rate of profit that occur during crises of overproduction.

Like most modern Marxists who take a serious interest in economics, including supporters of the Monthly Review school, Kliman is troubled by Marx's description of cyclical capitalist economic crises as crises of the generalized overproduction of commodities. Both Kliman as well as the various Monthly Review writers talk about the "overaccumulation" of capital. But unlike Marx and Engels, our modern Marxists avoid describing capitalist cyclical economic crises as crises of the overproduction of commodities.

Kliman does distinguish between what he sees as the basic cause of crises—a value rate of profit that is too low to sustain capitalist expanded reproduction—and the immediate cause of crises—which Kliman sees as disturbances in the credit mechanism. But Kliman doesn't understand that credit problems are actually mere reflections of overproduction.

I believe Kliman's difficulties—and the Monthly Reviews school's as well—with Marx's concept of crises caused by a general overproduction of commodities stems from the concept of "non-commodity" money, which Kliman unfortunately remains a prisoner of. (6)

Last month, I indicated that Kliman might be rethinking his belief that "non-commodity" money is possible. However, in a comment to this blog, Kliman makes clear that he still very much believes that non-commodity money is not only possible in theory but that it indeed forms the basis of the current capitalist monetary system.

Marx explained very early in "Capital"—in Chapter 3 of Volume 1—that a general overproduction of commodities is possible, because as simple commodity production develops, a special commodity differentiates out from other commodities. The peculiar use value of that commodity is to serve as the universal equivalent that measures in terms of its own use value the values of all other commodities.

James Mill, Say and Ricardo claimed that a general overproduction of commodities was impossible because commodities are purchased by means of other commodities. A relative overproduction of some commodities is possible, they conceded, but must be accompanied by a relative underproduction of other commodities. However, as Marx explained in Chapter 3, Volume 1 of "Capital," it is quite possible to have a general overproduction of all commodities relative to the special commodity that serves as the universal measure of value—money.

If "non-commodity fiat money" can replace commodity money as the measure of the value of commodities—as opposed to merely representing the money commodity in circulation—it is a relatively trivial matter to overcome any "underproduction" of money by simply having the monetary authority create more money through its printing presses or its electronic equivalent. If the capitalists hoard the "newly printed money," then all that is necessary to overcome the crisis is to have the central government borrow the newly printed money and spend it itself until "full employment" returns.

In a nutshell, this view of both Keynes and Michal Kalecki (1899-1970) is a theory that Monthly Review continues to defend, most recently in an article by economist Michael Perelman that appears in the current—April 2012—issue.

Kliman doesn't challenge this view—nor can he as long as he continues to hold that "non-commodity money" can act as the measure of value of commodities independent of a money commodity. This is why he has such difficulty with the view that cyclical capitalist crises are crises of the general overproduction of commodities. Indeed, the word "overproduction" appears in Kliman's book only when he is quoting Marx.

As a result, Kliman cannot grasp the fact that it is quite possible during a crisis of overproduction for the value rate of profit to be high while the market rate of profit *temporarily* collapses because of the inability of the capitalists to realize *in money form* the huge amounts of surplus value that they have appropriated from their workers. Kliman, like Jefferies, is forced to put all the "burden" of explaining the periodic crises that afflict capitalist production on a fall in the value rate of profit. (7)

Last month, I explained that the rate of profit must be measured in terms of the use value of the money commodity—for example, metric tons of gold bullion. I should make some additional observations regarding another error that is commonly made by present-day Marxists, including Kliman.

When calculating the average rate of profit, it is not a matter of simply making a mathematical average of the individual rates of profit made by the various industrial and commercial capitalists in a given year. We also must take into account a series of both good and bad years. The shortest discrete interval in which we can actually define the average rate of profit is therefore one industrial cycle. In order to statistically demonstrate the historical declining rate of profit—at least since capitalism developed to the point where it started to generate industrial cycles—we have to demonstrate that the rate of profit has declined across successive industrial cycles.

In contrast to Marx and Engles, Kliman and other members of the not enough surplus value school of crisis theory see the rate of profit falling *within* industrial cycles.

"The destruction of capital value through crises is a recurrent phenomenon," Kliman writes. And, "If capital value has been destroyed on a massive scale, the peak rate of profit in the boom that follows is likely to be *higher* than the previous peak [emphasis Kliman's]." He concludes: "The [law of the tendential rate of profit to fall] "therefore does not and cannot predict that the rate of profit will actually display a falling trend throughout the history of capitalism. And despite a common belief to the contrary, there seems to be no evidence that Marx predicted such a secular fall." (p. 25)

As evidence, Kilman produces the quote from Marx criticizing Adam Smith that I reproduced above. Smith believed that as society grew richer and capital more plentiful, the growing abundance of capital would cause the rate of profit to fall. Ricardo criticized Smith on exactly this point. Why would an increase in the quantity of capital cause the rate of profit to fall?

Marx agreed with Ricardo on this point. A mere increase in the quantity of capital—leaving aside *transient* crises of overproduction—all things remaining equal, will have no effect on the rate of profit. The only change brought about by an increase in the quantity of capital will be an increase in the mass of profit. Marx, therefore, made his distinction between the *temporary* fall in the rate of profit during a crisis of overproduction and a *permanent* fall in the rate of profit caused by a rise in the organic of capital. Kliman seems to have completely missed Marx's point.

Rosa Luxemburg in her "Anti-Critique," written from a prison cell in Berlin during World War I in defense of her "Accumulation of Capital," claimed that the fall in the rate of profit was harmless to capitalism. She remarked that capitalism wouldn't collapse from the falling rate of profit "until the sun burns out," because the fall in the rate of profit is compensated for by a rise in the mass of profit.

Luxemburg is generally grouped with the "underconsumptionists," because she attempted to prove that in a system of pure capitalist production, surplus value could not be realized. However, unlike Keynes, Kalecki or the Monthly Review school, Luxemburg did not think that the deeply rooted problem of overproduction could be overcome by having the "monetary authority" print more money and then having the government borrow and spend the newly printed money. With few exceptions, Marxists, including most famously Lenin, indicated that they disagreed with Luxembourg's view that it would be impossible to realize surplus value within a pure capitalist system where simple commodity production had completely disappeared.

Rosa Luxemburg, however, did have the merit of raising the question of how value and surplus value are actually realized, even if she did not answer the question correctly. Post-Luxemburg Marxists, to the extent that they have dealt with the question at all, either essentially agree with Keynes and Kalecki that while realization is indeed a problem it can be solved through the printing and borrowing of additional "non-commodity fiat money"—Monthly Review—or they have tended to assume that realization problems are merely a by-product of a too-low rate of profit. The latter is the view we find in Henry Grossman, Paul Mattick, Bill Jefferies as well as Andrew Kliman.

Was Luxemburg of the "Anti-Critique" correct in claiming that a fall in the rate of profit was harmless to capitalism if it is compensated for by a rise in the mass of profit? Marx most certainly did not share this view.

Kliman quotes Marx: "…in view of the fact that the rate at which the total capital is valorized [its value augmented—SW], i.e. the rate of profit, is the spur to capitalist production (in the same way as the valorization of capital is its sole purpose), a fall in this rate slows down the formation of new independent capitals and thus appears as a threat to the development of the capitalist production process; it promotes overproduction, speculation and crises…." (p. 21)

Let's examine this more closely.

First, the lower the rate of profit on a given quantity of capital, the higher the mass of profit must be if its owner and his family is to enjoy a "decent" standard of living from the profit that is yielded by the capital. For example, if I have a capital of $10,000 in 2012 U.S. dollars and I make a 100 percent rate of profit per year, my yearly income will be $10,000, not nearly enough to live on.

Therefore, I cannot function as a capitalist with a mere $10,000 of "capital" if the rate of profit is "only" 100 percent per year. But suppose I have a capital of $100 million with only a 1 percent rate of profit. In that case, I will have an annual income of $1 million. Even though a million dollars doesn't go as far as it used to, I can scrape by quite nicely on that amount and thus function as a capitalist. This is why Luxemburg of the "Anti-Critique" believed the tendency of the rate of profit to fall was harmless to capitalism. This was not Marx's view.

