

EDITED BY

**Jeannette Wicks-Lim**  
and **Robert Pollin**



# CAPITALISM ON TRIAL

Explorations in the Tradition of  
Thomas E. Weisskopf



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## Contributors

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Randy Albelda, University of Massachusetts Boston, USA  
Michael Ash, University of Massachusetts Amherst, USA  
Samuel Bowles, University of Massachusetts Amherst, USA  
James K. Boyce, University of Massachusetts Amherst, USA  
James Crotty, University of Massachusetts Amherst, USA  
William Darity Jr, Duke University, USA  
Ashwini Deshpande, University of Delhi, India  
Gerald Epstein, University of Massachusetts Amherst, USA  
Diane Flaherty, University of Massachusetts Amherst, USA  
Nancy Folbre, University of Massachusetts Amherst, USA  
James Heintz, University of Massachusetts Amherst, USA  
Shahrukh Khan, Mount Holyoke College, USA  
Kyle Knight, University of Alabama Huntsville, USA  
David M. Kotz, University of Massachusetts Amherst, USA  
Hwok Aun Lee, University of Malaya, Malaysia  
Minqi Li, University of Utah, USA  
Arthur MacEwan, University of Massachusetts Boston, USA  
Elaine McCrate, University of Vermont, USA  
John Miller, Wheaton College, USA  
Fred Moseley, Mount Holyoke College, USA  
Robert Pollin, University of Massachusetts Amherst, USA  
Michael Reich, University of California Berkeley, USA  
Eugene A. Rosa, Washington State University, USA  
Juliet B. Schor, Boston College, USA  
Gilbert L. Skillman, Wesleyan University, USA  
Frank Thompson, University of Michigan Ann Arbor, USA  
Mark Weisbrot, Center for Economic and Policy Research, USA  
Thomas E. Weisskopf, University of Michigan Ann Arbor, USA  
Jeannette Wicks-Lim, University of Massachusetts Amherst, USA  
Andrew Zimbalist, Smith College, USA





# Acknowledgments

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This volume collects the papers that were presented at the September/October 2011 Festschrift conference honoring the life's work of Professor Thomas Weisskopf. The conference was held in Gordon Hall at the University of Massachusetts Amherst, the home of the Political Economy Research Institute (PERI). All of us at PERI felt highly privileged to have had the opportunity to organize and host the Festschrift conference, and we the editors have been equally privileged to produce this volume honoring Tom. Tom has been our teacher, mentor, supporter, critic, and occasional collaborator. We therefore know well from decades of observation and experience that nobody is more deserving of this honor.

Neither the conference nor this volume would have been possible without the contributions of friends and co-workers. We must start with Judy Fogg, the incredibly competent and still always warm and gracious Administrative Director of PERI. When we say "we organized" the Festschrift conference for Tom Weisskopf, what we really mean is that we came up with some ideas on how to organize it and then Judy did most of the hard work to make it a reality. As always, we are very grateful to her for her efforts and great spirit. We also wish to thank Debbie Zeidenberg, PERI's Communications Director, for her efforts around the conference, in particular for organizing on-line video interviews with many of the conference participants. This enabled us to share some of the key themes of the conference—that is, putting "capitalism on trial"—with a much broader audience.

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Jeannette Wicks-Lim and Robert Pollin  
*Political Economy Research Institute,  
University of Massachusetts Amherst*



# Introduction

## Robert Pollin and Jeannette Wicks-Lim

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This volume collects the papers from a festschrift conference to honor the life's work of Professor Thomas E. Weisskopf of the University of Michigan Ann Arbor. The conference took place from September 30 to October 1, 2011 at the University of Massachusetts Amherst. It was fitting that the conference was held at Gordon Hall, the headquarters of our own workplace, the Political Economy Research Institute (PERI), which sponsored the conference. Gordon Hall is named for the late Professor David Gordon of the New School for Social Research, who had been a close friend and collaborator of Tom Weisskopf until Gordon's untimely death in 1996.

By his own description, Tom Weisskopf began his work as a professional economist in the mid-1960s as a questioning but still basically mainstream development economist. By the early 1970s, Tom had begun 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. He has remained a giant in the field ever since.

Weisskopf's life's work has been characterized by powerful commitments to both egalitarianism as a moral imperative and rigorous research standards, as a means, as Robert Heilbroner put it, of "making a workable science out of morality." His research themes have spanned widely, and have included the economics of developing countries; US imperialism; Marxian crisis theory; macroeconomic theory and policy within a broad left framework; contemporary economic history and institutional development; affirmative action, both in the United States and India; and the prospects for socialism as a framework for building non-exploitative, egalitarian societies. Weisskopf also made crucial contributions through writing textbooks, edited book collections, and popular articles that made radical economics accessible and compelling. This published work was also closely tied up with his brilliant and dedicated work as a teacher and administrator, first at Harvard, then at the University of Michigan. Tom has also delivered countless lectures and other presentations on all the themes of

his writings and teaching, and then some. Both the global economic crisis that began with the financial market crash of 2008–2009 and the long-run trends toward rising income and wealth inequality, in the US and globally, have underscored dramatically the need for precisely the kind of radical economics research and teaching to which Weisskopf has been committed throughout his professional life.

We chose the themes and contributors in this volume 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 book is divided into seven sections, as well as closing reflections by our honoree himself, Professor Weisskopf. Each section includes comments by discussants as well as the papers themselves. The book proceeds as follows.

## PART 1: REFLECTIONS ON THOMAS E. WEISSKOPF'S CONTRIBUTIONS TO POLITICAL ECONOMY

The first contribution in this section is actually not a paper at all, but rather a play, “Three’s a crowd: my dinner with Karl, Leon, and Maynard,” written by Samuel Bowles, Tom Weisskopf’s longtime friend and collaborator. The dinner guests referred to in the play’s title, Karl Marx, Leon Walras, and John Maynard Keynes, are obviously a formidable group. As the dinner begins, at the home of Sam Bowles, we find, not surprisingly, that these three economics titans disagree sharply, in this instance, about the dynamics of wage determination and the causes of mass unemployment under capitalism. They end up ruining some of Sam’s grandmother’s napkins by scribbling out their alternative perspectives as mathematical models—with Marx’s model focused on class struggle, Keynes’s on aggregate demand, and Walras’s on competition.

The dispute appears unresolvable until... Tom Weisskopf happens to show up at the gathering. Tom realizes that the way to incorporate the central features of the three models into an overarching, mathematically-determined framework is to take explicit account of economic policy. Marx, Walras, and Keynes all see Tom’s point. Weisskopf and Bowles then realize that three is not necessarily a crowd when the three can work cooperatively towards a solution. Thanks to Weisskopf’s intervention at the dinner, this turns out to be the case with Marx, Keynes, and Walras. It was also most certainly true with the collaboration of Bowles, Gordon, and Weisskopf, as the play recognizes in its conclusion.

In “Theses on Weisskopf” (Chapter 2), Robert Pollin reflects on Weisskopf’s extraordinary contributions to political economy by considering his work within the framework of ten theses. The best way to capture the spirit of the chapter is simply to list these ten theses:

1. Karl Marx's 11th Thesis on Feuerbach is wrong.
2. Radical economics is a great endeavor with an outmoded name.
3. One major reason why radical economics is a great endeavor is that Tom Weisskopf has been contributing to it for more than 40 years.
4. You will learn from studying Weisskopf, whether you agree with him or not.
5. Many underdeveloped countries of the 1960s could and did grow under capitalism and US imperialism, but Weisskopf was still more right than wrong.
6. There is no such thing as an economic crisis independent of a financial crisis.
7. The best empirical tests are almost always the simplest ones.
8. Pursuing ethnic-based affirmative action policies amid rising economic inequality is perilous.
9. Socialism remains a great emancipatory project, as long it is understood to be a series of explorations and challenges rather than a set of off-the-shelf answers.
10. Radical economists of the world unite! ...Standing on Tom Weisskopf's shoulders.

## PART 2: ISSUES IN DEVELOPING ECONOMIES

In "The military and economic development in Pakistan" (Chapter 4), Shah-rukh Khan argues that, to drum up support for the four coups it imposed on the country, the Pakistani military has made the case that military governments have been more successful than civilian governments at advancing Pakistan's economic development. The main purpose of Khan's chapter is to examine the evidence surrounding this claim.

Khan begins by considering what Walter Rostow had claimed were the preconditions for economic "take off" in less developed countries. These include: a strong commitment to applied science and training; the development of financial, political, and social institutions; and investments to create an effective physical infrastructure and high-quality management practices. Khan notes that these conditions set down by Rostow were very much in keeping with Mao Tse-tung's own priorities for rapidly advancing development. Khan then draws on the contemporary experience of China to understand the factors capable of delivering rapid growth in countries other than China, such as Pakistan.

Following this background discussion, Khan considers the specific question of whether the Pakistani military have been more successful than civilian governments in promoting growth. His conclusion is that the militarization of the Pakistani economy is inefficient and crowds out private sector activity. He further

finds that military administrations are no more competent or less corrupt than civilian alternatives. His overarching conclusion is that economic development requires, first and foremost, a willingness of the population to accept short-term sacrifices for what they trust will be longer-term benefits. Khan argues that the Pakistani military are not capable institutionally of achieving that level of trust from the Pakistani people.

In “Socialism: the twentieth century and the twenty-first century” (Chapter 5), Minqi Li advances a reassessment of the historical experience with socialism in the twentieth century and its prospects for the twenty-first century. He considers especially the experiences of the former state socialist countries as well as developing economies. Li argues that the countries operating under “actual existing socialism” in the twentieth century did achieve some major successes, in terms of delivering innovation and rising labor productivity in a range of areas, better health outcomes relative to a country’s level of development, full employment, and better life circumstances for the lower social strata of society—in sum, economies that were growing at reasonable rates while maintaining a far more egalitarian social structure. Li recognizes that the twentieth century socialist countries failed to match the growth performance of the most successful capitalist economies, such as Japan. But Li also writes that this drive for ever-greater growth is an imperative for capitalist economies, but is not necessary, or even necessarily beneficial, for advancing human well-being.

Li further argues that capitalism has now entered into a structural crisis, including “escalating financial instability, the impending global ecological collapse, and the growing class conflicts.” In Li’s view, socialism will emerge as an increasingly viable alternative precisely because the contemporary crises of capitalism—the ecological crisis most fundamentally—cannot be resolved within the historic framework of capitalism.

In “Economic growth: the great slowdown (1980–2000) and recovery (2000–2010)” (Chapter 6), Mark Weisbrot examines the long-term trends in global economic growth, focusing, like Li, on the experience of the developing world. Weisbrot identifies three broad growth trends for the developing countries: rapid growth between 1960 and 1980, the prolonged slowdown of the 1980s and 1990s, and a rebound from 2000 onward. The improvement in growth for low- and middle-income countries contrasts sharply with the collapse of growth in the Eurozone beginning with the 2008 financial crisis and Great Recession.

Weisbrot argues that the main force generating the global growth slowdown beginning in the 1980s was the ascendancy of neoliberalism—the aggressively pro-business agenda that included dismantling state-led economic planning and public ownership as a central feature of developmental state policy models. Weisbrot argues that China’s rapid growth experience over this period was primarily due to their unwillingness to embrace neoliberalism. He also finds that the upturn in growth for much of the rest of the developing world was

due to their success in greatly expanding trade with China. Moreover, in Latin America in particular, growth was restored after 2000 through the election of left-of-center governments that rejected neoliberalism in favor of a flexible range of developmental policies. By contrast, Weisbrot points to the ongoing slump in the Eurozone, which he explains as resulting from their continued adherence to neoliberalism. Weisbrot concludes by observing that, as long as the Eurozone countries remain bound to neoliberalism while the developing countries continue advancing well-designed alternatives, the developing world is likely to continue growing much faster than the high-income countries.

### PART 3: POWER DYNAMICS IN CAPITALISM

In “The wealth–power connection” (Chapter 8), Arthur MacEwan proceeds from a 1978 essay by Tom Weisskopf and his co-authors Richard Edwards and Michael Reich that asked the question, “How [has it been] possible for capitalists, who constitute an insignificant minority of the voting public, to get the state to act on their behalf?” As MacEwan describes, Weisskopf and his co-authors offered three main explanations: (1) *Money power*: Money buys access and influence and is generally decisive in winning elections; (2) *Ideology*: Capitalists can rule if they convince everyone else that the agenda of capital will benefit society as a whole; and (3) *Capitalists run the economy*: Since capitalists are directly responsible for hiring people into jobs—they are the “job creators,” in current right-wing rhetoric—the non-wealthy can easily become convinced that capitalists need to be supported by public policies, or else opportunities dry up for everyone.

MacEwan argues that this basic framework is just as valid in 2012 as it was in 1978. He demonstrates this by describing a series of contemporary case studies in support of all these points. For example, MacEwan cites a range of evidence showing that, in general, raising taxes on the rich and corporations does not discourage economic growth and job creation, nor does cutting these taxes stimulate jobs and growth. Nevertheless, tax rates on the wealthy and corporations are at historically low levels. This is despite the fact that, as MacEwan concludes, the economic crisis that emerged in 2008 could not be clearer in demonstrating “the fallacy of the claim that giving business and the wealthy what they want is good for all of us.”

In “The rise and decline of patriarchal capitalism” (Chapter 9), Nancy Folbre builds from her 1998 collaborative paper with Tom Weisskopf, “Did father know best? Families, markets, and the supply of caring labor.” In that joint work, Folbre and Weisskopf developed the idea that the supply of unpaid care could be described in part as akin to a game of “Chicken,” in which concern for others can reduce the individual bargaining power of the caring against those less willing

to provide unpaid care. This insight enables Folbre to pursue her reformulation of the concept of exploitation, by incorporating into the traditional Marxian approach the non-class-based sources of exploitation. These forms of exploitation derive from race, gender, age, kinship, and citizenship, and operate in parallel with exploitation derived from capitalist ownership of the means of production.

Given this more expansive understanding of exploitation, Folbre argues the need for a broader leftist political agenda. This broader agenda needs to recognize the importance of forms of collective identity and exploitation beyond those based on class alone. It also needs to take serious account of the fact that, as Folbre explains, “the responsibility that individuals take—both within the family and through the state—for the well-being of others has a fundamental impact on their own standard of living and their economic bargaining power.” Working within this broader agenda also sheds important light on the operations and levels of support for the welfare state. Indeed, as Folbre explains, in welfare state budgets, spending on dependents far exceeds that for employment-related measures. Thus, attacks on the welfare state, such as have become prevalent throughout the US and Europe in the wake of the Great Recession, can be understood as being an agenda for weakening society’s commitment to the fundamental human project of caring for others.

## PART 4: TRENDS IN US LABOR MARKETS

In “The rising strength of management, high unemployment, and slow growth: revisiting Okun’s Law” (Chapter 11), Michael Reich builds from Tom Weisskopf’s work in the 1970s on how the relative strength of labor and capital impacts the short- and long-run trajectories of the US economy. In his classic 1979 paper in the *Cambridge Journal of Economics*, Weisskopf presented evidence that what he termed the “rising strength of labor” through the 1950s and 1960s enabled US workers to bargain up wages and squeeze capitalists’ profits. Declining profitability then produced the economic slowdown of the second half of the 1970s. Moving into 2012, Reich argues that the “rising strength of management” can help explain why the United States economy has experienced three jobless recoveries in a row, and, in particular, why the unemployment rate has remained stuck so high 4 years after the onset of the Great Recession.

To examine this issue systematically, Reich draws on Okun’s law, the widely-used tool for analysing the relationship between changes in GDP growth and the unemployment rate. Reich finds, surprisingly, that since the 1980s the Okun’s law relationship has not changed significantly *within* each business-cycle recession and recovery. But Reich argues that, over the longer-term, since the early 1980s, management in the US has increasingly exercised its power to impose



layoffs and long-term cuts in the labor force. Reich argues that this long-term restructuring, from one full business cycle to the next is mostly responsible for the jobless recoveries that have occurred since the 1980s.

In “Reducing growth to achieve environmental sustainability: the role of work hours” (Chapter 12), Kyle Knight, Eugene A. Rosa, and Juliet Schor examine a broader set of issues with respect to job opportunities and the radical critique of capitalism. They argue that continued economic growth in the global North is antithetical to achieving long-term global environmental sustainability. As such, they support the idea of reducing growth, or even achieving zero growth, as a central strategy for achieving environmental sustainability. Moreover, they find that reducing work hours broadly is an effective way of ratcheting downward an economy’s growth path in an environmentally responsible way.

The research they undertake in this chapter consists of a panel data for 29 high-income OECD countries. Overall, they find that countries with shorter work hours will lead to reductions in both production and consumption. This fall in production and consumption, in turn, has led to lower ecological footprints, carbon footprints, and carbon dioxide emissions. Knight, Rosa, and Schor conclude by expressing the hope that their findings will help rekindle a debate among radical economists about the fundamental problems tied to economic growth and how best to overcome these problems.

## PART 5: DISCRIMINATION AND THE ROLE OF AFFIRMATIVE ACTION POLICIES

William Darity’s chapter, “Confronting those affirmative action grumbles” (Chapter 14), begins with a clear definition of the issue at hand: “Affirmative action targets groups subjected to discrimination, ridicule, and abuse for special support in their pursuit of preferred positions.” Darity also explains that affirmative action is not intended, *per se*, to produce general equality or reduce poverty, but to provide equal access for historically subordinated populations to good education, jobs, and income.

Within this framework, Darity then provides a careful examination of the six major “grumbles” that emerge persistently around affirmative action policies, both in the US and elsewhere in the world. These are: (1) affirmative action violates the principle of meritocracy; (2) affirmative action lowers productivity; (3) students from the target population are grossly underprepared for higher education when affirmative action is focused on access to colleges and university; (4) only the best positioned members of the target population really benefit from affirmative action; (5) the recipients of affirmative action are stigmatized by the preference or quota system; and (6) affirmative action programs should be

implemented on the basis of class, not race or ethnicity. Darity reasons that none of these arguments invalidates the basic purpose of affirmative action policies. Citing Lewis Gordon, he concludes that affirmative action policies do in fact work as intended. Equally important, he finds that the presence of affirmative action policies forces a society to “acknowledge that it continues to be a site where racism and discrimination operate.”

In “Screening for honesty and motivation in the workplace: what can affirmative action do?” (Chapter 15), Elaine McCrate explains how employers frequently rely on racial and ethnic stereotypes to compensate for the fact that they cannot easily obtain various sorts of important information about job candidates. But such practices constitute statistical discrimination. African American job applicants in particular suffer from statistical discrimination, especially in assessing their honesty and level of motivation, two important traits that are particularly difficult for employers to assess. To avoid relying on racial stereotypes, some employers have adopted a variety of screening tools to measure honesty and motivation. But McCrate argues that racial stereotyping in hiring has persisted nevertheless.

To explain why this occurs, McCrate describes each of several steps in the hiring process. To begin with, she shows that the results of the screening tests may not be reliable. But even if the test results are broadly reliable an employer may, for example, discount a test result showing that a black applicant has high integrity if the employer holds negative stereotypes about blacks. McCrate concludes by considering the potential for affirmative action policies to break through such employment barriers. She argues that stronger affirmative action policies could be helpful, if they are combined with a commitment to full employment and an attack against the biases faced by African Americans in the criminal justice system.

The construction industry in the United States has long been known for discriminating against women and minorities in its hiring practices. This created considerable concern with respect to the Obama administration’s 2009 economic stimulus program, because it was focused heavily on creating employment opportunities within construction that would disproportionately benefit white males. In “A stimulus for affirmative action? The impact of the American Recovery and Reinvestment Act on women and minority workers in construction” (Chapter 16), Jeannette Wicks-Lim asks whether current federal affirmative action regulations, as they apply to publically-funded construction projects, have been operating effectively, and thus spreading the benefits of the 2009 stimulus program more equitably than would have occurred otherwise.

Wicks-Lim’s approach to modeling this question takes advantage of the turbulence in the construction industry resulting from the Great Recession. First, as she shows, private sector construction activity fell off dramatically during the recession. This led to an equally dramatic rise in the share of publicly-funded

construction activity, and, therefore, the coverage of federal affirmative regulations. In addition, the new leadership from the Obama administration that took over the Labor Department in 2009 was committed to enforcing affirmative action policies. Wicks-Lim argues that under these circumstances, the construction industry workforce should have become more diversified after 2009. Indeed, this is the result that emerges from her research. She finds that women and Latinos achieved significant gains in their share of construction jobs, while the picture is more mixed for African Americans.

As Ashwini Deshpande explains in “Social justice through affirmative action in India: an assessment” (Chapter 18), the purpose of such policies in India is to provide preferential treatment for caste and tribal groups perceived to be the lowest in the social and economic hierarchy. As distinct from the US policies, affirmative action in India is not primarily focused around reversing discrimination based on race or gender. Also unlike the US, the Indian system operates under a system of quotas with respect to employment and education, as well as seats in public office.

Deshpande provides a careful survey of the empirical research which attempts to establish clearly: (1) what are the caste-based inequalities that affirmative action policies are meant to reduce; and (2) how much have caste-based affirmative action policies achieved in terms of reducing these inequalities. Broadly speaking, she finds that affirmative action policies have been successful in achieving their intended aims. She also uses this evidence to refute the main arguments against the Indian affirmative action approach. Deshpande concludes by proposing a series of measures—a “quotas plus” approach—for strengthening affirmative action policies in India. These include raising the standards for monitoring implementation of the quotas; broadening the educational offerings to support the targeted caste and tribal groups; strengthening the quota system at the entry level while allowing quotas to diminish at later stages; and expanding non-farm job opportunities and land reform within the agricultural sector.

## PART 6: MACROECONOMIC ISSUES IN THE UNITED STATES

In the aftermath of the 2008–2009 financial crisis and Great Recession, many observers have concluded that the US financial system has grown to excessive size relative to the economy’s non-financial sectors. But, as Gerald Epstein and James Crotty emphasize in “How big is too big? On the social efficiency of the financial sector in the United States” (Chapter 20), there does not yet exist any carefully derived theoretical frameworks or metrics to measure the social

usefulness of financial activities. Yet having such measures could become the basis for establishing the desirable size of the financial sector relative to the rest of the economy.

Epstein and Crotty undertake an initial exploration on ways to conceptualize the US financial sector's appropriate size and quality. They then marshal some initial data on the social efficiency of the financial sector in financing real-economy activity and the social purpose of financial innovation. They also consider the social purpose of other activities by the financial sector, including liquidity provision and market making. They conclude that what they term "income extraction" by the financial sector has grown significantly over the post-World War II period in the US relative to its useful contributions to broader economic well-being. They provide preliminary empirical estimates as to the magnitude of these "income extraction" activities by US investment banks as a proportion of their useful economic contributions. They conclude from this preliminary research that "the financial sector may need to be only one-half to one-quarter as large as it is currently to serve the existing needs of the real sector."

In "Unpacking the US labor share" (Chapter 21), James Heintz addresses a major vexing statistical question. That is, the labor share of US national income appears to remain remarkably constant over long periods of time, despite significant shifts in economic performance, policies, the distribution of power, and institutions. As Heintz notes, the constancy of the labor share seems to contradict other trends, such as falling real wages since the early 1970s for average non-supervisory workers.

In seeking to explain this disparity, Heintz builds on the approach to decomposing aggregate variables that Tom Weisskopf pioneered in his classic 1979 paper "Marxian crisis theory and the rate of profit in the postwar US economy." Heintz decomposes the US labor share up to 2010 according to three criteria: (1) how price movements affect the interpretation of the distribution of income between labor and capital; (2) how the trend of the labor share might change through focusing only on production and non-supervisory workers, as opposed to observing labor income as one broad category; and (3) how deindustrialization and the rise of a service economy have affected movements of the labor share. Heintz finds that underlying the constant labor share is a pattern in which the best-paid employees have seen their incomes rise at the expense of more vulnerable workers. He shows that we can understand these distributional shifts in income within the aggregate labor share in three interrelated ways: a shift from low to high-skilled workers; from production workers to the non-production, supervisory class of employees; and from traditional manufacturing to high-end service-sector workers.

## PART 7: APPLICATIONS OF MARXIST ECONOMIC THEORY

Tom Weisskopf and his co-authors Samuel Bowles and David Gordon developed the Social Structures of Accumulation (SSA) theory in the 1980s and 1990s to explain US economic trends during the first three decades after World War II. In “Social Structures of Accumulation, the rate of profit and economic crises” (Chapter 23), David M. Kotz argues that this initial SSA approach developed by Bowles, Gordon, and Weisskopf was too narrowly focused, because it considered factors that could cause a crisis only in terms of a declining rate of profit. Kotz develops an analysis of capitalist crises within a circuit of capital framework. As Kotz writes, his approach “has the advantage of effectively integrating within a single framework several crisis tendencies in capitalism, including those not based on profit rate movements.”

Kotz observes that the 48 percent decline in the average profit rate in the US economy from 1965–81 was the main factor causing the crisis from the mid-1970s to early 1980s. By contrast, he argues that, beginning with the neoliberal SSA in the early 1980s, the profit rate did not fall prior to any subsequent economic crisis, including the period immediately prior to the Great Recession of 2008–2009. Rather, during this neoliberal era, Kotz argues that capitalists overinvested precisely because profit rates were robust. This created a crisis of insufficient demand to purchase the products that this excessive capacity was capable of producing. Kotz concludes that “crisis analyses should consider possible realization problems as well as profit rate problems if they are to be adequate for explaining the variety of ways capitalism can produce crises.”

