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Abstract

This paper was originally presented at the 'Marxism and Political Economy' conference called by the International Socialist Journal on Saturday 29th September 2007. A revised version was presented to the Historical Materialism conference on 13th November 2007. It enquires why, although national economic equality is one of the most persistent features of the history of capitalism, economics as yet lacks a coherent economic explanation of it. It also enquires why Marxism has failed to develop such an explanation, and concludes that in both cases the inadequacies of existing theory arise from the constraints of the general equilibrium paradigm. In the second case, however, this paradigm is wrongly attributed to Marx.

The paper argues that Marx's own, original theory of value, contains the basis for an economic mechanism of divergence in the formation of market value as the average of many producers of differing productivities. The persistence of productivity differentials – excluded by the general equilibrium paradigm – is maintained by a positive feedback mechanism. It yields a surplus (above average) profit to the high productivity producers, who become geographically concentrated within a definite and very stable block of nation-states at an early point in the history of capitalism. From then on, this extra profit could be invested in maintaining a permanent productivity lead. This is an entirely temporal effect and cannot be predicted or reproduced if it is pre-supposed that productivity differentials are ignorable.

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Alan Freeman

In this paper I want to explain two great problems about the world: Why orthodox economics has failed to understand world inequality, and why 'Marxist' economics has also failed.

You will notice that I did not say 'explain world inequality', but 'why existing theories fail to explain it'. Actually, world inequality is easy to explain: it's the capitalist system, dummy. To understand *how* it produces world inequality, one needs a theory. It's not even difficult to produce a theory, and I will offer an obvious one by showing how Marx's conception of individual and social value explains world inequality. But that isn't, I think, the problem we face: what we should really ask is why economics fails to find such an obvious explanation. This isn't, I think, because the economists are stupid or lack 'facts'. It is because their theory makes it impossible.

This theory is the dogma of equilibrium, which dominates mainstream economics and was foisted on Marx by the Marxists, robbing it of all its explanatory capabilities.

Market breakdown

World inequality is only one of several empirically obvious phenomena that remained unexplained, which I call 'market breakdown'. These include

(1) long phases of declining average profit rates and slow growth, one of which we are still in now

(2) regular, cyclic crisis, which is back on everybody's lips at the moment.

Market breakdown is not the same as the 'market failure', the words economists use as an excuse for when things go wrong. This says that the market has not been allowed to work properly. For the equilibrium economist the market is never to blame. It is the fault of trade unions, bad governance, poor monetary policies, overregulation (or newly popular, underregulation), terrorism, historical backwardness, Islam, Communism – you name it, they blame it.

Market breakdown is a failure which the market does all by itself. Marx himself used a similar idea in talking about the falling rate of profit. Bourgeois economists, he said, hate this idea because it suggests capitalism contains internal limits, creating contradictions that sow the seed of its own destruction.

To avoid such conclusions, economics has been shaped over the years into a refined tool for denying that market breakdown is possible, and in the shape of equilibrium it has found the perfect Orwellian theory – it is a theory from which market breakdown cannot logically be deduced.

It is in a state of psychotic denial – it has fashioned a theory that cannot recognise the capitalist causes of its own problems out of pathological terror of admitting them. Equilibrium begins by assuming the market reproduces itself perfectly. Even when change is permitted, as in the theory of growth, we find this has to take place in unchanging proportions, which is simply another kind of perfect reproduction.

This does not mean the economist assume that change never happens: what happens is that the *cause of* change is always external. On the basis of such theories, we can

never understand any capitalist failure which capitalism does to itself.

The irony of ironies is that Marx's own value theory, which starts from a total and violent rejection of equilibrium, has been changed – re-interpreted – into an equilibrium theory. This started with von Bortkiewicz , was endorsed by the prominent American Marxist Paul Sweezy, and finally, in the hands of the followers of Piero Sraffa, converted it into an instrument for ruling Marx's own ideas out of court, on the utterly false grounds that they are internally inconsistent. The inconsistency, as Andrew Kliman, myself and others persistently explain, arises simply and only from imposing on Marx an economic theory he never held.

It is easy to explain market breakdown, once one departs from the dogma of equilibrium. It is impossible to explain it otherwise. That is why neither mainstream, nor 'Marxist' economics has been able to explain it, and is vital to detach Marx's own, non-equilibrium ideas from the dead hand of this dogma.