First, we have to consider the question of the rate of interest. According to Marx's theory of surplus value and profit, profit is divided into two parts: interest and the profit of enterprise. The rate of interest must be lower than the rate of profit, since if it were otherwise the very incentive to produce surplus value—for the capitalist to act as an industrial rather than a money capitalist—is destroyed. While the rate of interest might equal or even exceed the rate of profit briefly during a crisis, this cannot be a stable situation.

Suppose the rate of profit was only 1 percent, an extremely low rate. However, if I have a capital of $100 million, I can still realize an income of $1 million and live quite nicely. So where is the problem? If the rate of a 10-year government bond is 1 percent—at the time of writing (April 2012) this interest rate is hovering around 2 percent, which is considered extremely low—I will very likely invest my capital in Treasury bonds and thus produce no surplus value. The rate of interest would have to fall well below 1 percent before I would even consider making a productive (of surplus value) investment.

In addition, Marx pointed out that the lower the rate of profit is the more difficult it is for capitalism to develop new industries. New industries are pioneered not by big capitalists but rather by small would-be capitalists who have little capital to lose. A young Steve Jobs with only a few thousand dollars in “capital” is far more likely to take big risks than his present-day billionaire heirs are likely to take. Why is this so?

Suppose I have only a few thousand dollars in “capital” and I lose it all. I have not lost much. I was little more than a proletarian before, and so I remain. But if I have a $100 million net worth, and risk all my capital in a new and untried industry and lose it all, I have exchanged a guaranteed life of leisure for the life of a proletarian who must sell his or her labor power in order to live.

Therefore, the more the rate of profit falls the less likely it will be that new industries will be developed. Indeed, nowadays would-be capitalists with ideas of creating new industries are forced to go hat in hand to “venture capitalists” and beg for backing. If the “venture capitalists” do not give a thumbs up—which is usually the case—that is the end of it.

The falling rate of profit and overproduction

As we have seen, the lower the rate of profit the larger the individual capitals must be if they are to remain viable. Larger capitals mean the increasing concentration of the means of production in the hands of very large capitalists—whether very rich individual capitalists or, later, large corporations. This concentration of capital implies the development of very powerful means of production and employment of huge concentrations of workers who are capable of increasing production rapidly.

But this very ability to increase production rapidly implies the development of overproduction. The tendency that in embryo exists within the simple commodity relationship of production for production to expand faster than the market now for the first time can show itself concretely. There are “too many” large individual capitalists, and later on too many giant corporations, and some of the large capitalists including corporate giants must be eliminated in order for the market to clear.

The concentration of capital that enables large capital to compensate for a fall in the rate of profit through an increase in the mass of profit leads at a certain level of development to periodic crises of overproduction. The result is a fall in the number of independent capitals. Growing concentration of capital combined with periodic crises of overproduction leads to monopoly. A weakness of the Monthly Review school is that while they correctly put great emphasis on monopoly, they don’t really explore why monopoly develops out of competition in the first place.

Bank capital and ‘too big to fail’

Perhaps nowhere in recent years has the centralization of capital been more dramatic than in the sphere of bank capital. The centralization of bank capital is actually made necessary by the ability of capitalist industry to expand production faster than the market can expand.

The more capitalism develops, the more capitalist society has to economize on “hard cash,” which in the final analysis comes down to the quantity of monetary gold in existence, in order to keep capitalist production and exchange going. Inevitably, cash transactions increasingly give way to credit transactions. The maintenance of the huge and today highly computerized credit system that is increasingly based on relatively tiny amounts of hard cash requires the development of large banks that grow not only in absolute size but relative to the total economy.

When banking was still decentralized, as was the case during the 19th century, the failure of an individual bank had little consequence for the general economy, even if its depositors lost their life savings. But when banking becomes centralized into a few mega-banks, the failure of even a single such bank is enough to bring into question the whole system of credit and credit money. And if this credit money were to suddenly evaporate, society would be paralyzed.

The cashless society heralds the coming of socialism

Today, people in the rich capitalist countries increasingly carry little cash around. Instead, they rely on debit and credit cards—and now smart phones—to purchase groceries or even such trivial items as morning coffee. In the past, such purchases were generally made with state-issued token money in the form of fractional coins made of base metals and later, as inflation progressed, in paper money as well.

This tendency to replace state-issued token money cash with credit money created by for-profit commercial banks is sometimes called the “cashless society.” The further development of the “cashless” society and its spread to countries that now have a lower level of capitalist development is inevitable over the coming years.

What would happen, however, if the commercial banks were faced with an old-fashioned run and were unable to convert their deposit liabilities into cash. Suddenly all those retailers who happily accept credit cards—or smart phone payments—would start to demand old-fashioned cash—your phone wouldn’t do. Sales would collapse and people would find it hard to buy groceries needed to stay alive, let alone other types of commodities.

During the 19th and into the early 20th century, virtually all retail transactions were settled in the form of token coins made out of base metals—not actual “folding money.” Today, in contrast, in the wealthy capitalist countries “quasi-cashless societies” exist where even the most trivial transactions are settled in for-profit commercial bank-issued credit money.

When a bank collapse threatens, such as in 2008, for example, the central banks have little choice but to engage in “quantitative easing” on a huge scale, which leads to the devaluation of currency and undermines the very foundations of credit with consequences that we have been exploring in this blog.

Therefore, today’s “cashless society” is actually indicating that the whole system of “commodity-money” relations is approaching its end.

Forward to socialism or backwards to healthy decentralized capitalism?

Eventually, no matter how severe, every crisis runs its course—there are “no permanent crises.” In the wake of the crisis, complaints abound that the centralization of banking has gone too far. Reformers come forward with schemes to break up the mega-banks, which so abused their authority during the preceding boom. The post-crisis economy is awash in cash and not so dependent on credit, which enables some of these reforms to actually be put into effect. Capitalism seems once again to be on a “sound footing.”

But then the next boom arrives, and once again industrial capitalists—represented by even more gigantic corporate monopolies than before—are able to once again expand production faster than the markets for the commodities they produce can expand. The gap between the ability of the industrial corporations to increase production and the ability of the market to expand is once again bridged with credit. In order to keep the growing bubble from bursting, credit-restricting regulations that were imposed during the last major crisis must first be relaxed and then abandoned.

Once again, the banks must be given free reign to leverage an ever relatively tinier amount of hard cash into a vast system of credit that is more artificially inflated than before. Ponzi schemes and other forms of swindling abound. Then, inevitably, the whole artificial system of payments and credit bursts, and the state is forced to bail out the banks in an even more shameless way than it did during the preceding major crisis.

The problem is not merely technical, resulting from a lack of regulations. Still less is it located in the “greedy” character of individual bankers. It reflects the increasing incompatibility between society’s ever more powerful and ever more centralized forces of production and the growing fetter of capitalist social relations of production, expressed in legal language as capitalist property forms.

“One capitalist always kills many,” Marx wrote in Volume I of “Capital”. “Hand in hand with this centralization, or this expropriation of many capitalists by few, develop, on an ever-extending scale, the cooperative form of the labor process, the conscious technical application of science, the methodical cultivation of the soil, the transformation of the instruments of labor into instruments of labor only usable in common, the economizing of all means of production by their use as means of production of combined, socialized labor, the entanglement of all peoples in the net of the world market, and with this, the international character of the capitalistic regime. Along with the constantly diminishing number of the magnates of capital, who usurp and monopolize all advantages of this process of transformation, grows the mass of misery, oppression, slavery, degradation, exploitation;

but with this too grows the revolt of the working class, a class always increasing in numbers, and disciplined, united, organized by the very mechanism of the process of capitalist production itself. The monopoly of capital becomes a fetter upon the mode of production, which has sprung up and flourished along with, and under it. Centralization of the means of production and socialization of labor at last reach a point where they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated." (Chapter 32, "Historical Tendency of Capitalist Accumulation")

All kinds of "progressives" and "reformists" endlessly search for ways to reverse this process before it is too late and the "knell of capitalist private property sounds." The call is everywhere to break up corrupt monopolist banks such as the Bank of America (8); restore the New Deal-era Glass-Steagall law, which separated commercial from investment banking; have the Federal Reserve issue even more "fiat money" while having the federal government borrow and spend the newly created fiat money to make possible the restoration of "full employment." And finally, we hear that the 1 percent must learn to exploit the working class in a more "moderate way."