In “Exploitation without subsumption: the scope and limits of proto-industrial exploitation” (Chapter 24), Gilbert L. Skillman poses a question initially explored by Marx: do capitalists need to hire workers into their firms, and thereby directly control the labor process, in order for capitalists to be able to extract surplus value from these workers? As Skillman points out, Marx’s own writings focus on this process of “subsumption of labor under capital” as being central to the ability of capitalists to exploit labor. But Marx did also recognize cases in which capitalists are able to exploit workers and appropriate surplus value without directly controlling the production process, through purely contractual means of control. John Roemer explored this alternative further, demonstrating conditions in which, under conditions of perfect competition and frictionless contracting, labor can still be exploited by capital even when the workers are self-employed.

Skillman’s study examines what he terms an “analytic middle ground” in which neither direct capitalist control of production nor a scenario of ideal contracting is assumed to exist. In Skillman’s model, capitalists undertake

productive activities under conditions of imperfect information, in which the workers' effort level and other key variables are known only to the worker or unknown to both worker and capitalist. Drawing on the historical literature, Skillman uses the term "proto-industrial" production process to describe this middle ground. His model provides fresh, if still incomplete, answers to questions such as how such proto-industrial forms of organization have persisted throughout the capitalist era.

In "Morally arbitrary economic advantage" (Chapter 25), Frank Thompson considers the extent to which people throughout the globe experience economic advantages or disadvantages strictly due to where they happen to have been born. Drawing from John Rawls, Thompson explains that "there are some properties of each human individual that are not (or not at all easily) mutable by that individual but which ... confer advantages or disadvantages on that individual." Working within a standard neoclassical Solow growth model, Thompson utilizes data on 80 countries to measure how much a worker would earn in any given country, based on the capital and technology available in that country. In Thompson's model, the greater the contribution of capital and technology in determining a worker's wage level, the more this worker's wage is determined by morally arbitrary conditions. He finds that, throughout the 80 countries in his data sample, these morally arbitrary factors are a more important determinant of the wages paid to workers than is human capital.

The next stage in Thompson's analysis is to measure the extent of inequality in the distribution of technology and physical capital across the 80 countries in his sample. He finds that "differences in capital/labor ratios and levels of technology account for far more of differences in workers' outcomes than their differences in human capital." In other words, Thompson concludes that morally arbitrary factors are a major cause of income inequality throughout the world.

## PART 8: REFLECTIONS BY THOMAS E. WEISSKOPF

Tom Weisskopf closes this volume with a set of reflections on his career and the project of radical political economy more generally. Characteristically, these reflections are careful, insightful, and generous to others, ranging both widely and deeply. He also subjects his own work to a significant level of self-criticism. He makes clear that his overarching purpose with these observations, and his work more generally, is to contribute toward building societies that are fundamentally more committed to equality, social justice, and ecological sanity. In this spirit, Weisskopf provides a set of proposals for "what is to be done" in the United States today, given current political and economic realities. To begin with, he states boldly that "we need to be realistic about what the world is like now and

what can actually be accomplished in the foreseeable future.” He argues that “in the US we are far from even a half-decent form of social-democratic capitalism ... Things have gotten bad and they threaten to get much worse—while popular rage against the system that brought us the current economic crisis has been captured by the far Right, not the Left.” Weisskopf therefore concludes with the call that for “here and now, our most urgent task is to devote our teaching, our research, and our activism to reversing this alarming trend.”





1. Three's a crowd: my dinner party with  
Karl, Leon, and Maynard  
*A one-act play in seven scenes to celebrate  
the life and work of Tom Weisskopf<sup>1,2</sup>*

**Samuel Bowles**

---

PROLOGUE

NARRATOR

Years ago, a time when Tom and Sam were young colleagues and neighbors, one of Sam's daughters would ask if she could have some friends over to play. When Corinna would ask, he'd say sure you can invite Lizzie, or else it should be Joey, Susan, and Lizzie. Two kids have fun. Or four. Not three.

He had learned the hard way that with three kids somebody is going to feel left out.

Looking back, he still can't figure out why, after a long absence, he had invited Maynard, Karl, and Leon to dinner that evening. He'd have to spend most of the evening in the kitchen, and with three around the table there was bound to be trouble.

"I should have invited Tom," he mused. (Pause)

It started well enough...

## ACT ONE

**Scene One: Academic Scribblers**

*Open onto a professor's dining room as Karl enters. Leon and Maynard are already seated at the table.*

KARL

*(warmly shaking Leon's hand as he rises)*

Leon, I am very sorry that we were not able to meet that summer in 1862 when we vacationed on the same lake in Switzerland. *(Pause, Leon starts to say something but Karl continues)* Perhaps I could have persuaded you that even your modest market socialist reforms could be implemented only by a revolutionary working class.

LEON

Had I known of your interest in mathematics, Karl—may I call you Karl?—I certainly would have looked you up.

MAYNARD

*(suddenly interested)*

You, Karl, interested in math?

LEON

*(cutting in)*

Why surely, Maynard, you know that Karl wrote extensive notes on the calculus and had told his friend Fred in 1873 that one could “infer mathematically ... an important law of crises.”

MAYNARD

Sorry, Leon, but that was exactly 10 years before I was born.

KARL

*(quietly)*

...and I died.

MAYNARD

*(having not heard Karl's comment)*

But it does suggest a way that we can avoid the usual polemics when liberals, market socialists, and revolutionaries perchance meet: we can restrict ourselves to mathematical statements.

*(Pause)* Let's see if we can model the determination of the real wage and the level of employment. *(Pauses again, then with detectable condescension:)* That's what socialists are interested in, right?

*The three set to work.*

KARL

That's a linen napkin you're writing on there, Maynard!

MAYNARD

*(startled)*

You don't write on your napkins here?

NARRATOR

It was Sam's grandmother's fancy napkin, but he realized he could now sell it on eBay for a bundle.

*Sam enters with a stack of paper napkins.*

SAM

These are left over from one of Eve's birthday parties; don't mind the balloons. *(Suddenly)* You haven't even touched the crackers and cheese!

*He refills their glasses. Maynard, Leon, and Karl do not look up from their work. The silence continues.*

SAM:

*(to himself)*

Academic scribblers.

*Sam exits. After a long while, one by one, Maynard, Leon, and Karl eventually put aside their pens, and when they do, each smiles a bit.*

LEON

*(with a twinkle in his eye)*

You're the youngster, Maynard. You go first.

MAYNARD

Not at all, Leon. Karl has been around a lot longer than either of us, and he should give us his thoughts.

**Scene Two: Karl's Napkin**

KARL

You all remember my reserve army of the unemployed?

*Maynard and Leon both nod.*

KARL

*(continues)*

Well, since I passed on there are some fancy new models of this; the most famous one—"Unemployment as a worker discipline device"—was written by two guys who had never even *heard* of the reserve army; they thought it was something like ROTC or the national guard. *(Pause)* But who cares? It tickles me to think that after a century of economics following your lead, Leon, the term "worker discipline" has crept back in.

*The tension in the room builds, but Karl continues.*

KARL

*(continues)*

Leon, does that tell you something about your idea that you could eliminate people entirely from your models and as you once wrote: "simply consider the productive services as being, in a certain sense, exchanged directly for one another?"

LEON

Karl, we both have read Shapiro and Stiglitz, so you can skip the commentary... *(Pause)* ...I mean, details.

KARL

*(unfazed)*

These models are based on the fact that while a worker's time is something that can be contracted for, *her* effort is not.

LEON

*(ironically)*

Excellent use of the feminine pronoun, Karl.

MAYNARD

*(with equal sarcasm)*

Yes, *bravo*.

KARL

*(appearing not to notice the others' comments)*

That's where the "worker discipline" comes in; and the threat of unemployment does the job.

LEON

We understand your idea, Karl, let's see your equation.

KARL

*Effort... (he beams particularly brightly as he says the word)*  
...is determined by workers in response to the incentives and sanctions devised by the employer. These include monitoring and the threat of job termination if the worker is observed shirking.

LEON

Wait just a minute, Karl. Since when does a worker who refuses to work at the breakneck speed demanded by his—OK, her—employer get to be called a shirker?

KARL

It's just a word. (*Gaining momentum:*) The worker's effort choice depends on the present value of having the job, so it varies positively with her wage and inversely with her fallback position.

LEON

When did you learn to talk like that, Karl?

MAYNARD

Fallback position?

KARL

Yes, that's a new one, too, Maynard; it comes from game theory, something those Princeton boys figured out right after World War II, when you were reorganizing the world financial system and, it seems, not reading any economics.

*Maynard manages to keep quiet...*

KARL

There's a lot of evidence for this model. It was taken up by Bob Sutcliffe and Andrew Glyn and Jim Crotty and Raford Boddy.

*Leon looks at his watch.*

KARL

*(continues)*

Later Tom Weisskopf and his friends used it to show that periods of high employment are associated with a profit squeeze and a productivity slowdown. *(Beaming)* They named it after me, the “Marx effect,” and the Brookings Institution even published it.

*Leon and Maynard smile too.*

KARL

*(continues)*

Tom and his *Freunde* also showed that the labor discipline model predicts empirical movements in real wages just as in my figure.

MAYNARD

*(Sarcastically)*

Don’t keep us in suspense.

*Karl holds up his napkin.*

MAYNARD & LEON

*(together)*

Very nice.

KARL

Just in case anyone failed to get the point, I’ve added two arrows indicating how the wage would change for states not on my “reserve army locus.” *(He smiles.)* The juxtaposition of the archaic and modern terminology amuses me.

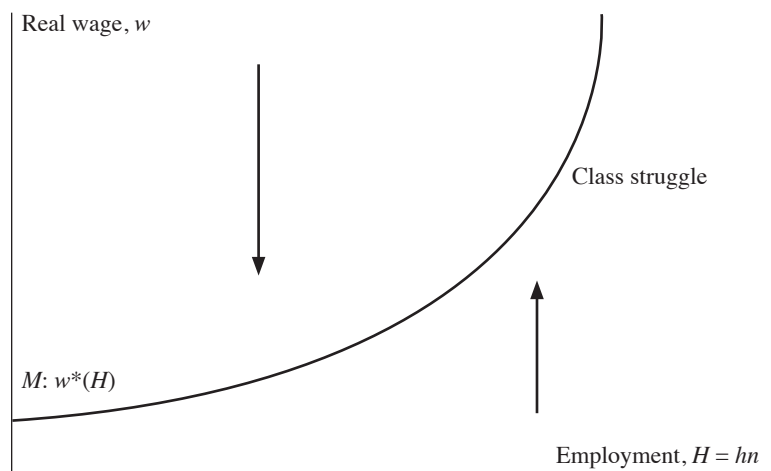
NARRATOR

Nobody had said a word about how good the chicken had tasted, but Sam didn’t really expect them to notice. He brought in some dessert.

LEON

Okay, Karl. I’ll go next.

Figure 1.1 Karl's napkin: class struggle



Notes: The letter  $h$  is the number of workers hired per firm and  $n$  is the number of firms. The arrows indicate changes in wages that firms adopt when the Marx (class struggle) function:  $w^*(H)$  is not satisfied.

KARL

One more thing about my picture, before you start, Leon. Given  $b$ , the level of the unemployment benefit, any point in  $w, H$  space determines how hard the worker is working.

### Scene Three: Leon's Napkin

LEON

I'm glad you added that, Karl, because this solves the remaining problem I was having with my picture.

*Leon is silent for a minute; he is writing another equation.*

LEON

*(continues)*

Ok, *allons-y!* You just said that I can write the worker's effort as

$$e = e(w, H, b)$$

and I'll assume that this determines the level of output per worker.

*The other two frown, Karl whispers something inaudible to Maynard.*

MAYNARD

Doesn't that depend on the technology in use and the capital stock per worker?

LEON

Not in my model. The capital goods per worker is identical for all workers. And just in case anyone is going to worry about relative prices let's say that there is just a single commodity in the economy and it is used for both investment and consumption.

KARL

*(smiling)*

Like corn? *(Aside)* Leon is sounding like David Ricardo.

LEON

*(impatiently)*

Yes, like corn.

LEON

*(continues)*

Well, if we know the wage, the output per worker and the capital stock per worker, then we know the rate of profit on the capital stock that is in use. We'll suppose that capital is mobile so that there tends to be a single common profit rate in the economy.

KARL

*(scowling)*

You're kidnapping my model, Leon.

LEON

I'm just paraphrasing what you wrote in "Equalization of the general rate of profit through competition" in *Capital, Volume III*.

KARL

*(to himself)*

You actually *read* that?!



LEON

So we can write the profit rate as

$$\pi = \pi(w, H, b)$$

where the function is decreasing in all of its arguments.

KARL

It's just my reserve army of the unemployed in action.

LEON

If the profit rate on capital goods in use exceeds the opportunity cost of capital, which I'll call  $\delta$ , then new firms will form, increasing the level of employment. And this will go on until

$$\pi = \delta.$$

I call this equation the zero profit condition.

KARL

*(impatiently)*

What's the take-home message, Leon?

LEON

The take-home message, if you insist on calling it that, is that for a given level of the unemployment insurance benefit ( $b$ ), opportunity cost of capital ( $\delta$ ), and wage ( $w$ ), there is just a single level of employment  $H^*$  such that the number of firms in the economy will be unchanging. So I can write the zero profit condition like this... *(Leon displays his napkin) ...Voila!*

MAYNARD

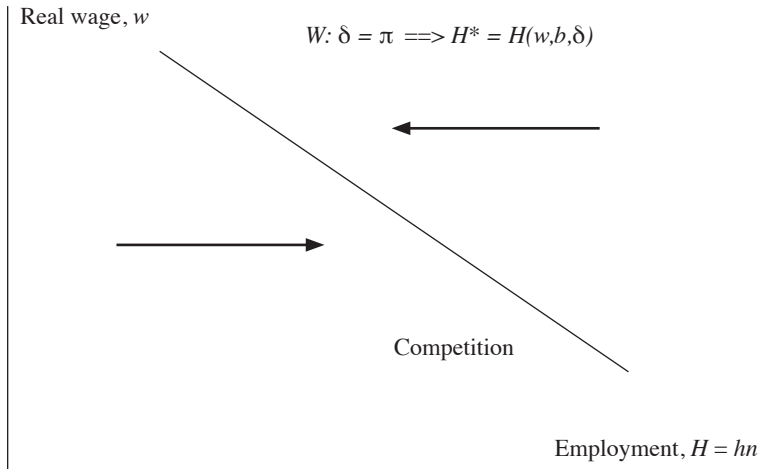
Why don't you put in those little arrows like Karl did so we can know what happens "out of equilibrium," as I'm sure you would put it.

NARRATOR

Leon did, but here the arrows were horizontal rather than vertical because it was  $n$ , and therefore  $H$ , that was adjusting.

*Leon returns to his chair. He looks pleased, which Maynard decidedly does not. He is already on his feet, pacing before the two of them.*

Figure 1.2 Leon's napkin: competition



Notes: As in Figure 1.1,  $h$  is the number of workers hired per firm and  $n$  is the number of firms. The arrows indicate the change in employment resulting from the entry and exit of firm when the Walras (competition) function  $\delta = \pi$  is not satisfied.

### Scene Four: Maynard's Napkin

MAYNARD

You don't have to be an Eton Mathematics Prize-winner to figure out where this is going, and I don't like it.

*Leon looks like he had been physically attacked.*

LEON

Chill, Maynard!

*...but Maynard is not even looking at him.*

MAYNARD

*(continues)*

I'll tell you why. *(staring at Leon)* The next thing you're going to do is to slap your silly zero whatever-you-call-it curve on top of Karl's and think you've solved the problem: two equations in two unknowns.

LEON

*(quietly with a smile and a nod)*

*C'est ca.*

*Maynard is not listening.*

MAYNARD

*(picking up steam)*

You've been eating too many of Sam's brownies, Leon.

*No one laughs.*

MAYNARD

*(continues)*

Okay, let's get back on track. And who's going to buy the goods that are produced?

*Silence.*

MAYNARD

*(continues)*

Karl, are you going to go along with Leon invoking this Say's law crap? You had some pretty harsh things to say about Jean Baptiste when you were alive, called him "mindless" as I recall.

KARL

*(conciliatorily)*

I thought you'd like my part of it, Maynard, it shows why you don't need any wage rigidity or other "market imperfections" to have unemployment.

*Maynard and Leon react in surprise.*

KARL

*(continues)*

And along with Leon's "zero-whatever-it-is" thing we have a general equilibrium with unemployment. *(Aside)* I would point out some problems with Maynard's theory of the labor market, but I have never favorably quoted a University of Chicago economist, and I'm not about to start at this age (which I guess would be 193).

MAYNARD

*(incredulously)*

Let me instruct you boys on some basics. *(Pause; calmer)* I'll try to fit my ideas into the model you've proposed so far. *(Pauses briefly)* I can write the determinants of aggregate demand as functions of the wage and the employment level because that's all I need to know to determine savings, investment, and government borrowing (if I assume that that's how the unemployment benefit is financed).

KARL

How does this fit into what Leon and I have done?

MAYNARD

Well, that's what I'm getting at, Karl: it doesn't. You'll see. In order for total supply to equal total demand, intended savings—that's just profits minus government borrowing—must be equal to intended investment. I write this as:

$$s - g = i.$$

How it connects to your graphs is that each of these terms can be written as a function of the real wage and the level of employment.

LEON

What do you get when you do that?

*Maynard holds up his napkin. He has already added the little arrows showing what happens when there is excess demand.*

LEON

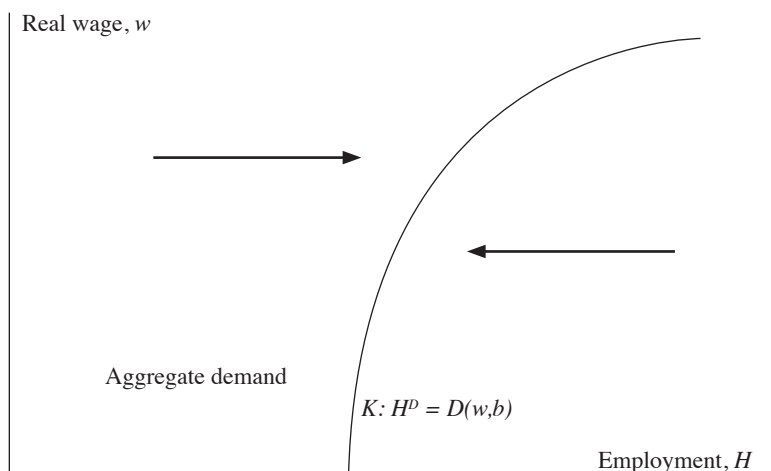
*(working out the logic of Maynard's picture on his napkin)*

I see that your function has the pleasant implication that higher wages are consistent with greater employment. But depending on the savings and investment functions, it could go the other way, your function could slope downward.

MAYNARD

Right you are, Leon, but when dining with two socialists one has to present ideas in as palatable a way as possible, to avoid disruptive outbursts.

Figure 1.3 Maynard's napkin: aggregate demand



Notes: The arrows indicate the changes in employment due to excess aggregate demand or deficient aggregate demand when the Keynes (aggregate demand) function  $H^D = D(w, b)$  is not satisfied.

LEON  
(smiling)

Very kind.

Karl smiles, too.

NARRATOR

But a cloud of impending doom crept through the open window and hung in the room. They all sensed that things were bound to head South now that everybody's napkins were on the table.

A foreboding silence ensues.

MAYNARD  
(breaking the silence)

What we have here, gentlemen, is an embarrassment of riches. (Aside) I must admit, it's rather generous of me to describe the others' equations as riches, but this is, after all, a dinner party, not the Cambridge Union.

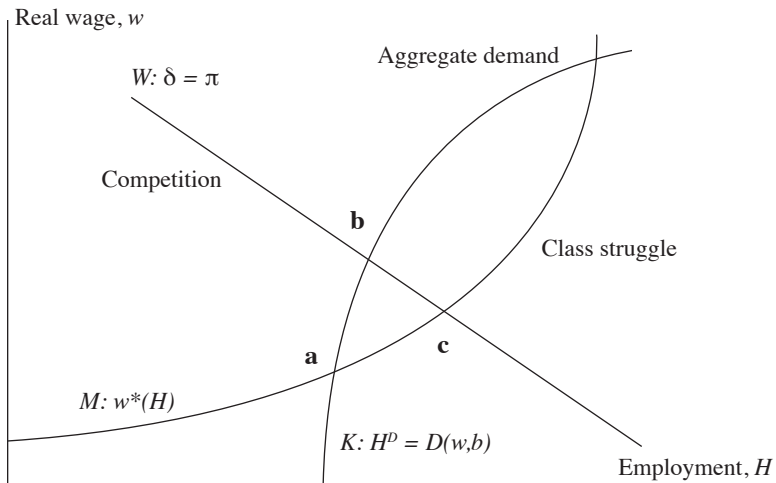
Maynard snatches the three napkins up, places them one on top of the other, and holds them up to the light.

MAYNARD

(pointing at his napkin)

Come round here, gentlemen, and tell me what you see.

Figure 1.4 The impasse



Notes: Over-determination by class struggle (the  $M$  equation), competition ( $W$ ), and aggregate demand ( $K$ ).

### Scene Five: The Impasse

KARL

The system is over-determined.

NARRATOR

Sam, listening behind the kitchen door, wished that his friends Steve Resnick and Rick Wolff could have heard that. It didn't really matter that Karl had not used the word exactly as they do: he had actually *used* the word. But Sam said nothing (*Pause*)

Maynard wrote the letters **a**, **b**, and **c** at the three intersections in the figure; you could tell he was putting on his professorial hat. He placed a hastily scribbled table before the other two.

Table 1.1 Maynard's taxonomy of over-determinations

Intersection	Stationary	Not stationary: reason	Change
<b>a:</b> $M \cap K$	$w, h$	$n$ : because $\pi > \delta$	Firms enter, total employment increases
<b>b:</b> $K \cap W$	$n, h$	$w$ : because $w > w^*$	Wages and effort fall
<b>c:</b> $W \cap M$	$n, w$	$h$ : because $D^e < 0, H^D > H$	Total employment falls

Notes:  $M \cap K$  means that both the Marx and Keynes equations are satisfied (and therefore the Walras equation is not).  $K \cap W$  and  $W \cap M$  are defined analogously. Notation:  $w$  = wages;  $h$  = workers per firm;  $n$  = number of firms;  $\pi$  = profit rate;  $\delta$  = opportunity cost of capital,  $w^*$  = equilibrium wage given by the class struggle function;  $D^e$  = excess demand;  $H$  = total employment; and  $H^D$  = employment level for which  $D^e = 0$ .

## MAYNARD

Here's the bad news. At point **a**, Karl, both your equation and mine are satisfied (that's what  $M \cap K$  means), so wages and the employment level of firms are stationary. But because the profit rate exceeds the opportunity cost of capital, new firms are entering, so  $H$  cannot be stationary. At point **b** total employment is stationary because both the zero profit condition and the zero excess demand condition hold, but workers are receiving more than the wage that maximizes employer profits, so wages must be falling.

## MAYNARD

(continues, resigned)

I won't even bother explaining point **c**; it's the same story.

## LEON

Had we all drawn our functions in different positions, there would be a different set of three intersections. For example, at point **a** it could be that the profit rate falls short of the opportunity cost of capital, so firms would exit rather than enter.

## KARL

This doesn't really change anything.

*Leon and Maynard nod. The room is silent again.*

## NARRATOR

At that point they might have simply taken their leave and gone to bed a little depressed. Sam wasn't happy either, but he was pretty sure this was the best he could hope for. But that's not what happened.

## MAYNARD

One of your equations is going to have to budge. *(To Leon)* Leon, why don't we drop Karl's equation? It's all based on his daft idea that the labor market is special, that labor is not something you can buy on a market, or rent, I guess would be better.

## KARL

What I guess, Maynard, is that you haven't read any micro-economics since you passed on. Incomplete contracts are now standard fare especially for labor market models. They've discovered my distinction between labor and labor power without even knowing it. Stiglitz had never heard of it.

## MAYNARD

*(to Karl)*

Well, Karl, I wouldn't mind if we dropped Leon's equation either... so we could have a model—

## LEON

*(interrupting Maynard)*

—in which the profit rate could remain well below the opportunity cost of capital indefinitely! What planet are you on, Maynard?

## NARRATOR

And that's when the wheels *really* began to fall off the wagon. Leon and Karl reverted to their native tongues so as to be able to draw on a richer array of insults. Sam thinks he heard *cretin*, *Schwachsinniger*, *dummkopf*, and bloody imbecile, but only the last would have meant anything to him.

*Maynard hurls a bun at Karl. Leon, using his fork as a catapult, fires a brownie back at Maynard.*



**Scene Six: The Miracle**

*There is a knock at the door.*

SAM

*(entering from the kitchen)*

A knock on the door! Never good news at this time of night.  
Who? *(He peers offstage.)* Good. Not the neighbors or the cops.  
But what is Tom doing here?

