# Right conclusion with weak evidence: a review of the failure of capitalist production

Jeong, Sangjun

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# Right Conclusion with Weak Evidence:

# A Review of *The Failure of Capitalist Production*

Sangjun Jeong*

**Abstract**

This paper reviews Andrew Kliman's *The Failure of Capitalist Production* (2011) with a focus on his critique of the underconsumptionist account of the current crisis. He innovatively refutes the underconsumptionist claims that the deterioration of income distribution and hence the decline of demand is the root causes of the crisis. However, his counterevidence based on the alleged rise in the share of workers' income is not strong enough to support his relevant criticism of the underconsumptionist theory and its political implications. Rather, we suggest an outline of alternative critique which would refute underconsumptionism more effectively.

Keywords: Andrew Kliman, Underconsumptionist, Worker's income share, Alternative critique

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* Department of Economics, Seoul National University, South Korea. E-mail: vorwarts@snu.ac.kr.

## 1. Introduction

This paper comments on the work of Andrew Kliman (2011), which contains in my view a vitally interesting and pioneering account of the current crisis. Based on the estimation of the historical-cost rate of profit derived from the temporal single system interpretation (TSSI) of Marx's value theory, Kliman contends U.S. corporations' rate of profit did not recover under the neoliberal regime, and the decline in the rate of profit is the main culprit for the decline in the rate of accumulation, which led to the stagnation of the U.S. economy and massive debt build-up, and finally the global financial crisis. Accordingly, he reveals the conventional left accounts which mainly focus on financialization or underconsumption rather than the fall in the rate of profit are empirically ill-grounded as well as theoretically incorrect.

He finds support for his ideas through meticulous examination of huge statistics, and I personally think highly of his incessant effort to 'crunch and analyze numbers' (p.9) given that some of the so-called left or Marxists stay away from such an empirical approach. However, his arguments leave a lot to be discussed. As other comments in this volume discuss the definition/estimation of the rate of profit, I would exclusively appraise his refutation of the underconsumptionism in chapter 8 of the book.

To sum the underconsumptionist account, the underlying fundamental cause of the crisis which started in the U.S. is the deterioration of income distribution from the late 20th century onwards, that is, a falling pay for workers and/or a decline in their share of income under the neoliberal regime and hence the lack of the aggregate demand. On the contrary, Kliman asserts that U.S. workers are paid more than a few decades ago, and that their share of the nation's income has not fallen. Therefore, the latest crisis cannot be traced back to a fall in the compensation for workers nor to a decline in their share of income.

However, Kliman's evidence against underconsumptionism is in part irrelevant. In the next section, we critically examine Kliman's empirical account on functional income distribution and show it is undeniable that the share of U.S workers' income has fallen or at least stagnated. And yet, even though the decline in labor's share is 'empirically' verified, the underconsumptionist theory and its political implications are not justified. Instead, in section 3, we suggest an outline of alternative critique of the underconsumptionist account, which would have been a better and consistent strategy for Kliman. Section 4 concludes.

## 2. Measures of Income Distribution

The underconsumptionist crisis theories, which regard the deepening of income inequality as the cause of reduced consumption, gain influence among the economists, for recession is often accompanied by a decline in labor's share. In practice, Bleaney (1976:14) classifies underconsumption theories as either an oversaving type championed by Malthus and a mass poverty type associated with Sismondi. Specifically, the latter attributes gluts to the inability of labor, owing to low wages, to buy its own product, which corresponds to the recently popular underconsumptionism.[1]

However, contrary to the underconsumptionist causation from the decline of workers' income to the lack of demand, Kliman explains that the fall of personal consumption due to the reduced workers' pay can be offset enough by a rise in businesses' investment demand. He also adequately expounds that Marx already in the expanded reproduction scheme showed the accumulation of capital is not necessarily limited by the final demand of consumption goods, and for the celebrated Baran and Sweezy's *Monopoly Capital*, Kliman makes a convincing argument that investment spending not only in theory but in the real world grew significantly faster than consumption spending and GDP.

This theoretical refutation is clear enough. Meanwhile, in terms of the empirical respect, Kliman argues the share of national income received by the U.S. working class has not fallen. Here, Kliman's measure of income distribution is far different from the underconsumptionists'. For example, the representative underconsumptionist writers John Bellamy Foster and Fred Magdoff use the ratio of wages and salaries to GDP as the measure. Kliman points that their measure underestimates labor's share by leaving out big and growing chunks of working people's incomes.

