

PROFITABILITY AND ECONOMIC CRISIS

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During the early and mid-1970s, an analysis of capitalist economic crisis which located its causes in the heart of the relations of production had some currency in Australia (e.g. Vort-Roland, 1974:6-13; Brezniak and Collins, 1977:7-16; Rowley, 1976:37-39; Silver, 1977:54-62.) This approach drew on Marx's account of the tendency for the rate of profit to fall. Overseas, some Marxists have continued to analyse developments in terms of the rate of profit. In Australia, however, such theories have fallen out of fashion. Recent discussions of the problems of the domestic economy by radical economists have made no mention of it.¹ Ironically, this neglect by radical theorists comes at a time when much improved statistical sources have begun to provide very useful data on profit rates, and there is increasing interest in the subject by economists pursuing the interests of business and involved in government policy making.

We use the term 'crisis' to refer to an outstanding feature of world capitalism over the past decade and a half. The crisis is the period of prolonged relative stagnation since the early 1970s, rather than a sharp rupture or turning point. Different explanations of the economic crisis can have radically different implications for political action.

The following discussion seeks to establish the relevance of the approach which focuses on the theory of the tendency of the rate of profit to fall. The opening section surveys recent overseas evidence on profit rates and offers a theoretical account of the tendency for profit rates to fall. This provides a background to a tentative examination of Australian evidence

¹ eg *Journal of Australian Political Economy* 23 August 1988. The articles by Wheelwright and Jones give no indication that the stock market slump could be related to movements in profit rates; nor does Stilwell indicate that increased speculative investment might reflect declining profit rates from productive investments. However, profit rates are subject to an essentially empirical treatment in 'Economic Notes', *Journal of Australian Political Economy*, No 4 1989:134-143).

and the attention paid to the issue by some mainstream economists. At appropriate points we suggest some political implications arising from the theory.

International Crisis

Concern about the health of the world economy has recently focussed on 'underlying' imbalances in trade relations. The cause is generally regarded as 'exogenous', the mistaken economic policies of the major powers, to be cured through internationally co-ordinated monetary and fiscal policies.²

- fiscal and international payments imbalances are overcome, without jeopardising growth
- unemployment is reduced through labour market flexibility
- protectionism is kept in check
- developing countries restructure their economies and promote employment and income growth. I.B.R.D., 1987:25,27. The conventional wisdom has been that the USA should reduce its budget deficit, while Japan and West Germany, in particular, should follow expansionary policies to ensure that the level of international demand is maintained.³ Not surprisingly the main emphasis has been placed on the latter aspect in the USA, sometimes with the addition of demands for lower levels of protectionism and subsidies in Europe and Japan.⁴ Elsewhere the stress has been placed on US domestic policy adjustments. It seems likely that international trade imbalances will be widely perceived as a primary cause of the anticipated recession of the late 1980s or early 1990s, just as debt problems were highlighted during the international recession of the early 1980s and energy prices were a focus during the recession of the mid-1970s.

Trade and debt imbalances and oil prices have undoubtedly been factors in the timing of the short term recessions during the longer run crisis of

- 2 The World Bank maintains that high international economic growth can be achieved if:
- 3 See, for example, *The Economist*, 1987: 15-16; *Commonwealth Bank of Australia Economic Newsletter*, November 1987:2; *ANZ Bank Business Indicators*, 1987:2. A public opinion poll in late 1987 indicated that the most popular explanation of the stock market crash was US Government policies *Sydney Morning Herald*, 9.11.1987.
- 4 Former U.S. Federal Reserve Board Chairman Paul Volcker has argued: 'Too much emphasis was being put on the dollar to cut the US trade deficit and not enough emphasis on persuading such nations as Japan and West Germany to stimulate their economies' (*AFR* 15.12.1987).

the 1970s and 1980s. They may be consequences of poor policy decisions and extra-economic forces. But accounts which focus on them do not explain why the world economy has become so sensitive to policy failings and external shocks. After all, policy errors and shocks are hardly unique to the 1970s and 1980s! A more satisfactory approach must address the contradictions which develop within the capitalist accumulation process itself.

The following analysis is premised on the labour theory of value. It assumes that human labour is the only element in the production process which creates new value (as opposed to simply passing on the labour it embodies to the final product). For capitalists it is not the amount of the value newly created in the production process, the mass of surplus value (s), s/he can appropriate, by virtue of owning capital, that is the main measure of economic success. Nor is it the ratio between that mass and the wages, variable capital v , paid to the workers who produce the new value, known as the rate of surplus value, s/v . The capitalist is concerned with the ratio between the mass of surplus value and his/her whole outlay, on both means of production and raw materials, known as constant capital (c), and wages i.e. with the rate of profit, $s/(c+v)$.

The rate of profit in any enterprise, compared with that earned by competitors or in other lines of business, is a key indicator of whether a capital is performing successfully and is likely to survive. In terms of economic aggregates, healthy profits are the main incentive for investment. Low profit rates depress investment levels and act as a brake on the process of capital accumulation and growth. Profit rates are therefore an important starting point in the analysis of economic crisis.