These types of "progressives" are looking backward to the healthier past of capitalism based on free competition and not forward to a socialist society.

Kliman rejects the arguments of the reformists, often echoed by the Keynesian-Marxists. He senses that in order to answer their arguments, which divert the struggle of the working class away from socialism toward an idealized capitalist past, it is necessary to return to Marx. This is what makes his book an important contribution.

However, Kliman is still using only a part of Marx's law of value. He doesn't yet understand why value must have an independent value form that renders "non-commodity money" as a measure of value impossible and makes inevitable a situation where "one capitalist" must "kill many" other capitalists. To his credit, he realizes that surplus value must be produced and cannot arise in circulation by the "profits of alienation." But he doesn't seem to understand that once surplus value is produced its realization in terms of the use value of the money commodity is far from guaranteed. He doesn't understand why there must be a money commodity at all.

His work, though extremely important because it provides a critique of the Keynesian-Marxist Monthly Review school, is therefore incomplete as it stands. Hopefully, Kliman will overcome these weaknesses and in his future work continue to make important contributions to the struggle to revive and promote unfalsified Marxism for many years to come.

Notes Part 3

1 Units of use value and real income are not very precise concepts. For example, in 1972 home computers, laptops, smart phones and tablet computers, along with the World Wide Web these devices are used to access, were unknown. Now, they are commonplace and are for many absolute necessities. However, the social substance of abstract human labor in which both the necessary value—the value that the workers receive in exchange for selling a given quantity of labor power to the capitalists—and the surplus value—the value workers must produce for the capitalists for free—does not change throughout the life span of the capitalist mode of production.

2 This is the same organization that issues highly questionable calls about the peaks and troughs of economic cycles in the U.S. economy.

3 As a marginalist, Feldstein would deny that the workers are exploited no matter what share of the national income goes to "labor" versus "investors." According to marginalist theory, all factors of production such as "labor" and "capital" earn exactly the value they produce in a "free market economy." However, capitalism certainly looks like a fairer system if the more it develops the greater the share of the national income going to labor as opposed to capital—investors—because capital grows less scarce relative to labor as society grows richer.

4 An extreme example of what is called "crisis mongering" is the bizarre case of the 89-year-old American amateur economist Lyndon LaRouche. LaRouche is sometimes given credit, especially outside the United States, for correctly predicting the financial meltdown of 2008.

LaRouche was for many years a member of the U.S. Socialist Workers Party, then the main U.S. Trotskyist organization. Starting in the 1960s, while still a member of the SWP, LaRouche began to predict a near-term collapse of the world capitalist economy. He left the SWP in the mid-1960s and several years later formed an initially left-wing organization of his own. Over the years, LaRouche shifted from the far left wing of the U.S. political spectrum to its far right wing.

But despite the radical change in his political positions, one thing remained unchanged. He continued to predict in virtually every issue of his newspaper—whose name changed as his political stance evolved from Marxist to far right—the imminent collapse of the world economy. An economic prediction of imminent economic collapse that is made on a weekly basis for more than 40 years is, in fact, completely worthless.

Compared to LaRouche's "success" in correctly predicting the "Great Recession," Bill Jefferies' mistake in predicting that there would be no serious economic downturn, based on a serious if flawed theory of capitalist crisis, was actually far more fruitful.

5 Kliman is a supporter of the theory that the Soviet Union and its Eastern European allies, along with the Peoples Republic of China before the Deng Xiaoping reforms, were "state capitalist" societies. He therefore does not see the re-introduction of private capitalist ownership in the former Soviet Union during the 1990s or the similar re-introduction of large-scale private capitalist ownership in Eastern Europe or the flourishing of large-scale private capitalist ownership in China, operating on a scale that dwarfs the stunted capitalism in pre-1949 China, as representing a setback for the working class. At most, he would see a shift back toward *private* capitalism from an equally exploitative *state* capitalism.

Bill Jefferies until a few years ago also held to a variant of the theory of "state capitalism." But in recent years, he has broken with this theory and now considers what he sees as the restoration of capitalism in the former Soviet Union, Eastern Europe and China as representing a huge setback to the global working class. These setbacks expressed themselves, Jefferies now believes, in a sharp rise in the rate of surplus value and consequent rise in the rate of profit.

While this blog is for very well-thought-out reasons narrowly focused on the question of capitalist crisis and therefore not the place to discuss the nature and fate of the Russian Revolution or the Yugoslav, Albanian, Cuban, Vietnamese and Chinese revolutions, I believes that Jefferies' current views are more in line with reality than either his former "state capitalist" views or the "state capitalist" views still held by Andrew Kliman.

6 Since Paul Sweeney declined to discuss Marx's theory of money in "The Theory of Capitalist Development," published in 1942, which forms the "pre-history" of the Monthly Review school, that school has generally avoided the whole question of Marx's theory of money. This, though unfortunate, is understandable, because if the Monthly Review school did deal with the money question, they would either have to reject Marx's theory of money, and thus at least partially reject the Marxist theory of value, or abandon their attempts to synthesize Keynes and Marx along with the reformist implications of their hybrid "Keynesian-Marxist" views.

7 I say value rate of profit because there is no doubt that crises are characterized by a sharp fall in the rate of profit. Indeed, during the super-crisis of 1929-33, profits largely disappeared altogether for a few years.

8 Many "progressives" looking back more towards an idealized capitalist past than a socialist future are urging small savers that belong to the 99 percent to put their money in small community banks as opposed to corrupt mega-banks like the Bank of America. They forget that the Bank of America actually started out as a community bank in San Jose, California—then a small agricultural town—providing banking services to poor, mostly Italian immigrants, who in those days experienced racist discrimination and were denied banking services by other commercial banks of the time.

However, the evolution of the Bank of America into the corrupt monster that it is today was no accident, nor did it simply reflect ill will on the part of its owners. Rather, it reflects the objective laws of capitalist production that Marx analyzed in "Capital" and that we are exploring in this blog. If another community bank in the future develops into a mega-bank, it will inevitably turn out just as badly as the Bank of America.

A Reply to Comments by Andrew Kliman and Doug Henwood

Andrew's comments to my extended review of the "The Failure of Capitalist Production" has clarified both the points of agreement and the differences that exist between us in the field of Marxist economics.

First, the agreements. We both agree that the Keynesian-Marxism of the Monthly Review school as it stands is inadequate both as an analysis of monopoly capitalism and as a response to the current historic crisis of the capitalist system that began with the onset of the "Great Recession" in 2007.

We also agree as against Sweezy and Monthly Review that Marx's law of the tendency of the rate of profit to fall is necessary both to understand the laws of motion of the capitalist system and the problem of capitalist crisis. We agree that Marx and not Keynes provides the answers.

We also agree that the "neo-Ricardian" claim that there are basic inconsistencies in Marx's theory is value is incorrect. We both uphold Marx's law of labor value.

We have important differences, however, on our interpretation of Marx's law of value. I believe that Marx's law of labor value requires the existence of commodity money, notwithstanding the end of the gold standard at the end of the 1960s and early 1970s. Andrew disagrees. This difference of opinion affects both our interpretation of capitalist crises and our approach to the transformation problem.

In addition, I think there are some misunderstandings on Andrew's part on what defines a capitalist that should be clarified. In addition, I need to say a little more on the evolution of the rate of surplus value since the end of the post-World II prosperity 40 years ago.

Despite my differences with Andrew, I want to stress what I said at the beginning of this extended review. I liked "The Failure of Capitalist Production" and recommend it to all serious students of the Marxist critique of political economy and students of the present extended economic crisis of capitalism, which is increasingly becoming a grave political crisis—as the recent elections in France and especially Greece reveal.

I also found Doug Henwood's remarks to be useful as well, since it sheds light on my critique of the attempts to mix Marx and Keynes.

I must stress that the aim of this blog is not to destroy or crush other Marxists with whom I disagree on one and other point, but to advance Marxist economic science in order to get nearer to the truth.