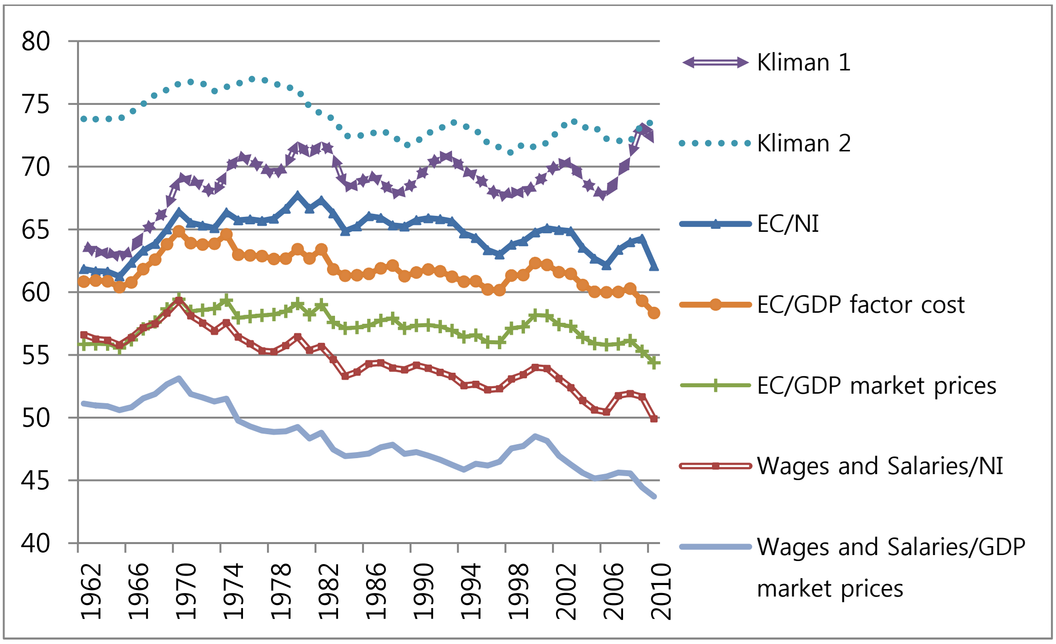
However, in the first place, we should note that economists do not have a practical as well as theoretical consensus on which measure is the most appropriate when evaluating functional income distribution (Krueger, 1999; Glyn, 2009). In general, labor's share or workers' share is defined as labor income per value added of the nation. Still, several issues remain. To name only a few, 1) for the numerator, should we add employee compensation such as employers' contribution to pensions and

[1] For instance, Foster and Magdoff say, "Under these circumstances, in which consumption and ultimately investment are heavily dependent on the spending of those at the bottom of the income stream, one would naturally suppose that a stagnation or decline in real wages would generate crisis-tendencies for the economy by constraining overall consumption expenditures....Except for a small rise in the late 1990s, real wages have been sluggish for decades" (2009: 28).

social security to 'wages and salaries'? 2) Should a wage component of self-employment income be added to labor income and what is the right methodology to make such an adjustment or imputation? and 3) for the denominator, should value added (GDP) be calculated at market cost or at factor cost? Will not national income (NI) be a more adequate denominator?, etc. The answers to the above questions need reasonable explanations on the characteristics of a non-wage component of compensation, indirect taxes and capital consumption and the like, all of which cannot but be chosen arbitrarily according to the purpose of each research.

Therefore, instead of choosing one unique measure, we constructed a variety of measures of the income distribution in the U.S. (see chart 1), corresponding to Kliman's figure 8.1 (p.154). As the chart 1 shows, the levels of those measures show a wide range between about 45% and 70%. It is true Foster and Magdoff's measure, the lowest series in the chart, shows the most remarkably declining trend over the four decades, which may be exaggerating the fall of the U.S. working class' income as Kliman argues. On the other hand, when employee compensation which has increased significantly since 1970s is added to wages and salaries, the downward trend is not so pronounced. However, except for Kliman's own measure ('Kliman 1'), which shows an overall increasing trend and even records the highest level in the late 2000s, the other measures generally show stagnant or declining trends from the 1980s onwards, which becomes more noticeable during the recent decade.

Chart 1. U.S. Labor's % share of total income: various definitions



This discrepancy between Kliman's and other general measures lies in ‘the net government social benefits'. Specifically, in addition to the before-mentioned employment compensation, Kliman includes the difference between social benefits provided by the government and what people contribute through their taxes. The social benefits are social security and medicare benefits, veterans' benefits, and other items such as welfare assistance and unemployment insurance benefits. In effect, net benefits have increased far faster than wage and salary income since 1970s, which inflates Kliman’s own esimates.

However, his estimates overstate workers' income in the following two respects.

First, the net social benefits should not be counted in one piece. Some tax contributions for the government social insurance are allocated to capital either directly or indirectly, the incidence of tax on labor only should be taken into account. Equally, the government expenditures that benefit workers exclusively should be identified as well. This is far from being such a simple task as Kliman calculates from the NIPA table.