LEON, KARL, & MAYNARD

*(at once)*

Tom?!

TOM

*(surprised)*

Hello, Maynard. Karl. *Bon soir*, Leon. I didn't realize I was interrupting.

LEON

Not at all! Please, join us for *une petite gorgée du vin*.

TOM

*Ah, bon. Avec plaisir.*

SAM

*(he fills their glasses)*

Gentlemen, you'll both have to speak in the local language, please.

NARRATOR

Leon quickly brought Tom up to speed about the impasse.

LEON

Karl, Maynard, have I left anything out?

*Both men shake their heads.*

MAYNARD

*(playfully)*

Tom, I wonder if those clever chaps at MIT might have taught you something that would help us break our impasse.

TOM

*(smiling)*

Not really. But I wouldn't want to speak ill of my former teachers after all these years.

MAYNARD

*(packing his briefcase, including the linen napkin)*

Well, we are very pleased you have joined us.

TOM

But I do have an idea about how you can get your curves—class struggle, aggregate demand, and competition—to work together. *(Pause)* I am the only one here—excepting Sam, who is still hiding in the kitchen—born in a democratic country.

MAYNARD

*(interrupting)*

What are you talking about, Tom? My *grandfather* voted!

TOM

*(continues, without addressing Maynard directly)*

There were property ownership requirements for suffrage in England until Maynard was 35 years old, for example, not to mention women being disenfranchised until even later.

MAYNARD

What does that have to do with our impasse, Tom?

TOM

Everything. Typically when economists face a problem of over-determination like this they think of some market—real or imaginary—that will automatically adjust one or more of your pesky equations so that all three coincide at some point. But, instead, sometimes politics does the adjusting.

*Maynard has returned to his chair at the table. All the men listen to Tom.*

TOM

*(continues)*

Let's think about point *c* on Maynard's napkin about the impasse. Workers are being laid off and unemployment is rising. The public is worried both for the unemployed and about their own jobs. A bill to raise unemployment benefits is quickly passed. What's that going to do?

KARL

It will raise my class struggle function in the figure: the higher fallback position of workers will lead employers to raise wages (for any given level of employment).

*Karl draws the new curve on the impasse napkin. Maynard barely waits for Karl to finish.*

MAYNARD

*(interrupting)*

And the increase in government borrowing (and the consumption of the unemployed that it financed) would shift my aggregate demand function to the right.

*Maynard draws his new curve, placing it exactly where the process of adjustment to the increase in unemployment benefit would come to a halt because the three functions coincided.*

MAYNARD

*(continues)*

And that takes care of our over-determination problem.

LEON

*Voilà!*

*The three elders smile, nodding. They resume cheery conversations with each another, happy to put an end to the arguing. One hears the sound of clinking glasses. Tom sips his wine. Leon looks at his watch.*

LEON

It's getting late... *Au revoir*, Sam!

KARL

*Tschüss*, Tom!

MAYNARD

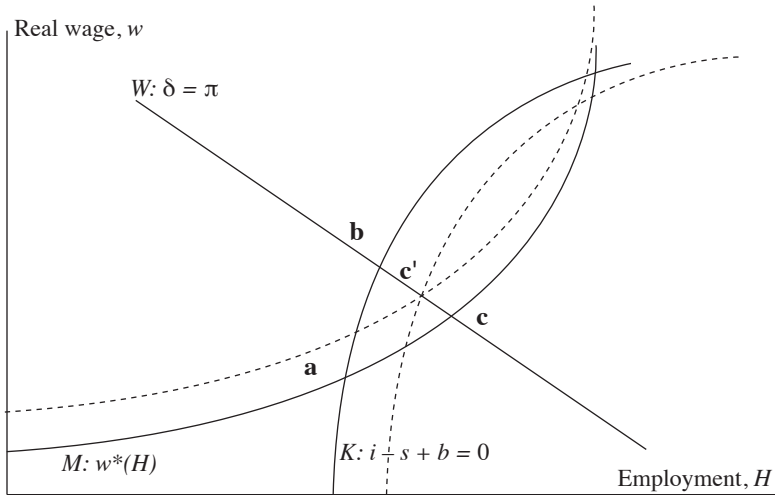
Good evening, friends.

LEON

Oh! The chicken was *delicieux*. *Au revoir!*

*Sam shuts the door behind his guests and faces Tom.*

Figure 1.5 Tom's solution



Notes: As employment falls (from point c) workers demand greater unemployment benefits, increasing workers' bargaining power and raising aggregate demand. The dashed lines indicate the upward shift in the class struggle function and the increase in aggregate demand due to the increase in unemployment benefits. The new (not over-determined) outcome is c'.

### Scene Seven: Post Mortem

SAM

Well, what do you think about my guests?

TOM

A convivial bunch.

*Sam rolls his eyes.*

SAM

If only you knew what had been going on when you knocked on the door. *(Pause)* There's something else, Tom. *(Long pause)* If it was so easy for you to figure this out, why did we adopt such a limited model in our papers and books with David?

*Both pause and remain a few moments in silence.*

SAM

*(continues)*

We basically took a Marxian system of production and wage determination as the supply side of our model and married that to a classical profit-driven investment system for the demand side.

TOM

Not quite. We did not think aggregate demand was unimportant, but rather we had the view that the position of Maynard's excess demand equation was a political football.

SAM

Football?

TOM

When profits are falling, due to what employers considered to be "excessive labor demand," fiscal and monetary authorities would be pressed to restrict aggregate demand so as to restore a more employer-friendly labor market situation.

SAM

You're right, Tom—that was our story about the productivity slowdown, profit squeeze, and policy reaction in the late 1960s and 1970s.

TOM

*(smiling)*

It fits perfectly with the model these three guys put together this evening.

SAM

*(skeptically)*

It does?

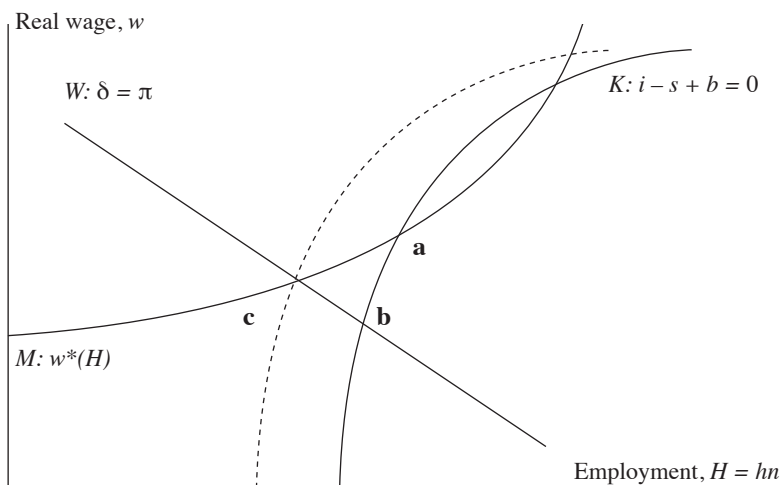
TOM

*(continues, looking around)*

Have we used up all the napkins yet?

*Sam gives Tom the last napkin, and Tom scribbles.*

Figure 1.6 Tom's version of the model in his joint works with Sam and David



Notes: Capital responds to the high employment profit squeeze (point a) by restricting aggregate demand, and establishing a new (not over-determined) outcome at c with lower wages, higher profits and lower employment.

TOM  
(continues)

Have a look at this.

Tom turns it around towards Sam.

TOM  
(continues)

Point a, as before, is a case where the class struggle and aggregate demand functions are satisfied but the zero profit condition is not, but now profits are less than the opportunity cost of capital, so firms are leaving. What happens? Employers press for more restrictive macroeconomic policy to put some teeth back into the threat of unemployment, shifting the aggregate function to the left and restoring a three-way coincidence of the functions.

SAM

And the result would be a restoration of the profit rate brought about by a fall in wages and employment.

TOM

We even estimated functions representing the fiscal response to the declining cost of getting sacked. Just like Glyn and Sutcliffe and Crotty and Boddy.

SAM

...just like Crotty and Boddy and Glyn and Sutcliffe. *(Pause)* One more thing, Tom, before you go? *(Again, pauses)* After David passed away, you stopped working on these things and moved on to study the transition economies and affirmative action.

TOM

*(interrupting)*

...and *you* drifted off into the economics and biology of human cooperation.

SAM

Are you ever sorry you moved on?

TOM

*(pauses, thinking)*

No.

SAM

And about tonight, Tom? Maybe I was wrong about three's a crowd. Perhaps what goes for kids doesn't go for economics. It really would have been less fun if it had been two rather than three—only Karl and Leon, or Leon and Maynard, or Maynard and Karl. It would have been too easy for them to agree. And you would have just been another guest sipping wine around the table.

TOM

*(muses for some time)*

Three really worked for us, Sam.

SAM

*(looks at his watch)*

Thanks for coming by, Tom, you worked a miracle.

TOM

Don't be ridiculous. Good night!

SAM

Good night, Tom!

The end

## NOTES

1. Thanks to Tess Lerner Byars for assistance in the playwright's debut.
2. Historical note: This play was first performed at the Political Economy Research Institute at the University of Massachusetts on September 30, 2011 as the opening of the commemoration of the life and work of Tom Weisskopf, with the roles played by the following: Marx (Herbert Gintis); Keynes (Gerald Epstein); Walras (Nancy Folbre); with the author and the Feste playing their own parts. Arthur MacEwan narrated. Film rights have not yet been sold.

## SOURCE NOTES

*vacationed on the same lake in Switzerland.* The playwright recalls that in his youth Wm Jaffe (Leon's biographer) mentioned this to him, but it may not have really happened.

*infer mathematically ... an important law of crises.* Marx (1983).

*"Unemployment as a worker discipline device"* Shapiro and Stiglitz (1984).

*"simply consider the productive services as being, in a certain sense, exchanged directly for one another"* Walras (1954 [1874]), p.71.

*taken up by* Glyn and Sutcliffe (1972); Crotty and Boddy (1975).

*a series of papers showing that periods of high employment are associated with a profit squeeze and productivity slowdown.* Most of them collected in Bowles and Weisskopf (1998).

*predicts ... movements in ... wages* Bowles (1991). See also Blanchflower and Oswald (1994).

*any point in w, H space determines how hard the worker is working.* Bowles and Boyer (1988).

*"Let me instruct you both on some basics."* Maynard's model is from Bowles and Boyer (1995; 1990; 1988).

*slap your silly zero whatever-you-call-it curve on top of Karl's and think you've solved the problem* As is done in Bowles (2004).

*requirements for suffrage in England* Therborn (1977).

*our papers and books with David [Gordon]* Bowles, Gordon, and Weisskopf (1983b; 1983a; 1989); and Bowles and Weisskopf (1998).

*estimated fiscal response functions to the declining cost of getting sacked* Bowles, Gordon, and Weisskopf (1983a).

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## 2. Theses on Weisskopf

**Robert Pollin<sup>1</sup>**

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The following ten theses are the result of reflections regarding Tom Weisskopf's extraordinary body of work in economics over the past 40 years.

### **1. Karl Marx's 11th thesis on Feuerbach is wrong.**

In 1845, Marx famously concluded his *Theses on Feuerbach* by declaring that "The philosophers have only interpreted the world in various ways; the point is to change it." Since this statement was first published by Engels in 1886, it has given inspiration to all kinds of people committed to the political left—that is, to people who embrace the ideals of egalitarianism and democracy and are ready to fight for these ideals in the trenches of real-world politics.

Generations of leftist scholars, conducting research in a wide variety of fields, constitute a significant share of the people inspired by Marx's 11th thesis on Feuerbach. This is despite the fact that most leftist scholars devote the bulk of their working lives to the task of interpreting the world in various ways, whether or not they succeed in changing it. I would include Tom Weisskopf and Karl Marx himself as among the leftist scholars who have devoted most of their working lives to interpreting the world, as opposed to being directly engaged in changing it. Few, if any, scholars have done more to change the world than Marx, in both good and some bad, if unintended, ways. But the only reason that Marx has exerted a profound influence on changing the world is that his voluminous works of interpreting the world were themselves profound.

Thus, if one has any aspiration to change the world for the better, one needs to work from a solid foundation of ideas and knowledge. The projects of interpreting the world and changing it for the better are inextricably bound.

### **2. Radical economics is a great endeavor with an outmoded name.**

In a 1971 article in the Indian journal *Economic and Political Weekly* titled "The growth of radical economics in the US," Tom Weisskopf wrote:

The radical wants to understand better why poverty, racism and sexism persist in the United States, why American troops and bombs continue to be sent to distant lands to wreak havoc on innocent people, why the natural environment is destroyed in the name of progress, why increasing wealth does not appear to lead to greater human welfare but only to a heightened sense of alienation on the job, in the community and at home. The radical suspects that these problems are in fact deeply rooted in the basic institutions of American capitalism. To understand and to combat these problems, the radical requires an analysis of the fundamental nature, structure and dynamics of that society. (1971, p. 2015)

Reflecting on Weisskopf's observation 40 years later, I am struck by how little one needs to change about this statement in terms of defining the radical economics project. The world has certainly changed over the past 40 years, in some ways for the better. Racism and sexism have diminished somewhat, relative to 1971, though they persist as fundamental problems. The official US poverty rate as of this writing, at 15.1 percent, is now fully 3 percentage points higher than in 1971. Forty-six million US residents now live below the official poverty line, the highest figure since such statistics began being collected. In 2007, just prior to the onset of the economic crisis, the share of income going to the richest 1 percent of households reached its highest point since 1928. The US is still dropping bombs on innocent people and still destroying the environment. We should take little solace from the fact that fewer innocent people have died in Iraq and Afghanistan than in Vietnam, and that the environment is now being despoiled at a slower rate than it was in 1971.

The need for a radical economic and social transformation to overcome these problems is just as urgent now as it was in 1971. Moreover, all of these problems result, to a major extent, from the operations of capitalism in the United States, though they are certainly not entirely economic in nature. To the extent that they are economic problems, I think it is fair to say there is little hope of overcoming them in the absence of a body of research that grapples with them from the perspective of radical economics. That is, if we want to change the world for the better, a necessary but insufficient condition for achieving likely success is that radical economists do their job well.

But what does it mean for radical economists to do their job well? The first thing that needs sorting out is the relationship between political commitment, ideology, and research standards. That is, while a vision of social and economic injustice under capitalism certainly compels radical economists into undertaking research projects in the first place, the only way to make that research persuasive and effective for changing the world is to ground it firmly within rigorous research methods. Joseph Schumpeter (1954) explored insightfully this relationship between analysis and what he termed "pre-analytic vision," writing that "Analytic work begins with material provided by our vision of things, and this vision is ideological almost by definition. It embodies the picture of things as we see them, and whenever there is any possible motive for wishing to see them in

a given rather than another light, the way in which we see things can hardly be distinguished from the way in which we wish to see them.” But then Schumpeter also emphasizes that “We also observe that the rules of procedure that we apply in our analytic work are almost as much exempt from ideological influence as vision is subject to it ... They tend to crush out ideologically conditioned error from the visions from which we start” (1954, pp. 42–3).

In fact, Schumpeter placed excessive faith in the capacity of scientific procedures to overcome ideology in determining what research will receive the scientific seal of approval from the professional mainstream. Consider just the core area of “rational expectations” macroeconomics, which has been at the heart of professional economics work for a generation. This research literature offered sweeping claims about the self-regulating capacity of markets and the inevitable ineptitude of government interventions to promote full employment. But this was without having bothered to develop, just for starters, anything remotely resembling serious research on how real-life humans actually form expectations, rational or otherwise.<sup>2</sup> Nevertheless, Schumpeter’s broader point still holds. To do their job well, radical economists will of course need to remain motivated by their visions of both just and unjust social structures and outcomes. At the same time, the most effective way to live by these commitments through their research is to embrace as much as possible, as Schumpeter put it, rules of procedure that are exempt from ideological influence.

What about the name “radical economics?” It was a good fit in the late 1960s when the Union for Radical Political Economics (URPE) was founded by Tom Weisskopf and others, since the precise meaning of the word “radical” connotes getting to the root of something. But more recently the term has been commonly used to describe various types of extremists, including those of the “radical right.” The terms “progressive” and “heterodox” have emerged in places as substitutes. But “heterodox” implies no political orientation, while “progressive” is more descriptive of policy conclusions rather than research commitments. Many members of the radical economics community do self-describe as “Marxist economists.” But I find it hard to think of Tom Weisskopf, for instance, as strictly a Marxist, since he clearly has learned a lot from Marx but just as much from other authors. We have a similar problem with Karl Marx himself, who openly declared that “I am not a Marxist” precisely to fight against people using his work dogmatically. I do not have a solution, other than to suggest we just proceed with our work, look out for new possibilities, and do not worry about it too much otherwise. As William Shakespeare observed, “a rose by any other name would smell as sweet.”

### **3. One major reason why radical economics is a great endeavor is that Tom Weisskopf has been contributing to it for more than 40 years.**

Tom Weisskopf has been a central contributor to radical economics, first of all, by his very early explorations that articulated forcefully what the radical economics project was all about. He has also written textbooks as well as edited collections of papers that made this approach accessible to students throughout the world. But important as this work has been, Weisskopf's most significant contributions have been through his research work, addressing four fundamental sets of issues:

- A) *Third world development and first world—especially US—imperialism.* Before he became committed to a radical economic agenda, Weisskopf's early work was in development. He soon came to believe that the overarching barrier preventing development was US imperialism. He thus was among the first to synthesize a radical perspective on third world development with an economic critique of US imperialism.
- B) *Neo-Marxian crisis theory and Social Structures of Accumulation analysis.* There have been many contributors to Marxian crisis theory over the past 150 years, including Rosa Luxemburg, Michal Kalecki, and more recently Paul Sweezy, Glyn and Sutcliffe, Boddy and Crotty, John Roemer, and Anwar Shaikh. What set Weisskopf apart from this eminent group was that he established a new level of clarity and discipline in the literature through his highly original formal modeling and empirical methods. Having accomplished this, Weisskopf then joined with Sam Bowles and David Gordon to advance the Social Structures of Accumulation (SSA) mode of analysis. This anchored the neo-Marxian approach closer to the ground by taking history and institutions seriously.
- C) *Democratic market socialism.* The overwhelming global response to the fall of the Berlin Wall and the collapse of the Soviet Union in 1989 was to declare socialism dead. But there were also many on the left who saw this moment as a vindication of their longstanding critiques of Soviet-style socialism and an historic opportunity to renew the project of creating democratic egalitarian societies—that is, the only types of societies that deserve to be called “socialist.” Tom Weisskopf almost immediately became a leading contributor to this project of, as he himself put it in the title for one of his papers, exploring “Towards a Socialism for the Future in the Wake of the Demise of the Socialism of the Past” (1992). His approach was to begin a new set of explorations around the concept of market socialism. This is an economy in which, for the most part, prices are set and resources are allocated by business firms engaged in competitive market activities. What distinguishes a market socialist economy as *socialist* is that there are limits on the levels of private ownership of businesses. After 1989, Weisskopf saw market socialism

as offering the prospect of a relatively gentle incremental adjustment out of Eastern Europe's Communist administrative command system, as opposed to the "shock therapy" approach of embracing raw capitalism without any institutional framework to support such a system.

- D) *Affirmative action*. Debates around affirmative action policies—or what Tom Weisskopf calls "positive discrimination" measures in his extensive writings on this topic since the early 2000s—have long been highly charged, and for good reason. On the one hand, such policies aim to attack patterns of racism that have marginalized and brutalized members of ethnically disadvantaged groups for centuries. On the other hand, the approach to redressing such historic and ongoing crimes is to discriminate in favor of disadvantaged groups, in areas such as university admissions standards and job opportunities, relative to members of ethnically advantaged groups, even if the particular members of the advantaged ethnic groups who now face reverse discrimination have not themselves personally received advantages.

Weisskopf's involvement with this issue emerged out of debates taking place at his own longtime workplace, the campus of the University of Michigan, in particular around admissions policies for the law school. Through participating in the debates at Ann Arbor, Weisskopf found that the body of high-quality scholarship on this topic that moved beyond broad philosophical principles was limited. Thus, similar to his initial engagement with Marxian crisis theory, Weisskopf pursued the task of reformulating the broad principles being debated into a series of sharply specified questions. In addition, he examined the question on a comparative basis, considering positive discrimination policies in both the United States and India, where they have been practiced since the early 1950s. This comparative approach helped to further break down the broad philosophical issues into specific questions facing distinct societies in different historical circumstances.

**4. You will learn by studying Weisskopf, whether you agree with him or not.**

This will become evident in what follows.

**5. Many underdeveloped countries of the 1960s could and did grow under capitalism and US imperialism, but Weisskopf was still more right than wrong.**

In a 1973 article focused on India, Weisskopf concluded that:

In the absence of a revolutionary transformation of the domestic class structure, an ex-colonial underdeveloped country faces a choice between economic stagnation or

economic dependence on the major capitalist powers. The latter course opens the country to Western imperialist influence, which in turn reinforces the dependency relationship by strengthening those domestic classes most interested in a Western-oriented capitalist path of economic growth. Thus, dependence and imperialism are closely woven together in the fabric of international capitalism. (1973, p. 75)

With the benefit of 40 years of hindsight, we now know that, starting with South Korea, Taiwan, Hong Kong, and Singapore, the original Asian Tiger economies, many developing countries, including Brazil along with other Asian countries, have grown at generally healthy rates within a global economy that is decidedly capitalist and dominated politically by US imperialism. Average living standards in the original Asian Tiger countries are now roughly on par with or higher than those in Greece, Portugal, and Eastern Europe, and the gap will almost certainly be growing as the Great Recession continues to batter Europe but not Asia. More recently, China and India—the two most populous countries in the world—have also experienced dramatic advances in economic growth, and have also been mainly sheltered from the worst effects of the global crisis, all while participating expansively in the global capitalist economy.

It is therefore clear that Weisskopf's writings in the early 1970s, along with those of many other leading leftist economists of that period such as Paul Baran and Andre Gunder Frank, were wrong about a key aspect of dependency theory—that underdeveloped countries would not be able to sustain a solid growth trajectory as long as they were closely aligned with global capitalism and US imperialism. Moreover, it is undeniable that one of the primary engines of sustained growth for these countries was success in global export markets—that is, through becoming increasingly integrated in the global economy as opposed to insulating themselves from global market competition.

But there are important areas in which the perspectives advanced by Weisskopf and others still hold firm. The first is that the growth in these countries was certainly not achieved through following a free market capitalist model. It was rather a result of extensive levels of economic planning and industrial policies. These policy interventions included heavily subsidizing technology transfers and manufacturing investments, supporting firms that were succeeding as exporters, and maintaining tight control over their financial systems.<sup>3</sup>

All such initiatives were well encapsulated in Amsden's phrase, "getting prices wrong." Amsden (2001) meant by this that if producers in less developed economies could not succeed as competitors at existing global market prices, they should not then simply surrender a potential market opportunity because the orthodox theory of comparative advantage would endorse such a course of action. The role of government policy was rather to support and cajole private businesses as well as mixed public-private firms, through subsidies, infrastructure investments, and other measures, to produce at higher quality and lower costs, so they could deliver acceptable products at lower prices. The lesson is

that the real barrier to economic growth was never capitalism per se, or even US imperialism per se, but rather neoliberal capitalism. Neoliberal policies applied to less developed countries included the proposition that underdeveloped countries would grow on the basis of “getting prices right”—that is, through countries discovering their particular niche in the global comparative advantage hierarchy as established by the bracing regimen of free trade, unsubsidized domestic enterprises, free flows of foreign direct investment and finance capital, and unregulated domestic financial markets.

Weisskopf also was right in 1973 when he posed the question, with India specifically in mind, that even if the obstacles to growth imposed by capitalism and US imperialism could be overcome, “what kind of growth does capitalism offer a country like India?” Weisskopf argued that unbridled capitalist growth in India would produce: (1) mass unemployment, as farmers are forced to leave agriculture but are unable to find adequate job opportunities in either manufacturing or services; (2) ever-widening inequalities of income and wealth, due to the rise in unemployment along with the growing gains for society’s privileged strata; and (3) a breakdown of traditional norms and institutions of community and solidarity, without adequate alternative forms of social protection emerging as substitutes.

What Weisskopf described in 1973 is indeed the broad pattern of social development that both China and India have experienced during their high-growth era. Yet, as an important contrast, South Korea and Taiwan implemented measures capable of preventing excesses of inequality accompanying their own growth experience. The key factors here were land reform, extensive pension systems supported by public policy, widespread access to decent-quality public education, as well as long-term employment contracts for those with jobs, with wage increases generally linked to productivity gains. At the same time, it is important to recognize that these policies were implemented alongside generally repressive policies toward labor unions and weak, and often non-existent, commitments to democratic institutions and practices. As such, the political dynamics pushing these models forward, including the cross-currents and pressures created by the Cold War, were fraught with contradictions.<sup>4</sup> In terms of developing a sustainable growth trajectory for China and India, the biggest single challenge is to enable wages to rise and incomes to equalize, which in turn will provide a strong undergirding to the growth of domestic markets—that is, to establish a wage-led growth model not unlike that which Weisskopf and his co-authors proposed for the United States in the 1980s.



