The Rate of Profit is the Key

by Michael Roberts

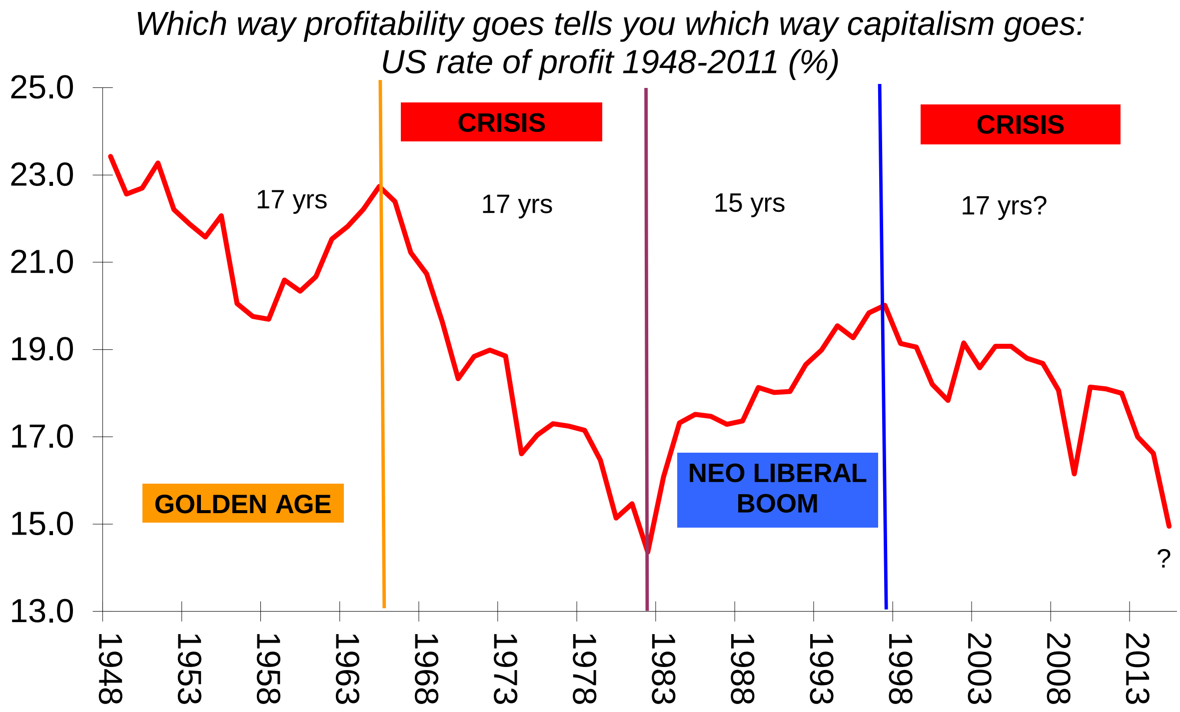
The modern world economy is dominated by the capitalist mode of production. Under capitalism, money is used to make more money. Profit drives production, not social need. And capitalist production does not proceed in a straight line upwards. It is subject to recurrent crises of 'booms and slumps' that destroy and waste much of the value previously created by society (workers). The 1880s and 1890s saw a massive destruction of US production and wealth; the Great Depression of the 1930s also. Now we have suffered the first Great Recession and are still in the Long Depression of the 21st century.

The capitalist mode of production has recurrent crises because it has two major fault-lines. First, in a monetary economy, of which capitalism is the epitome, there is always the possibility of crisis. Holders of money may not always spend it or invest it, but hoard it. If they do so for whatever reason, it can cause a dislocation of the exchange process and create a crisis in buying and selling.

Second, the capitalist system of production for profit will falter if not enough profit is created to satisfy the owners of the means of production. And there is an inherent tendency for the rate of profit to fall. This is the underlying cause of all slumps.

Individual capitalist businesses do not cooperate to produce the things and services that society needs. On the contrary, they compete with each other to sustain and increase their profit. To do so, they make workers worker longer or harder, but they also increasingly use new technology to boost the productivity of labour to get more value. But this is capitalism's Achilles heel. The accumulated cost of investing in new plant, equipment etc inexorably rises compared to the size and cost of the labour force. As only labour can create new value (machines on their own cannot do it), the profitability of each new unit of investment begins to fall. If profitability falls consistently, eventually it will cause a fall in the mass of profit. Then capitalists stop investing and 'go on strike'. A crisis of production ensues.

Capitalists try to avoid this crisis in various ways: by trying to exploit workers more; by looking for cheaper forms of new technology; and by speculating in unproductive areas of the economy i.e. the stock market, banking and finance, where they gamble for gain. But these things can only work for a while. Eventually, the law of falling profitability will operate.



The rate of profit in the US is well below where it was in 1948. But it has not moved in a straight line. After the war, it was high in the so-called Golden Age from 1948-65. This was also the fastest period of economic growth in American history.

Then profitability fell consistently from 1965 to 1982. GDP growth was much slower and American capitalism (like elsewhere) suffered severe slumps in 1974-5 and 1980-2.

Then in the era of what is called 'neoliberalism', from1982 to 1997, profitability rose. Capitalism managed to get counteracting factors to falling profitability into play i.e. greater exploitation of the American workforce (falling wage share); wider exploitation of the labour force elsewhere (globalisation) and 'speculation' in unproductive sectors (real estate and the rise of finance capital). This 'neoliberal period' had less severe slumps, although economic growth was still slower than in the Golden Age because much of the profit was diverted away from real investment.

Profitability peaked in 1997 and began to decline. This laid the basis for the Great Recession of 2008-9. That slump and the ensuing Long Depression that we are still in was more severe than anything seen since the 1930s, because of the huge build-up of debt and financial assets in the previous two decades that did not create real value. Instead, there were credit-fuelled bubbles first in hi-tech stocks (crash in 2000) and then in housing (crash 2007). The unproductive financial sector contributed 40% of all capitalist profit. Finally, this credit bubble burst, bringing down the banking sector and the economy.

The high level of private sector debt was compounded by the state having to bail out the banks. Until this overhang of debt is cleared (deleveraged), profitability cannot be restored sufficiently to get investment and economic growth going again. Indeed, it is likely that another huge slump will be necessary to 'cleanse' the system of this 'dead (toxic) capital'. The Long Depression will continue until then.

Ending the Long Depression will not be possible by more government spending through increased borrowing and/or taxes, as this eats into the profitability of the capitalist sector. While that sector remains dominant, lower profitability means that new investment will not take place to restore lost jobs and incomes. The New Deal in the 1930s did not succeed in ending the Great Depression, even though it was much more radical than any measures now proposed by Obama. It was watered down by capitalist opposition. But also it did not work because it could not restore profitability - on the contrary. In the end, only a World War that put the labour force onto a military footing (while killing millions globally) did the trick.

Under capitalism, terrible slumps will reoccur and inequality will remain. The end of poverty and prosperity for the majority can only come through replacing private production for profit with democratically-planned production for social need.