While there are differences over estimates of the timing of the decline, a number of studies of industrialised capitalist countries have found that profit rates have been lower in the 1970s and 1980s than the 1950s and 1960s. Hill, in his OECD study of rates of return for selected countries between 1955 and 1976, concluded that 'the overwhelming impression' is one of decline (Hill, 1979:22).⁵ Herman Liebling's study of U.S. profitability for 1949 to 1977 indicated that 'profitability of non-financial corporations - interpreted in great definitional variety - has declined substantially during the 1970s' (Liebling, 1980:81). He also noted that the

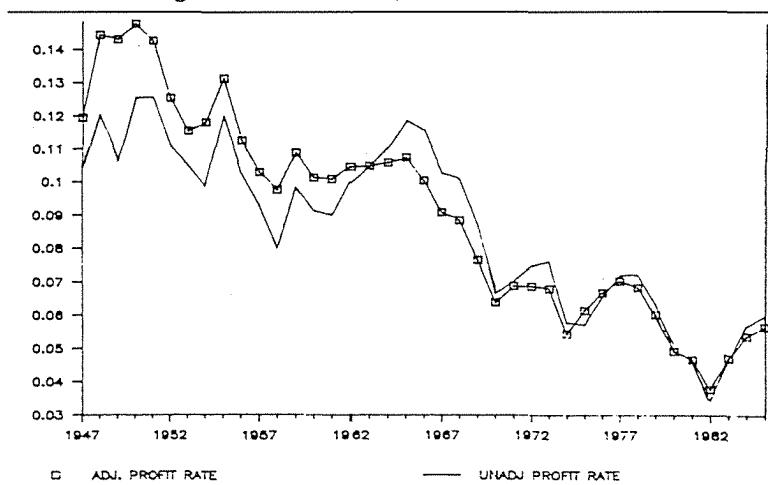
5 Note Hill's qualification that figures for Japan and the U.S.A. do not show a significant downward trend.

depressing effect of higher energy prices on profitability has only been transient. Ed Downe's estimates of cyclically adjusted rates of return to 1980 for seven major OECD countries confirm this impression and give a stronger indication of decline in the U.S.A. and Japan than do Hill's figures (Downe, 1986:101-110).⁶ In a more recent OECD study of eleven countries, James Chan-Lee and Helen Sutch observed that

despite somewhat mixed sector and country trends, regression analysis [of rate of return statistics] reveals statistically significant negative time trends in almost all cases. The decline after 1973 was general and particularly significant in manufacturing (Chan-Lee & Sutch, 1985:127-167).

Making use of official U.S. capital stock, wages and corporate profit data, Anwar Shaikh has produced a time series for the rate of profit in the U.S.A., adjusted for capacity utilisation. The series provides support for the argument that the crisis has been characterised by lower profit rates than the boom period (Shaikh, 1987a:113-126; also Glick, 1987:127-137).

Figure 1. Profit Rates, U.S.A. 1947 to 1985



Source: Shaikh, 1987a:121

6 For a discussion of profit rates in Britain see Green, 1987:6-8.

The stagnation of profit rates since the late 1960s can be regarded as a key feature of the economic crisis of the 1970s and 1980s. This explains the sensitivity of the world economy to shocks and policy mistakes resulting in two cyclical recessions deeper than any since the depression of the 1930s, interpolated by 'recovery' periods of continuing high unemployment and unstable growth. There is a variety of explanations for declining profit rates. During the late 1960s and early 1970s explanations in terms of a decline in the share of profits in national income had some plausibility. In most advanced capitalist countries, profits shares have recovered their pre-1972 levels since the recession of the mid-1970s, yet the problem of profit rates remains. Despite recent improvements in profit rates, Chan-Lee and Sutch concluded that

the recovery is as yet incomplete if levels in the early 1970s and especially the mid-1960s are taken as points of reference (Chan-Lee & Sutch, 1985:165).

Following Marx, Shaikh and other writers such as Chris Harman have attributed declining profit rates to rises in the organic composition of capital, the ratio of constant capital to total costs in capitalists' outlays, $c/(c+v)$.⁷

In volume III of *Capital*, Marx argued that the process of capital accumulation tends to increase the value of machinery, equipment and raw materials compared with wages in total outlays. Enterprises which increase their own organic compositions of capital, by investing in more constant capital per worker, raise the productivity of their workforces and reduce the cost of individual products, compared with their competitors. This allows them to achieve higher profit rates in the short term. These arise because innovating enterprises can sell their products, despite their own lower production costs, at or slightly below the prevailing price which is a function of the average production costs of all producers. When the rest of the industry has adopted the new technology, in order to compete with the innovators, the prevailing price will fall, reflecting the now lower average production cost of the industry. Not only does the innovator's extra profit disappear but the average profit rate for the

⁷ For a basic introduction to the tendency for the rate of profit to fall approach see Shaikh, 1978:21. A more technical presentation is Shaikh, 1987b:755-758. For a discussion of critiques of the theory of the tendency of the rate of profit to fall see Harman, 1984, and Green, 1986.

industry will decline to a level lower than that before the new technology was adopted. This process has not increased the amount of surplus value produced, though it is now embodied in a larger number of commodities, each with a lower unit value. The same surplus value is thus the return to a larger total capital outlay, so the average rate of profit has fallen in the industry as a whole.

If capitalists in an industry or economy reduce the weight of variable capital (the value creating component) in total outlays, the consequence will be a lower average rate of profit, given that the rate of surplus value is constant (Marx, 1981:Part Three). For Marx this is the contradiction at the core of capitalist relations of production:

the capitalist mode of production tends towards an absolute development of the productive forces irrespective of the social relations within which capitalist production takes place; while on the other hand its purpose is to maintain the existing capital value and to valorise it to the utmost extent possible (i.e. an ever accelerated increase in its value). In its specific character it is directed towards using the existing capital value as a means for the greatest possible valorisation of this value. The methods through which it attains this end involve a decline in the profit rate, the devaluation of the existing capital and the development of the productive forces of labour at the cost of the productive forces already produced (Marx, 1981:357-358).

The historical expression of the tendency of the rate of profit to fall cannot simply be read off the abstract theory. Marx's presentation identified a number of 'counteracting factors'. Thus the organic composition of capital falls and the rate of profit rises if the cost of raw materials or means of production falls or if a return from a given capital outlay can be secured more quickly, that is by reducing the turnover time of capital. Such measures reduce the value of constant capital.

