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Comment on Kotz, Skillman and Thompson

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PREFACE

This working paper is one of a collection of papers, most of which were prepared for and presented at a festschrift conference to honor the life's work of Professor Thomas Weisskopf of the University of Michigan, Ann Arbor. The conference took place on September 30 - October 1, 2011 at the Political Economy Research Institute, University of Massachusetts, Amherst. The full collection of papers will be published by Elgar Edward Publishing in February 2013 as a festschrift volume titled, *Capitalism on Trial: Explorations in the Tradition of Thomas E. Weisskopf*. The volume's editors are Jeannette Wicks-Lim and Robert Pollin of PERI.

Since the early 1970s, Tom Weisskopf has been challenging the foundations of mainstream economics and, still more fundamentally, the nature and logic of capitalism. That is, Weisskopf began putting capitalism on trial over 40 years ago. He rapidly established himself as a major contributor within the newly emerging field of radical economics and has remained a giant in the field ever since. The hallmarks of his work are his powerful commitments to both egalitarianism as a moral imperative and rigorous research standards as a means.

We chose the themes and contributors for this working paper series, and the upcoming festschrift, to reflect the main areas of work on which Tom Weisskopf has focused, with the aim of extending research in these areas in productive new directions. The series is divided into eight sections, including closing reflections by our honoree himself, Professor Weisskopf. Each section except for the last includes comments by discussants as well as the papers themselves.

The eight sections are as follows:

1. Reflections on Thomas Weisskopf's Contributions to Political Economy
2. Issues in Developing Economies
3. Power Dynamics in Capitalism
4. Trends in U.S. Labor Markets
5. Discrimination and the Role of Affirmative Action Policies
6. Macroeconomic Issues in the United States
7. Applications of Marxist Economic Theory
8. Reflections by Thomas Weisskopf

This working paper is 4 of 4 included in Section 7.

- *Jeannette Wicks-Lim and Robert Pollin*

Comment on Kotz, Skillman and Thompson

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COMMENT ON KOTZ

David Kotz argues that the 1970s crisis was a profitability crisis, but the current economic crisis is not a profitability crisis. Instead, the current crisis is due in large part to stagnant real wages, which threatened to cause a realization problem. This, however, was temporarily averted by an unprecedented explosion of household debt facilitated by increasing speculation in the financial sector. This debt bubble, of course, turned out to be unsustainable.

I pretty much agree with all of this, but I think there is a crucial link between the 1970s crisis and the current crisis that seems to be missing in Kotz's paper. And the missing link is that the stagnant real wages since the 1970s did not just drop out of the sky, but were themselves the result of an all-out offensive by capitalist to *restore the rate of profit* back up to its early postwar level. The neo-liberal SSA was designed, above all else, to restore the rate of profit.

So in this long-run sense, the current crisis was due in part to the prior decline of the rate profit in the early postwar period – in that the current crisis was caused in large part by the consequences of the measures taken to restore the rate of profit. As Marx said many times, attempts to solve one contradiction in capitalism lead to other contradictions.

In previous periods of capitalist history, the decline of the rate of profit generally led to a depression, which included widespread bankruptcies, and this resulted in a significant devaluation of capital. The bankruptcies made the depression worse, but the devaluation of capital contributed to the restoration of the rate of profit. Wages were also cut and the intensity of labor increased, which also contributed to the restoration of the rate of profit. Most of the restoration in these earlier depressions, however, was due to the devaluation of capital.

In the postwar period, a depression has been avoided by expansionary government policies (so far at least). But avoiding a depression and bankruptcies has also meant avoiding the devaluation of capital and its restorative effect on the rate of profit. So the full adjustment of the rate of profit this time around has had to come from suppressing wages and increasing the intensity of labor. But this alternative method of restoring the rate of profit at the expense of workers caused a realization problem, which ultimately led to the current crisis.

I used to think that the falling rate of profit and a realization problem were mutually exclusive causes of crises (and I have taught this to a generation of students). And I still think that is true for any given period. But I have come to realize, as a result of recent decades in the US economy, that in a dynamic, long-run sense, a falling rate of profit may evolve into a realization problem, in circumstances such as the recent decades in the US economy, in which government policies have attempted to avoid a depression and bankruptcies.

COMMENT ON SKILLMAN

The main purpose of Gil Skillman's paper is to provide theoretical support for Marx's claim that capitalist production is not necessary for exploitation; i.e. that exploitation is possible without the capitalist's direct control of production through exchange contractual relations with simple commodity producers. He also seeks to identify the limits of exploitation through these exchange relations, which provides a motive for the transition to capitalist production. Two main types of pre-capitalist modes of production are considered – capital financed simple commodity production (usury capital) and the putting-out system (merchant capital), which Skillman identifies (respectively) with the “*Kauf* system” and the “*Verlag* system” in the literature on “proto-industrialization”.