The 'classical' tradition offers no explanation

The first thing to establish is easy, because it is widely admitted: the mainstream economic tradition offers no explanation of the growing inequality of nations and confidently predicts it should not happen. For Adam Smith in the 'wealth of nations', trade is what causes wealth. For Ricardo, the theory of comparative advantage – still trotted out as the basis for IMF policies, while Marx is derided as 'out of date' – predicts that provided nations specialise appropriately, the outcome of trade will be optimum. In no classical writing do we find the slightest inkling that trade under fully capitalist conditions can *create* or *increase*, rather than *decreasing*, national differences.

There has been no improvement. The famous Samuelson factor-price theorem, starting point of nearly every textbook on international trade, 'proves' an embarrassing conclusion: in a developed capitalist market, *even* in the presence of national boundaries, the 'price of factors' should equalise. Profits and wages should over time become the same the world over.

Samuelson logically proves that, under equilibrium assumptions, an unconstrained capitalist market cannot produce any other outcome. If one accepts this theory, therefore, the only possible answer of inequality is a failure of the peoples thus impoverished. The victims are to blame for their own subjection – the foundation of modern racism and the all-pervasive idea of 'backwardness'.

Economics meets the economy: Is backwardness a historical phenomenon?

These predictions simply have not happened. A well-established literature agrees that the 'great divide' has got *worse,* the more developed is world capitalism. The theoretical question is then simple: since world poverty and divergence are clearly produced by capitalism, why is there no theory to explain how capitalism does it?

To illustrate this I constructed a simple indicator of world inequality. Taking the IMF's own classifications, I calculated the output (GDP) of the *whole* so-called 'advanced' world and the *whole* of 'rest'. Dividing this by population yields output per person – a reasonable proxy for output per worker – of these two great parts of the world. Dividing one by the other gives us a measure of world inequality.

What emerges is that poverty under 'globalisation' nearly doubled between 1980 and

2000. In 1980, the rich one-fifth of the world was on average 12 times richer per head than the poor four-fifths. By 2000, this had risen to 22 times.

A number of other things emerge. The first is the extraordinary geographical stability of the 'rich' world. Since the time Lenin, territories that have escaped 'backwardness' contain at most 80 million people = 2% of population of the 'backward' world.

The second is that the persistence of polarisation is a secular trend. Unlike the decline in the profit rate, it is essentially *never* reversed. It may go quicker or slower, or reverse for a short while. But over virtually any ten-year period, it always gets worse.

The third point is that polarisation is extreme. In 1907 according to Pritchett, the ratio of the poorest to the richest country in GDM per capital was 7 times. By 1997 it was 132 times. The inequality ratio for the whole world is now three times greater than the gap between the poorest and richest countries in 1907. The ratio of GDP per capita of the rich countries to that of key, large countries such as India is now of the order of 40:1. To put this another way, the output of one worker in the rich countries exchanges against the output of forty Indian workers.

Crap by any other name

What is most interesting is that the *same* thing has gone by so many different names. In the 19th C rich and poor countries were called 'Civilised and Barbarous'; in the early 29th, Imperialist and Colonial and semi-colonial; from the forties onwards, developed and underdeveloped, after Mao's speech the first and the third world. Then in the 1970s we had dominant and dependent, then North and South, in the IMF's language advanced and non-advanced and now guess what? With Huntingdon's 'Clash of civilisations' we are back to Civilised and Barbarous. When the same object is called by so many different names this tells us two things: one, it is mighty persistent, and two, people are trying to avoid it.

The dogma of equilibrium

Why cannot equilibrium theory explain this? Because equilibrium assumes that all differences have been eliminated. You have to assume that the average technique for making every product is the single, actual technique. That means you rule out finding low and high productivity producers in the same market. The deduction flows from this theory : it is a theoretical consequence of it, and if you want to deduce another conclusion, you either have to use another theory, or you have to find something *non-*economic to explain it.

Is there an economic mechanism of backwardness?

How does this differ from what Marx himself says, and how, therefore, does Marx's theory make it possible to explain national differences in income?

First, Marx *never* states that profit rates actually equalise. To the contrary, differences in profit rates or *surplus profits* are the motor of capitalist dynamics. He sets out where these differences arise, in chapter 8 of volume III and in the unpublished 'Chapter 6' of Volume I otherwise known as the *Resultate*, which is published in the Penguin edition of this work.