A rise in the rate of surplus value can also counteract a fall in the rate of profit. The rate of profit is a direct function of both the organic composition of capital and the rate of surplus value.⁸

Alternatively, if the organic composition of capital is defined as c/v the expression for the rate of profit is $s/(c+v) = s/v[1/(1+c/v)]$ Other things

8 In mathematical terms: $s/(c+v) = s/v[1-c/(c+v)]$

being equal, either reducing wages while maintaining the level of output, or forcing workers to work faster without raising their wages, raises the rate of surplus value and hence the rate of profit. When the value of the commodities workers buy declines, the value of their labour power falls, providing scope for a higher rate of surplus value. Increased productivity due to a higher organic composition of capital can, by cheapening the value of commodities, therefore facilitate an increase in the rate of surplus value. There are, however, limits on this counter-tendency. The total value produced by workers in a day sets a limit on the mass of surplus value. In the extreme case a capitalist might appropriate not only the surplus value workers produce but, by not paying any wages, also the value of the workers' labour power. (Before this limit is reached it will be necessary to pay workers enough to ensure that the workforce does not die out.) On the other hand there is no such limit on the level of investment and hence the mass of constant capital.⁹

In any given period it is necessary to determine whether the tendency of the rate of profit to fall or the counter-tendencies are dominant. Nevertheless Marx regarded the tendency as a more fundamental feature of capitalism as it was rooted in the very logic of capital accumulation while the counteracting factors were essentially of a conjunctural nature.¹⁰

Shaikh provides empirical evidence for a rising organic composition of capital, as an explanation for the operation of the tendency of the rate of profit to fall in the USA during the post-war period. He identifies a significant rise in the ratio of capital to production-worker wages (the value composition of capital) as well as the capital output ratio (Shaikh, 1978:119-120).

If the tendency for the rate of profit to fall is a characteristic feature of capitalist production, this has important implications for socialist politics. Henryk Grossman, the first economist since Marx to enlarge upon the theory in detail, and, more recently, Russell Jacoby elaborated the political logic of this explanation.

Grossman argued that Marx

9 This explanation is based on that in Harman, 1984:28. A more technical account is to be found in Okishio, 1972:1-7.

10 For a discussion of these questions see Marx, 1981:14. The following include discussions of the substantial debates on Marx's crisis theory: Harman, 1984:19-38, esp. 27-28 on the influence of the rate of surplus value on the rate of profit; Shaikh, 1987a; Devine, 1986:1-12.

undertook to demonstrate the historical necessity of the decline and final disintegration of capitalism...A condition of over-saturation with capital will arise, and no adequate new possibility for capital investment will be available.

This 'over-saturation' is the consequence of declining profit rates due to increases in the organic composition of capital. Marx's approach, according to Grossman, is not one of fatalistic breakdown:

No economic system, no matter how weakened, collapses by itself in automatic fashion. It must be 'overthrown' ...[through] the active participation of the working class in the historical process.

He reaffirms the centrality of working class self-activity to Marxism as the agency for revolutionary social change, 'the historical role of the proletariat as the carrier of the transformative principle and the creator of the socialist society'.¹¹ If capitalism is inherently crisis prone, then its revolutionary overthrow is the only effective alternative to recurrent periods of economic stagnation. There is thus an intimate connection between, for example, Rosa Luxemburg's under-consumptionist account of capitalism's necessary experience of economic crisis or Grossman's more satisfactory approach, based on the tendency of the rate of profit to fall, and their revolutionary politics (Jacoby, 1975: 48). Reforms play an important part within such a perspective. They can provide short term material benefits. But more importantly the struggle for reforms can deepen class solidarity, open up a challenge to the hegemony of capitalist ideas and give workers the confidence to fight for more radical demands. This is certainly the conclusion Marx and Engels drew in the Communist Manifesto:

Now and then the workers are victorious, but only for a time. The real fruit of their battles lies, not in the immediate result, but in the ever-expanding union of workers (Marx and Engels, 1971:41).

11 Quotations are from Grossman, 1943:519-21. Unfortunately Grossman's main work on crisis theory, *Das Akkumulations-und Zusammenbruchsgesetz des Kapitalistischen Systems* first published in 1929, has not yet been translated into English.

On the other hand a social democratic strategy of reforming capitalism into socialism becomes more plausible if crises are not intrinsic to capitalism so that depressions can be avoided and economic prosperity secured by means of state economic policies as capitalism is gradually transformed into socialism.¹²

The long boom of the 1950s and 1960s, therefore, presents a challenge to the theory of the tendency of the rate of profit to fall and to revolutionary politics. The credibility of the theory requires an account of the period of capitalist stability and healthy profits in terms of counter-tendencies to the tendency of the rate of profit to fall which explains why it cannot be reproduced by means of active government policies. Harman has highlighted a particular counter-tendency whose influence was necessarily of limited duration. In the process, he provides a framework for understanding contemporary imbalances between the most powerful national economies. Harman maintains that international profit rates were stabilised during the long boom because the world's preponderant economies in the postwar period, the U.S.A. and U.S.S.R., reduced the amount available for accumulation through large scale spending on arms (Harman, 1984:38-49, 75-102). This situation was undermined as the weight of other countries, less encumbered by arms spending, in the world economy grew. Japan and West Germany, in particular, were able to improve their competitiveness by ploughing back a higher proportion of profits into productive investment than was the United States.