Andrew Kliman's comments

Andrew writes: "Imagine that a trucking company purchases gasoline. The value of the gasoline, determined by the amount of labor needed to produce it, is 100. But the amount of value invested in order to acquire the gasoline is 300. Its price is three times its value, so three times as much value needs to be invested in order to acquire it as would have been the case if its price equaled its value. Now in the New Interpretation and the Sraffian revision, 100 is entered into the denominator of the 'value' rate of profit while 300 is entered into the denominator of the 'price' rate of profit, and, lo and behold, the 'price' rate of profit doesn't equal the 'value' rate of profit. Marx has been 'proven' to be internally inconsistent. But single-system interpretations recognize that his account of the transformation refers to the capital value invested, so 300 is entered into the denominator of the value rate of profit as well as the denominator of the "price" rate of profit. The result, of course, is that the price" rate of profit equals the "value" rate of profit, exactly, and the other two aggregate equalities are also preserved. So there was never an internal inconsistency, but only an external inconsistency, between what Marx meant by the capital value advanced and what it means in the New Interpretation and the Sraffian revision.

"Now notice that none of the above has anything to do with money vs. labor-time. I wrote '100′ and '300,' not '\$100′ and '\$300,' and certainly not '100 labor-hours' and '\$300.' Think of these numbers as 100 labor-hours and 300 labor-hours: the concepts and distinction make sense, and the aggregate equalities are preserved in one case but not in the other. Now think of these numbers as \$100 and

$300: once again, the concepts and distinction make sense, and the aggregate equalities are preserved in one case but not in the other. ($100 is what Marx sometimes called the monetary expression of the value of the gas, and at other times called the value of the gas. $300 is the (money) price of the gas.)"

This clarifies the difference of opinion I have with Andrew.

Marx emphasized that the capitalist begins with a sum of money M and ends with a larger sum of money M'. Marx does not speak here of value or even the "monetary expression of value"—what Anwar Shaikh calls the direct price. Instead, he speaks of "money" or M. The general formula that Marx gives for capital is M—C—M', not V—C—V' (with V standing for disembodied value). For industrial capital, the formula that Marx gives is M—C..P..C'—M' and not V—C..P..C'—V'. Marx used the term M even when he was assuming that the commodities sell at their values and not at their prices of production. And Marx doesn't do this in one place, he does this in many places.

Andrew seems to imagine that value can exist in disembodied form independent of an actual commodity or service (a service being a type of commodity that exists only momentarily).

What actually is value?

Value is a social relationship of production. To Marx, value is defined and exists in reality as abstract human labor measured in terms of time embodied in a commodity. Every commodity—not just the money commodity—represents at any given point in time a certain quantity of abstract human labor.

The abstract human labor that a commodity represents is determined by the average conditions of its production. This means that the amount of abstract human labor represented by a commodity can sometimes vary quite radically from the amount of concrete labor, also measured in terms of time, that was actually used to produce the given commodity. On average, an hour of concrete human labor equals an hour of abstract human labor—but this will almost never be true in individual cases.

Defined the way Marx defined it, value simply cannot exist independently of a commodity. Can a token such as a dollar bill represent value? Not directly. A token can only represent a given quantity of a commodity such as gold bullion at a given point in time. In turn, the gold bullion represented by a dollar, just like the case with all commodities, represents a quantity of abstract human labor—value. According to Marx's theory of value, only in this way can a dollar, euro, yen, ruble, yuan and so on be a "symbol of value."

This is an economic law. Under the gold standard—as late as 1971—it was a legal law as well. The U.S. dollar was defined legally as a definite weight of gold bullion. As long as the monetary authority was willing to redeem its currency in terms of actual gold, whether in bullion or coin, the amount of gold that a unit of the currency represented was fixed. But the amount of value—abstract human labor—was not fixed, since the conditions of production in the gold bullion producing industry—mining and refining—was, as was the case with all other commodities, constantly changing.

But why can't a dollar represent value directly without the mediation of a money commodity? For the same reason that value cannot exist independently of a commodity. Abstract human labor is not yet value. It only becomes value when it becomes embodied in a commodity.

The Ricardian theory of value versus the Marxist theory of value

The Ricardian theory of labor value is often confused with the Marxist theory of value. While the Marxist theory of value owes much to the classical labor theory of value, particularly the Ricardian version, it is by no means the same thing.

The classical economists including Ricardo made no distinction between value and exchange value. Ricardo, like earlier classical economists, distinguished between use value and exchange value, market prices and prices of production. But he made no distinction between value and exchange value.

The Ricardian theory of value states that the value of a commodity is measured by the quantity of labor that is needed to produce it under the prevailing conditions of production. This was Marx's starting point as well. If Marx had died in the late 1840s, the Marxist and Ricardian theories of value would have been pretty much the same. In his early writings, Marx upheld the Ricardian law of value. (1)

But as Marx's thought evolved during the decade of the 1850s, he moved far beyond the Ricardian law of value. Marx came to realize that value and exchange value were not actually the same thing. Exchange value, he came to understand, is the ratio of exchange between a commodity with a given use value and quality and another commodity of a different use value and quality. Marx realized that this relationship between two commodities—things—is not the essence of value but simply the necessary form of value.

The essence of value is a social relationship of production among people who work for their own individual accounts and exchange the products of their private labors with one another. It is only in the act of exchange that the abstract human labor embodied in a commodity that was performed privately can be confirmed to be a fraction of the total social labor.

Money is simply a generalization of what Marx calls the equivalent form of value, the commodity that in its use value the value of another commodity is measured. The abstract human labor that the commodity that functions as the universal equivalent represents differs from the abstract human labor that all other commodities represent in only one important respect. The abstract human labor that the commodity that serves as money embodies is directly social. That is, this labor does not have to show that it is part of the the social labor of society by being sold for money. This labor is embodied in a commodity that already is money.

If all commodities equally supported the value of the currency—functioned as money —the labor embodied in all commodities would be directly social. But this is possible only in a system of planned production, not commodity production. If no commodity functioned as the money commodity, there would be no way to determine whether the private labor embodied in a commodity was a fraction of the social labor. This would render commodity production and thus capitalism impossible.

Therefore, the Marxist law of value is also a theory of exchange value, money and price. In my opinion, the full Marxist law of value is necessary if we are to understand capitalist crises and the growth of monopoly that emerges out of them. A correct crisis theory as well as a correct theory of the relationship between competition and monopoly is not possible without it.

Value, the form of value, money and the fetishism of commodities

Most people who have a casual acquaintance with Marx's theory know that Marx in "Capital" wrote about the fetishism of commodities. It is generally assumed that Marx was referring to capitalism's tendency to create a massive preoccupation with material things that constitute wealth. Each individual industrial capitalist is forced to create a need for the particular commodity he produces. He must convince his potential customers that they absolutely must have this commodity.

For example, Apple tells us that we not only must have an iPhone, we must have the very latest model. Last year's model simply doesn't cut it. Sleep Train tells us we need a new mattress now because "we need a better night's sleep." This preoccupation with material things leads to a preoccupation with money, and the preoccupation with money leads to a preoccupation with the stock market.

You can be sure that the latest iPhone will include an "app" that will flash the latest quotations from world stock markets. Perhaps Sleep Train will soon be selling mattresses that have computer chips in them that will run apps that inform the awakening sleeper about the latest action on the stock market and how it affects that individual's portfolio the moment he or she awakens.

While the preoccupation with material things, money and the stock market is an inevitable result of the capitalist mode of production, Marx actually meant something rather different by the term the fetishism of commodities. Marx was referring to the fact that what we see at the surface of economic life is not value at all but exchange value. Instead of seeing a relationship between people engaged with production, we observe a relationship between commodities—things.

One of the illusions that commodity fetishism gives rise to is that it is possible to carry disembodied value around in our pocket, as though value were a thing and not a social relationship. Think about it. Can we carry a given quantity of a relationship among people around in our pocket? Of course not. Nor can a capitalist advance a relationship among people—value—as capital. He must advance a thing—money. Money is the independent existence of exchange value in which all wealth is measured. But it is not and cannot be the independent existence of value. I can carry around a sum of money in my pocket—independent exchange value—but not value independent of any specific commodity.