Skillman's paper employs a principal-agent model, with two key assumptions: (1) capitalists can choose whatever payment scheme they want; i.e. they can choose any combination of interest payments (on loans to the producers) and piece rates; and

(2) the producer's endowment of wealth can be used as collateral for the capitalist, and thus the capitalist's expected profit is a non-decreasing function of the producer's wealth. For example, if the producer's wealth declines, then the capitalist's collateral and expected profit will decline as well, thus providing a motive to switch to the direct control of production (i.e. to capitalist factory production).

Skillman's modeling is impressive, but I am afraid that his theoretical model has little to do with the real world and the actual transition from pre-capitalist to capitalist production in England and Europe and elsewhere, because the contractual relations between capitalists and producers in these pre-capitalist modes of production *almost never involved collateral*, not even in the *Kauf* system. The *Kauf* system consisted of self-employed artisans who usually did not depend on outside capital finance. To the extent that credit was used in the *Kauf* system, it was “trade credit”, without the producers' wealth as collateral. And credit and collateral were never a part of the much more widespread putting-out system. Declining wealth of the producers no doubt contributed to the transition to capitalism, but not because of declining collateral for loans (which was never significant), but rather because producers became increasingly dependent on wage-labor for survival.

Therefore, Skillman's proof – that capitalists *could have* extracted surplus-value through exchange with producers in these pre-capitalist modes of production *if* capitalists had been able to require collateral from the producers – does not prove that capitalists were in fact able to extract surplus-value in the actual pre-capitalist modes (which is what Marx was referring to in his few brief comments on this subject), because collateral did not exist in these pre-capitalist modes. Similarly, a decline in producers' collateral to guarantee contracts for capitalists could not have been a cause for the actual transition to capitalist production, because collateral did not exist to begin with.

I prefer Marglin's explanation of the transition from the putting-out system to capitalist production – in order to increase control over the producer, and thereby increase the intensity of labor. Another important cause was technological change, i.e. automatic machinery which required large factories and made simple commodity producers no longer competitive. Skillman's model holds technology constant throughout.

In sum, Skillman is clearly a master at the modeling game, but in this case it is only a game, with little to do with the real world. Skillman criticizes historians for doing history without economic theory, but I think Skillman makes the even greater mistake of doing theory without history.

COMMENT ON THOMPSON

Frank Thompson's paper raises an interesting and important ethical question – is the vast inequality between workers' wages in developed countries and developing countries morally justified? Do workers in advanced countries *deserve* the much higher wages that they receive? How do we evaluate this huge discrepancy in wages on the scales of global economic justice?

However, the theoretical framework of the paper is marginal productivity theory, and marginal productivity theory is very problematic and widely discredited, ever since the capital controversies of the 1960s and the complete absence of a theoretical response to this critique. The paper even uses an aggregate production function, which has been criticized ever since Joan Robinson in 1953, and Frank Fischer has shown that the conditions of valid aggregation of physical capital are never satisfied. I realize that Thompson is trying to work within the mainstream, but I think there are limits to accommodation, and in my view marginal productivity theory is on the other side of the line.

The reason Thompson uses marginal productivity theory is to provide quantitative estimates of the relative contributions of advanced technology and the K/L ratio to the differences in the “marginal product of labor” and hence to the differences in wages. But this apparent quantitative precision is spurious.

First, aggregate production functions are not theoretically grounded, as already mentioned. Secondly, there is no reason to expect that an aggregate function (if it existed) would have a Cobb-Douglas functional form. Thirdly, estimates of the capital stock are notoriously difficult and unreliable, much less reliable than estimates of annual income flows, especially for developing countries. But all the results depend critically on estimates of the capital stock.

Finally, Fischer and Shaikh and others have shown that the good fit between wages and the marginal productivity of labor for time series data have been due in large part to the relative constancy of the wage share over the period of study. Shaikh's infamous “humbug production function” dramatically illustrated this point. So I wonder if Frank's “reasonably good fit” with cross-section data is also due to the relative constancy of the wage share in his sample of countries. If you look at the wage share for OECD countries in his table, they are all within a fairly narrow range, from .68 to .74. Frank admits that there is “no reason to expect” the fit would be as good in a larger sample. I suggest that there is reason to expect *not* as good a fit, because there would be more variation in the wage share in a larger data set that included developing countries.

Another problem I have with using the marginal productivity theory of wages is that it implies acceptance of the marginal productivity theory of profit or interest. Thompson's paper doesn't say anything at all about profit and capitalists, but I think he should ask the parallel question: do capitalists *deserve* the profit they receive? Marginal productivity theory suggests yes; Marx's theory suggests no. What does Thompson suggest? In general, how should we evaluate capitalists and profit on the scales of economic justice?