Marx explains that in his view, value is never identical between producers but is an *average* of the use-values produced, divided by the labour expended by the global labourer. Many producers, with many productivities, coexist at any time. Since they

all sell their product for a single price, the most productive – the ones with the lowest costs – make more profit, or to put it in value terms, value that is produced by the less productive is appropriated by the more productive.

Of course, this is in continuous motion. As average productivity rises, producers exit, bankrupt or dead, from the bottom, and new, more productive ones come in at the top. The point, is that *this does not abolish the differential profit,* as equilibrium theory must suppose. As fast as poor producers leave, more rich producers arrive, just like a waterfall which plunges into a chasm but is continuously filled from upstream,

Moreover, these differential profits become concentrated because there is a 'positive feedback' mechanism. It *concentrates geographically*. Since the producers in the high-productivity countries are making higher profits, they plough them back into innovation and keep their lead. In the low productivity countries, the only way to compete is to cut wages – which is what happens. The exchange rate drifts downward, expressing the fact that the labour of 10, 20 and 40 workers in a low productivity country is exchanged by the market against the labour of 1 worker in the high productivity countries. On the one hand, therefore, the price of domestic products falls leading to rising 'purchasing power parity'. But this does not deal with the fundamental problem of growth. To the contrary, the price of *technology* which is a quasi-monopoly of the high productivity countries, in effect costs 10, 20, 40 times more than what the labour of the poor country can contribute in order to obtain it.

Market or state?

What does this tell us, in conclusion, about the present state of the world? At this point I will refer to some of Marx's decisive and relevant political conclusions, concerning the role of the state and its relation to the market.

Mainstream social theory has an ambiguous relation to the state in the world economy. The sociologists want to say that globalisation has hollowed out the state which has ceased to matter. But the economists want to put the blame for the market's own breakdowns somewhere else, so it tells us that bad or rogue states are responsible. This leads to the odd conclusion that a hollowed-out rogue state can plunge the world into nuclear war.

Actually, the state has a clear relation both to the national and to the world market, which is that it creates the conditions for their existence. What it has given, it can also take away. The market is there *due to the grace* of the state, a grace sometimes rudely enforced.

The state also overrides, within its own territory, contradictions that threaten capitalist power. It regulates social conflict and finds ways to override, at least partially, the extreme regional differences which characterise relations between nations.

The state is also the 'executive committee of the bourgeoisie' and enforces and advances its national interests. It can therefore *override* or *reenforce and exploit* the world market, and loses no opportunity to do so.

The executive committee of the world bourgeoisie, which in 1972 was, by delegated authority, the USA, took at that time a vital decision which has driven its growth ever since, to place US interests above world interests including those of its rivals. My view, shared with my collaborator Radhika Desai, is that 'globalisation' was essentially a working out of this, a political imposition of the USA to force the world to pay for its inability to compete.

Two things are happening now. The first is that this has decisively *slowed down* the growth of its economic rivals, Europe and Japan. The US lead in 'world growth' in 2002 was *not* because it had taken off but because everyone else slowed down to a dead crawl.

Total growth of GDP per capita (per cent over the decade)	**1970-80**	**1980-90**	**1990-2000**
North America	24.6	24.8	20.9
Euro Area	122.0	25.4	-8.4
South-East Asia	128.9	68.1	19.9
Rest of the world	35.4	-19.8	-14.5

Second, it hasn't worked, in two senses. First, it has created a crisis of *governance* in the states of the Third World. So-called 'rogue states' are simply territories where the economic policies cravenly imposed during the time when the IMF wrote them on behalf of local people, have lost the support of the people, so that no government that supports IMF polcies – that is, those dictated by the USA – can stay in power.

Second, it hasn't solved the problems of the USA. Its debt, at 8% of GDP, has become so unmanageable that it has provoked an crisis in the financial system that can be 'resolved' by only one of two means, which is to take it out of the pockets of the US consumer, or to take it out of the pockets of the world's poor. But the political processes which make the second possible have reached their utmost limit, which is why we see Giuliani running on a platform of nuking Iran, and the Neocons grimly hanging on to start the war before the election.

To add: imperialism; the role of the state as coordinator of gains from superprofits; the division of labour between the imperialist powers as to specialisation (US financial and commercial with UK junior partner, Germany-Japan technical). Breakdown of hegemony with decline of US domination of technical superprofit >1967, tipping point as no longer hegemonic organiser of financial superprofit. Military advantures the only US ruling class recourse against internal highly accelerated class conflict