I can also carry around checks or drafts (credit money) or state-issued tokens (legal-tender currency) that can be exchanged for a certain quantity (use value) of gold bullion–the commodity that functions as the independent form of exchange value, or money. (2)

More on the Ricardian theory of value versus Marx's theory of value

Ricardo, following earlier classical economists, distinguished between value in use—utility—and exchange value. Classical political economy, however, had no conception of a distinction between value and its value form, exchange value. The classics did distinguish between market prices that fluctuate according to changes in supply and demand and what they variously called natural price, price of production and cost of production, which the classics including Ricardo identified as "value." Value to the classics, including Ricardo, was the average price of a commodity over a period of time.

Ricardo assumed that the relative costs, or prices of production—remember, for Ricardo the cost of production always included the average rate of profit—of different commodities would correspond to the different quantities of labor that were necessary to produce them. It was a bold proposal. But even in Ricardian times, it was clear that this was only approximately correct.

While classical political economy had no notion of constant capital, it was well aware that different types of capital had different durabilities. If average prices—not market prices—corresponded directly and exactly with the quantity of labor that is necessary to produce commodities, then capitals that produced commodities that had slower turnovers than average would yield to their owners a lower rate of profit than commodities that had faster turnovers than average. This is the "fine wine aged in old chests" problem that Andrew mentions in one his comments. This stands in contradiction to Ricardo's theory of exchange value that held that exchange value of commodities was determined only by the quantity of labor that was necessary to produce them.

But it was well understood that competition among different capitalists would tend to equalize profits over time. Why would a capitalist invest in the making of fine wines that have to be aged over a long period of time if it meant a lower annual rate of profit? Ricardo had no answer to this question. The transformation problem was born.

Why the Ricardians were not able to solve the transformation problem

Ricardo died in 1823. By the 1830s, the class struggle between the growing British industrial working class and the capitalist class was rapidly intensifying and overshadowing the older struggle between the landlords and the capitalist class. Early British socialists—called Ricardian socialists—used the Ricardian theory of value—which they understood imperfectly—to point out that Ricardo's theory of value proved that profit and interest—not just rent—arose only because the working class was performing unpaid labor for the capitalist as well as the landlord class.

Taking alarm, the bourgeois economists from the 1830s onward decided that Ricardo's theory of value had to go. And since Ricardo's theory of value was inconsistent as it stood, the (bourgeois) economists had powerful arguments. Though contradictory or inconsistent, as the transformation problem showed, the Ricardian theory did have the potential for further development. But it could not stand in the form that Ricardo left it when he died in 1823.

The foundations of the marginalist school were laid.

By the end of the 19th century, the marginalist theory of value, armed with formidable looking—for the layperson—differential equations, had replaced any form of the labor theory of value for the (bourgeois) economists. The marginalists claimed it was they not Marx who had finally made economics a true and consistent mathematical science.

In 1960, Piero Sraffa (3)—a neo-Ricardian—published a small book that he had been working on for decades, entitled "The Production of Commodities by Means of Commodities," which proved, using simple algebra, that the neo-classical marginalist theory of value was mathematically inconsistent. Sraffa's work is one reason among many why marginalism should be abandoned once and for all. And indeed, it would have been abandoned if modern (bourgeois) economics was actually a science. But if marginalism is abandoned, the defenders will have no real economic theory at all and therefore no answer to Marx.

The uses and abuses of Sraffa

Unfortunately, Ian Steedman, a British socialist neo-Ricardian, used Sraffa's work aimed at marginalism to launch a massive attack on Marx. (4) His work comes down to proving that except under very restrictive assumptions the rate of profit in value terms will deviate from the rate of profit in terms of prices of production.

Therefore, Steedman, basing himself on Sraffa's work aimed against marginalism, believed that he had once and for all disproved any form of the labor theory of value.

Andrew belongs to a school of thought, which I believe was originated by the late American Marxist Robert Langston, who tried to solve the contradictions that Steedman thought he had located in Marx's theory of value by bringing in the factor of time. The supporters of this school attempt to answer Steedman and other "neo-Ricardians" by arguing that prices of production are not determined simultaneously but are established only in time. Therefore, if I understand Andrew here, it is not inconsistent to hold that value consists ultimately of abstract human labor while calculating profits in terms of prices of production.

I believe, in contrast, that if we fully grasp Marx's theory of value and realize how it differs from the Ricardian classical theory of labor value, the transformation problem born out of the very real contradictions of the classical/Ricardian theory simply disappears. All we have to do is remember that money itself is a commodity. A deviation of prices from labor values are balanced by an offsetting deviation of the "prices" (price lists read backwards) of money.

Once we arm ourselves with Marx's full theory of value—and not a quasi-Ricardian substitute—it puts other problems such as crisis theory, monopoly and imperialism and, finally, the historical limits to the capitalist mode of production in a whole new light. This is what I have been attempting to do in this blog.

For example, it becomes possible to grasp why not only are crises of generalized overproduction of commodities possible but why at a certain stage of development they become inevitable. We also see how these crises lead of necessity to the centralization of capital and the transformation of capitalism based on free competition to a hybrid system of monopoly combined with free competition (monopoly capitalism, or imperialism), and then sooner or later to a socialist planned economy.

Professional economists fail to understand value

In the current issue (May 2012) of Monthly Review, John Bellamy Foster and Robert W. McChesney attempt to answer the question of how the professional economists could have failed so miserably to predict the coming of the "Great Recession" and its aftermath of slow growth at best and now renewed recession combined with a growing political and social crisis in Europe.

Foster and McChesney write: "The reason for this we believe can be traced to the fact that neo-classical economists and mainstream social science generally have long abandoned any meaningful historical analysis. Their abstract models, geared more to legitimizing the system than to understanding its laws of motion, have become increasingly other-worldly constructed around such unreal assumptions as perfect and pure competition, perfect information, perfect rationality (or rational expectations), and the market efficiency hypothesis."

While this is true as far as it goes, I would add that the failure of the neo-classical economists to predict the "Great Recession" and its aftermath—including the renewed European recession—lies in their failure to understand the real nature of value, exchange value as the form of value, money as the independent form of exchange value, and the nature and origin of surplus value. Or, if we have to boil it down to a single factor, it is the failure of the modern economists to understand value.

Of course, the "neo-classical" school cannot understand value because in that case they would also have to understand and explain surplus value. This would force them not only to admit to the exploitative character of capitalism but also the historically limited nature of capitalism. In other words, they would have to cease to be bourgeois economists!

Therefore, the neo-classical economists, with perhaps a few individual exceptions, are a hopeless case. They are merely what Marx called "hired prize fighters" of capitalism, just like their predecessors have been since the 1830s.

But Marxists face a problem as well. The problem is that the workers' movements represented by the old Second and Third Internationals only partially understood Marx. (5) They did understand Marx's theory of surplus value, and it was on that foundation that the mass parties of the Second International—the Social Democratic Parties—and later the Communist Parties were built. But in the end, this was not good enough. The partial Marxism that dominated both the Social Democratic and later Communist Parties ended up succumbing to Keynesianism and reformism. This proved to be the road to ruin for both Internationals as instruments of workers' struggle.

Faced with the wreckage of the old movements and a new historical crisis of capitalism, today's Marxists who take an interest in economics are divided into two main camps. There are those who emphasize the problem of the production of surplus value and the tendency for the rate of profit to fall, and those like the adherents of the Monthly Review school who emphasize the realization of value and the problem of monopoly. Both have part of the truth—and I especially recommend Andrew's book for its powerful criticisms of the Monthly Review school—but both schools are incomplete and one-sided as they stand.

Monthly Review, though correct to emphasize the problem of realization, and especially of monopoly, has been doomed to not actually understanding the problem of realization ever since Sweezy in his "Theory of Capitalist Development" thought he could deal with the problem of crisis without dealing first with the problem of money—the independent form of exchange value. Until Monthly Review finally repairs Sweezy's error in this regard, it will remain mired in the swamp of underconsumptionism and Keynesianism.

The other main Marxist school of economic theory, the Grossman-Mattick school, of which Kliman is emerging as a key leader, makes many valuable criticisms of the Monthly Review school and correctly rejects "underconsumptionism" and "Keynesianism." But they seem to have difficulty in understanding that capitalism actually does face a major problem of realizing the value of commodities.