## 6. There is no such thing as an economic crisis independent of a financial crisis.

Weisskopf's initial major contributions to understanding economic crises were his work modeling alternative sources of profitability decline within the post-World War II US economy (1979). From that strong foundation, he then moved into a much more institutional and historical approach, working frequently on this with Sam Bowles and David Gordon, sometimes with other collaborators, as well as on his own (for example, Bowles, Gordon, and Weisskopf, 1984, 1986, 1991).

Examining these historical and institutional questions was a major step forward in bringing the debates that had been structured around Marx's analytic framework much closer to the day-to-day realities of US economic life. This expanded research agenda yielded important new perspectives on the dynamics of capital-labor relations, the economic effects of US dominance in the global economy, and the rise of citizen movements, such as the environmental movement, which were capable of constraining corporate profitability by increasing business regulations. Weisskopf's collaborator David Gordon introduced the term Social Structures of Accumulation (SSA) to describe this analytic approach.

Despite the substantial contributions that emerged from this work, it was also true that Weisskopf and his collaborators overlooked a fundamental feature of the overall historical and institutional landscape. This was the role of financial markets and institutions. Of course, looking backward, it is easy to see this gap in Weisskopf's work in the aftermath of the 2008–2009 financial crisis and Great Recession. Such neglect of financial issues was also prevalent among radical economists in the 1970s and 1980s. Nevertheless, in terms of understanding the causes of profitability decline, as well as the sources of instability and crisis, there are at least five major reasons why it is necessary to incorporate the financial system into the analysis of economic crises. These are as follows:

- A) If a first task with crisis theory is to understand the movements of the aggregate profit rate, one needs to be able to explain the sources of profits flowing to financial institutions. Marx, for one, defined his circuit of money capital— $M \rightarrow M'$ —in which profits appear to be generated through mere trading. This is in contrast with the circuit of productive capital— $M \rightarrow C \rightarrow (MP + LP) \rightarrow C' \rightarrow M'$ . With the circuit of productive capital, we see clearly how surplus value is generated through exploiting labor in the production process. Does the  $M \rightarrow M'$  circuit merely represent one capitalist extracting a capital gain at the expense of other capitalists? Or is the  $M \rightarrow M'$  circuit simply the most visible top layer of a set of structural changes occurring within the productive circuit of the economy? Operating strictly at

- a theoretical level for the moment, one cannot explain the movements of the aggregate profit rate without giving at least some attention to these issues.<sup>5</sup>
- B) In terms of measuring profitability empirically, we of course need to settle on how exactly we are defining profits before proceeding further with the analysis of observed trends. Marx's own definition usefully divides overall profits into two components: (1) the profits that are generated within productive non-financial enterprises and retained there, that Marx called "enterprise profits"; and (2) those profits that are generated at the level of productive enterprises, but get siphoned away from non-financial firms and into the banks' coffers as interest payments. Once we recognize this distinction between enterprise profits and interest payments, it then becomes clear that the observed fall in enterprise profits could be occurring simply because financial capitalists are getting a growing share of overall profits, with non-financial enterprises correspondingly receiving a smaller share. Before we can consider sources of aggregate profitability decline, we do have to be clear about how much this diversion of total profits into interest payments is affecting the trend for enterprise profits.<sup>6</sup>
- C) Financial bubbles—in which over-optimistic assessments of new profit opportunities lead to large-scale over-leveraging and persistently rising asset prices—have been endemic throughout the history of capitalism. "Hardy perennials" was the term Charles Kindleberger used in his classic 1978 book, *Manias, Panics and Crashes*, which developed historical perspectives on crises derived from Hyman Minsky's theoretical framework. Given this historical experience, it is simply not possible to tell a full story about the history and institutions associated with economic crises, broadly understood, if one neglects the role of financial history and institutions. This is true regardless of how one might see causation running between financial and non-financial factors in explaining the emergence and trajectory of crises.
- D) In terms of causal forces in generating crises, there is also at least one critical issue to raise in exploring the nexus between financial and non-financial forces. That is, considered on its own, there is no reason to assume that a decline in the average aggregate rate of profit will cause an economic crisis as opposed to inducing only a slower rate of balanced growth. Building from discussions in Marx, Crotty explored this point in a 1985 paper. Crotty argued that what transforms a decline in average profitability into a crisis is that a chain of financial commitments has gotten formed based on assumptions that the rate of profit will remain at the high levels that had emerged during the bubble. If actual profit flows become significantly lower than those prevailing during the upswing, this then makes the economy increasingly vulnerable to the effects of defaults at any point along this full chain of financial commitments. This is how an incremental fall in the average profit rate can lead to a full-scale economic crisis.

E) We cannot understand the resolution of crises unless we take seriously financial bailouts as a policy tool. Considering just the United States experience, the massive bailouts in 2008–2009 engineered through both the US Treasury and Federal Reserve were widely derided. But in fact, without such bailouts, both the US and global economies would have experienced a far more severe crisis than the one that resulted—which has been, of course, quite serious enough. The 2008–2009 bailouts were also no aberration from past recent experiences. Bailouts have rather been the most important policy interventions in dealing with the 1987 Wall Street crash, the 1989–90 Savings and Loans collapse, the 1997–98 Asian crisis and collapse of Long-Term Capital Management, as well as the bursting of the dot.com bubble in 2001.<sup>7</sup>

A broader analytic issue also comes into play here. If such bailouts had not occurred, and thus if the consequences of economic crises had been significantly more severe than they actually ended up being, this would likely have exerted some significant influence over public opinion as to the stability, sustainability, and desirability of capitalism. Certainly the average person, but perhaps even policymakers, and maybe even a few mainstream economists, would have been more likely to put capitalism as a system on trial. Seen from the another angle, precisely because the bailouts have worked basically as intended, they have allowed the majority of mainstream economists, policymakers and the population in general to avoid asking hard questions about the stability of capitalism as a system.

## **7. The best empirical tests are almost always the simplest ones.**

Weisskopf's 1979 article in the *Cambridge Journal of Economics* was a masterpiece of empirical economics, probably the first one that came directly out of the radical economics literature. It was the first effort to use empirical modeling to systematically compare alternative Marxian explanations for the decline in profitability of US corporations that began in the mid-1960s relative to the previous 20 years after World War II. There had certainly been many prior efforts at utilizing Marx's three distinct explanations for the decline in profitability—that is, the rise in the profit share for labor income relative to capital income (the profit squeeze approach); a weakening of market demand relative to the economy's productive capacity (underconsumptionism); and the rise in investment in plant and equipment relative to the profits that could be generated by this capital stock expansion (rising organic composition of capital). There had also been some valuable previous efforts to empirically examine the factors behind the profitability decline, both in the US and elsewhere. But Weisskopf's paper was pathbreaking because it provided the first framework through which

one could directly compare the empirical strengths of each of the alternative approaches against one another.

The single most compelling feature of Weisskopf's approach in this paper was its clarity and simplicity. In his effort to accurately encapsulate, as he put it, "the extensive Marxian literature on capitalist crises," Weisskopf introduced an equation for the aggregate rate of profit, which he then decomposed into three component ratios. Each of the three ratios captured some essential features—though certainly not all features—of each of the Marxian approaches.

Weisskopf's equation for the rate of profit was as follows:

$$\rho = (\Pi/K) \times (Y/Z) \times (Z/K)$$

where  $\Pi$  measures the volume of profits;  $K$  measures the capital stock;  $Y$  measures the actual output (or income); and  $Z$  measures potential output (or capacity). Thus, the aggregate rate of profit in this equation is definitionally equal to the product of the share of profits in income, the rate of capacity utilization, and the capacity/capital ratio. As Weisskopf put it, "Each of the three variants of Marxian crisis theory can be shown to focus on different elements in [this equation] as the initial source of decline in the rate of profit" (1979, p. 342). Within this simple framework, the paper explores in considerable depth each of the three explanations for profitability decline, including through further decompositions, as these became useful for expanding on his arguments.

One could certainly raise issues with Weisskopf's approach, and many people did so. One issue was whether one could accurately capture the main features of the Marxian arguments through relying on conventional data categories compiled within the national income accounts. Another issue, more serious in my view, was that the decomposition exercise was not capable of measuring potential causal and interactive relationships between these different effects as they unfolded over time. For example, a long-term trend stagnation in the growth of market demand, even if modest on a year-to-year basis, could be capable of establishing a ceiling for how high the profit share could rise at any given time. This could be true even while in terms of time sequencing and annual data that we observe, the decline in the profit share could dominate over the annual decline in the rate of capacity utilization within the overall movement in the profit rate. But regardless of such specific issues, Weisskopf's model succeeded in reshaping the terms of the debate and the methods for addressing the issues in an empirically rigorous way.

One measure of the strength of Weisskopf's simple modeling approach here is to compare it with the subsequent work he did on the profitability question and economic crisis in the series of publications with Sam Bowles and David Gordon (see for example 1984, 1986, 1991). This later work certainly enriched

the literature by incorporating sharply-observed historical and institutional perspectives into an explanation of the long-term profitability decline in the United States beginning in the late 1960s. This later work did also make extensive use of formal empirical methods. But, in my view, the formal features of this later work were less effective than in Weisskopf's original 1979 paper, in large part because the simple modeling approach of the 1979 paper was not continued in this later work.

For example, in one version of this later work, Bowles, Gordon and Weisskopf developed an econometric model to explain the movements of corporate profitability in the postwar US economy to that point (see for example Bowles, Gordon and Weisskopf, 1986). The explanatory variables in the model sought to capture what they hypothesized were the three basic factors pushing the profit rate down—the rise of workers' power in wage bargaining and at the workplace; the decline of US power globally; and the gathering strength of citizens' movements, which in turn lead to increased business regulation. To represent each of these three factors, their model included up to 13 separate explanatory variables. Some of these were index numbers they had taken from other researchers, such as that which aimed to measure "the intensity of government regulation of business." However, considering this particular index number as a case in point, this measure of regulatory intensity took no account of possible variations in the degree to which regulations were enforced or actually imposed costs on businesses. Of course, Bowles, Gordon and Weisskopf were trying with this modeling approach to quantify a complex set of historical and institutional forces. But in significantly ratcheting up the level of complexity in their model relative to Weisskopf's earlier work, their later models also became much more vulnerable to pitfalls and alternative interpretations. In my view, with even such highly complex institutional considerations at play, their approach would have been more effective if, as much as possible, they had attempted, as with Weisskopf's earlier work, to break down the issues at hand into relatively straightforward empirical descriptions and decompositions.

The spirit of what I am proposing is expressed persuasively in what might seem like an unlikely source, which is an outstanding 1991 paper by Lawrence Summers titled "The Scientific Illusion in Empirical Macroeconomics." Summers writes in this paper that "just as not all demonstrations of virtuosity contribute to knowledge, most empirical work that actually contributes to knowledge does not display the author's capacity for statistical pyrotechnics ... In large part, it is its simplicity that makes it persuasive" (1991, p. 146). Albert Einstein made the same point when he said "everything should be made as simple as possible, but not one bit simpler." This remains the fundamental lesson to extract from Weisskopf's classic 1979 paper.

## **8. Pursuing ethnic-based affirmative action policies amid rising economic inequality is perilous.**

Weisskopf's research in this field to date concludes with a tightly argued and cautious endorsement of affirmative action policies for both the US and India. But less important than Weisskopf's conclusions per se are the characteristically rigorous research methods that he developed to reach those conclusions. For example, he finds that the viability of positive discrimination measures would depend on, among other factors, the extent of the prior discrimination, the magnitude of the preferences being provided, the level of elitism in the society, and the job prospects for educated youths in the society.

The most important basis Weisskopf offers in support of affirmative action policies is that they can "bring about greater integration of society's elite, on the premise that society functions more efficiently, more equitably, more democratically, and more harmoniously if its professional, managerial, academic and political elite is ethnically well integrated," (2004, p. 244).

Of course, Weisskopf equally supports other policies for promoting economic equality across all ethnic groups—that is, policies that diminish the gap between the power and privileges of the elite strata and the rest of society. But he does not give adequate attention to a fundamental problem embedded in this dynamic. Consider the circumstance in which affirmative action policies succeed in breaking down barriers to entry for members of ethnic minorities to join the elite social strata, at the same time that the privileges showered on the elite are expanding while the opportunities available to the non-elites of all ethnic backgrounds are under attack. This is the situation that prevails in the United States today (not to speak of other countries for which my knowledge is more limited). In such a situation, it is imperative to not only intensify the fight for universal egalitarian policies as a first priority, but also to firmly link affirmative action initiatives to this broader egalitarian agenda.

Weisskopf does take pains to address this problem, but in the end avoids facing the hard questions. He writes:

In an ideal world, one would adopt some policies designed to address the ethnicity-group inequalities ... and some other policies to address socio-economic class inequalities. One set of policies need not compete with, much less exclude, the other. But these two kinds of policies could be seen as competitive in at least two important aspects: the political energy needed to get them seriously addressed, and the resources needed to implement them. (2004, p. 231)

Weisskopf argues that there should be no shortage of political energy to tackle both issues, since politicians and political movements deal with multiple concerns all the time. With respect to resource constraints, he says that affirmative action policies can be achieved at much lower costs than egalitarian economic

policies. This means they can be implemented more quickly and without absorbing resources that could still be deployed for advancing economic equality.

The serious danger here is that unless there are broad groupings in society committed to equality—including a significant share of the economic elite—the growing gap between the elite and everyone else will, with justification, deepen class resentments. This then erodes the support for affirmative action, following Weisskopf's own standard that the viability of affirmative action policies diminishes when elitism is more severe. This is true even in cases when affirmative action policies are not geared toward opening membership to society's elite strata, but rather to broadening opportunities at non-elite levels. For example, male construction workers will be much more open to affirmation action measures to support women getting hired into construction jobs when there is an abundance of jobs available for both men and women. Amid mass unemployment, the political case for affirmative action is still legitimate in principle, but is certain to meet with stiff resistance in practice. It is thus imperative to connect affirmative action policies with a broader egalitarian commitment and not allow the two to become separated.

**9. Socialism remains a great emancipatory project, as long as it is understood to be a series of explorations and challenges rather than a set of off-the-shelf answers.**

Weisskopf wrote as follows in 1991:

Market socialism seeks to promote socialist goals of equity, democracy and solidarity while largely retaining one major feature of capitalist economies—the market—but largely replacing another major feature of capitalism—private ownership of the means of production. For at least the major sectors and/or the most important enterprises in the economy, market socialists propose some form of *social* ownership of enterprises. (1991, p. 8)

This concept of market socialism was certainly not new, a variant of which had been developed conceptually as early as 1936 by Oscar Lange in his famous debate with Frederick Hayek around the prospects for advancing a workable socialist economic model.<sup>8</sup> The Yugoslavian economy under Tito operated for 40 years around broad principles of market socialism, and the Soviet Union itself explored this approach under the New Economic Policy during Lenin's last years in the early 1920s and prior to Stalin's takeover of power.<sup>9</sup>

In the particular historic circumstances of the early 1990s, Weisskopf held that developing a viable market socialist model would provide a third way for Eastern Europe after the fall of the Berlin Wall. Weisskopf's idea was that the then existing Eastern European economies could build upon the institutions and norms already in place that supported egalitarianism—job guarantees, small pay differentials, and an extensive welfare state—while eliminating the repressive

state apparatus to which the egalitarian institutions had been tightly chained. Weisskopf's approach turned out to be a path not taken in Eastern Europe. But the broader issues he explored, about how to organize a viable socialist economy through combining markets and competition with public ownership and other active forms of government intervention, remain alive.

This is the case, in my view, because we have reached an historical juncture where we can conclude with confidence that a viable democratic, egalitarian economy will be one which includes markets, competition, self-interest, and even greed. These will operate in combination with institutions, laws, and norms that promote social solidarity and restrict market freedoms. The real, challenging questions are therefore: what is the right mix; how do we know when we have the right mix; and how do we achieve that mix? These are precisely the questions that Weisskopf was grappling with as regards Eastern Europe in the 1990s.

As a general matter, the first answer to these questions should be: we don't know, and the only way we will know is through trial and error, amid ongoing struggles on behalf of social and ecological justice—that is, struggles for decent jobs and full employment, to defend the environment, and to maintain a well-functioning welfare state. In other words, slogans and exhortations aside, this is why socialism should be seen as a series of questions and challenges, not as a set of off-the-shelf answers. The model of a “participatory economy” advanced by Michael Albert and Robin Hahnel (1991a; 1991b)—which prohibits allocations through markets and develops highly specific voting systems through which allocations are to be made—is, in my view, an example of socialism as pre-packaged answers, assuming we are meant to take their proposals at face value.

By contrast, Weisskopf's development of market socialist models for Eastern Europe in the early 1990s worked with the raw materials of historical experience. At that time, public ownership of the means of production still prevailed in Eastern Europe; and as such, his proposals were building constructively off of that reality. But that historic moment has passed in Eastern Europe and almost everywhere else in the world. As such, the socialist project today will best be served by learning from and building on the models that are still before us. The most notable case here is the social democratic model of Sweden and other Nordic countries.

The Nordic countries have achieved major successes in terms that should matter to socialists. They have succeeded in combining high levels of equality and average living standards while also maintaining expansive economic and political freedoms. Their commitment to environmental stewardship is the strongest in the world, as they produce levels of per capita GDP roughly on par with the United States while emitting roughly half as much greenhouse gases into the environment. They have accomplished these results through political movements achieving victories within the framework of capitalism. This is the place where virtually all countries find themselves today.<sup>10</sup>



This is not to say that the Nordic model is ideal or that its specific features can be readily transferred to other countries facing their own unique history, institutions, and political and economic challenges. Indeed, it is more constructive to think in terms of what Robert Heilbroner used to call “slightly imaginary Sweden” (for example, 1988). With slightly imaginary Sweden, we are still free to muse over our own pure visions of a just society. But we are then also bound to return from all such reveries to the realities before us. The projects of both envisioning and struggling to achieve versions of slightly imaginary Sweden in as many places in the world as possible would benefit greatly from the Weisskopf project for Eastern Europe in the 1990s—that is, trying to advance a realistic framework for socialism amid the hard realities of economic and social collapse.

### **10. Radical economists of the world unite, standing on Tom Weisskopf’s shoulders.**

Isaac Newton observed in a letter in 1676 that “If I have seen a little further, it is by standing on the shoulders of giants.” Radical economics will need to continually advance in creative and sometimes unforeseeable ways, and perhaps under a new name, in order for the fundamental principles of equality, democracy, solidarity, and ecology to have a fighting chance of prevailing over the next generation. Tom Weisskopf’s lifetime of work as a radical economist will be an indispensable resource in this great project of building a more humane future.

## NOTES

1. I am grateful to Tom Weisskopf for allowing me to interview him at length as background for writing this article. The chapter benefited from comments on an earlier draft by Diane Flaherty, Jayati Ghosh, James Heintz, Josh Mason, and Jeannette Wicks-Lim as well as the full group of participants at the September 2011 festschrift conference in honor of Professor Weisskopf.
2. Kahneman (2011) summarizes his own pathbreaking research with Tversky as well as that of others that seriously attempts to understand how people form expectations.
3. Amsden (1989, 2001) are classic references in explaining such approaches to development.
4. In addition to Amsden’s work, additional important references describing these developmental patterns in Taiwan and other East Asian countries in addition to South Korea are Wade (1990), Rodrik et al. (1995) and Kwon (2007).
5. Pollin (1996) examines these questions on Marxian analysis.
6. Pollin (1986–87) examines this issue in the context of the decline in US corporate profitability experienced from the mid-1960s through the 1970s.
7. Pollin (2009) briefly discusses this pattern with bailouts. The broader analytic point on the centrality of bailouts was advanced most forcefully by Minsky (1982, 1986).
8. See also Lange and Taylor (1938) and Hayek (1937, 1945).
9. Cohen (1973) presents a brilliant historical exposition of the debate in the Soviet Union on the New Economic Policy in this period.
10. Erixon (2010) is a good analysis of the Swedish economic model. Sassoon (1996) describes the broader historical setting for the emergence and development of the Nordic social democratic model. Data on greenhouse gas emissions in Sweden and other Nordic countries from the US Energy Information Administration (2011).

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### 3. Comment on Bowles and Pollin

**Diane Flaherty**

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Celebrating Tom Weisskopf's life and work has provided a wonderful opportunity to revisit his work and see it as a coherent and enlightening whole. It also has been a great surprise to read the two chapters upon which I am commenting. We all know Tom as a leader in economics, but unknown to me until now was his role as artistic muse. Somehow, he has inspired Sam Bowles and Bob Pollin to take creative leaps in their chapters. Bowles has written his first contribution to off-off-off Broadway and Pollin to the genre of the political tract, ready for nailing on the doors of investment banks, our modern equivalent to Luther's churches.

The contributions of both Bowles and Pollin are deep and dense and in commenting I can only scratch the surface of their analyses. So I will give my perspective on just a few issues of both method and substance of the chapters and suggest ways in which they are solidly in the framework of Weisskopf's work.

First, on method, the overarching point made by both Bowles and Pollin is that Weisskopf was a pivotal figure in moving economics to take history and institutions seriously. Clearly, social structure of accumulation theory marked a big step forward in the systematic incorporation of institutions into economic analysis. This new approach revealed in great detail the extent to which ahistorical theories are unable to analyse and predict even large movements in economic conditions.

What I have always found to be significant in this body of work, including the work of Bowles as well as Weisskopf, is that their commitment to incorporating history and institutions did not derive from or imply a rejection of formal modeling.

The left often argues for the rejection of formal mathematical models because of their level of abstraction and simplicity. Still, simplicity can be desirable because of its potential for making transparent the basic assumptions and relations of the analysis. Complexity, on the other hand, can be more obfuscatory than revealing of the central forces assumed to be operating on the economy. Weisskopf's 1979 paper on crisis theory discussed by Pollin is both pathbreaking and in this regard courageous, since it was written at a time when abstraction and simplicity were increasingly in disrepute among his peers.

This paper also is an interesting example of how Weisskopf has been able to bridge the gap between careful historical and institutional analysis and the development of formal models that isolate the central influences behind the thick description of the SSA approach. Both methods are much criticized, thick description for not explaining and justifying sufficiently the relative importance given to the privileged institutions and phenomena. As Pollin's chapter notes, at the other end of the bridge is Tom's simple decomposition model of the competing theories of the falling profit rate and crisis. In sorting out causes of crisis, Weisskopf here clearly demonstrated the nature of interaction between a simple skeleton of abstract theorizing used to prioritize across historical and institutional detail and this detail itself, which must be allowed to push back against inappropriate, ahistorical abstractions.

A rallying cry in the early days of URPE (Union for Radical Political Economics) was "off the pike," signaling rejection of the formalism of turnpike theorems. (Robert Dorfman et al. [1958] provide a concise statement of turnpike theorems in economics.) Weisskopf certainly was a leader in taking us to the exit ramp, but he was also a force in keeping us from going totally off-road into a ditch of theoretical incoherence. He never stopped holding radical economics to a high standard of rigor or insisting on the appropriateness of many paradigms and approaches, including simple models.

Bowles's chapter is a clever and fun reconciliation of significantly different paradigms at a very high level of abstraction. Note, however, that the path back to equilibrium, if we are not there, is anything but abstract. Rather, the shifting of each of the curves representing the core relationships between wages, employment, and labor supply comes from political pressure and action. This methodological approach is, I think, very fruitful. Paradigms starting from very different specifications of the central economic relationships can be compared and contrasted only at a very abstract level, where the bare bones of the theory are exposed. Yet, to make the story dynamic, Bowles is clear that the bones must be fleshed out with political muscle to motivate the return to equilibrium. Identifying political factors behind class struggle, competition and determination of aggregate demand in turn requires an understanding of history and institutions. Indeed, Bowles's work since the end of the 1990s is directly related to this task of understanding the formation of group norms and the requirements for groups to act in concert for joint ends. I do have a quibble with the play, however. I would have liked the actors to be more explicit about the difficulty of specifying the relevant dynamics in a world of shifting political alliances and power relations behind the determination of fiscal and monetary policy. Discussing dynamics would have revealed the differences at the table in Bowles's kitchen and surely have started a food fight. Keynes's ultimate faith in the ability of capitalism and its managers to correct its excesses is after all in direct conflict with a Marxian theory of ultimate decline.

Pollin's theses also reveal a close kinship with Weisskopf's approach to economics. On market socialism, Pollin rejects the blueprint approach which defines the ideal form of socialism without saying much about how to get there from here. In contrast, Weisskopf's theory takes seriously the initial conditions, namely capitalism, and constructs a theory of socialism building on gradual changes toward an end that can only be seen dimly through the veil of uncertainty that is the future.

I completely agree with Pollin here that a main strength of Weisskopf's models of market socialism is that they are open-ended. If we are serious about developing models with historical roots, it is impossible not to find detailed blueprints for socialism a bit silly. Social systems evolve in path-dependent ways and the outcomes cannot be specified in advance.