Meanwhile, we can refer to Miller (1992) and Shaikh and Tonak (2002). They constructed the concept of a 'net social wage', which is very similar to Kliman's 'net government social benefits', and their estimation for the U.S. economy showed throughout most of the postwar period it is slightly negative or effectively zero: that is, U.S. workers paid more in taxes than they received in the form of government benefits. Contrary to Kliman's explicitly positive estimate of the net benefits, the negative or zero estimate means that the distributional effects of U.S. government policy has been marginal and pro-capital, not pro-labor. This difference is due to, for example, Miller, Shaikh and Tonak count veterans' benefits as part of the cost of war and thereby exclude them from social spending or social wage. Although whose methodology of estimating the social wage is appropriate to measure the distribution of income needs further examination, Kliman's methodology conceals the class-content of taxation and government spending on the working class and hence (presumably unintentionally) produces a misleading support for the (pseudo-) Keynesian alternatives.

Second, Kliman’s measure is constructed as a share of national income. However, even when we accept his controversial assumption that the majority of those net benefits accrue to working-class (p.223), U.S. Bureau of Economic Analysis (BEA) categorizes those net government social benefits into personal income, not national income. While national income is the total of factor incomes, personal income is that income which is actually received by the individuals. Personal income is counted from national income by deducting the income earned but not received, such as undistributed corporate profits and corporate income taxes, and by adding income received but not earned, such as transfer receipts.

Therefore, Kliman's measure including the net government social benefits would rather be divided by personal income, not by national income so that it better serves his original purpose to find how much the U.S. workers 'received'. We devised the measure ('Kliman 2' in Chart 1). Compared to the 1960-70s, the share diminished noticeably during the neoliberal decades and no such significant trend upward as 'Kliman 1' is apparent.

On the other hand, Kliman additionally considers the ‘real’ income of workers; i.e., inflation-adjusted measure of compensations, wages and salaries. His Figure 8.2 and 8.3 (p.157) show the pay of U.S. workers has risen in real terms under the neoliberalism and the results hold irrespective of the price deflator used. However, first, given that the workers’ income includes the pay of employed entrepreneurs which is at the top of the workers’ pay distribution, a significant part of (if any) the upward trend should be attributed to the jump in the pay of the top 1 or 5% wage-earners since the mid 1990s.[2] In addition, if the precise Marxist distinction between productive and unproductive labor is applied, the stagnant/decreasing trend of the wages of production labor would be more noticeable since 1980s (see Mohun 2006).

Besides, it should be reminded that the price indexes such as Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) tend to systemically understate the real cost of living (see Williams 2004). Since the Boskin Commission revised the way of measuring CPI in 1996 in the name of improving accuracy, the official rate of U.S. inflation has been dramatically reduced and this bias still stands a chance to lie under Kliman’s upward trend of the inflation-adjusted workers’ income. PCE index preferred by the Fed is also not free from the underestimation bias of prices. For instance, since it gives housing less weight than does the CPI and hence fails to reflect exactly the soaring house prices in the 2000s, it is not a coincidence the gap between the two series of workers’ income deflated by CPI and PCE in figure 8.2/8.3 gradually narrows. Overall, although it is inevitable to use the official price index available, the inflation-adjusted result should be taken with a grain of salt.

[2] Dumenil and Levy (2012) show that the concentration of income in favor of high wages was confined within the upper 5% while the share of the 90-95 fractile was preserved and the share of the 0-90 diminished during the neoliberal decades. Sure enough, Kliman addresses this contentious issue (see p.126, 220).

## 3. Alternative line of reasoning

With the findings that income distribution has in reality worsened as explained above, does the underconsumptionism touch the root cause of the crisis? The answer is still negative. Although during recession we witness stagnant wages, unused capacity and sluggish consumer spending combined, “it is a pure tautology to say that crises are provoked by a lack of effective demand or effective consumption" (Marx 1978: 486-7). Likewise, underconsumptionists commit more fundamental error of confusing the causes and effects of the crisis. Still, the lack of demand owing to workers’ weak purchasing power is not the cause of the crisis.

Their misunderstanding is due to, above all, ignoring the crucial role of investment as a major component of demand and thereby leaving the dynamics of capital accumulation in the business cycle unexplained. However, it is capital accumulation which links between profitability and income and determines to a large extent the income growth. As a consequence, the inevitably resulting class struggle shapes the income distribution. That is, to quote Marx again, “putting it mathematically the rate of accumulation is the independent, rather than the dependent variable, and the rate of wages is the dependent variable” (1976:770).