I believe that the division in our ranks into these two main schools can be transcended if we devote the time and effort to fully master Marx's mature value theory. Not only will we be able to retain what is valuable in both schools—while disregarding what they get wrong—but we will be able to provide a new workers' movement with the solid theoretical foundation that was largely lacking in the old Internationals.

In the academy, the "hired prize fighters" of capital are ever eager to do all they can to undermine Marxism. This is especially true under present conditions when their own theory—marginalism—is so threadbare. As Andrew points out, they do this by attempting to prove that Marx—like Ricardo—was inconsistent. If Marx's full theory of value were widely understood, the professional Marx refuters would be banging their heads against a solid wall. They would find themselves reduced to the role of today's creationist Darwin refuters in biology.

What has given them a certain opening is that Marx in a sense is still so far ahead of the rest of us. The work of the Second and Third Internationals spread a basic understanding of Marx's economic theory, but its more subtle elements remained either unexplored or poorly understood. Lenin, after studying Hegel's "Logic," and referring to "Capital," especially the first chapter, wrote that "half a century later [after the its publication] none of the Marxists understood Marx!!". [Lenin's exclamation marks—SW]

While I am certainly no Lenin, the more I have delved into Marx's value theory, the more I see how so few Marxists have fully understood it. Most understand it only in a partial Ricardian way and therefore only partially understand his economic theory as a whole. This opens the way for the introduction of Keynes-like notions into the workers' movement, or replacing Marx with Keynes altogether under the plea that Keynes and Marx were really saying the same thing.

Taking advantage of this situation, and no doubt their own lack of genuine understanding of the subtleties of Marx's thought, our modern "neo-Ricardian" Marx refuters in the universities prove for the nth time that Marx was inconsistent, mistaking Ricardo for Marx.

The main service the Marx refuters perform for their employers—the ruling capitalist class—is to "prove" that capitalism has no real contradictions and can last forever, or as Andrew puts it, deny that "capitalism has really failed." Instead, our Marx refuters claim that it is only specific government and central bank economic policies that have failed, not capitalism itself. It must be given another chance. If only the governments and central banks follow correct policies in the future—our economists, of course, argue heatedly over what are the magic "correct policies"—capitalism will finally achieve the promised "full employment with low inflation" and go on forever—or at least as long as the sun shines.

In addition to proving Marx's theory of value inconsistent—hence the mountains of books and papers on the "transformation problem"—our economists are ever eager to refute Marx's law of the tendency of the rate of profit to fall—hence the Okishio theorem. Why does the Okishio theorem—divorced from reality as it is—remain so popular in the academy? The reason is that the economists believe that if they can show that there is, in fact, no tendency of the rate of profit to fall they will have proven that capitalism can indeed last forever. That is the main point of bourgeois economics, after all.

The same need to provide an ideological defense of capitalism is also central to the claim of the Keynesian economists that money does not have to be an actual commodity. If money does not have to be a commodity but can be replaced by "fiat money issued by the monetary authority," then the problem of overproduction can be overcome just like Keynes and Kalecki held, by state borrowing and spending money to whip up "effective demand." But what if there is not enough money to go around? Then simply have the "monetary authority" issue more right up to the point at which "full employment" is achieved. Problem solved!

If "full employment" is not achieved, then it must be either because wrong policies are being followed or reactionary policymakers are deliberately creating unemployment. In this case, we must replace these reactionaries with "progressives" who will follow "full employment policies" to the mutual benefit of the majority of the capitalist class as well as the working class.

A few more comments on the evolution of the rate of surplus value

I have made no attempt to calculate the rate of surplus value myself because of the very problems that Andrew points out, though I am inclined to believe that it has probably risen considerably on a global scale over the last 40 years. Perhaps I am wrong on this and am merely reflecting the popular impression that capitalism has been growing steadily more exploitative during the "neo-liberal" era. In any case, I agree with Andrew, especially when we look at the state of the international data, that there is simply not enough reliable information to attempt to calculate the actual global rate of surplus value.

In dealing with the question of the evolution of the rate of surplus value in the U.S., I should mention one thing that I did not deal with in the main body of my review of "The Failure of Capitalist

Production." By the middle of the 20th century, the U.S. had built up a huge monopoly in the most powerful means of production. The productivity of U.S. workers was thus far ahead of workers in other countries, not because U.S. workers were more skilled but because they were working with far more powerful means of production. This meant that every actual hour of (concrete) labor performed by a U.S. worker on average translated into considerably more than one hour of abstract labor on the world market.

Suppose in 1945 that for every eight hours of concrete labor a U.S. worker performed, she received a wage that came to four hours worth of abstract labor—value. If the eight-hour U.S. working day actually represented eight hours of abstract human labor on the world market, the rate of surplus value in the U.S. would have been 100 percent. However—and I am not saying that these figures are the actual numbers but am using them only for illustration—it might be that though U.S. workers worked eight hours a day, their labor counted for 16 hours of abstract labor on the global market. Once this factor is taken into account, the rate of surplus value (s/v) would not be 4/4 or 100 percent but rather 12/4 or 300 percent!

Now let's suppose the U.S. workers are paid a wage equal to only three hours of labor today as compared to four hours of labor in 1945. If it were true that an hour of labor performed by a U.S. worker still counted for two hours on the world market and the workday has remained unchanged at eight hours, this would mean that the rate of surplus value has risen to 13/3 or 433 percent.

But today the productivity advantage of U.S. industry has greatly eroded. Let's assume for the sake of illustration that an hour of labor performed by a U.S. worker on average now represents only one hour of abstract human labor. In other words, that U.S. workers have only average productivity. We are not there yet, but this is indeed the historical tendency.

If productivity of labor in the U.S. is now only average—though it has increased absolutely—the rate of surplus value would have fallen to 5/3 or 166 percent. Even if the organic composition of capital has remained unchanged since 1946, this would translate into a considerable fall in the rate of profit within the U.S. but not globally.

Therefore, such a drastic fall in the rate of surplus value and consequently fall in the rate of profit would be expected to lead to a massive transfer of industrial production out of the U.S. While the figures in this example are purely for argument's sake, we have indeed seen in the real world a trend toward massive de-industrialization within the U.S.

This is why in attempting to demonstrate a fall in the rate of profit caused by a rise in the organic composition of capital—Andrew has made no attempt to do this but other Marxists have—we have to make the calculation only on a global basis. This, as Andrew has pointed out, is virtually impossible considering the lack of reliable statistics.

The social wage

Andrew wrote in one of his comments replying to my review of his book that I either argue or lean towards the position that retirees are capitalists because they are consuming surplus value. This needs to be clarified. I certainly do not believe that retired workers who receive pensions are capitalists. But I must say that Andrew has done a real service in bringing this up, because this is a very important point.

First, not all consumers of surplus value are capitalists. A capitalist is defined as a person who is "entitled" to a portion of the total surplus value either in the form of interest and or profit of enterprise due to his or her legal ownership of capital. In contrast, an owner of unimproved land—which is not capital because it is not a product of human labor and therefore is not a commodity in Marx's sense of the word—is entitled to a portion of the total surplus value in the form of rent. A person who owns and rents out only unimproved land is a landlord and not a capitalist.

In addition to landlords, unproductive workers—unproductive in the capitalist sense of not producing surplus value—also consume surplus value. The value they consume in the form of consumer goods must be replaced, as is the case with capitalists and landowners, out of surplus value produced by the productive (of surplus value) workers.

Does this make the unproductive workers capitalists? No. The wages and salaries of unproductive workers are derivatives of the two prime forms of surplus value: profit—including interest—and rent. For example, a capitalist might use some of his profit to employ personal servants. Or the state uses a portion of the surplus value that it has obtained through its taxing power to employ "public servants."

Unlike a capitalist, an unproductive worker has to sell his or her labor power to obtain his or her share of the surplus value. As long as such a person has no "property income"—in the sense of income from capital and landed property—such a person is a proletarian and very far from a being "capitalist." Marx, for example, speaks of the "commercial proletariat," which he generally saw as unproductive of surplus value.

Conflict of interest between young and old?