I would, however, emphasize more than Pollin does another aspect of Weisskopf's theory of market socialism, which highlights a theme throughout Tom's work, namely democracy as a condition for economic growth.

This fundamental issue arises most prominently in assessments of growth in countries like South Korea and more recently China. It is very obvious that the conditions for growth in these countries substantially have involved the role of the state in allocating resources, but the downside of central control is often not sufficiently recognized. For example, the left can be schizophrenic on China. While criticizing the increasing inequality that is arising in China as part of its growth process, the growth rate per se nonetheless often is held up as an example of how government control is a condition for success. Insufficient discussion goes on of the relationship between growth driven by state priorities and the negative side-effects of growth in China, inequality and also pollution for example. The historical enthusiasm for the South Korean growth strategy is another case in point. While inequality in South Korea did not reach the proportions of India and China, the point remains that South Korea was a repressive regime for decades and its suppression of the rights of trade unions was a key part of its political control over economic outcomes. While wages did grow steadily, workers for a long time were not allowed to contest the imposed trade-off between wages and worker rights. Here I suggest and perhaps disagree somewhat with Pollin that getting the prices wrong is not sufficient—the wrong prices must not lead to wrong outcomes in income distribution and participation.

This brings us back to Weisskopf and his nuanced analysis of market socialism. His model takes into account the need for economic loci of countervailing power to a central planning authority. Without such a multiplicity of sites of economic decision-making, the historic failure of state control to support democratic decision-making cannot be addressed or reversed. This concern for democracy is also clear, as Pollin notes, in Weisskopf's analysis of affirmative action. Here, too, Weisskopf's point is to construct a careful and delicate argument concerning the specific conditions under which affirmative action is a positive

force for change. Weisskopf's weapon of choice is not an ideological hammer: as ever, he prefers to persuade by logic and evidence. I do take Pollin's critical point, though, that affirmative action must be embedded in a broader economic environment in which affirmative action does not become a zero sum game across groups. Weisskopf does perhaps pay too little attention to how to loosen such a system-wide constraint as part of the application of affirmative action.

Finally, back to market socialism. I am just back from Croatia, where I met with many East European economists. From this experience, I have to qualify by way of an update Pollin's point that Eastern Europe did not follow Weisskopf's suggested path in the transition. There is growing dissatisfaction in the region with the "discipline of the market" and increasing interest in mixed economy models, especially those that can to some extent mitigate the domestic effects of the global crisis. Thus, the kind of transition Weisskopf proposed is in fact receiving new attention. Taking us back to the second theme of these comments, the sticking point for more government intervention is democracy and its fragility in many transition countries. The legacy of repressive governments is great suspicion of the ability of the government to intervene in ways that serve the public interest rather than the maintenance and expansion of the power of bureaucrats. Weisskopf's emphasis throughout his many fields of inquiry on democracy as a core part of any desired economy is a fixed point we all would do well to keep in view.

Weisskopf's consistent commitment to and success in producing nuanced, historically-grounded, and evolutionary theory, rejecting adherence to received doctrine, is an example for all of us. Clearly, in their contributions here as well as in their other work, Bowles and Pollin provide two additional examples of the fruitfulness of this approach and it was a pleasure to read their chapters.

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## 4. The military and economic development in Pakistan<sup>1</sup>

**Shahrukh Khan**

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### 4.1 INTRODUCTION

The military in Pakistan has staged four coups and predominantly justified them based on the economic incompetence and corruption of the political administrations in office.<sup>2</sup> In this chapter, we first review the concepts of economic growth and development in a comparative economic systems context and use that as a framework to examine the role of the military in Pakistan's economy. We turn next to an illustrative comparative performance of Pakistan's economy under military compared to civilian administrations. We show that there is little justification for military intervention on economic grounds.

### 4.2 ECONOMIC GROWTH AND THE DEVELOPMENT PROCESS

Poor nations strive to catch up with rich ones but the task is very challenging. In Pakistan's case, the military adds to this challenge in several obvious and less obvious ways highlighted in this chapter. We start with some reflections on China, which represents the latest "miracle" in economic development, and see what lessons it might have for an economy intertwined with a military presence and other political and social problems.

Since the late 1930s or so, scholars have identified many factors that might break vicious circles that lead to low economic growth and initiate a high and sustained economic growth trajectory; governance being among the more recent ones.<sup>3</sup> However, as Hausmann et al. (2008, pp. 5–16) conclude when making a case for growth diagnostics, all approaches to identifying constraints to growth such as cross country growth regressions, growth accounting, or benchmarking

using cross country surveys in which countries are ranked on various indicators, such as constraints to doing business, are problematic. These methods are dismissed on theoretical grounds and, in the case of benchmarking, because of inherent problems with the data collection method. However, growth diagnostics, the latest in the arsenal of such tools is also problematic on many grounds, as indicated by Dixit (2007) and Khan (2011). Case studies have been more promising, and one lesson is that there is no single solution for moving from vicious to virtuous circles, and certainly countries that managed to attain and sustain a high economic growth trajectory started from different circumstances and did so in different ways.

Rostow (1960) reflected on the preconditions for economic “take-off.” While he ostensibly wrote an anti-communist manifesto, his stages-of-growth framework is not unlike that implicit in the thinking of Mao Tse-tung.<sup>4</sup> Rostow describes preconditions for take-off as the critical stage prior to economic take-off. These preconditions include a change in attitude to fundamental and applied science and training to operate in disciplined organizations. Other preconditions include the development of financial, political, and social institutions. Institutional development needs to be accompanied by appropriate social and physical infrastructure (ports, docks, roads, railways) and management skills.

Mao Tse-tung’s (1968, pp. 5 and 67) characterization of a take-off would be quantification and then a qualitative leap where the quantification is the preconditions and the take-off the qualitative leap. Mao also refers to internal and external conditions, with the former as the preconditions being more critical (*ibid.*, p. 28) and external conditions such as a favorable international environment possibly acting as a catalyst. A “take off,” or whatever one calls the phenomenon (catch-up growth perhaps), is an empirical reality in the case of China and perhaps other emerging economies like Brazil and India, and was certainly the case in Japan, Korea, Taiwan (Province of China), Malaysia, and Thailand before them.

There is plenty of evidence that qualitative changes occur, but we do not know as much about what causes them and why. It is also very likely that the critical internal and external conditions vary by country. We speculate in this chapter on what the critical internal conditions are likely to be in Pakistan’s case. We make a qualification given our concern with social justice. A “take-off” is not a necessary condition for generalized wellbeing, as we are currently seeing in China and India, although it is a sufficient condition. A take-off can create opportunities for distribution and pressures for it. The more likely story is that prosperity spreads because people fight for a larger share of the larger pie (worker strikes in China) or the state engages in distribution because of the likely social conflict and other constraints to growth if they do not (China addressing lagging rural income with infrastructure). Nor do workers necessarily wait for a sustained take-off. Bangladeshi ready-made garment workers have been engaged

in a protracted struggle for increased wages from a sector that contributes over four-fifths of total merchandise export earnings. Just as nations have to struggle and develop against the odds, workers often face a similar struggle.

In the context of Mao's philosophy, among the very favorable internal conditions are a sound administration and managerial capacity and strong citizen identification with a common national project. I visited China to give a series of lectures on economic development at the Beijing Language and Cultural University (BLCU) in the summer of 2009, during the peak of the swine flu epidemic. It was strange to be lecturing on economic development in a country that one really should be learning from. In fact, one set of lessons came very early on in the trip—even before reaching the hotel from the airport—and these pertain to administrative and managerial capacity.

On disembarking in Islamabad, Pakistan en route to China, passengers were greeted with a large sign suggesting that they report to the Ministry of Health if they were coming from a country where the flu originated or where the incidence was high. The best that could be said for this public health initiative was that the sign was prominent and difficult to miss. It seems unlikely, however, that many passengers reported to the Ministry of Health the next day.

Two days later, when the plane landed in China, the public health precaution could not have been more different. When the plane came to a complete stop, passengers were asked to remain seated. Rapidly and carefully, a team of public health officials electronically scanned each passenger for temperature. Seat numbers of those with a temperature above a certain threshold were noted and these passengers were later subjected to further tests. We learned that day that the mayor of New Orleans was quarantined for a week in a Shanghai hotel because he was deemed to represent a public health risk. In the case of BCLU, foreign faculty were not allowed to be exposed to students for 1 week and so sight-seeing tours were organized and, beyond this, faculty and their families, if they were in tow, had the opportunity to do this on their own also (board and lodging covered).

Other experiences also revealed a very high level of public health alert and the capacity to take preventive measures across the board. Taxi drivers routinely rolled down windows if a passenger sneezed, suggesting an effective public health campaign. In Qingdao, 882 km south of Beijing on the Yellow Sea, a family member's sore throat bloomed into a cold. Medicine for a cold was procured from a traditional medicine store by looking at a visual card showing apparent cold symptoms. A hotel receptionist with English language skills was asked to read the dosage. Very shortly after this consultation, a public health official knocked at our hotel room door for a temperature check.

All this public health precaution was very visible to a foreigner being immersed in Chinese society without knowledge of the language. More might have been gleaned with access to the language and media. Even so, the level of public

health preparedness, both at the official level and in terms of the diffusion of knowledge, possibly via media campaigns, was impressive.

Perhaps it is the administrative and managerial ability of the communist party that generates the observed level of social efficiency. However, as an observer and interested reader of the Chinese scene, it also appears that there is a broad identification with what one might view as a common project to catch up to the West as soon as possible. While many might view the Chinese space program as premature and wasteful, the expression of national pride at the first human flight into space observed on the media did not appear staged. In so far as development is a collective action issue, this critical ingredient for collective action to be realized seems to be present in China. A country as vast as China is inevitably complex and many people seem shabbily treated and human rights appear to be trampled on. But there seems to be a larger story of a country on the move, a country that possesses adequate administrative and managerial capacity, and one where there is broad identification with a national project.

These two critical ingredients may be sufficient to trigger a virtuous circle that induces other ingredients that in turn add to the snowballing impact of enhanced economic prosperity. For example, one way to look at the current Chinese miracle is that, historically, administrative and managerial ability delivered reasonable quality physical and social infrastructure as a base. That this happened was no accident but was systematically planned for in the dialectical vision for economic development and balanced growth that Mao Tse-tung (1968, pp. 129–30) propounded in 1951. Heavy industry was to be the core, but it needed the simultaneous development of agriculture and the associated light industry. Agriculture would provide the raw materials and markets and enable the capital accumulation needed for heavy industry. In turn, industry would provide the materials needed to continue to boost agriculture, such as heavy machinery and transportation equipment, fertilizer, equipment for water conservancy, power, fuel, and building materials for infrastructure.

A managerial decision to catch up then put uniquely Chinese incentives into place to trigger prosperity (Rodrik, 2010); again very consistent with Mao's advocacy of adapting based on local conditions (Tse-tung, p. 131). The original source of the organizational and managerial ability might have been the communist party, which is still a force; but this ability is widely diffused, and visiting any factory or observing the cleanliness and efficiency of the subway systems in Beijing or Shanghai makes this evident.<sup>5</sup>

Finally, to sustain the prosperity and truly catch up requires embodying an endogenous technological capacity in society and the economy so that it keeps moving up the technological ladder.<sup>6</sup> However, as the Japanese, Korean, and Taiwan (Province of China) experience shows, this is not automatic but planned for with an extensive technology and training policy.<sup>7</sup> It is also evident now that the Chinese are using their new-found resources and administrative and

managerial ability to invest in creating an endogenous technological capacity, including by drawing back expatriate talent.<sup>8</sup>

China, however, faces major challenges. As mentioned above, the socialist investment in humans, as the ultimate wealth of the nation, and infrastructure created the base for unleashing China's productive potential as it harnessed the power of the market. Deng Xiaoping, the architect of market reforms, is alleged to have said "To get rich is Glorious." Despite this unleashing of personal incentives, the state has not withdrawn from continuing to make human investments and as a medium human development nation, its human development index increased from 0.556 in 1985 to 0.772 in 2007. However, social inequality has increased and while the Gini coefficient in 1981 was 28.8, it rose in 1995 to 38.8 and in 2001 to 45.0.<sup>9</sup>

The Chinese Communist Party also recognized that industrialization was resulting in immense environmental degradation and human suffering and its current drive to lead in renewable technologies like solar and wind might have been one response to this immense challenge. Its metric tons of CO<sub>2</sub> per thousand declined from 1.77 in 1990 to 0.95 in 2005; the steepest decline among all countries for which such data were reported (World Bank, 2010, p. 262).

Thus authentic development for us requires investing in people as an end, but also as a means, for attaining equitable and sustained prosperity by developing an endogenous technological capacity to diversify the economy. Such capacity needs to be harnessed along with containing consumption to preserve natural capital. While China's centralized leadership may have advantages in its capacity to deliver on such objectives, our preferences incline strongly towards democratic governance and so we would be averse to recommending centralized and autocratic governance as a mechanism for delivering administrative and managerial capacity.

In Pakistan's case, there is one institution that does seem to have administrative and managerial capacity to deliver as indicated above for China. Based on the traditions of the British colonial military, the Pakistani military distances itself from the population, physically and otherwise. That may be necessary for inculcating and preserving an administrative and managerial capacity that enables it to get things done efficiently. All who have exposure to the military cantonments and bases testify to the better quality of maintenance. Resources certainly help, but resources can leak via corruption or improper use without delivering much.

However, such administrative and managerial capacity and efficiency is not unique to the military. Indeed, the better-managed private sector firms and universities show similar excellence as do Pakistan's highway police.<sup>10</sup> One could argue that such capacity was devoted to developing and sustaining a nuclear program (Pakistan's equivalent of a space race), although in our view the country would have been better served had this single-minded effort been

directed towards an export drive and human development. While the military's evident managerial and administrative superiority is widely accepted among the educated public and part of popular lore, the key questions for us are whether this capacity is real and can or should it be tapped for broader economic development, or whether the military represents a constraint to economic development in Pakistan's case. Let us consider a possible diffusion mechanism of the military's superior administrative and managerial ability.

It could directly engage in economic activities and diffuse success to the private sector in a competitive framework. However, the cost-effectiveness or profitability of this activity is difficult to gauge because of a lack of access to the data needed for evaluation. Indeed, judging from the need for subsidies to bail out commercial military operations, it seems much more likely that the military is not competitive in private sector activity (Siddiq, 2007, ch. 9). A prominent English-language daily, *The News International*, September 22, 2010, quoted a report of the Parliament Public Accounts Committee as stating that military-run corporations were drawing a subsidy of Rs. 200 billion. This was about half the budgeted Public Sector Development Program of Rs. 406 billion for 2009–10 (Government of Pakistan, 2010, p. 39).

Many, though not all, such activities are headed and staffed by retired military personnel. One could argue that they would carry their discipline into these activities after retirement and this should contribute to success. But private sector activities are more complex and require more than military training, which could account for the high failure rate of the military's venture into economic activities. There is thus no compelling case to support the military's venture into private sector activity.

The military's other forays into civilian life that could have diffused a sense of discipline and efficiency has been no more successful. Retired military personnel in civil society organizations bring to their work some of the strengths of their military training. However, discipline, punctuality, and carrying out instructions efficiently are offset by a lack of flexibility and creativity. There is also a cultural clash of democratic norms with an autocratic and hierarchical mindset.

General Musharraf made the standard arrogant assumption held in the military that they are better than civilians in all matters and appointed serving generals to head important civil institutions including the Pakistan Cricket Board.<sup>11</sup> WAPDA (Water and Power Distribution Authority), one of the largest utilities in the country, was put under the management of a serving general in 1999. The average annual power and distribution losses for the next 5 years (until 2003) increased to 25 percent of total output relative to 23 percent during the political governments (1988–1999).<sup>12</sup> The general's disastrous tenure as the head of cricket in Pakistan caused much heartburn.

Thus, Pakistan's sustained take-off is unlikely to be based on the kind of administrative and managerial capacity described for China, and the military

certainly cannot be relied on to diffuse such a capacity by militarizing civilian life each time they assume dictatorial power and arrest the political process. With each assumption of political power, they have made deeper inroads into civilian life and this is not in the national interest but in the interest of sustaining a larger and larger military economic empire whose beneficiaries are military personnel and their families and not the general public (Siddiqi, 2007).

### 4.3 IS THE MILITARY'S ECONOMIC MANAGEMENT IN PAKISTAN MORE EFFICIENT?

We have argued above that the administrative and managerial capacity that the military uses to handle its affairs does not carry over to success in private sector activities, administering public corporations, or in running civil society organizations. Nonetheless, there is a widely held assumption in the military that it can much more competently manage the economy. The lack of civilian competence in this regard was stated as one of General Musharraf's reasons for assuming power, as had been stated by the three other intervening generals before him. Fortunately, serving generals were not appointed in key economic positions, but it was assumed that the military administration would have the judgment to appoint competent people to improve economic performance.

There is no simple way to test the economic performance of a military administration and compare it with that of a civilian administration. Comparing the administration of General Ayub Khan (1958–69) with those that preceded or followed it might be a good test case, because he was personally very hands-on in economic management. His political autobiography, *Friends Not Masters*, suggests a development vision not unlike that of President Park Chung-hee (1961–79) of Korea. The two countries had a similar per capita GDP in the 1950s. Pakistan's per capita GDP as a percentage of the US's in 1950 and 1960 was 9 percent and 7.8 percent respectively, while Korea's was 7.6 percent (lower than Pakistan's) and 11.8 percent respectively. By 1995, this percentage was still stagnant at 8.3 percent for Pakistan, but it had increased to 42.4 percent for Korea.<sup>13</sup>

While both generals had a vision for economic development, the base they established for this was very different. General Park Chung-hee is credited for successfully industrializing the Republic of Korea and establishing the base for its economic progress to high income country status and joining the rich country club of the OECD (Organisation for Economic Co-operation and Development). General Ayub Khan willingly (political advantage) or inadvertently (weakness and incompetence) ushered in an era of crony capitalism that is still the bane of Pakistan's economy. Thus, while the Korean economic team ruthlessly demanded

performance (quality exports) in exchange for limited time incentives, Pakistan was shielding industrialists from both external competition via tariffs and internal competition via permits.<sup>14</sup> In 2010, garments topped the list of Pakistan's high value exports<sup>15</sup> and the cacophony of demands from industrialists for special privileges is still unceasing.<sup>16</sup>

Since, as was indicated earlier, poor economic performance has been used as one of the main justifications for military intervention by all military regimes, we tested the hypothesis, using data from 1961–2009, that military regimes lead to better economic performance.<sup>17</sup> We did not find that military regimes result in superior economic growth, nor did we find that poor economic performance results in military intervention.<sup>18</sup>

Olson (1993) makes an economic case for preferring democracy over autocracy on theoretical grounds. The empirical findings regarding the association of democracy and development, mostly using cross country growth regressions, are mixed (Rivera-Batiz and Rivera-Batiz, 2002, p. 143). Bowman (2002, pp. 183–206) finds a negative association of militarization and democracy, economic growth, and equity for 18 Latin American countries.

Khilji and Akhtar (1997) provide weak support of a negative association running from dictatorship to economic growth in Pakistan but they do not use co-integration. While we have reservations regarding growth regression on theoretical and measurement grounds, we nonetheless estimated a standard growth equation using an implicit production function and time series analysis with GDP growth being explained by capital formation and labor in addition to regime.<sup>19</sup> Our estimates suggest that a military regime accounts for 1.9 percent higher growth.<sup>20</sup> However, although the result is statistically significant, we have little confidence in this result because the overall ability of the equation to explain growth, especially for a time series regression, is very poor (an R bar square of 13 percent).

We also compare the economic, social, and human condition variables under the General Musharraf administration compared to that of the political administrations that preceded it (those of Prime Ministers Benazir Bhutto and Nawaz Sharif following the dictatorship of General Zia ul Haque) using data from the Government of Pakistan (2010) and the World Bank's World Development Indicators (on-line). The comparison is suggestive because much else could explain economic performance rather than the competence of the economic management, civilian or military. Also, the impact of the policies of the past governments can carry over to successive governments for at least a short time-period. Averaging over a number of years in each case—ten for the political governments and eight for the military government—can partly resolve this problem. Ultimately, if the performance is not dramatically different, it would call into question the assumption of obvious superiority made by the military administrations.



While we do not report tables to save space, the evidence suggests there is reason to call into question this assumption, since the comparative performance shows mixed results.<sup>21</sup> In reviewing the fiscal and monetary discipline of the military administration relative to the political administrations that preceded it, the most striking finding is that military allocations as a percentage of GDP were almost twice as large under civilian administrations compared to the period of military rule.<sup>22</sup> It appears that when directly in charge, the military is forced to be more fiscally responsible. During nominally civilian regimes, it can bring pressure to bear behind the scenes. Looney (1989, table 1) cites evidence, using World Bank data for 31 countries, showing that this seems to be more broadly the case when comparing military to civilian regimes. However, while there might have been genuine cuts elsewhere, it appears that for Pakistan the cuts are a case of smoke and mirrors.

Military allocations are often camouflaged under the head of some other ministry. Also, *The News International* on September 22, 2010 reported that General Musharraf's administration removed military pensions from the military budget in 2001. They subsequently skyrocketed from Rs. 26 billion in 2001 to Rs. 76 billion in 2010 for the 3 million military retirees according to the Parliament Public Accounts Committee. This amounted to an average of Rs. 24 000 per military retiree compared to Rs. 3600 per civilian retiree. Pakistan's military allocations in budget 2010–11 under a civilian regime represented a 16.5 percent increase relative to budget 2009–10. In addition to this direct allocation, the Defense Division also receives an allocation from the Public Development Sector Program for military projects.<sup>23</sup> The other surprising result is the much lower tax effort under the military government which once again calls into question their superior economic management.

Beyond this, the military government subjected itself to the discipline of the IMF, and its economic management team was very comfortable with this economic ideology.<sup>24</sup> While this shows up in better fiscal discipline (smaller fiscal deficit), the price is paid in terms of lower development expenditure as a percentage of GDP, and this shows up in low infrastructure development. Other macroeconomic indicators show better economic performance under the military administration with saving, capital formation, and public and private investment as a percentage of GDP considerably higher under the military-led administration relative to the civilian governments.

The better input indicators in terms of capital formation and private investment did not efficiently translate into outcome variables. The GDP growth rate of the military administration was only marginally higher than under the tenure of the civilian administrations. Also, exports as a percentage of GDP—a marker of the competitive quality of output—actually declined. However, the biggest failing was the lack of investment in the long-term future growth of the economy by building productive physical infrastructure. For example, the percentage growth

in installed capacity for electricity, roads, and telephones all declined multifold. The decline in growth of installed capacity of electricity from 110.8 percent to 10.5 percent could account for the electricity shortage during the last years of the Musharraf administration. Excessive load-shedding has been endemic since 2010 in the country and it is likely to continue for a while.

However, the more serious failing of the military government is a reluctance to invest in improving the social and human condition of the population. Democratic administrations are answerable to the broader electorate and ignore such delivery at their electoral peril. The commitment to education and health by the military administration was lower in terms of expenditure on these vital social sectors as a percentage of GDP. The crude outcome indicators also show a worse performance of the military in most cases, with schools and hospitals getting more crowded. Even worse was the comparative performance in terms of the human condition.

Unemployment increased and the real daily wage of skilled workers decreased. It is not surprising, then, that the military administration's performance was much worse on various indicators of inequality and poverty. There was negative progress in reducing the Gini coefficient and much smaller progress in reducing poverty and the poverty gap.<sup>25</sup>

While inflation, which conditions real wages, was lower on average during the military administration period, it dramatically picked up in the last year of the Musharraf administration. The military government performed better on indicators of child and infant mortality rates and life expectancy, though not that of adult females. Overall, however, based on economic, social, and human condition variables, the assumption of overwhelming superiority of the management of the economy and society under military rule is called into question. Yes, despite this evidence, the military is likely to continue to assume that it is superior on all counts and this may have something to do with military training and the formation of the military mindset that seems to avoid taking evidence into account.<sup>26</sup>

#### 4.4 CONCLUSION

Successive military coups in Pakistan have been justified in terms of economic incompetence and corruption of political administrations. We provide evidence in this chapter that the militarization of economic life is inefficient and crowds out private sector activity. We also demonstrate that there no evidence to support the claim that military administrations are more competent in managing the economy or indeed less corrupt. There is evidence to suggest that they may invest less in social and physical infrastructure and that their terms in office coincide

with increased poverty and inequality and a more generalized deterioration of the human condition. This is as one might expect, since they are not answerable to a political constituency.

The problem of economic development, a national project, can be thought of in terms of identifying what is most likely to galvanize the populations to accept short-term sacrifices and do the hard work.<sup>27</sup> In China's case, we identified managerial and administrative capacity and patriotism as central. Patriotism does not simply emerge with crude attempts at persuasion in the syllabi and the media.

In Pakistan's case, we believe it is only likely to emerge in a deep sense once the perception is created that social justice is being administered by rolling back the military's disproportionate privileges. It might also be more possible in principle to address provincial, sectarian, and class divides that undermine national cohesion if the military was not such a heavy financial burden.