The declining effectiveness of the mechanism which had previously offset substantial rises in the capital/labour ratio and hence declines in profit rates was the precondition for a long period of international stagnation from the early 1970s. But while the crisis is international it has been unevenly experienced. It is possible for some enterprises, through the use of a proportionately larger and more modern capital stock than their rivals or by employing cheaper labour power or raw materials, to increase their profit rates while the average rate of profit declines. Similarly, at the level of nation states, international trade and capital flows mean that those countries with the highest organic composition of capital will tend to have higher than average, or rising profit rates, even while their accumulation,

12 'The rejection of the crisis theory in the name of subjectivity, consciousness and choice characterised a social democratic tradition' (Jacoby, 1975:48).

by raising the international organic composition, reduces average global profit rates.

It would be mistaken to view the U.S. trade deficit primarily as a cause of international economic problems. The deficit, resulting from an underlying uncompetitiveness on world markets as much as mistaken government policies is more a consequence of the unevenness of the crisis.¹³ Robert Brenner attributes the relative decline of the United States to the costs of its leadership during the long boom, in terms of its tardiness in institutional and technological change and the costs of providing the main international currency and particularly the costs of the arms race. (Brenner, 1986a: esp 21-24 and Brenner, 1986b; Green, 1985:3-53). The uneven experience of declining profit rates provides a basis for making sense of both trade and financial imbalances as symptoms of a more fundamental process (*Australian Financial Review* 16.12.87).

Crisis in Australia

The argument so far might seem to imply that Australia is simply the passive victim of powerful forces operating 'outside' in the world economy. However the mechanisms which account for the crisis internationally also operate in Australia. A crisis theory focussing on declining rates of profit, arising from an increasing organic composition of capital, allows us to overcome an excessive distinction between internal and external factors.

The Hawke Government's supporters have counterposed struggles for immediate improvements in living standards to a long term goal of economic improvement within capitalism in their attempts to justify 'wage restraint' under the Accord. This strategy essentially relies on improving the competitiveness of Australian industry by cutting wages and state expenditure, modernising productive capacity and eliminating inefficient sectors, in order to boost Australia's relative performance.

13 Conversely, *Business Review Weekly*, 4.12.87, concluded that much of Japanese industry, including large corporations, would remain profitable and competitive at an exchange rate of ¥100 to the U.S. dollar.

14 Improving international competitiveness is central, for example, to ACTU/TDC, 1987:90-91. See Kuhn, 1988, for an account of the emergence of a new consensus on Australian industry policy.

¹⁴ Australia's competitors, from Japan to the Soviet Union to the Philippines, are pursuing similar strategies.

Our analysis suggests that competitive attempts to overcome the crisis within a capitalist framework will ultimately exacerbate it by raising the organic composition of capital and placing renewed pressure on the rate of profit. The process of competitive capital accumulation, whether the competition be between individual firms or national economies, is itself the source of recurring crises. The structure of international production and state organisation militates against sustained cooperative efforts in international policy making to overcome this problem.¹⁵

This analysis has important political implications: if current government policy cannot solve the problems of Australian capitalism, it follows that workers should not accept the Government's austerity measures. In the short run a militant struggle is required in defence of living standards. In the long run the only viable solution is a revolutionary reorganisation of the mode of production. Given the radical political implications, it is important that the analysis be given an empirical foundation. Thanks to recently developed statistical series it is now easier to draw some conclusions about movements in the real profit rate and organic composition of capital.

Until the 1980s Australia, unlike a number of OECD countries, had no satisfactory data on capital stock at the aggregate level or by industry. In 1980 Haig published a time series for capital stock in manufacturing industry for 1920 to 1977 (Haig, 1980). The following year Cherylee Bailey pioneered the methodology used subsequently in the Australian Bureau of Statistics' (ABS) capital stock series (Bailey, 1981). This was elaborated by Robert Walters and Rob Dippelsman in 1985, who produced a preliminary estimates of capital stock (Walters & Dippelsman, 1985). Since 1987 ABS has published *Australian National Accounts: Estimates of Capital Stock* (5221.0), with data on industry and asset type. This series goes back to 1966-67, with some data back to 1959-60. Further improvements in the scope of capital stock series are planned (Moore & Brown, 1988). In 1987 the Bureau of Industry Economics (BIE) also

¹⁵ Henry Kissinger's comment more than a decade ago is still an apt description of the prospects for international economic cooperation 'One interesting feature of our recent discussions with both the Europeans and the Japanese has been the emphasis on the need for economic co-ordination...How you, in fact, co-ordinate policies is yet an unresolved problem.' (*Business Week* 13.1.75, quoted in A. MacEwan, 1981:128).

published estimates for capital stock in manufacturing industry (BIE, 1987). The BIE has subsequently used ABS data.

Mainstream economists have recently paid considerable attention to the question of profit rates, making use of the new statistical data. Their discussions have not taken place within the framework of the theory of the tendency of the rate of profit to fall and they have focused on the rate of return to capital, approximately s/c , as opposed to the rate of profit, that is, $s/(c+v)$. Nevertheless, economists from the Business Council of Australia (BCA), the Economic Planning and Advisory Council (EPAC) and the BIE have shown a greater appreciation of the centrality of profit rates and changes in capital stock to the health of Australian capitalism than most economists on the left. As the BCA has pointed out:

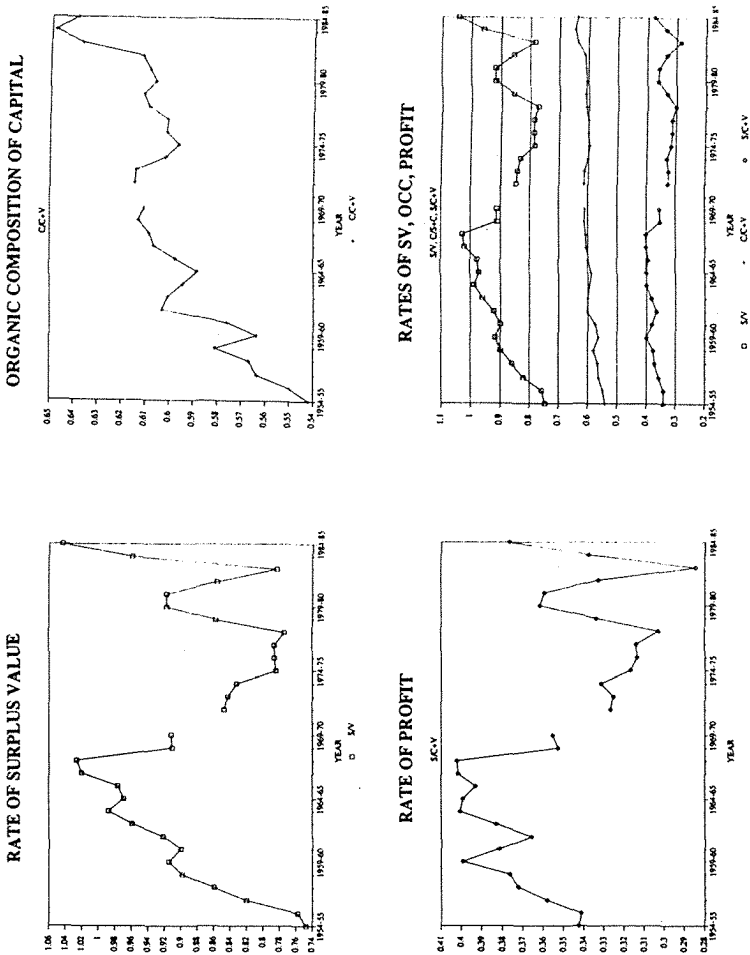
The profit trend and rate of return figures ... are not simply of academic interest. They are central to judgements about current economic policy and to a growing political commentary on current income shares in Australia (BCA, 1985:3).

The following graphs provide an indication of movements in key aggregates for manufacturing industry. However, the limitations of the calculations behind them should be emphasised. It is difficult to render data collected on the basis of the Keynesian national accounts into Marxist categories. Moreover, the methodology used here is particularly rough and ready. It is described in the Appendix. The direction of the changes in the variables plotted are therefore of more interest than their magnitude. Differences between the methodology used here and the more sophisticated approach employed by Shaikh mean that it is not useful to compare the level of Australian profit rates and those for the U.S.A. in Figure 1.

The rising organic composition of capital indicated can be attributed to the pressure of competitive capital accumulation. It has been associated with a declining trend in profit rates.¹⁶ The average annual rate of profit fell from 0.38 during the period from 1954-55 to 1969-70, to 0.33 for the period 1971-72 to 1984-5.

16 For another measure of the increase in the organic composition of capital see BIE, 1987:34.

Figure 2. Key Aggregates, Australian Manufacturing Industry 1954-55 to 1984-85



Sources: BIE, 1987; ABS (1968-69)

Movements in the rate of surplus value can be related to the course of industrial struggles. The late 1940s and early 1950s saw a major ruling class offensive, which started under the Chifley Government and included its successful efforts to defeat the 1949 coal strike. The offensive continued under Menzies who strengthened the Arbitration Court's penal powers, attempted to ban the Communist Party and contributed to the climate of the cold war. The Industrial Groups in the trade unions were active and hostile to industrial militancy during this period. The 1952-53 recession, the deepest until the 1970s, also served to undermine working class self-confidence. After the recession labour's share of national income was four per cent lower than before it (Kuhn, 1979:5-11). The decline in the rate of surplus value during the late 1960s coincides with rising levels of industrial militancy, particularly in the metal industry. Industrial struggle remained at high levels during the early 1970s until the fall of the Whitlam Government and, particularly, the 1975 recession undermined working class self-confidence. The decline in the rate of surplus value in the early 1980s can be related to the demise of the indexation system of wage restraint in 1981. The 1982-83 recession weakened workers' bargaining power, paving the way for a higher rate of surplus value.

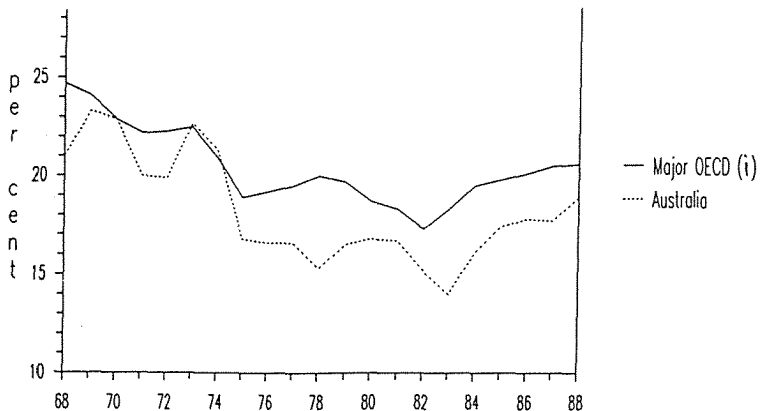
The Business Council of Australia has consistently drawn attention to the developments in profit rates/rates of return and their influence on economic activity through their effects on levels of investment (BCA, 1987:5; BCA, 1986:1-5; BCA, 1988:4-6). In August 1988 the Council noted:

Recent revisions to investment numbers have also improved the historical picture. However, the rate of return on investment remains low by earlier standards and the capital stock is still not growing rapidly enough.

The BCA, which is made up of the chief executive officers of the largest enterprises in Australia, demonstrated the significance attributed to profit rates by the representatives of big capital. EPAC has indicated that this concern is also felt by senior economists in public sector employment. In July 1988 EPAC published *Trends in Profitability*, which examined changes in profits shares and rates of return, the impact of taxation and Australia's performance compared to other countries.