Capitalist spokespeople are increasingly claiming that there is a huge and growing antagonism between the young people today who are just entering the work force and the aging "baby boomers" who are beginning to retire from the work force and will continue do so in rising numbers over the next few decades.

In the United States, the most well-known pension system is the government-run Social Security System. The Social Security System is actually a system of transfer payments. Workers and employers are required to pay tax on up to $110,100 of wages or salaries into a fund. The top corporate brass do not have to pay a cent in taxes into the Social Security part of the trust fund on their yearly millions of dollars of income above $110,100.

Up to this point, the Social Security Trust Fund has always run a cumulative surplus, which now totals some $2.5 trillion, not counting an additional roughly half a trillion dollars cumulative surplus in the Medicare and disability insurance funds.

The surplus funds are lent to the U.S. federal government through the issuance of special bonds that only the Social Security Trust Fund is allowed to buy. The U.S. federal government then uses these borrowed funds for "general expenses," including the costs of the wars necessary to defend U.S. imperialism's vast global empire.

Due to centuries of struggle, workers—at least in the imperialist countries—may get in addition to hourly wages—or weekly salaries—benefits such as unemployment insurance, health insurance and old-age pensions. This extra income is sometimes called the social wage. The capitalist class does not like the social wage and continually tries to minimize it and, ideally, get rid of it altogether. Why is this so?

Suppose there were no social wage? No social security, no government-provided health insurance, and no unemployment insurance. Such a situation would greatly tighten the invisible chains of wage slavery. As soon as a worker lost her job, her income would drop to zero! In addition, if the worker were unable to work for any reason—whether due to illness or old age—her income would also drop to zero.

Under these conditions, unemployed workers facing starvation would accept a job at almost any wage or any working conditions, no matter how bad. Wages both in terms of value and in terms of real income would plummet toward biological subsistence levels. The rate of surplus value would soar and with it the rate of profit.

Actually, the "ideal" of absolutely no social wage cannot ever be fully realized by capital only because if it were, large portions of the working class would die off during crises. As soon as the crisis ran its course, the capitalists would face massive labor shortages and consequently upward pressure on wages. Capital for its own reasons, therefore, must maintain its "reserve industrial army."

But what about workers who have completed their working lives and are no longer able to produce surplus value for the capitalists? From the viewpoint of capital, such workers should simply not exist. What capital desires is for the worker to produce surplus value right up the moment of death. Once the worker has passed the point where she can work, she should cease to exist. This is what lies behind the attacks on pensions and the moves to raise the retirement age that we see to one extent or another in every capitalist country today.

In the decades following the Russian Revolution, the capitalist class was forced to make considerable concessions on pensions and social wages in general in order to prevent the workers from "listening to Communist propaganda." Capital feels far less pressure to do this today, and the capitalists are doing all they can to return to the ideal of no old-age pensions at all except for those who directly serve the ruling class as enforcers, such has high-ranking military and police officers.

If old-age pensions for the working and even "middle classes" were eliminated, active workers would be forced to use a portion of their hourly wages or weekly salaries to keep their parents alive. They would be much more vulnerable to being blackmailed by their employers, because they would feel responsible not only for themselves and their children but their retired—or soon to be retired—parents as well. Right-wing politicians and business leaders complain that the "social wage" encourages a feeling of dependence on the part of the working class. What they really mean is that the social wage undermines the feeling of dependence that the workers have on their capitalist slave masters.

It is a basic feature of capitalist politics that the ruling class's hired politicians attempt to create antagonism among the working class and their potential middle-class allies while hiding the real antagonism between the capitalists and the working classes. One of the antagonisms the capitalist politicians and their economists have "discovered" is that between young workers and older and retiring—or soon to be retired—"baby boomers."

In the U.S., the spokespeople of capital claim that the Social Security System is facing bankruptcy down the road. The argument is that the Social Security Trust Fund will stop running a surplus in a few decades if these tendencies continue. Then the trust fund, instead of buying bonds from the U.S., will be forced gradually to redeem its government bonds. In effect, the U.S. Treasury would be forced to pay down the debt that it owes the workers.

Eventually, once this debt is paid down, the trust fund would no longer be able to meet its obligations. What the reactionary economists and politicians fail to mention is the alternative of forcing the rich to pay into the Social Security Trust Fund by eliminating the $110,100 cap on income subject to the payroll tax, and including interest and dividend income as well wage and salary income.

Reply to Doug Henwood's comment

Now I should respond to Doug Henwood's comment, which follows:

"A few months ago, I was on a panel on which I said that Volcker had created a great deal of misery with his tight monetary policy. After the session, his long-time book editor came up to me and denounced me for my rudeness. When he asked what the alternative was, I said socialist revolution.

"Since that wasn't on the political agenda at the time, I was only half serious. But really, whoever wrote this, I don't think that at that point the system could have lived with higher inflation. The provoked recession of the early 1980s was all about breaking working class power and recasting everything on terms favorable to capital. It was very successful. I talk about this at some length here: http://lbo-news.com/2012/01/29/ reflections-on-the-current-disorder."

Doug Henwood agrees that the system could not have lived with even higher rates of inflation. But he also calls the recession of the early 1980s "provoked." To call the recession provoked is to imply that the recession could have been avoided by alternative—presumably Keynesian—policies that were available within the framework of the capitalist system.

However, if the recession was caused by "overproduction," then there were no alternative policies available to the U.S. capitalist class and its government and central bank policymakers that could have avoided the recession of those days—at least not for very long—besides socialist revolution. This was hardly an option for U.S. policymakers of the time—and today as well!

I think Henwood here is wavering between Keynes and Marx. According to Keynes, inflation is caused by rising prime costs, by which he meant mostly money wages. The Keynesian analysis is that faced by soaring wage costs, causing inflation to soar, the Fed under Volcker decided to "provoke a recession" with the aim of radically increasing unemployment. The higher unemployment caused by the "provoked" recession then lowered money wages thus dramatically reducing the rate of inflation.

In addition, the high rate of unemployment would hold real wages in check without inflation, causing the rate of unemployment to gradually fall after the early 80s "provoked recession." It is quite possible that Volcker, who no doubt knows his Keynes, reasoned more or less along these lines

Bringing in Marx, Henwood then believes that the consequent higher rate of surplus value raised the rate of profit, which enabled U.S. and world capitalism to pull out of the recession at the expense of the workers through the restoration of a higher rate of profit. That is, Doug believes that the subsequent recovery was built on a higher rate of surplus value—a higher rate of exploitation—of the working class. Such views are not unique to Henwood—assuming I understand him correctly—but are widespread on the left.

The problem with mixing Marx and Keynes in this way is that Marx and Keynes held completely different theories of wages and profits. Keynes believed that money wages determine prices. He held to a version of Adam Smith's old cost-of-production theory of prices. According to Smith, under capitalism the price of the commodity is determined by the wages plus profits plus rents—Smith left out the constant capital. If you raise wages, Smith reasoned, you increase the cost of production and you get higher prices. This theory of Smith and Keynes was refuted long ago by Ricardo on the basis of his theory of value, which was more than adequate for this task.

In addition, unlike Smith, Keynes was also a marginalist who believed that the workers in terms of (real) wages get the full value that their labor produces.

Marx, in contrast to Keynes, believed that the workers never get anything close to the full value that their labor produces, because if they did there would be no surplus value and therefore no profit whatsoever. The capitalists would then have no incentive to hire workers. However, if the capitalists always pay the workers considerably less value than their labor produces, it is quite possible to raise wages and even raise wages considerably as long as surplus value is still being produced.

The capitalists, of course, would prefer to get more surplus value—there is indeed no limit to the desire of a capitalist for surplus value, but being practical fellows the capitalists will, if they are forced, settle for less surplus value rather than have no surplus value. This is the basis of the daily trade union struggles.

Marx denied that the rate of surplus value was governed by some "iron law" but rather was variable and depended in no small measure on the degree of organization and militancy of the working class. He was always wary of capitalist claims that any fall in the rate of surplus value and profit would bring the collapse of capitalist production.

Crises and the rate of surplus value

Certainly one of the functions of crises is to increase the rate of surplus value. However, the extent to which the rate of surplus value rises depends in no small part on how the workers react to crises. After the crisis of 1929-33—the worst in the entire history of capitalism up to the present—for the first time in their history U.S. workers achieved the unionization of basic industry on a lasting basis. This crisis, far from "breaking the power" of organized labor, largely gave birth to the power of "organized labor."