## NOTES

1. Thanks are due to Aasim Sajad Akhtar, Daniel Altschuler, Daniel Barbezat, Robert Pollin, and Jeannette Wicks-Lim for helpful comments and suggestions.
2. While the reference throughout this chapter is to the military, the army with about 58 percent of the total active duty personnel is predominant in power and influence.
3. An example of a vicious circle would be ethnic and social conflicts leading to low investment, low growth, a lack of resources, and more ethnic and social conflict.
4. Rostow was criticized for merely presenting a descriptive framework rather than a theory, since he presented no testable hypothesis other than a threshold saving rate and that did not prove correct. A more telling criticism was that he was completely ahistorical.
5. More complex societies continue to face more complex managerial challenges (for example, financial collapses) and so the process of learning and moving on and facing new challenges is never-ending.
6. Chang (2010).
7. Refer to Gallagher and Shafaeddin (2010).
8. Sharon LaFraniere, "Fighting Trend, China is Luring Scientists Home," *New York Times*, Business, January 6, 2010; also refer to Zweig (2006).
9. This contrasts with Cuba which has stuck with its socialist philosophy and ranks as a high human development nation with an index of 0.863 in 2007 (UNDP, 2009, pp. 167–8). The Gini is a measure of social inequality with complete social equality at 0 and maximum inequality at 1. Data are taken from various issues of the World Bank's *World Development Reports*.
10. This is better constructed and maintained than most highways I have seen in the West and also exceptionally policed. It is an amazing demonstration of effective foreign local partnership between a foreign company (Daewoo) and a local government and also of how functioning institutions can be created against the odds. A special police force was created and trained with a much higher salary structure than other traffic police and the esprit de corps is notable (harkens back to the police reforms of British Prime Minister Sir Robert Peel in 1829). These policemen are courteous but not even a member of parliament is spared a ticket. So effective has this police force been that they were invited to police the capital with a remarkable transformation of traffic discipline from a free-for-all to one that is watchful and disciplined. Transparency International declared the Islamabad Tariff Police corruption-free in 2009 (*Daily Times*, Wednesday, June 24th, p. A3).
11. This arrogance was carried to an extreme degree when military officers were appointed as civilian watchdogs. This created resentment and, to add insult to injury, the officers knew little

- about what they were supervising. This practice of inducting military personnel into civilian life was institutionalized by General Zia who set a quota of 10 percent of civilian jobs in civilian administration for military personnel (Aziz, 2008, p. 71).
12. World Bank, World Development Indicators (on-line).
  13. commons.wikimedia.org/wiki/File%3APer\_capita\_GDP\_of\_South\_Asian\_economies\_%26\_SKorea\_(1950-1995).png.
  14. Refer to Wade (2004) for a review of Korean economic development strategy and Papanek (1967) for Pakistan's economic development strategy at an equivalent time period. Korea's experience shows that a national project can be autocratically induced. While this is superior to a predatory dictatorial regime, we view achieving an economic take-off with public identification and participation in a common national project as superior.
  15. In July 2009–April 2010, at 53 percent of total exports, textiles topped the list of Pakistan's exports (Government of Pakistan, 2010, p. 89) while in 2010 Korea was edging out Japan in automobile exports to the US market.
  16. In 2010, there was a virtual Textile war. The spinning subsector was demanding cheap cotton, the weaving subsector cheap yarn, and the garment subsector cheap fabric. Each was demanding this at the expense of the other subsectors earlier in the value chain and the imposition of export restrictions was the common demand.
  17. Data were drawn from the World Bank's World Development Indicators (on-line).
  18. Our tests only explored a limited form of causality referred to in the time series econometric literature as Granger causality. For a basic treatment of the subject, refer to Gujarati (1995, pp. 620–23).
  19. The Johansen co-integration test suggested our growth equation was co-integrated at the 5 percent level.
  20. Also, the result is clearly not robust since both investment and labor are statistically insignificant in explaining economic growth. Most important, we only found investment data between 1980 and 2008, and hence missed about half the relevant economic history.
  21. For the tables, refer to Khan, Khan, and Akhtar (forthcoming, ch. 1).
  22. In 2008, Pakistan Armed Forces were almost three times larger as a percentage of the labor force (1.65) than the Indian Armed forces (0.57); On-line World Bank, World Development Indicators, <http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2>.
  23. These are non-trivial allocations and for 2010–11 amounted to 5.86 percent of the total Public Sector Development Program, [http://app.com.pk/en/\\_index.php?option=com\\_content&task=view&id=105227&Itemid=174](http://app.com.pk/en/_index.php?option=com_content&task=view&id=105227&Itemid=174).
  24. Civilian governments, including the current one (2008–) have also been subject to the discipline of the IMF. However, in the past, there have been many recriminations on the part of these financial institutions about violations of conditionality while the military government of General Musharraf was given high marks in this regard (refer to Khan (2007)).
  25. The numbers understate the performance of the political governments or overstate the performance of the military government in terms of the reduction of the poverty gaps. Since the gap had already been reduced by the political governments, a given percentage reduction by the military government means a smaller absolute reduction since the base is smaller. Thanks are due to Christopher Kingsley for pointing this out.
  26. Huntington (1959, ch. 3) uses the expression "The Military Mind" and provides associated references to earlier use.
  27. Chang (2006) points out that even when Korea became a successful auto producing country, it continued for a while to have lower per capita consumption of cars than in low income countries of Sub Saharan Africa and South Asia with a much lower per capita GDP.

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## 5. Socialism: the twentieth century and the twenty-first century

**Minqi Li**

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According to classical Marxism, capitalism is characterized by the basic contradiction between the objective tendency towards socialization of production and the capitalistic system of private appropriation. This contradiction would lead to increasingly irreconcilable class conflicts as well as progressively more devastating economic crises. The contradiction could only be resolved by replacing capitalism with a fundamentally new economic and social system, based on social ownership of the means of production and society-wide economic planning that would allocate social resources rationally to meet social needs (Engels, 1978[1880]).

The twentieth century socialist states were the historical products of workers' and peasants' revolutions in the periphery and semi-periphery of the capitalist world system. The basic means of production were nationalized or collectivized. Industrial and agricultural production was organized by state-wide economic planning. Despite their historical limitations, the twentieth century socialist states were characterized by internal class relations far more favorable for the ordinary working people than those typically found in a capitalist state, especially in the context of the periphery and semi-periphery.

The twentieth century socialist states remained a part of the capitalist world system and had to compete against capitalist states economically and militarily. Political and economic power were concentrated in the hands of privileged bureaucrats and technocrats, which over time evolved into a new exploitative ruling class that favored capitalist restoration.

After 1989, the consensus among the mainstream economists and a large section of the leftist intellectuals was that socialism as an economic system was fundamentally flawed and suffered from fatal problems such as the information problem, the motivation problem, and the innovation problem. This chapter argues that this consensus against socialism is not consistent with available evidence. Moreover, an examination of both theory and the current world historical conditions suggests that the actual and potential failures of capitalism are far more devastating to the long-term future of humanity.

To the extent that contemporary capitalism fails to resolve escalating financial instability, the impending global ecological collapse, and the growing global class conflicts, global capitalism has entered into a new structural crisis that can no longer be resolved within the historical framework of capitalism. As the global capitalist crisis deepens and broadens, socialism as a revolutionary movement by the working class and other exploited people as well as a historical search for a post-capitalist society freed from exploitation and oppression will soon be back on the world historical agenda.

## 5.1 HAS SOCIALISM WORKED?: THE TWENTIETH CENTURY EXPERIENCE

After 1989, a consensus was established among the mainstream economists that socialism, as an economic system characterized by social ownership of the means of production and society-wide planning, was fundamentally flawed. It was widely accepted that the socialist economic system could not work rationally because it failed to solve the information problem, the motivation problem, and the innovation problem. The consensus was shared by large sections of the leftist intellectuals.

According to the mainstream consensus, a modern economy with millions of different inputs and outputs is too complicated for centralized economic planning to operate effectively and rationally. It is not possible for the central planning authority to collect, process, and efficiently utilize the massive amount of economic information required for rational allocation of resources. Moreover, without private property, people are not rewarded properly and adequately for their work effort and risk-taking. As a result, the overall levels of effort and risk-taking tend to be far below the economically optimal levels.

By comparison, in a capitalist market economy, all individuals are rewarded for their pursuit of self-interests. All individuals are motivated to collect and utilize any potentially useful economic information that is dispersed throughout the economy. Through market prices, the economic information collected by many different individuals is efficiently transmitted and shared across the whole economy. A market economy thus efficiently solves both the information problem and the motivation problem.

According to the mainstream view, a major failure of the socialist economies had to do with their inability to promote innovation. Without private property, there was insufficient reward for innovation and risk-taking. On the other hand, without competition and the threat of bankruptcy, there was no penalty for failure to innovate.<sup>1</sup>



Did the post-1989 consensus provide a broadly correct assessment of the actual historical experience of the twentieth century socialist economies? Did twentieth century socialism fail because it failed to work rationally as an economic system?

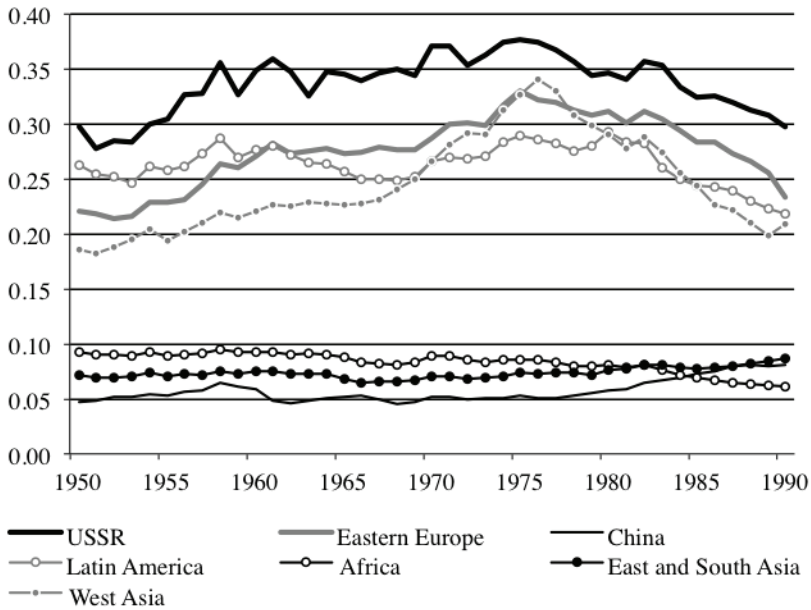
The historical socialist states were a part of the capitalist world system and constrained by the basic laws of motion of the capitalist world system. The capitalist world system was divided into three structural positions: the core, the semi-periphery, and the periphery. The core included the historical imperialist powers where the global surplus value was concentrated. The semi-periphery included the geographic areas that had made advances in basic industrialization in the early twentieth century but continued to lag behind the western advanced capitalist countries in high value added activities. The periphery included the geographic areas where the great majority of the world's population lived. Until the late twentieth century, the periphery had had limited advances in industrialization and specialized in agriculture and raw materials exports in the global capitalist division of labor.<sup>2</sup>

The capitalist world system has been characterized by the three structural positions since the sixteenth century. Western Europe emerged as the core of the capitalist world system through plunder and exploitation of the rest of the world. Since then, the core countries have been able to maintain their advantages through monopoly over technology, finance, and the high value added activities in the capitalist world economy. Over time, North America and Japan managed to move up the ladder and become members of the core, and some peripheral countries have managed to rise to the semi-periphery. But, overall, the mobility between the three structural positions has been very limited (Wallerstein, 1988; Arrighi, 1991).

The twentieth century socialist revolutions took place in the periphery and semi-periphery of the capitalist world system. In the early twentieth century, Russia was a declining semi-peripheral state (Wallerstein, 1979, pp. 30–31). The more advanced Eastern European states, such as Czechoslovakia and Hungary were a part of the semi-periphery (though East Germany was a part of a core imperialist state). The rest of Eastern Europe, such as Poland, Romania, Bulgaria, and Yugoslavia, were peripheral states that had yet to complete industrialization. China, North Korea, Vietnam, and Cuba were peripheral colonies and semi-colonies before the revolutions.

Thus, a proper assessment of the historical socialist performance needs to take into account the historical origins of the socialist states and recognize the reality of their different structural positions within the capitalist world system. Figure 5.1 compares the index of per capita GDP of the major peripheral and semi-peripheral regions from 1950 to 1990. The semi-periphery included the former Soviet Union, Eastern Europe, Latin America, and West Asia, with per capita GDP ranging from 20 to 35 percent of the US level. The periphery included

Figure 5.1 Index of per capita GDP



Note: US=1.00, 1950–90.

Source: Maddison (2010).

China, East and South Asia (excluding China and Japan), and Africa, with per capita GDP ranging between 5 and 10 percent of the US level.

Both the Soviet Union and Eastern Europe succeeded in significantly narrowing their respective income gaps with the United States from 1950 to 1975. After 1975, their relative economic performance deteriorated. By 1990, their per capita GDP indices were roughly back to their respective levels in 1950.

However, the relative decline of the Soviet Union and Eastern Europe from 1975 to 1990 was not an isolated experience. The 1980s was the lost decade for Latin America, Africa, and West Asia. Under the neoliberal global restructuring, development efforts collapsed in the entire semi-periphery and a large part of the periphery (mainly Africa).

From 1950 to 1980, the Chinese economic performance was unspectacular. Its per capita GDP fluctuated around 5 percent of the US level. But this was by no means a failure when China was compared to the rest of the periphery. From 1950 to 1980, the average index for East and South Asia fluctuated around 7 percent and the average index for Africa declined slightly from 9 percent to 8 percent.

The Chinese economy grew rapidly in the 1980s as China started to undertake market-oriented economic reform. But throughout the 1980s, China's urban sector was dominated by state-owned enterprises and central planning continued to dominate the allocation of industrial sector inputs and outputs.

As one makes assessment of the historical socialist economic performance, it seems fair to say that any unbiased observer would make the following observations. First, the twentieth century socialist economies operated with reasonable effectiveness in the sense that they not only managed to produce millions of different modern goods and services in large quantities, but also succeeded in delivering substantial improvements in living standards for hundreds of millions of people over several decades.

Second, the twentieth century socialist economies operated in a variety of economic and cultural contexts, ranging from primarily agricultural economies such as China to modern industrial economies with relatively high levels of technical sophistication such as the Soviet Union and the German Democratic Republic.

Third, the twentieth century socialist economies clearly demonstrated the ability to conduct innovation on a large scale and in a systematic manner, and to deliver rising labor productivity over time. In some areas, the socialist states even managed to match or surpass the achievements of the advanced capitalist countries. Though it could be argued that the socialist states did not succeed in achieving a pace of innovation that was more rapid than what was found in the best performing capitalist economies.<sup>3</sup>

Fourth, with the exception of Yugoslavia (which practiced "market socialism"), the historical socialist states had practically achieved full employment, as a part of their normal economic and social conditions.

Fifth, in the provisioning of the population's basic needs, such as health care and education, the performance of the historical socialist states was decisively better than that of capitalist states with similar levels of economic development.

Vicente Navarro (1993, p. 23) studied the health indicators of capitalist and socialist states and concluded that "at least in the realm of underdevelopment, where hunger and malnutrition are part of the daily reality, socialism rather than capitalism is the form of organization of production and distribution of goods and services that better responds to the immediate socioeconomic needs of the majority of these populations."

Similarly, Giovanni Arrighi (1991, p. 58) pointed out that "[socialism] versus [capitalism] has made a big difference in the status and welfare of the lower social strata of the regions in question—strata that in middle- and low-income regions constitute anything between one-half and two-thirds of the population. ... The USSR has probably done no better (and may have done worse) than Latin America in the 'race' to catch up with the standards of wealth set by the West. Yet the lower social strata of its population have done incomparably

better than the lower social strata of the population of Latin America (Brazil included) in improving their nutritional, health and educational standards. And the improvement has been even greater for the lower social strata of China in comparison with those of South Asia or Southeast Asia.”<sup>4</sup>

In all of these aspects, the twentieth century socialism had “worked” as an effective economic system.

In what sense had socialism “failed” then? The historical socialist states had failed to catch up with the most advanced capitalist country in living standards and labor productivity. But so had the rest of the periphery and semi-periphery in the capitalist world system.

The historical socialist states had also failed to match the performance of some capitalist economies that had done exceptionally well. For example, Japan managed to rise from semi-periphery into the core after World War II. But exceptions are exceptions.

Certainly, the twentieth century socialist experience did not provide evidence that an economic system based on state ownership of the means of production and centralized economic planning could develop “productive forces” more rapidly than capitalism. In the actual historical context of the twentieth century, this meant the socialist states had failed to prevail in the economic competition against the capitalist states.

Within the capitalist world system, all states (including the socialist states) are forced to compete against one another in both economic and military terms. Those that fail the competition would lose their share in the world market, suffer from internal instability, or be defeated in wars against other countries. Economic growth (or capital accumulation) provides the basic means to achieve both economic wealth and military power. Thus the constant and intense drive towards rapid economic growth is among the basic laws of motion of the capitalist world system.

But the capitalist laws of motion would remain the laws of motion only to the extent that the capitalist world system itself remains a viable historical system.

## 5.2 HAS CAPITALISM WORKED, OR FAILED?

According to the conventional wisdom, capitalism is a rational economic system that efficiently allocates resources and generates the maximum possible economic growth and rising living standards over the long run.

Under capitalism, people are free to pursue their self-interests. Guided by the “invisible hand” of prices determined in competitive markets, people’s actions in pursuit of their self-interests lead to economic results that turn out to be socially optimal.

Of course, no serious modern economist would deny that there are market failures. Despite the recognition of market failures, the mainstream consensus is that the positive side of capitalism greatly outweighs the negative side and capitalism remains the best among all possible economic systems.

When there are market failures, prices are “wrong” or they do not correctly reflect social costs and social benefits. The mainstream argument would be valid if the wrong prices were limited to exceptional cases, if the wrong prices did not deviate from the correct prices by large margins, and if the wrong prices could be quickly corrected.

However, a careful consideration of the actual performance of global capitalism suggests that there are at least two major “market failures” that could lead to capitalist market prices that are pervasively wrong, persistently wrong, and wrong by large margins.

First, consider the labor market and capital market. It is well known that both markets normally tend to suffer from asymmetric information and moral hazards. Thus, the prices of factors of production normally tend to be wrong. Since the prices of goods and services are based on the factor prices, one has to conclude that the prices of all goods and services normally tend to be wrong and, for this reason, wrong prices are pervasive.

Moreover, because of the lack of complete future markets, uncertainty about the future could result in sudden and wide fluctuations of capital asset prices that bear no relation to the actual economic performance. The experience since the early 1990s suggested that capital asset bubbles could result in capital asset prices that deviated from “fundamental values” by very large margins and failed to correct themselves for prolonged periods. Thus, the capital asset prices could be persistently wrong and wrong by large margins.

To the extent that the capital asset prices help to determine the future production of goods and services, the prices of all goods and services could also be wrong by large margins and for prolonged periods.

Second, consider the environmental externalities. All economic activities directly or indirectly involve material exchanges with the natural environment. In this sense, all economic activities have environmental impact. It is now common knowledge that the global ecological system is deteriorating in almost every important aspect and the deteriorating trends have persisted for centuries since the beginning of the capitalist world system.

Thus, where environmental externalities are concerned, it is safe to conclude that the observed prices of goods and services in capitalist markets are persistently and pervasively wrong. Further, the global ecological crisis has by now developed to the point that the global ecological system is on the verge of collapse and the very survival of human civilization is at stake. Thus, one has to conclude that the observed prices of goods and services are likely to be wrong by very large margins compared to what are required to achieve global ecological sustainability.

Why do the wrong prices matter? The entire invisible hand argument rests upon the belief that capitalist market prices are “correct,” or at least roughly, mostly, or generally tend to be correct. It is because of the correct prices that individuals’ pursuit of self-interests would happily end with socially optimal outcomes or at least the best among all possible outcomes.

Both advocates and critics of capitalism agree that in a capitalist society, individuals are highly motivated or heavily pressured to pursue the maximization of their self-interests. But if the individuals’ actions are not guided by at least roughly correct prices, and instead by prices that are pervasively and persistently wrong, it would have to mean that, under capitalism, individuals are highly motivated to pursue far from socially optimal objectives.

To the extent that the pervasively and persistently wrong prices are wrong by large margins, it may not be inaccurate to conclude that capitalism is in fact an economic system which strongly motivates or forces individuals to pursue actions with socially destructive outcomes.

### 5.3 THE HISTORICAL LIMITS OF CAPITALISM

All social systems are historical and capitalism is not an exception. The rise and the development of capitalism have rested upon a particular set of historical conditions. With changing historical conditions, it has become increasingly difficult for capitalism to reproduce its essential conditions of operation.<sup>5</sup>

In particular, the following developments suggest that capitalism may have approached its own historical limit:

1. Modern capitalism cannot operate without the stabilizing functions of big government institutions. However, big government stabilization has costs and side effects that over time tend to grow, and we may have reached the point where the costs of big government stabilization start to exceed the benefits.
2. Capitalism is based on the endless accumulation of capital which implies the expansion of material production and consumption on increasingly large scales. This is in fundamental conflict with the basic requirements of ecological sustainability. The fact that the global ecological system is now on the verge of collapse suggests that the existence of capitalism is no longer compatible with what would be required for the survival of human civilization.
3. The development of capitalism has led to the rise of proletarianized working classes. Historically, proletarianization was limited to the core of the capitalist world system which was accommodated by capitalism with a set of welfare state institutions. The western capitalist social compromise is now in crisis. Moreover, proletarianization is now taking place in the much larger

non-western part of the world. Capitalism may not be able to simultaneously accommodate the challenges from both the western and non-western working classes.

### 5.3.1 Socialization of Risks without Socialization of Investment

In Chapter 1 of *Stabilizing an Unstable Economy*, Hyman P. Minsky made the following comments:

It may also be maintained that capitalist societies are inequitable and inefficient. But the flaws of poverty, corruption, uneven distribution of amenities and private power, and monopoly-induced inefficiency ... are not inconsistent with the survival of a capitalist economic system. ... A capitalist economy cannot be maintained, however, if it oscillates between threats of an imminent collapse of asset values and employment and threats of accelerating inflation and rampant speculation, especially if the threats are sometimes realized. (Minsky, 2008 [1986], p. 6)

Since the Great Depression, it has been widely recognized that free market capitalism was fundamentally unstable and a modern capitalist economy cannot function normally without the intervention and regulation of a big government sector.

In *The General Theory*, John Maynard Keynes argued that capitalist investment was fundamentally unstable and, moreover, that the development of capitalist financial markets was likely to have further intensified investment instability (Keynes, 1964 [1936], pp. 147–64). Towards the end of *The General Theory*, Keynes proposed that “a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation of full employment” (ibid., p. 378). However, Keynes insisted that the proposed socialization of investment would not require social ownership of the means of production.

Hyman Minsky argued that “big government” institutions were indispensable for stabilizing the fundamentally unstable capitalist economy. In a modern capitalist economy, the big government helps to sustain capitalist profits during recessions and the central bank helps to stabilize asset prices during financial crises. These institutions help to prevent the declines of capitalist profits and investment from developing into a self-sustained downward spiral that had often plunged the free market capitalist economy into devastating depressions (Minsky, 2008 [1986]).

However, big government institutions have strong side effects. Big government deficits in effect help to socialize business losses, and the central bank’s lender of last resort actions in effect help to socialize risks of private financial markets. Despite the partial socialization of risks and losses, investment decisions continue to be made by private businesses for the purpose of making private profits. Big government capitalism thus encourages excessive

risk-taking in finance and investment and tends to increase the potential of financial instability.

Thus, on the one hand, big government institutions are indispensable for preventing depressions; but, on the other hand, big government capitalism does not abolish the inherent tendency under capitalism towards financial instability. On the contrary, with the effective socialization of risks and losses, the excessive risk-taking in private investment and finance has led to frequent financial crises with increasingly destabilizing consequences (Pollin and Dymski, 1994; Li, 2009).

The financial crises necessitated government interventions, forcing the government to run large deficits during recessions. The deficits that occurred in recessions were typically not offset by surpluses during expansions. As a result, there has been a tendency for the government debt to rise in relation to GDP. This tendency was intensified under neoliberalism as interest rates tended to be relatively high in relation to economic growth rates (Li, 2009). The government debt–GDP ratios cannot keep rising indefinitely. Beyond a certain point, the debt–GDP ratio could be so high that the government’s ability to stabilize the capitalist economy would be seriously compromised.

From the Marxist perspective, this contradiction of big government capitalism reflects the underlying contradiction between the capitalist system of private appropriation and the objective tendency of socialization of production. While the development of the capitalist economy requires growing social regulations through institutions such as the big government and the central bank, the basic means of production continue to be owned by private capitalists and used by private capitalists to make private profits.

Thus, on the one hand, a high level of socialization of investment risks and losses has become indispensable for the normal operations of modern capitalism; but, on the other hand, the lack of social control over investment has led to growing financial instability and increasingly large government debts. This underlying contradiction has found its expression through progressively more destructive economic and financial crises. Contrary to what Keynes argued, the eventual resolution of this structural contradiction may require nothing short of a comprehensive socialization of the basic means of production.