EPAC's sectoral breakdown of rates of return indicated declines in mining, manufacturing and private tertiary industries. All have experienced some improvement under the Hawke Government, especially manufacturing, but 1988 levels remain below those for the early 1970s in all sectors. Pre- and post-tax net rates of return do not show movements in different patterns for the periods 1967-68 to 1973-74, 1974-75 to 1983-84 and 1984-85 to 1987-88. Rates of return in Australia have been lower than in the major OECD countries since 1968, except for 1973 and 1974. Nevertheless the movements have been broadly similar, with a recent relative improvement by Australia. EPAC also presented the Reserve Bank's Q Ratio for Australia and its own Incentive Ratio as measures of the incentive to invest. The Q Ratio, developed by Tobin, compares the market and replacement values of existing capital stock. The Incentive Ratio compares 'the post-tax net rate of return on capital to a required rate of return (based on the return to dwelling investment). Both of these ratios show a deterioration since the late 1960s, with some recent improvement (EPAC, 1988:4-7,11,18-20).

**Figure 3. Rates of Return in the Private Business Sector
1968 to 1988**



(i) USA, France, FRG, Italy, UK, Canada and Japan

Since 1983 it appears that rates of profit have improved, though they remain significantly below levels achieved during the long postwar boom. An examination of the specific reasons for this improvement shows that the latest trends are consistent with the analysis presented above.

The 1982-83 recession had a significant impact on the organic composition of capital. It tended to reduce the ratio of capital to labour, or slow its increase, by forcing some firms out of business and allowing others to acquire their capital equipment at bargain rates. Figure 2 indicates that this ratio did in fact fall in manufacturing industry in 1984-85 after a peak in 1983-84. Simultaneously, it reduced workers' bargaining power, which allowed employers to impose wage cuts and extract greater productivity from their labour forces. The blow to workers' confidence caused by the experience of the recession made it possible for the government to secure real wage cuts, which further increased capital's share of national income. The rate of surplus value in manufacturing rose dramatically during the first years of the Prices and Incomes Accord, according to Figure 2. As late as 1986, however, the increase in the profits share of national income had not increased the rate of profit sufficiently to stimulate significant new investment.

More recently, profitability has finally improved to the point where stronger investment activity resumed. Real fixed capital expenditure in manufacturing rose by nearly 6 per cent in 1987-88 (Johns, 1988:2).

One short-term factor which has contributed to the improvement in profit rates, in some sectors, has been a cyclical rise in international commodity prices. Data from the Australian Bureau of Agricultural and Resource Economics indicate that prices received by farmers rose by 17 per cent in 1987-88, while the wage costs of rural employers only increased by 4 per cent (ABARE, 1988: 211).¹⁷

Apart from such cyclical movements, there are three active approaches available for improving Australian profit rates. These are not mutually exclusive and may continue to have some impact, though the extent to which any can overcome the stagnation of Australian profit rates is limited. The first approach is to increase the rate of surplus value. The second is to decrease the organic composition of capital through de-

17 Commodity prices are, however, particularly prone to cyclical fluctuations. They cannot be relied upon to sustain a long term rise in profit rates.

valorisation, as happens during the shake-outs of less profitable capitals during recessions, and the improvement in the efficiency of use of capital, notably by reducing turnover time. The third strategy is to increase the organic composition of capital, by securing large new investments in the most modern equipment and technologies. If Australian capital was able to pull ahead of other countries by dramatically increasing its organic composition of capital in this way, bolstered by the other approaches, it could secure an improved profit rate despite (and at the expense of) a lower global profit rate.

The BCA and EPAC and other orthodox economists have used rate of profit figures to justify calls for further 'wage restraint' and productivity improvements (EPAC, 1986; EPAC, 1988:21; BCA, 1988:6; Clark, 1985:12; Clark, 1988:38; Davis, 1988:26). The rate of surplus value (for which the profits share can be regarded as a crude proxy) is only one factor in determining the rate of profit. Wage cuts may alleviate but, in the current context, they cannot solve the problem of low profit rates. The organic composition of capital has increased very substantially: the BIE's index of capital intensity in the manufacturing sector rose by over 200 per cent between 1961-62 and 1981-82 (BIE, 1987:78). The increase in the rate of surplus value necessary to offset such increases in the organic composition of capital in the past two decades would necessitate the destruction of the organised labour movement in Australia, which is not on the short or medium term agenda, rather than the erosion of its influence. The longer the economic recovery is sustained, moreover, the greater the bargaining power of workers, beginning with those whose skills are in short supply. At the very least this will restrict the ability of Government and employers to enforce further wage cuts and hence rises in the rate of surplus value. The coexistence of a restored profits share of national income with still depressed profit rates and investment levels also suggests that there is limited scope for off-setting lower rates of profit by increasing the rate of surplus value through less than draconian wage cuts. Pro-capitalist economists may recognise that profit rates are important and therefore stress the significance of the rate of surplus value. However, their analyses are one-sided, ignoring the way the process of capital accumulation (investment) itself, when also pursued by a producer's competitors, can lower profit rates.

Increases in capacity utilisation, which increase the turnover time of capital, tend to enhance profitability during the recovery phase of the trade

cycle. They do so by maximising the surplus value extracted from existing employees, and by expanding the workforce without increasing the capital stock, thus lowering the organic composition of capital. A recent paper by Ralph Lattimore has examined different measures of capacity utilisation in Australian manufacturing industry. There has been a significant increase in capacity utilisation at the aggregate level since the 1982-83 recession (Lattimore, 1988:10,14). In addition to improvements due to greater demand during the mid-1980s, it seems that companies also resorted to a range of devices to improve the utilisation of existing capacity. Improvements in capacity utilisation can be achieved through greater use of shift work, changes in work practices, 'Just In Time' inventory management and similar devices, all of which have been conspicuous features of the industrial scene in recent years. But the scope for improvements in turnover time is restricted by physical and technical opportunities for increasing the length of the working day, reducing stocks, the vagaries of securing orders which ensure consistent high capacity utilisation and the additional labour costs due to loadings for shift-work and over-time.