The result was a historical rise in real wages including the introduction in the U.S. of a social wage—Social Security and unemployment insurance. After World War II, the rise in real wages combined with an expansion of the already existing social wage spread to Western Europe and then Japan.

No doubt the rate of profit after World War II was considerably lower than it would have been if real wages including the social wage had stayed at the levels that prevailed before the Depression. All the same, these lower profits did not prevent the “great” postwar boom, nor did the rise in money wages lead to runaway inflation. And what inflation there was can largely be traced to Roosevelt’s 40 percent devaluation of the U.S. dollar and the devaluations of other currencies as well.

The idea that recessions are deliberately “provoked” by central bankers in order to weaken the trade unions remains popular in large sections of the left. For example, see Michael Perelman’s article in the April 2012 edition of Monthly Review. The thought that if only pro-labor people were put in charge of central banks—for example, if Rich Trumka, head of the AFL-CIO, were appointed chairman of the Federal Reserve Board—that crises could be avoided is really quite naïve.

Let’s see how Frederick Engels described crises in his 1877 work “Anti-Duhring,” a work read and approved by Engels’ co-worker Karl Marx, who was still alive at that time. “Commerce is at a stand-still, the markets are glutted, products accumulate, as multitudinous as they are unsaleable, hard cash disappears, credit vanishes, factories are closed….”

Notice Engels mentions “hard cash disappears” and “credit vanishes.” Is the disappearance of hard cash and the vanishing of credit the cause of the crisis, according to Engels? Not at all. The “tight money” is the result of the crisis, not the cause of the crisis. Engels says nothing here about the Bank of England—whose directors were at the service of capital just as much as their counterparts on the U.S. Federal Reserve Board are today—creating tight money and causing crises in order to break the power of the British trade unions. Then what does cause the crisis?

“[T]he mass of workers,” Engels continued, “are in want of the means of subsistence, because they have produced too much of the means of subsistence….”—and I would add too many means of producing the means of subsistence.

Then how does capitalism recover from the crisis? Is it through breaking the power of “organized labor”? Again, Engels says nothing about that. “The stagnation,” he explains, “lasts for years; productive forces and products are wasted and destroyed wholesale, until the accumulated mass of commodities finally filter off, more or less depreciated in value, until production and exchange gradually begin to move again.”

Breaking the power of organized labor can neither prevent the crisis nor can it enable capitalism to emerge from the crisis. What “breaking the power” of “organized labor” will do is raise the rate of profit once recovery sets in, but it does not eliminate the need to liquidate the huge mass of overproduced commodities.

If the capitalists are successful in raising the rate of surplus value during a crisis, they will benefit from a higher rate of profit once the liquidation of the overproduced commodities and the means of producing the overproduced commodities has removed the barriers to the realization of value and surplus value. But the extent they succeed in this—if at all—depends on the class struggle.

This does not mean that the central bankers have never deliberately slowed the economy down or even under exceptional conditions deliberately caused an artificial recession to attack “organized labor.”

For example, the 1937-38 recession under Franklin Roosevelt’s “New Deal” comes to mind. The U.S. Treasury and the Federal Reserve System took actions that deliberately slowed the U.S. economy very sharply at that time. These included moving to balance the budget and preventing the inflow of gold from abroad from expanding the U.S. money supply—carried out by the U.S. Treasury—and increasing the reserve requirements of the commercial banks—carried out by the Federal Reserve Board.

In 1937, the U.S. dollar was very strong as indicated by the strong inflow of gold to the U.S. as money capital fled from Europe to the U.S. on the eve of World War II. There was no real economic reason for either the U.S. Treasury or the Federal Reserve System to “tighten” under those conditions. Indeed, the reason given at the time—that these measures were needed because of the dangerous growth in U.S. bank reserves—made no sense. As would be expected, the deflationary measures carried out by the Roosevelt administration in 1937 actually increased the inflow of gold and led to an even more rapid growth of bank reserves in the years that followed. It therefore seems highly likely that organized labor was indeed the target in this exceptional case.

Remember, these were the days of the sit-down strikes and the rise of the CIO. Unionization was spreading throughout U.S. basic industry—with the exception of the Jim Crow South—and beyond. If this trend had continued, the majority of U.S. workers might have been unionized.

In 1979, however, when Volcker was appointed Federal Reserve chairman, the situation was virtually the opposite. Organized labor, in contrast to 1937, was already in a deep retreat. In contrast to 1937, when there was virtually no inflation and the U.S. dollar was rock solid, the U.S. dollar was entering a free fall against gold. The resulting massive devaluation—not rising money wages, which were merely reacting to and lagging behind the soaring cost of living—was stirring up massive inflation.

The fact that the U.S. Federal Reserve Board could only keep the economic "expansion," such as it was in the late 1970s, going through ever greater doses of inflation to the point where it would have led to complete economic collapse within the near future, as Henwood acknowledges, indicates that Paul Volcker's "tight money" was not the real cause of the economic crisis of the early 1980s at all. On the contrary, Volcker's "tight money" polices were the result not the cause of the economic crisis of those days.

Doug Henwood is quite correct on one thing. The only alternative to a deep recession beginning in 1979 was indeed a socialist revolution. Since as is well known there was no socialist revolution in 1979, a severe recession in the near future was unavoidable. (For more on this, see here.)

Next month: We'll take another look at the European crisis, following up on our posts "Greek Workers Show the Way" and "Is the Economic Crisis Over?"

Notes

1 The early Marx differed from the Ricardian socialists, because he actually understood that the Ricardian law of value described capitalism and was not the ideal of a future socialist society. To the Ricardian socialists, the equal exchange of commodities was a programmatic norm. According to the Ricardian socialists, the fact that rent, interest and profit existed meant that the equal exchange of commodities that embody equal amounts of labor to produce was being violated. They demanded that the equal exchange of commodities be put into effect in practice in order to eliminate rents and profits.

However, it wasn't until Marx began to distinguish between labor and labor power around 1857 that Marx was able to explain how surplus value—rent and profit including interest—could emerge not in contradiction to the equal exchange of commodities but because of it.

2 Credit money, IOUs payable in state-issued legal tender money, is not payable in actual commodity money. But this is possible only so long as the token money that the credit money is convertible into remains exchangeable on the open market for the money commodity.

If the U.S. dollar were ever to go the way of the German mark in 1923, checks payable in U.S. dollars would be worthless, just like "rubber" checks not actually convertible into cash are worthless today.

3 Sraffa (1898-1983) was an Italian Marxist in his youth. He fled from Mussolini's fascist dictatorship to Britain and became a professor of economics at Cambridge, the university where Keynes also studied and taught. A great admirer of Ricardo, Sraffa edited and published his works and letters.

In his Cambridge years, Sraffa did not use Marxist categories and it remains unclear to what extent if at all he remained a "closet Marxist." Sraffa's Cambridge writings are "neo-Ricardian." However, unlike Ian Steedman and other "neo-Ricardians," Sraffa aimed his fire with devastating effect at the marginalists and not Marx.

4 Unfortunate in a way but fortunate in another way. In "Marx After Sraffa," his main work, Steedman urges Marxists to abandon the labor theory of value once and for all, claiming that the

Sraffa method of calculating prices of production showed not only that the rate of profit in price of production terms deviated from the rate of profit in value terms but that value analysis was completely unnecessary.

Steedman did not understand Marx's theory of value, probably confusing it with the Ricardian theory of value.

But fortunate in another way. Steedman's work, obstructionist though it was, showed the need to end the confusion between the Ricardian and Marxist theories of value.

5 This is not say that no members of the Second International (which included Engels and later Lenin) or Third International (which included Lenin) understood Marxist value theory, but rather that a complete understanding of Marxist value theory did not sink into the collective understanding of these Internationals and their leaderships as a whole. While I don't want to say this is the only factor or even the chief factor in the decline and fall of these earlier workers' Internationals, it did facilitate the eventual victory of Keynes-like reformist theories over Marxism that brought these Internationals to their disastrous ends. We will simply have to do better in the 21st century.