US profit rates decline despite productivity growth

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The latest calculations of labour productivity growth highlight the emergence of a deepening contradiction in the US economy, and by implication, the world economy. While productivity has sharply increased over the past five years, profit rates have declined and, in the aftermath of the high-tech and stock market bubble of the late 1990s, the economy has entered a period of "jobless growth," if not double-dip recession.

Speaking at a conference in Washington last week, Federal Reserve Board chairman Alan Greenspan noted that productivity growth "will almost surely be reported as one of the largest advances, if not the largest, posted over the past 30 years." While the surge could taper off there were indications that it would continue for some time, he said.

At the same time, however, the Federal Reserve's beige book, comprising reports from around the US, noted that economic conditions in most regions remained sluggish with weak retail sales and manufacturing activity slowing down.

Greenspan told the conference that economists at the Federal Reserve, in government and in the private sector were "struggling to account" for the surge in productivity because such increases were generally associated with "recoveries from steep recessions" and not the "only modest economic growth" experienced over the past year.

The following day Federal Reserve Board vice-chairman Roger Ferguson provided some figures on the surge in productivity growth in a lecture delivered at the London Business School.

From 1995 to 2001 labour productivity grew at an annual rate of 2.25 percent compared with a rate of only 1.5 percent from 1973 to 1995. At the height of the post-war boom—the period from 1960 to 1973—the growth rate was 3 percent.

Ferguson pointed to research by two Federal Reserve Board economists which found that the acceleration in the productivity growth rate after 1995 could be fully accounted for by the impact of hi-tech equipment which made possible more efficient production techniques and management systems.

There seems little doubt on all the available evidence, both statistical and anecdotal, that productivity has increased markedly since the mid-1990s and is likely to do so for some time as hi-tech capital equipment spreads throughout the economy.

Contrary to the conventional economic wisdom, however, this is not leading to improved economic conditions. Rather, the US and the rest of the global economy have entered a period of low growth, if not outright stagnation.

To understand why the marked acceleration in the growth of labour productivity over the past seven years has failed to boost the economy, it is necessary to delve into its relationship to the accumulation of profit—the fundamental driving force of the capitalist economy.

In the final analysis, the source of all profit is the surplus value extracted from the employment of wage labour by capital. Surplus value is the difference between the value created by labour over the course of the working day, embodied in a particular commodity, and the value of labour power, the commodity the worker sells to capital, expressed in the form of wages.

The working day falls into two parts—the portion devoted to the reproduction of the value of labour power (necessary labour) and the portion in which surplus value is created (surplus labour).

In the economy as a whole the total mass of surplus value, which appears in the form of profit, interest and rent, is determined by the number of productive workers (those creating surplus value) and the amount of surplus value extracted from each of them.

An increase in the productivity of labour taking place throughout the economy has a contradictory impact on the accumulation of surplus value, and therefore profit. To the extent that it leads to a decrease in the number of workers employed it results in a decrease in the mass of surplus value. However, to the extent that it results in an increase in the amount of surplus value extracted from each of them it leads to an increase in the mass of surplus value.

This means that if the increase in the productivity of labour is sufficiently great, the decline in the mass of surplus value caused by the elimination of workers from the production process will be more than offset by the increased rate at which surplus value is extracted from those who remain. Consequently, the mass of surplus value will grow, profits will expand, investment will increase and the economy as a whole

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will grow.

The division of the working day makes clear that the extent to which increased productivity can increase surplus value and thereby fuel increased profits and economic growth is limited.

If, for example, the working day of eight hours divides in the proportions of four hours necessary labour and four hours surplus labour, then a 25 percent increase in productivity, reducing necessary labour from four to three hours would bring an increase in surplus labour of 25 percent, from four to five hours. But if the necessary labour at the time of the productivity increase were only one hour, then a 25 percent increase in productivity, reducing necessary labour by a quarter of an hour, would only bring an increase in surplus labour of just over 3.5 percent.

What this numerical example shows is that the impact of labour productivity on the rate of profit depends on the preceding economic development. Under conditions where previous advances in labour productivity have already reduced necessary labour to a relatively small proportion of the working day, the same increase in labour productivity which, in an earlier period gave rise to an increase in the overall mass of surplus value and profits, will not have the same effect. Indeed, it may not be large enough to counteract the fall in profits resulting from the elimination of labour from the production process.

The significance of this analysis is not that it provides a complete picture of the impact of productivity on the economy—there are many other complex processes at work. But it does begin to point to the underlying tendencies of development which are now being reflected in statistics on profit rates.

In an article in the latest issue of the magazine *BusinessWeek* economics editor Michael Mandel points to what he calls a "painful truth" about profits. According to Mandel, profits in the US may rise over the next year but there will not be a normal business recovery and, in order to make profits, firms will have to "make deep cuts in payrolls and productive capacity."

How deep is indicated by the estimate that, in order to increase profits by 12 percent next year, companies in the S&P 500 will need to axe 900,000 jobs, or some 4 percent of the workforce.

Figures cited by Mandel make clear that increased productivity does not imply increased profit rates. While US corporations are 25 percent more productive than they were in 1992, the after tax profit rate on corporate investment, according to government figures (rather than the often phoney figures produced by corporations themselves), peaked at just over 8 percent in 1997. Today it stands at only 5.2 percent: no higher than it was a decade ago and well below the long-term historical average of around 6.5 percent.

In addition, Mandel notes, "the downward pressure on profits is taking place around the world. Profit rates in Britain, France, and Germany are far below where they were at the beginning of the 1990s."

Yet in these countries as well there have been major increases in productivity, even if they have not matched those in the US.

These figures point to the fact that at the very heart of the capitalist economy there is a contradiction between the development of the productive forces—as reflected in the growth of labour productivity—and the accumulation of private profit.

When profit rates began to fall, leading to the end of the post-war economic boom in 1973, capitalist firms responded as they had in the past. There was a drive to develop new technologies and production processes that could cut costs as individual firms sought to improve their own position in the market. But the cumulative impact of this transformation some quarter of a century on has not resulted in a new economic upturn.

On the contrary, even though labour productivity has markedly increased, profit rates have tended to stagnate and even decline, leading to the creation of a vicious circle.

Faced with worsening market conditions—an expression of falling average profit rates—individual firms and corporations seek to improve their position by driving up productivity, above all through cutting jobs. But this process, as the analysis of the relationship between labour productivity and surplus value shows, can lead to a further decline in the rate of profit, provoking yet more attacks on jobs and social conditions.

In other words, rather than increased labour productivity being the road to improved living standards under capitalism, as conventional economic wisdom continually asserts, it is the reverse.

There could be no clearer indication of the historically outmoded character of the profit system than the fact that under the operation of its laws, increases in the productivity of labour—the means to satisfy increased human needs—actually lead to a worsening of the social position of the mass of the population.

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