In particular, when capital accumulation stagnates, capitalists make arduous effort to shift the looming recession burden onto workers and the income distribution changes depending on the power of the working class. Undoubtedly, it is the current global crisis when this mechanism is being displayed distinctly in the U.S and Eurozone countries. Given that U.S. workers for decades have been subjected to more outright neoliberal policies in comparison to continental Europe, and hence the power of U.S. working class has been undermined severely, we expect the causation chain from capital accumulation to income distribution is stronger in the U.S. than in Europe. Actually, for example, Jeong (2012) conducted econometric analysis of the relationship between labor’s share and the rate of accumulation for the U.S. economy over the last four decades. Its non-causality Granger tests in the vector error correction model support unidirectional causation form the rate of accumulation to labor’s share.[3]

It neither implies that change of capital accumulation always precedes that of income distribution nor that increase/decrease of workers’ income share has little effect on the investment activity of

[3] The detailed methodology and regression tables are available on request.

capitalists. Simply put, the rate of accumulation (ΔK/K) is by definition the product of the profit rate (Π/K) and the ratio of net investment to profit (ΔK/Π), and the profit rate is equal to the profit share (Π/Y) times the output-capital ratio (Y/K). Therefore, the movement in the profit share is no wonder related to the movement in the rate of accumulation.

But despite the increase in the profit share as we confirmed in Section 2, capital accumulation started to stagnate and showed a decreasing trend during the neoliberal age. Then, to explain its cause, we should notice the movements of the two remaining variables, the output-capital ratio and the ratio of net investment to profit. In brief, while Kliman centers on the fall of the former variable related to the increase in the value composition of capital, the 'financialization' theorists emphasize the latter one related to the rising influence of financial sphere on the productive investment. We do not go further into this issue here due to space restrictions. But this line of reasoning implies that to statistically demonstrate the rise in the profit share (equally, the fall in the wage share) under the neoliberal regime does not undermine but rather buttress the argument that other fundamental cause hampered capital accumulation and led to the recession, which is shared by Kliman as well.[4]

As mentioned above, we do not deny that once a recession has occurred, capitalists' fierce survival competition results in cutting wages and mass lay-offs, and the large stock of debt piled during the boom[5] squeezes the household, all of which lower consumer demand and thereby encourage lasting stagnation. However, in Devine (1983)'s words, this 'underconsumption trap' occurring *in the wake of* the onset of the crisis should be distinguished from the root cause of the crisis, where underconsumption forces play a direct role only under restrictive conditions.

In sum, it is not that Kliman missed such underconsumptionsts' misplaced chain of causation (see pp.3-4, 165-166). Rather, we suggest more rigorous empirical analysis of the dynamics between profit,

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[4] Kliman persuasively shows in chapter 5 that capital accumulation is to a large extent determined by the profit rate.

[5] On the other hand, debt accrued during the boom also cannot be attributable exclusively to the sluggish wage growth as underconsumptionists argue. Specifically, the increase of household debt at issue has an ambivalent aspect, financing for asset investment of the 'better-off' households as well as for necessities of the 'worse-off' households. The former feature is in no way negligible in the U.S. economy and this speculative 'overconsumption' could expand with the supply of overseas fund into the U.S. in the global imbalance constellation. However, underconsumptionists tend to provide a snapshot of the impoverished workers only and understate the role of speculation prevalent even among the rank and file.

accumulation, and distribution would reveal underconsumptionism's theoretical and empirical flaws more effectively.

## 4. Conclusion

Inasmuch as pointing the income distribution as the fundamental cause of the current crisis is on the increasing vogue, Kliman's hard-edged and succinct criticism of underconsumptionism is a well-timed intervention. It is clear what Kliman's critique logically directs: rejecting their political implications. Such underconsumptionist account "induces false hope that capitalism can be made more equitable and relatively crisis-free" (p.151) and that "crises and slumps can in principle be averted by giving them [the workers] a bigger slice of the pie" (p.197). As we have recently witnessed a vast magnitude of fiscal and monetary interventions into the wrecked markets in the name of preventing another crisis, the world now may well be more inclined toward, in Kliman's felicitious words, this "trickle-up" economics without a gloom of another great recession.

However, contrary to these policies with a rosy picture, Kliman insists "if a persistent fall in the rate of profit is an important (albeit indirect) cause of the crisis and recession...at best, they will delay the next crisis. And artificial government stimulus that produces unsustainable growth threatens to make the next crisis worse when it comes" (p.7). I am in sympathy with his straightforward claim that underconsumptionism does not provide a scientific explanation of the crisis and as a result, its (Keynesian) policy proposals only contribute to the political reformism which reproduces a myth of 'There Is No Alternative' among workers. However, his strong conclusion is based on relatively weak evidence on the income shares. Instead, even with the plain fact of the worsened income distribution, underconsumptionism can be rejected effectively. We outlined such an alternative line of reasoning and hope to develop the discussion with further research.

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