The Government and conservative economists have stressed the importance of increasing levels of investment, in order that Australia is better able to compete on international markets for goods other than primary commodities. The problem of investment has been examined from radical perspectives by Phil Toner and Frank Stilwell. Stilwell has argued that 'the problem of inadequate investment does not stem directly from inadequate profitability'. Here profitability is understood as the profits share of national income (Stilwell, 1988: 26). Toner similarly draws attention to the profits share. Arguments such as Stilwell's and Toner's have some currency in the labour movement.¹⁸ They constitute a valid case for rejecting wage cuts as a means to stimulate the economy. But, as the BCA has pointed out 'perhaps more relevant to investment than the profits share are the rates of return' (BCA, 1989: 10). The ratio of net profits to shareholders funds which Toner also highlights is a very poor proxy for profit rates as measured against real capital (Toner, 1988:43-44).

In order for Australia to come out ahead, through a strategy of increasing competitiveness by encouraging investment, very substantial injections

18 See Marginson, 1985:10.

of capital would be necessary. This is particularly the case because other countries, including those already achieving high profit rates, are pursuing the same strategy. While some of Australia's commodity export sectors may already be reaping super-profits, thanks to a high capital intensity combined with natural conditions, such a situation does not seem to prevail in most other productive sectors, notably manufacturing. This situation reflects the fact that in Australia 'overall, the proportions of both savings and investment to national income are low, compared with faster-growing economies' (Drake and Nieuwenhuysen, 1988:138).

For Australia to catch up with the current front-runners, large new sources of investment capital would have to be found. The improvements in the level of investment since 1987 have not been sufficient. The Business Council has argued that, despite business investment reaching record levels as a proportion of GDP, capital stock growth has not been as impressive. This is because, during the period of low investment since the early 1970s, the average age of the capital stock increased by 25 per cent: 'Gross business investment now has to be 1% of GDP higher than the early 1970s just to keep the existing net capital stock up to date' (BCA, 1989:10).

The most plausible means of further boosting investment levels are domestic savings and foreign capital inflow. Drake and Nieuwenhuysen have pointed out that 'it is probable that an unequal distribution of income promises greater total savings' (Drake and Nieuwenhuysen, 1988:31-32). They justify greater income inequality in the short term in order to transfer resources from the main consumers in the economy (workers) to the main savers (capitalists and the state). The implications for working class living standards are obvious.

The alternative of increasing foreign investment entails pushing up profit and/or interest rates in the short-term to attract overseas capital. The means for doing this are, again, reducing the organic composition of capital through de-valorisation or using the existing capital stock more efficiently, alongside increasing the rate of surplus value. This in turn implies further cuts in real wages and the social wage. In the longer term, foreign investment also carries with it the risk of larger outward flows of profits and interest, which can intensify a current account crisis and put additional downward pressure on working class living standards.

Even if further increases in the organic composition of capital occur, there is no guarantee that a strategy of high investment will pay off for workers, even in the longer term. Proponents of this approach have offered no convincing evidence, beyond 'We can do it! C'mon Aussie, C'mon' exhortations, to suggest that Australia can emulate the success of Japan, South Korea or Taiwan, the countries which seem to have followed the high investment path successfully.¹⁹ The circumstances of rapid capital accumulation in these countries from the 1950s included: favourable international circumstances during the initial stages of rapid accumulation, notably expanding international markets for exports; very weak labour movements; low wages; initial absence of a substantial, dated capital stock much of which was destroyed in war; injections of cheap state funds into industry; economic advantages of the international military balance (in the case of South Korea and Taiwan, this involved the availability of US loans to government; Japan did not have the burden of maintaining armed forces commensurate with its economic weight).²⁰

There are additional considerations which make a high organic composition of capital strategy doubtful. Such an approach entails a greater reliance on export markets, so capital intensive producers can reap super-profits by selling their cheaper products at, or slightly under prevailing world market prices. (The more closed an economy, the more increased investment and a higher organic composition of capital will simply serve to push down local profit rates.) In the context of rising international economic tensions, small economies are particularly vulnerable to trade barriers against even the cheapest and most efficiently produced of their exports. The recent Australian experience of being caught in the cross-fire of U.S. and European agricultural policies and restrictions on Japanese and South Korean exports into Europe and America took place while the world economy was expanding. Pressures for protectionism will be much greater during a recession.

19 The Swedish model may be easier to achieve, but it is not that of achieving high profit rates through a higher general organic composition of capital. Sweden has suffered from lower growth rates than Australia during the 1980s, has experienced similar kinds of balance of payments problems and has a comparable proportion of gross domestic investment to gross domestic product.

20 For a discussion of the circumstances of South Korean industrialisation and growth see Hamilton, 1986. On the growth paths of the Asian 'Gang of Four' (South Korea, Taiwan, Hong Kong and Singapore) see Harris, 1986: 30-69. On the class dynamics of Japanese growth see Rytting, 1989:26-29.