### **5.3.2 Endless Accumulation vs the Limits to Growth**

All human societies depend on the earth’s ecological systems for survival and development. Human societies use renewable and nonrenewable resources for material production and consumption. The human production processes, in addition to producing useful goods and services, generate material wastes and pollution. To sustain the normal functioning of the ecological systems, the human consumption of nonrenewable resources should be minimized, the human



consumption of renewable resources should stay within the ecological system's natural regenerative capacity, and the material wastes generated by human activities need to stay within the ecological system's natural absorptive capacity.

Thus, to maintain ecological sustainability, the human environmental impact (resources consumption and pollution) must stabilize at a level that is within the ecological system's natural limit. However, the capitalist economic system is based on production for profit and endless accumulation of capital. The normal operation of capitalism tends to lead to unlimited expansion of material production and consumption. The basic laws of motion of capitalism are therefore in fundamental conflict with the requirements of ecological sustainability.

This may be illustrated by the following simple formula:

$$\text{Environmental Impact} = \text{GDP} * \text{Environmental Impact per Unit of GDP}$$

Thus, unless the growth of GDP is more than offset by declining environmental impact per unit of GDP, capital accumulation (economic growth) will result in growing environmental impact, potentially leading to ecological collapse.

After centuries of relentless capital accumulation, many aspects of the global ecological system are now on the verge of total collapse. In particular, climate change, caused by greenhouse gases emitted by human consumption of fossil fuels, is now threatening the very survival of human civilization. The global average temperature is now about 0.8 degrees Celsius higher than it was in pre-industrial times and rising at a rate of 0.2 degrees per decade. There is a growing consensus among scientists that if global warming rises above 2 degrees Celsius, dangerous climate feedbacks may be triggered, leading to the release of more greenhouse gases from the ocean and terrestrial ecological systems. In the event of runaway global warming, much of the world would cease to be inhabitable and catastrophic declines of global population may ensue (Spratt and Sutton, 2009).

Is it possible for the global ecological crisis to be resolved within the historical framework of capitalism? According to the defenders of the existing system, capitalism is an exceptionally innovative system. With proper incentives, capitalists would be motivated to develop "eco-friendly" technologies that help to reduce environmental impact per unit of economic output, allowing capitalism to achieve both endless accumulation of capital and ecological sustainability.

However, in reality, the economic growth rate is almost always higher than the reduction rate of environmental impact per unit of output, so that the global consumption of most natural resources and the global generation of most pollutants continue to grow exponentially. Why has capitalist technological progress failed to deliver ecological sustainability?

In addition to various economic and technical limits, the pace of technological progress is limited by the pace of infrastructure transformation. Each year

only a fraction of the existing capital equipment and buildings may be replaced. Suppose an economy each year replaces 5 percent of its capital infrastructure. Making the heroic assumption that the new capital is twice as efficient as the old capital so that the environmental impact per unit of output falls by 50 percent for the new capital, for the economy as a whole, this represents a reduction of environmental impact per unit of output by 2.5 percent. But a modern capitalist economy often needs a 3 percent economic growth rate to prevent the unemployment rate from rising. Thus, even with this very optimistic assumption about technological progress, the rate of technological progress is smaller than the economic growth rate required for capitalist stability, implying rising environmental impact.

In many areas, resources depletion and environmental degradation are now proceeding at rates far above the sustainable rates. Thus, to stabilize the global ecological system and achieve sustainability would require not stable environmental impact, but declining environmental impact. For example, to prevent long-term global warming of more than 2 degrees Celsius, global carbon dioxide emissions need to start to fall immediately, declining at an annual rate of 5 percent from now to the end of the century. To prevent long-term global warming of more than 3 degrees Celsius (which would carry a significant risk of runaway global warming), global carbon dioxide emissions need to decline at an annual rate of 1.5 percent from now to the end of the century (Anderson and Bows, 2011; Li, 2011).

Thus, it is impossible for global capitalist accumulation to be made compatible with global ecological sustainability. To the extent that the continuing existence and operation of the capitalist world system is now in fundamental conflict with the survival and development of human civilization, capitalism has ceased to be a historically viable social system.

## 5.4 SOCIALISM AND THE WORLD HISTORICAL AGENDA IN THE TWENTY-FIRST CENTURY

In the *Communist Manifesto*, Karl Marx predicted that, as capitalism developed, a growing proportion of society's labor force would become wage workers (or proletarians). As the proletarianized working class grew in strength and learned to get organized, sooner or later it would become so powerful that it would prove to be the "grave diggers" of capitalism (Marx and Engels, 1978 [1848]).

From the mid-nineteenth century to the mid-twentieth century, working class organizations had grown throughout the advanced capitalist countries. In Western Europe, socialist and communist parties became powerful political forces. In response to the growing working class challenge, the capitalist classes

made some major concessions. After World War II, the capitalist institutions were restructured, to be based on a new scheme of social compromise (the “new deal”) which provided the western working classes with a package of social welfare as well as the promise of rising living standards over time, in exchange for their political loyalty to the capitalist system.

The new deal compromise did not secure social peace forever. The postwar rapid economic expansion led to the depletion of the remaining rural surplus labor force in the advanced capitalist countries. The working class bargaining power was further strengthened by the welfare state institutions. By the 1960s, the western working classes had become strong enough to demand wage rises that started to undermine capitalist profitability. From the mid-1960s to the early 1980s, the profit rate fell in all the advanced capitalist countries, leading to a prolonged period of economic and political instability.

In response to the crisis, the capitalist classes organized a counter-offensive which has been known as “neoliberalism.” The neoliberal policies attempted to roll back some of the economic and social gains won by the western working classes over the previous decades. Much industrial capital was relocated from the advanced capitalist countries to areas with a large cheap labor force, especially China. The massive expansion of the global cheap labor force helped to undermine working class bargaining power and the capitalists enjoyed rising profit rates from the 1980s to the 1990s.

However, the neoliberal “success” had some serious side-effects. As the working classes in much of the world suffered from declining living standards, global effective demand was constrained. Many economies attempted to get around this problem by pursuing export-led growth. But it was impossible for all countries to pursue export-led growth. From the 1990s to the early 2000s, the US had sustained the global economic expansion through debt-financed consumption. The large US trade deficits allowed the rest of the world to pursue export-led growth. The growth model was unsustainable and eventually led to the “Great Recession” of 2008–2009.

All the advanced capitalist countries are now confronted with serious fiscal crises. According to the Bank of International Settlements, under the existing trends, government debt-to-GDP ratio is set to rise to 400 percent in France, 300 percent in Germany, 250 percent in Italy, 600 percent in Japan, 500 percent in Britain, and 400 percent in the United States by the mid-twenty-first century (Cecchetti et al., 2010). In the advanced capitalist countries or the core zone of the capitalist world system, the historical space for social compromise seems to have been exhausted.

On the other hand, in recent years there have been large formations of industrial working classes in the non-western world. Until now, the large cheap labor force in the non-western world has been functioning as a pool of global reserve army that helps to undermine the global working class bargaining

power. But this is about to change. In the coming decades, one would expect that as the non-western working classes continue to grow in size and learn to get organized, the workers in the non-western world will demand higher wages as well as a growing range of political and social rights. Can the demands by the non-western working classes be accommodated by the capitalist world system?

Historically, the western capitalist classes had managed to accommodate the working class challenge by providing a package of social reform. However, if the capitalist world system can no longer afford the social reform package for the comparatively small western working classes, there is little chance for it to offer and afford a similar package for the much larger non-western working classes.

The historical social compromise between the western capitalist and working classes took place when global energy and natural resources remained abundant. By comparison, centuries of relentless global capital accumulation have by now exhausted the global ecological space.

In the coming decades, if global capitalism fails to accommodate the growing demands of the non-western working classes while maintaining social peace in the core zone of the world system, then socialism as a global revolutionary project will be back on the historical agenda.

## 5.5 CHALLENGES FOR TWENTY-FIRST CENTURY SOCIALISM

According to classical Marxism, the historical contradictions of capitalism could only be resolved by replacing capitalism with a fundamentally new economic and social system based on social ownership of the means of production and society-wide planning.

The twentieth-century socialist states remained a part of the capitalist world system and had to compete against the capitalist states economically and militarily. While the socialist states failed to prevail in the competition against the capitalist states, twentieth century socialism did demonstrate that an economic system based on state ownership of the means of production and centralized economic planning was able to achieve full employment and meet the population's basic needs more effectively than capitalism.

Twenty-first century socialism will face fundamentally different historical challenges. As global capitalism ceases to be a historically viable social system, the question is no longer about how socialist states could compete effectively against capitalist states within the capitalist world system. Instead, the overwhelming challenge for humanity is to reorganize the global material production and consumption in ways consistent with global ecological sustainability.

To prevent global ecological catastrophes, economic growth rate needs to be adjusted downwards so that the economy grows more slowly than the pace of ecological technological progress. If necessary, the absolute level of global material consumption may need to be adjusted downwards.

For this to happen, an economic system is required where society exercises collective and democratic control over the use of the surplus product (the part of society's total product that is above the population's basic consumption), so that society could collectively decide to use the surplus product not for capital accumulation, but to contribute to the population's physical and mental development and to improve the ecological system.

The requirement of social control over the surplus product not only rules out any economic system dominated by private ownership of the means of production, but also any economic system dominated by market relations. With the dominance of market relations, individuals, businesses, and states would be under constant and intense pressures to compete against one another. To survive and prevail in market competition, individuals, businesses, and states would be both motivated and forced to use their profits or revenues to accumulate capital, leading to uncontrolled economic growth that in the long run inevitably leads to ecological catastrophes.

The environmental records of the historical socialist states were mixed. The former socialist states suffered from some of the world's worst pollution problems and environmental degradation, partly due to their orientation towards heavy industrial development. In the case of China, though, environmental conditions have deteriorated further under capitalist transition (Smil, 1993; Auer, 2005; Wen and Li, 2006).

On the other hand, since the 1990s, Cuba has undertaken a relatively effective transition towards ecological agriculture in response to the major energy challenge it had to confront after the collapse of the Soviet Union (Pfeiffer, 2006, pp. 53–65). According to *The Living Planet Report 2010* (WWF et al., 2010), Cuba is one of the few countries in the world that has managed to achieve near "sustainable development," with sustainable development defined as achieving a high level of human development as measured by the United Nations Human Development Index while keeping the per-person ecological footprint at a level below the world average bio-capacity.

The historical socialist states remained a part of the capitalist world system and had to engage in economic and military competition against the capitalist states. As a result, the system of centralized economic planning was mobilized to maximize economic growth instead of promoting ecological sustainability. It should be noted that while the historical socialist states suffered from notable environmental failures, it is the leading capitalist states that have been responsible for the bulk of the greenhouse gas emissions that threaten to bring about global climate catastrophes.

According to James Hansen, one of the world's leading climate scientists, the United States accounted for 27 percent of the world's cumulative carbon dioxide emissions from fossil fuel burning from 1750 to 2010, while the United Kingdom, Germany, and Japan together accounted for 16 percent. On the other hand, China accounted for almost 10 percent and Russia accounted for 7 percent. The bulk of China's emissions have taken place since China began the transition to capitalism (Hansen, 2011).

Politically, the historical socialist states were non-democratic and Cuba remains a non-democratic state as the term is conventionally defined. The non-democratic feature reflects primarily the historical origin of the socialist states. It should be pointed out that in the early and the mid-twentieth century, when socialist revolutions took place in Russia, Eastern Europe, China, and Cuba, few peripheral and semi-peripheral states were democratic and some were yet to become formally independent states. Even in the United States, a significant portion of the population (the African Americans in the Southern states) was deprived of basic civil rights. In the twenty-first century, as the population's political consciousness rises to a much higher level, it is difficult to imagine a future socialist state without formal democratic institutions.

The precise form of twenty-first century socialism will have to be decided by the actual practice and struggle of the global working classes. However, the classical Marxist conception of social ownership of the means of production and society-wide planning are likely to be essential features of any future socialist system.

## NOTES

1. For a classical critique of socialist economic planning, see Hayek (1996 [1948]). For a summary of the contemporary mainstream critique of socialism, see Stiglitz (1994). For a critique of socialist economic planning from market socialist perspectives, see Blackburn (1991) and Roemer (1994).
2. For an elaboration on the structural positions within the capitalist world system, see Wallerstein (1979).
3. When there was a clear social objective, centralized planning could be effective in promoting certain innovations, such as in the military area (Stiglitz, 1994: 197–206). During the years of the Cultural Revolution, China accomplished several scientific achievements of global significance, including the hybrid rice crop, the electronic publishing system of Chinese characters, the artificial synthetic crystalline insulin, and the compound Artemether, together known as the new “four great inventions” (Gao, 2008: 143–4). The hybrid rice crop made a major contribution to raising rice yields throughout the world and the compound Artemether is considered the world's best hope for a malaria cure.
4. In saying that the former Soviet Union might have done worse than Latin America in catching up with the West, Arrighi was constrained by the data available to him. Based on the currently available authoritative data compiled by Maddison (shown in Figure 5.1), the Soviet and Eastern European growth records were actually marginally better than those of Latin America for the postwar years, and this has not yet taken into account the Soviet industrialization miracle during the 1930s.
5. For more detailed arguments on the historical limit of capitalism, see Wallerstein (1998).

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## 6. Economic growth: the great slowdown (1980–2000) and recovery (2000–2010)

**Mark Weisbrot**

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The vast majority of developing countries experienced a sharp slowdown in economic growth from 1980–2000, which received very little attention among economists, policymakers, or in the press. The slowdown coincided with the widespread introduction of neoliberal reforms during the 1980s and 1990s, with some of the reforms beginning in the mid to late 1970s. The possible connection between these policy reforms and the growth slowdown has also not been explored. These reforms included: increasing independence of central banks and tighter monetary policy; tighter and sometimes pro-cyclical fiscal policies; privatization of state-owned enterprises; financial deregulation and opening up to international trade and capital flows, sometimes in an indiscriminate manner; increased protectionism in intellectual property; and the abandonment of state-directed and state-led industrial policies and development strategies.

These policies were implemented differently in different countries, and to varying degrees; and they could have different effects in different cases. In some cases trade opening can contribute to growth, for example if imports increase efficiency and do not cause too much damage to domestic production. Privatization of state-owned enterprises that are grossly inefficient and cannot be reformed can also bring significant efficiency gains. In countries where the fiscal and monetary authorities have pursued policies that led to balance of payments crises and/or hyperinflation, a move toward more fiscal and monetary discipline may be in order.

However, it is also possible for such reforms to have considerable disruptive effects and lead to outcomes that reduce growth, especially if they are implemented without regard to their impact on growth and development. For example, tighter monetary policy will generally slow growth, either directly through the effect of high interest rates on investment, or—often more importantly in developing countries—by increasing the exchange rate. Tighter fiscal policy will also slow growth, and both tight fiscal and monetary policy can be especially damaging if they are used pro-cyclically—that is, when the economy is weak or

in recession. It is also difficult for most developing countries to move to higher value-added areas of production without an industrial policy or development strategy.<sup>1</sup> So it should not be surprising to find a sharp slowdown in GDP growth from 1980–2000, for the vast majority of low and middle-income countries. This will be examined below. As would be expected, there was also a decline in progress on major social indicators such as life expectancy and infant and child mortality during this period.

Since the early 2000s, there was a rebound of economic growth to levels of the 1960–1980 period, in spite of the serious global economic crisis and recession of 2008–2009. Since the 2-decade slowdown in growth received relatively little attention, the rebound has also gone largely unnoticed. This is also examined below, with possible explanations for the rebound.

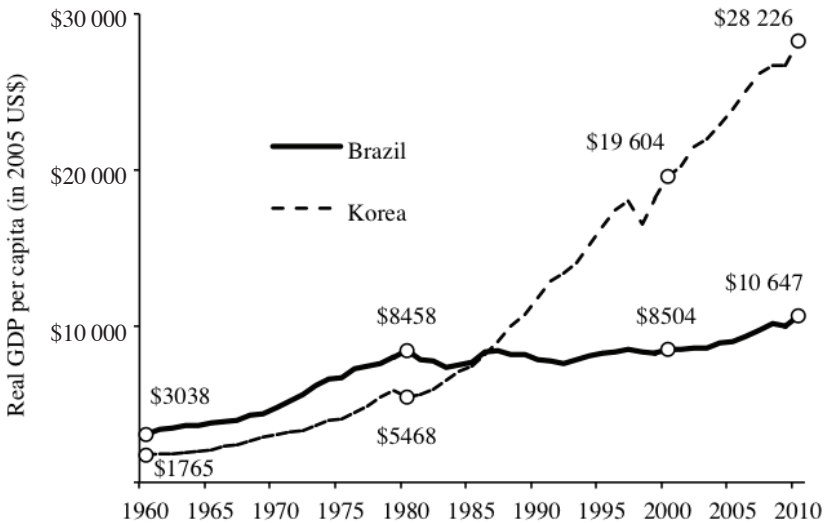
Finally, in 2012 the global economy is facing a significant risk from the financial crisis in the eurozone. This chapter will also look at this crisis as another example of the policy failures that slowed global economic growth during the 1980–2000 period. In many ways it is similar to the past experience of developing countries, complete with IMF agreements, pro-cyclical macroeconomic policies, debt, and financial crises—the difference being that this is now the experience of a group of high-income countries. It remains to be seen how much damage this will do to global economic growth in the current decade.

## 6.1 THE DIFFERENCE THAT ECONOMIC POLICY CAN MAKE

As an illustration of how much difference economic policy can make over the long term, it is useful to compare the development experiences of Brazil and South Korea, which both started out as low-income countries in 1960. This is shown in Figure 6.1. Brazil was much poorer than South Korea, with less than 60 percent of South Korea's per capita income. They both grew at about the same pace over the next 20 years, so that the gap widened in absolute terms; but Brazil picked up a bit in relative terms. Both countries made large gains during this period, with Brazil more than tripling its per capita GDP.

But in 1980, the two countries took different paths. Both were hit by the world recession of 1980–1982, but South Korea recovered and resumed rapid growth. Brazil, which adopted a whole different set of macroeconomic and then development policies in the 1980s and 1990s, stagnated for the next 20 years, with almost no per capita income growth at all. Growth finally picked up after 2004, although it did not return to pre-1980 rates.<sup>2</sup> South Korea, by contrast, grew 259 percent in per capita terms from 1980 to 2000. The result was that by 2010, South Korea became a high-income country, with income per capita of

Figure 6.1 Brazil and South Korea: per capita GDP



Note: See Appendix for methodology.

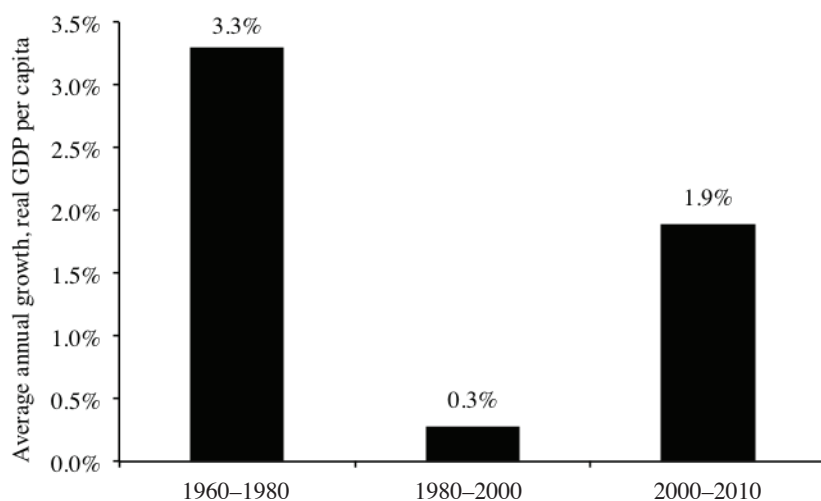
Source: Weisbrot and Ray (2011).

more than US\$28 000; Brazil remained a middle-income country with income per capita of less than US\$11 000.

Social indicators also demonstrate starkly the difference between the two countries today, as a result of their different economic policies. Brazil still has about 42 million people, or 22.3 percent of the population living on US\$3 a day—despite considerable progress under the leftist government since the early 2000s, 12.7 percent live on less than US\$2 per day.<sup>3</sup> South Korea is listed as having less than 2 percent of the population living below the US\$2-per-day poverty line; the actual percentage is probably well below 2 percent.<sup>4</sup> South Korea is ranked 12 among all countries on the UN Human Development Index, while Brazil is ranked 73.<sup>5</sup> The average number of years of schooling in South Korea is 12; in Brazil it is 7.<sup>6</sup> Infant mortality in Brazil is four times that of South Korea (17.3 vs 4.2 per 1000 live births).<sup>7</sup>

Brazil's story is to a large extent representative of what happened in Latin America over the last half century. Figure 6.2 shows the region's growth in per capita GDP.<sup>8</sup> As can be seen from the graph, there was a drastic fall-off in per capita income growth from a reasonable 3.3 percent for the 1960–1980 period, to just 0.3 percent in 1980–2000. In cumulative terms, this is a difference between 91.5 percent and just 5.7 percent across the two 20-year periods. Growth then

Figure 6.2 Latin America and the Caribbean: average annual per capita GDP growth



Note: See Appendix for methodology.

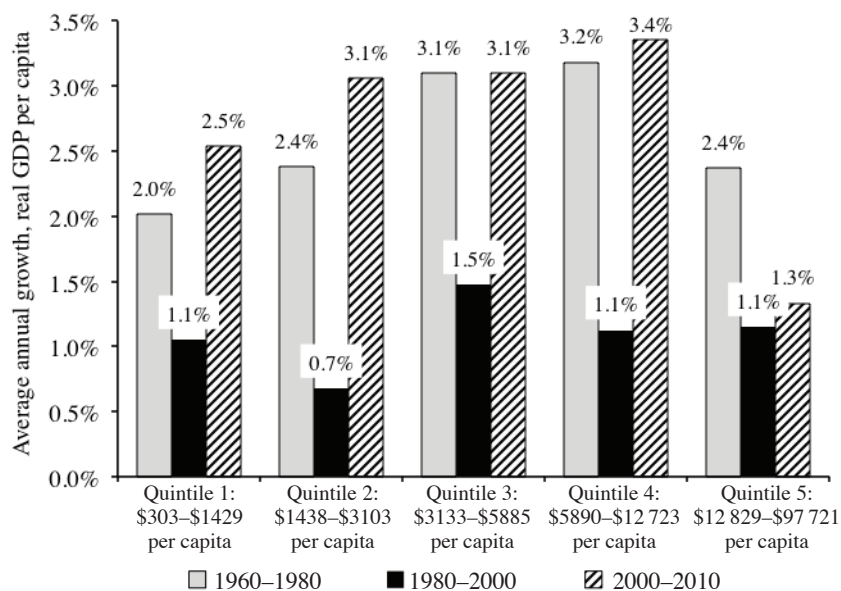
Source: Weisbrot and Ray (2011).

rebounded after the year 2000 to 1.9 percent per capita—a major improvement, but still well below the performance of the pre-neoliberal era.

The growth slowdown in Latin America of the 1980–2000 period—it actually extended into the first few years of the 2000s—was the worst long-term growth failure for at least a century. It led to unprecedented political changes from 1998 to 2011—the vast majority of people elected left and left-of-center governments, including in Venezuela, Brazil, Argentina, Bolivia, Ecuador, Uruguay, Paraguay, El Salvador, Nicaragua, Honduras, Haiti, and El Salvador. Most of these governments did not make a sharp break with the neoliberal policies of their predecessors, and did not embark on development or industrial strategies that were comparable with those of the past. However, there have been some significant movements away from neoliberal policy—for example, the macroeconomic policies of Argentina and, to a lesser extent, of Brazil, Ecuador, and Venezuela—and a greater attention to reducing poverty and increasing access to health care and education.<sup>9</sup> But the growth slowdown was almost completely ignored as a possible cause of these enormous and widely-discussed political changes.

The growth slowdown in the rest of the world can be seen in Figure 6.3. This compares annual growth in per capita GDP for countries for which data

Figure 6.3 Average annual per capita GDP growth, by quintile



Note: Countries are divided into quintiles based on per-capita GDP at the beginning of each time period, in 2005 USD. See Appendix for methodology.

Source: Weisbrodt and Ray (2011).

is available, over three periods: 1960–1980; 1980–2000; and 2000–2010. This is a fair comparison because the first period is a reasonable benchmark. While the 1960s was a period of very good economic growth, the 1970s suffered from two major oil shocks that led to world recessions—first in 1974–1975, and then at the end of the decade.

In Figure 6.3, the countries are divided into quintiles, with the poorest countries on the left. For example, the second quintile contains countries that started each period with an income between \$1438 and \$3103 in 2005 US dollars. Countries that started out in the second quintile in 1960 included Cote d'Ivoire, Haiti, Morocco, Nigeria, and South Korea; at the upper end were Brazil, Ecuador, Bolivia, and Turkey. The Dominican Republic, Honduras, Panama, and Malaysia were towards the middle of the quintile.