A combination of rationalisation of capital arising from the 1982 recession, better prices for commodity exports, wage 'restraint' since 1983, more effective capacity utilisation and, since 1987, some increases in levels of investment have, apparently, led to a recent reversal in the longer term decline in profit rates which began during the early 1970s. However, there are some obvious limits to this prospect. First, commodity prices cannot be relied on to remain high. Second, the scope for further substantial increases in the rate of surplus value are limited, without a major assault on organised labour. Third, there are technical and social limits on improved efficiency through reduced turnover time. Fourth, attempting to achieve higher profit rates through large scale investments is a risky strategy, premised on further increases in the rate of surplus value. Finally, renewed investment in Australia and overseas will tend to increase the organic composition of capital, imposing renewed downward pressure on profit rates, at a time when Australia is unlikely to secure a general competitive advantage from very large-scale new investments.

Conclusion

There is strong evidence that profit rates have been falling until recently, both in Australia and overseas. The mechanisms which explain the international process also apply within Australia. There is competition, which motivates investment, amongst local firms and increasingly with overseas firms, in pursuit of lower costs and higher profits. Conflict between capital and labour also provides incentives to increase the capital intensity of production in order to exert greater technical control over the production process (for example, the increasing interest of building industry employers in tilt-up panels arises from the strong bargaining position currently enjoyed by bricklayers). Increased investment raises the organic composition of capital, which in turn lowers the rate of profit.

Declining profit rates, rather than domestic macroeconomic policies or external shocks, constitute the necessary starting point for an explanation of the economic crisis in Australia. Policy decisions, technical developments and natural occurrences are significant aspects of the crisis. The same can be said for other, secondary features of the Australian situation which are often identified by orthodox economists, other social scientists and left nationalist political economists. These include

- the small size of the domestic market
- the effects of a sustained period of protection, by means of tariffs and quantitative import
- controls, for domestic manufacturing industry
- the effects of conditions in international mineral and agricultural markets²¹
- the course of the class struggle in Australia²²

An understanding of these factors is essential to any systematic analysis of developments in the Australian economy. But they are best understood within the broader analytical approach we have developed above which focuses on the contradictions arising from the dynamic of capitalist accumulation.

Our argument has clear implications for economic policy and political strategies. The solutions offered by the Hawke government to the problems confronting Australian capitalism, like those of the governments of other countries, are premised on the idea that state intervention and/or the restraint of workers' efforts to defend their wages and conditions can help secure favourable conditions for investment. We have argued that this approach is unlikely to be successful in Australia. Pursued by many countries' governments, it is a recipe for assaults on the world working class. To the extent that levels of investment increase, the strategy is self-defeating, contributing to a higher organic composition of capital and further falls in international profit rates. An alternative to resolving the crisis at the expense of workers does not exist within the framework of capitalism. But the generalisation of workers' immediate struggles today provides a starting point for revolutionary supercession.

Appendix

Calculations of the rate of surplus value, organic composition of capital and rate of profit for Australian manufacturing industry between 1954-55 and 1984-85 were made on the following basis:

21 Bryan, 1988: 14-26 provides valuable insights in this regard.

22 Kahn, 1981 provides an excellent account of class relations from 1975 to 1981; Kuhn, 1987, relates changes in the level of class struggle to changes in the currency of ideas in the labour movement.

Wages and salaries were taken as a proxy for variable capital (v). This was deflated by the consumer price index to arrive at constant 1974-75 prices.

Bureau of Industry Economics capital stock figures were used as a proxy for constant capital (c). Capital stock is only equivalent to the fixed part of constant capital. The circulating part, i. e. raw materials etc., is left out of consideration in the following calculations. There is some justification for this in the much shorter turnover time of circulating as opposed to fixed constant capital. That is, any figure for annual circulating capital would in any case have to be discounted by the number of turnovers in a year if it was to be included in the calculation. However, not including circulating constant capital will tend to understate constant capital and therefore understate the organic composition of capital and overstate the rate of profit. On the question of turnover times see Marx, 1978: Part Two.

Value added (prior to 1968-69 value of production) minus wages and salaries was taken as a proxy for surplus value (s). On the one hand the salaries of senior executives are excluded from this proxy but would be included in a more rigorous measure of surplus value. On the other hand miscellaneous expenses notably depreciation, workers' compensation insurance are included in this proxy but would not be included in a more accurate measure (see ABS, 1969-69:2). This was deflated by the consumer price index to arrive at constant 1974-75 prices.

Given the above assumptions the rate of surplus value was straightforwardly calculated as

$(\text{value added} - \text{wages and salaries}) / \text{wages and salaries}, (s/v).$

The organic composition of capital was calculated as $\text{capital stock} / (\text{capital stock} + \text{wages and salaries}), (c/(c+v)).$

It is assumed here that constant and variable capital have the same turnover time. It is more likely that variable capital turns over significantly faster than constant capital. This would lead the calculation used here to understate the organic composition of capital.

The rate of profit was calculated as

$(\text{value added} - \text{wages and salaries}) / (\text{capital stock} + \text{wages and salaries}), s/(c+v).$

The problems of not including circulating constant capital in the proxy for constant capital used and of the turnover times of variable and constant

capital arises in this calculation too. The former leads to an overstatement the latter to an understatement of the rate of profit.

We hope our efforts to make use of recent capital stock data will encourage others to apply more sophisticated methodologies to them, within a Marxist framework.

Note that it was not possible to obtain a set of observations for 1970-71.

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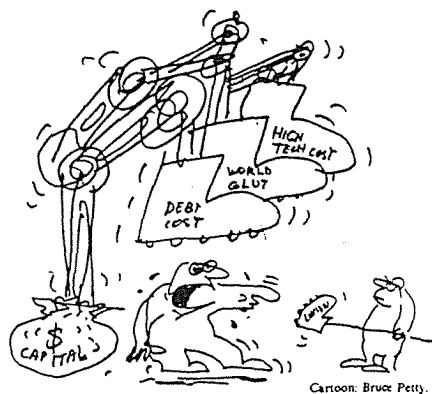
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