This methodology here avoids the problem of diminishing returns. In other words, we would expect economies that have already reached a high income level to grow more slowly than developing countries starting out at a lower level. So instead of comparing the same countries over time, as in Figure 6.2, we are comparing all of the countries that begin each period (for example, 1960) at the

same level of GDP. This means that we can compare countries that started out in 1980 with the same level of income that other countries had in 1960. So there is no problem of diminishing returns; there is no reason to believe that a country with real per capita income of US\$6000 in 1980 should grow any more slowly than one that starts out at the same level in 1960. If anything, it should be able to do better, since the world store of knowledge and technology has increased.

In fact, it is striking that so very few countries have caught up with the living standards of Europe, the United States, or the countries that were the first to industrialize. For example, only three small countries out of 51—Botswana, the Maldives, and Cape Verde—have moved up from the group of Least Developed Countries since the category was created by the United Nations in 1971.<sup>10</sup> These long-term patterns by themselves suggest that there are barriers and obstacles that have their origins in international relations, rather than simply within countries.

It is also worth pointing out that the unit of analysis in this method is the country. Therefore a small country such as Iceland, with 300 000 people, has the same weight in the averages shown here as does China, with 1.4 billion people and the world's second largest economy. The reason for this method is that economic decisionmaking is done at the level of the individual government, and this analysis aims to compare the results of such decisionmaking across countries.

As can be seen in the graph, there was a sharp slowdown in growth in all of the quintiles: from 2 percent annual per capita GDP growth from 1960 to 1980 to 1.1 percent for the second period (1980–2000) in the poorest quintile; from 2.4 percent to just 0.7 percent growth in the second quintile; 3.1 to 1.5 percent in the third quintile; 3.2 to 1.1 percent in the fourth quintile; and 2.4 percent to 1.1 percent in the highest quintile. Since this is not the result of diminishing returns, and the falloff in growth is so large and takes place over such a long period of time—2 decades—this is something that merits investigation. The fact that it coincides with a set of policy changes, described above, does not prove that the whole package of neoliberal reforms was a failure. It does, however, make for a strong *prima facie* case that some kind of major policy failure took place in this period.

Figure 6.3 also shows a rebound of economic growth since the early 2000s, despite the financial crisis and world recession of 2008–2009. In all but the highest quintile, growth rebounds to its rate of the first period or somewhat higher. (The top quintile contains both middle and high-income countries). How are we to account for this turnaround? And can we expect it to last?

There are a number of changes that may have contributed to the rebound in economic growth since the early 2000s. Probably the most important is the rise of China, and its imports from developing countries. China's economy has multiplied more than 17 times since the early 1980s, to become the world's second-largest economy. Its imports from developing countries have grown enormously since the early 2000s, from just 0.5 percent of the GDP of non-

OECD countries in 1995 to 3 percent in 2010. This surge in demand from China has undoubtedly contributed very significantly to the growth of many low- and middle-income countries.<sup>11</sup> Africa, for example, had GDP growth (not per capita) of 5.7 percent annually since the early 2000s, as compared to 2.4 percent during the 1980s and 1990s.<sup>12</sup>

China is by far the least neoliberal of all of the major economies in the world. Even after more than 3 decades of reform, it is very much a state-led economy. China's success cannot be attributed to the reforms that most countries adopted in the post-1980 period. Although both foreign direct investment and exports contributed substantially to China's growth, both were heavily managed and handled quite differently than in other developing countries. The government has played a major role in shaping investments that would fit in with the country's development goals. These include such priorities as producing for export markets, an increasing level of technology (with the goal of transferring technology from foreign enterprises to the domestic economy), hiring local residents for managerial and technical jobs, and not allowing foreign investments to compete with certain domestic industries. China's policy toward foreign investment has therefore been directly opposed to the major worldwide reforms of recent decades, including the rules of the World Trade Organization (WTO); the same is also true in the important area of intellectual property.<sup>13</sup>

About 44 percent of the assets of major industrial enterprises belong to state-owned enterprises.<sup>14</sup> The financial system is state-controlled, with the government owning the four largest banks. The Chinese government's control over the most important and strategic sectors of the economy, especially finance, proved crucial in maintaining rapid economic growth during the world recession. In 2009, China's net exports had a negative 3.7 percentage point contribution to the economy's GDP growth; but growth was maintained at 9.1 percent, due partly to a nearly 20 percent surge in capital formation.<sup>15</sup> It is difficult to imagine this having happened without the government's control over bank lending and state-owned enterprises generally.

It is important to emphasize what happened here because it runs so contrary to conventional wisdom. Starting in the late 1970s and 1980s, and continuing into the 1990s, a whole set of neoliberal reforms were adopted in almost all low- and middle-income countries. This coincided with a prolonged economic growth failure from 1980–2000 in the vast majority of the countries that adopted these reforms. However, the one large economy whose development policy was state-led, and did not adopt the neoliberal reforms, grew faster than any economy in world history, to the point where it became the second-largest economy in the world. This economy then pulled up the growth rate of dozens of other economies through its imports.

There were also policy changes in the low- and middle-income countries, and changes in the international financial system, that contributed to the turn-

around. In some cases failed policies were abandoned—for example the fixed, overvalued exchange rates in Russia, Argentina, and Brazil that contributed to the severe crises and resulting output losses of the late 1990s. In India, which was—along with China—one of the few sizeable economies that grew faster in the second period (1980–2000) than in the first, there is evidence that reversals of neoliberal policies contributed to the rapid growth acceleration that took place after 2003. These included, most importantly, a loosening of monetary policy by India’s Central Bank, and a large depreciation of the country’s overvalued exchange rate.<sup>16</sup>

In other cases, disastrous neoliberal policy failures of the 1990s—most importantly in Eastern Europe and the former Soviet Union—ran their course, and the economies were re-established on a more stable footing. The former Soviet states that make up the Commonwealth of Independent States saw their economies shrink by an enormous 2.8 percent annually in the 1990s, but rebound with 5.4 percent annual growth since the early 2000s. The economic collapse in these countries was one of the biggest and most obvious neoliberal policy failures of that era. The fact that this was a policy failure, and not merely an inevitable cost of transition from a planned economy, can be seen by comparison with the transition of China, which also managed a transition from a planned economy during the same period, but did so gradually and in a very different manner—as noted above, with economic growth breaking world historical records.

Another major change that took place since the early 2000s was the collapse of the IMF’s power to influence policy in many developing countries. Prior to this, the IMF headed up a “creditors’ cartel” whereby countries that did not agree to its conditions did not get funds from the much larger World Bank, regional development banks or other official lenders, or sometimes even the private sector. This was the major avenue of influence of the US government in low- and middle-income countries, and was used to promote neoliberal policy changes in many countries. This began to break down when the countries that were hit hard by both the Asian economic crisis of 1997–99 and the IMF intervention there began to pile up reserves so that they would never have to borrow from the Fund. A series of other events led to a remarkable loss of IMF influence in middle-income countries.<sup>17</sup> These included Argentina’s successful battle with the IMF, in 2002–2005, after its record sovereign debt default, and remarkable economic success after defying the Fund; and the increasing availability of alternative sources of foreign exchange, for example in Latin America, from Venezuela and China. The IMF’s loss of influence was one of the biggest changes in the international financial system since the breakdown of the Bretton Woods system in 1973. (The poorest countries, especially in Africa, are still subject to IMF/World Bank policy prescriptions, but even that is beginning to erode as China becomes an alternative source of funding in Africa.)



The IMF's total outstanding loans fell from US\$105 billion in 2003 to less than US\$20 billion in 2007.<sup>18</sup> Although the IMF dramatically increased its resources to record levels as the world financial crisis and recession unfolded—from US\$250 billion to US\$750 billion—it never regained influence in the middle-income countries of Asia, in Latin America, Russia, or other countries that it lost during the early 2000s. The Fund did play a role in the implementation of pro-cyclical policies in many countries during the world economic downturn—a look at 41 agreements at the end of 2009 showed that 31 contained pro-cyclical macroeconomic policies.<sup>19</sup> In these cases, IMF agreements provided for budget tightening, monetary tightening, or both while the economy was experiencing a significant growth slowdown or already in recession. But the Fund's role in this crisis was considerably more moderated than in the past—for example, in comparison to the crisis of the 1990s. In some countries pro-cyclical policies were reversed as the downturn worsened. And the IMF also had some positive impact: the Fund's lending that did not have pro-cyclical or other harmful conditions attached, which was significant in the last few years, made a positive contribution. For example, the countries that were able to borrow from the Fund during the financial crisis, without pro-cyclical conditions attached—including low income countries such as Tanzania, Mozambique, and Zambia—were in a better position to pursue expansionary policies and avoid foreign exchange or balance of payments crises. It is difficult to measure the overall net impact of the Fund since the beginning of the world recession, but clearly it did not have anything approaching the negative impact that it had from 1980 to 2000. Also, there was a coordinated intervention by central banks in response to the financial crisis, and expansionary monetary and fiscal policy in many countries, especially in high-income and some middle-income countries, in response to the downturn. All of these changes in the international financial system had an impact on allowing for higher growth during the early 2000s, as compared to the 20 years prior.

## 6.2 LOOKING AHEAD: POLICY CRISIS IN THE EUROZONE AND GLOBAL GROWTH PROSPECTS

Looking forward at the time of this writing, there do not seem to be any obvious obstacles within the low- and middle-income countries themselves to their continued growth at the pace of the decade prior to 2012. That is, the long period of sharply reduced growth, which appears to be associated with neoliberal policy changes, seems to have come to an end. There have not been any significant reversals of the changes that have taken place during the 2000s that have allowed for this renewed growth. Most significantly, the Chinese government is still committed to economic growth. The IMF has not regained its influence over policy

in the middle-income countries that it lost during the 2000s. There are no large projects of liberalization of trade or capital flows on the horizon; this is of course still part of the WTO agenda, but that agenda has been stalled since the early 2000s and is unlikely to make a rapid, destructive comeback in the near future.

The biggest threat to economic growth in developing countries right now comes from neoliberal macroeconomic policies in the eurozone. In fact, this is perhaps the clearest example in the past 20 years of neoliberal policies directly imperiling the health of the global economy, although neoliberal policies also contributed to the Great Recession. While the Great Recession in the United States was caused primarily by the bursting of a real estate bubble,<sup>20</sup> its effects, especially worldwide, were amplified by neoliberal policies, including the years of financial deregulation that allowed for very high levels of leverage in the banking system; regulatory failures such as the widespread lack of oversight in mortgage markets; and the neoliberal dismantling of capital controls during the 1970s to 1990s, which led to vastly larger international capital flows that helped the financial crisis spread to many countries.

Much of the analysis of the current problem has treated the eurozone crisis as a debt crisis, but this is not really true, with the possible exception of Greece. The weaker eurozone economies mostly reduced their public debt-to-GDP ratios during the expansion that preceded the financial crisis and world recession in 2008–2009. Even in the case of Greece, the country had a debt-to-GDP ratio of 115 percent at the beginning of 2010, which would have been manageable had the European authorities kept its borrowing costs down and recovered normal growth. Instead, Greece negotiated an agreement with the IMF in May 2010 and the European authorities (the European Commission and European Central Bank (ECB)) that set in motion a downward spiral that increased its debt burden to 162 percent of GDP by November 2011. Unemployment passed 17 percent of GDP and the IMF continually lowered its growth projections for the Greek economy, with a forecast by November of negative 5.5 percent for 2011.

The financial crisis in the eurozone accelerated in July of 2011 because the ECB initially refused to intervene in Italian and Spanish bond markets in order to put a ceiling on these interest rates. The IMF lowered its projections for Italy's growth from its Spring to Fall World Economic Outlook because of the government's agreement to a US\$75 billion austerity package. Fear returned in force to European financial markets in November, as the prospect of Italy repeating the downward spiral of Greece became visible. As fiscal tightening reduces growth, government revenue falls, and it becomes more difficult to meet the promised target of fiscal tightening. The government then tightens further, and further reduces growth. At the same time, borrowing costs increase as the value of the country's sovereign bonds falls. The rise in Italy's borrowing costs over 2011 have added about one more percentage point of fiscal tightening that the government has agreed to do. Meanwhile, the loss in value of Italian,

Spanish, and other bonds held in the hundreds of millions of euros by European banks has threatened the financial system and raised the specter of a Lehman Brothers-style collapse. The Italian debt—much more than that of Greece, Portugal, Ireland, and even Spain combined—is more than can be handled by the European Financial Stability Facility (EFSF). And attempts to expand the capacity of the EFSF have so far been too slow to deal with the current crisis.

The crux of the current crisis is the refusal of the ECB to act as a lender of last resort for the sovereign bond market. It could purchase Spanish and Italian bonds and put an end to the crisis by lowering these interest rates. But the ECB has been far more neoliberal than the Federal Reserve in the United States, which has recognized the potential severity of the crisis and has created more than US\$2 trillion since the US recession began; and has also kept short-term rates at or near zero since December of 2008. As of this writing (2012), the European authorities—with the IMF as a subordinate partner—have gone along with the ECB and are insisting that the solution will come from more fiscal tightening in the eurozone.

It remains to be seen if the European authorities, including the ECB, will reverse course in time to avoid a severe financial crisis. My own view is that they probably will do so, eventually. However if they do not avoid a severe crisis, the contagion effects are potentially serious. The European banking system is considerably larger than that of the US, and they are linked. The United States economy is recovering slowly and is vulnerable to contagion effects as well as some slowdown through trade. Europe and the United States together are about half of the global economy, and are also China's two largest trading partners. The eurozone crisis is already slowing global economic growth; the question is how much farther the European authorities will push these failed macroeconomic policies, and how much of a financial crisis and contagion will result. This is currently the biggest threat to the world economy, and to the continued growth of the low- and middle-income countries.

### 6.3 CONCLUSION

There has been a sharp rebound in economic growth for developing countries since the early 2000s. Despite the world financial crisis and recession, low- and middle-income countries experienced their best decade-long growth since the 1960–1980 period, before the prolonged slowdown of the 1980s and 1990s, which extended into the first years of the twenty-first century.

This chapter has argued that certain neoliberal policy changes that were adopted in most developing countries worldwide very likely contributed to the long period of economic failure that preceded the start of the new century. Although

most of these policy reforms were not reversed, it appears that China—one of the few countries that did not adopt a neoliberal approach to macroeconomic policy and development—contributed greatly to growth rebound in many developing countries since the year 2000. China is now one of the world's largest economies, and developing Asia—now including a much faster-growing India—seems likely to grow rapidly into the foreseeable future. For this reason, much of the trend during the 2000s seems likely to continue.

The biggest threat to global economic growth now comes from the rich countries, especially the eurozone. It is here that a rigid adherence to neoliberal macroeconomic policies, complete with IMF agreements that previously were only applied to low- and middle-income countries, has brought the regional economy to its second recession in less than 3 years, and threatened a potentially more damaging financial crisis. But regardless of how these problems are resolved, the trend of a much faster-growing developing world—as compared to the prior 2 decades—and slower, below-potential growth in the high-income countries, is likely to continue in the foreseeable future.

## NOTES

1. See, for example, Chang (2002).
2. For a review of Brazilian macroeconomic policy in the last decade, see Serrano and Summa (2011).
3. World Bank (no date a, b).
4. UNDP (2009). The UN statistics count anything less than 2 percent on this measure as the same.
5. UNDP (2010).
6. *Ibid.*
7. World Bank (no date b).
8. This is the per capita income for the region as whole, not the average of the countries as will be used below.
9. For more on these changes, see Serrano and Summa (2011), Weisbrot and Ray (2010), Weisbrot and Sandoval (2009), and Weisbrot et al. (2011).
10. UN DESA (2008).
11. Since this analysis is looking at the non-weighted average of all countries in this chapter, if China's imports from poor countries, or countries with small economies, lifts their growth rate, this has a large effect on the average growth rate, even though China is not large enough to lift the world economy as a whole by the same amount. Also, even though these countries also increased their imports from China, in many cases the imports would have come from elsewhere, but the market for exports—for example, of primary products from Latin America and Africa—would not have been there, nor would prices of these products have risen so much without the rapid growth of Chinese demand.
12. IMF (2011).
13. For more on China's investment policy, see OECD (2003, 2006, and 2008).
14. World Bank (2010a, p. 3, Box Figure 2).
15. World Bank (2010a, p. 11, Table 2; and 2010b, p. 3).
16. See Bhalla (2010); Rodrik and Subramanian (2004). It is also likely that some of the liberalizing reforms beginning in 1991 contributed to India's later growth, including reducing the peak tariff rate from 300 to 110 percent, and the loosening of the monopolies and Restrictive Trade Practices Act, which reduced barriers to entry. For more discussion and references, see Weisbrot and Ray (2011).

17. See Weisbrot (2007).
18. Calculated from IMF (no date a, b).
19. Weisbrot et al. (2009).
20. See Baker (2010 and 2011).

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## A6.1 APPENDIX

### A6.1.1 Calculating GDP Growth

To calculate per capita GDP growth, we use the following method:

1. For 1960 to 2007, we use the Penn World Table's (PWT) real per capita GDP (purchasing power parity converted) variable, chained, in 2005 international dollars: `rgdpch`.

2. For 1981 to 2010, we use the IMF World Economic Outlook (WEO), which offers a per capita GDP (purchasing power parity converted) variable, but in current international dollars, so this is deflated to 2005 values using the US GDP deflator.

For the overlapping years of the two datasets (1981 to 2007), resulting values do not always match. In order to create a fluid dataset, we use the following method:

1. We calculate the annual growth rates implied by each dataset.
2. Beginning in 1981, we apply an indexed average of the two growth rates, as follows:  
 $1981\text{GDP} = 1980\text{GDP} * [1 + (1/28 * \text{WEO rate for 1981}) + (27/28 * \text{PWT rate for 1981})]$   
 $1982\text{GDP} = 1981\text{GDP} * [1 + (2/28 * \text{WEO rate for 1982}) + (26/28 * \text{PWT rate for 1982})]$   
 ...  
 $2006\text{GDP} = 2005\text{GDP} * [1 + (26/28 * \text{WEO rate for 2006}) + (2/28 * \text{PWT rate for 2006})]$   
 $2007\text{GDP} = 2006\text{GDP} * [1 + (27/28 * \text{WEO rate for 2007}) + (1/28 * \text{PWT rate for 2007})]$

In cases of countries whose records begin after 1980, we used the Penn World Table value of GDP for the first year of records, and then apply the same formula for later years, substituting the correct number of years for the “28” listed above. If those countries appear in the WEO data one (or more) year(s) before they appear in the PWT data, we started with the first year of PWT data using the above steps, and calculated backwards to the first year of WEO data using the WEO annual growth rates.

Finally, in two cases (Serbia and Timor-Leste) the PWT has data for only 2005 while the WEO has data for several years. To match the methodology for other countries, relying more heavily on the PWT than WEO data, we apply the WEO’s growth rate forward and backward to the 2005 PWT data point to generate estimates for the years prior to, and after, 2005.

# 7. Comment on Khan, Li, and Weisbrot

**James K. Boyce**

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## 7.1 TAKING THE STATE SERIOUSLY

When it comes to the state, an odd schizophrenia afflicts the American public on both the right and left of the political spectrum. The right mistrusts the state in theory but loves it in practice. The left loves the state in theory but mistrusts it in practice.

The right's love affair with the state is most ardent in the case of the military, the US government's biggest single component, but it extends to other creations of "big government," too, including nuclear power, the death penalty, the war on drugs, border fences, and prisons. The left's mistrust of the state is evident when it decries imperialism, militarism, corporate welfare, infringements on civil liberties, and the co-optation of politicians by moneyed interests.

The chapters in this volume by Sharukh Khan, Minqi Li, and Mark Weisbrot invite us to think more deeply about the nature of actually existing states, drawing in particular on experiences in the developing countries of the global South.

## 7.2 MILITARY–INDUSTRIAL COMPLEX, SOUTHERN-STYLE

Khan focuses on Pakistan, a state that now in many ways exemplifies the military–industrial complex against which US President Dwight D. Eisenhower warned in his 1961 farewell address:

In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military–industrial complex. The potential for the disastrous rise of misplaced power exists and will persist. (Eisenhower, 1961)

After describing the dominance of the military in the Pakistani state and economy, Khan compares Pakistan and China in terms of the managerial ca-



capacities of their respective governments. In analysing state capacities it can be useful to distinguish between the ability to do something and the willingness to do it. The Pakistani state, as Khan points out, displays considerable ability when it comes to defending and advancing the interests of the military officer corps. The fact that the state has done so little to improve the lot of the Pakistani people springs not from an inherent ability deficit, but rather from an unwillingness to deploy resources to that end.

Why are some states willing to invest in the broad-based wellbeing of their citizenry, while others put the interests of political elites ahead of the interests of the people? Why, in other words, do some states succeed while others fail in meeting the challenges of economic development? The answer, I believe, lies in the distribution of power.

Khan (p. 68) hints at this when he writes that “a take-off can create opportunities for [re]distribution and pressures for it,” as “people fight for a larger share of the larger pie (worker strikes in China) or the state engages in distribution because of the likely social conflict and other constraints to growth if they do not.”

This brings to mind the hypothesis on the distribution of power that Simon Kuznets advanced nearly half a century ago:

One may argue that not only the welfare equivalents but also the power equivalents of the same relative income show a much wider range when the underlying average income is low than when it is high; and this means that as time goes on, the spread in economic power will perpetuate and widen still further the underlying income differentials. (Kuznets, 1963, p. 49)

If economics were simply the story of a vicious circle in which disparities in income and power perpetually reinforce each other, it would be a dismal science indeed. But history and politics play crucial roles, too, as Kuznets himself recognized in concluding that the study of economic development requires “a shift from market economics to political and social economy” (Kuznets, 1955, p. 28).

What circumstances can explain the differences between the willingness of the state in Pakistan and China to serve the people? Here I will mention only two factors. First, in China the 1949 revolution and subsequent land reform resulted in a profound redistribution of wealth, which brought about a far more democratic distribution of power in the countryside, notwithstanding the quite undemocratic features of the communist regime. In Pakistan, by contrast, the landed oligarchy survived the political transformations wrought by partition and independence in 1947. Second, China experienced relatively little external intervention after the revolution. Indeed, the country was virtually isolated from the “free world” for more than two decades. In Pakistan, by contrast, the military’s rise to political dominance was aided and abetted by large injections of US economic and military assistance, notably in the early 1970s, when Pakistan’s government was rewarded for facilitating Henry Kissinger’s gambit to

play the “China card” against the Soviet Union, and above all after the Soviet invasion of Afghanistan in 1979. While differences in agrarian structure and foreign involvement do not tell the whole story, they are important strands in the two countries’ starkly divergent postwar trajectories.

### 7.3 STATE VERSUS MARKET, OR DEMOCRACY VERSUS OLIGARCHY?

In his chapter, Li advances an argument for socialism, framed in terms of the state-versus-market dichotomy that defined the political left and right in the twentieth century. Capitalism is identified with the dominance of the market and private ownership of the means of production; socialism is identified with central planning and state ownership of the means of production. He predicts that socialism will be on the agenda in the twenty-first century, as the world grapples with financial instability, global class conflict, and the crisis of global ecological sustainability.

The state-versus-market framework conflates three dimensions of difference into one. Two are explicit in Li’s account, while the third is implicit. The first is the difference between private and public ownership, theoretical poles between which in practice there is a wide continuum. Not only do real-world economies have a mix of private, public, and common property rights, but also the bundle of sticks that comprise these rights—such as the rights to access, extract, manage, exclude, and sell—can be and often are unbundled, with different sticks held by individuals, firms, communities, and the state (Cole, 2002).

The second dimension is the difference between the market and central planning as mechanisms for resource allocation. Again, this is a continuum rather than a binary distinction. Markets play a role in the most “socialist” of regimes, and state planning plays a role in the most “capitalist.” This is no accident, since both market allocation and state planning have practical advantages that cannot easily be tossed aside for the sake of ideological purity.

The third dimension is the distribution of wealth and power. The poles on this spectrum can be called democracy and oligarchy, where these terms are understood to refer not simply to the presence or absence of formal institutions such as free elections, free speech, and freedom of assembly, but more fundamentally to the distribution of power across the population. Power and wealth are closely correlated, although the relationship between the two is an interesting topic in its own right (MacEwan, this volume). Although Li does not explicitly include this in his definition of socialism, on the political left most people believe that public ownership and state planning go hand-in-hand with a more egalitarian distribution of wealth and power. On the political right, most believe the opposite.

These three dimensions of difference—allocation, ownership, and distribution—are not necessarily congruent. As an illustration, consider the Regional Greenhouse Gas Initiative (RGGI) launched in the northeastern US states in 2008, in which state governments auction off to power plants a limited number of emission permits with the total number set by a cap. This is an example of what is often dubbed a “market-based incentive” approach to environmental regulation, as opposed to conventional “command-and-control” regulations. The labels “market-based” and “command-and-control” invoke the rhetoric of the market-versus-state dichotomy, so the RGGI might be seen as a move towards the “capitalist” end of the allocation spectrum. Under command-and-control regulations, however, pollution that is legal is *free*: polluters pay nothing to use our air and water as sinks for wastes. Under the RGGI, prior regulations are now coupled with the requirement that polluters must pay the government to pollute by purchasing permits. The RGGI thereby extends public ownership, transferring property rights from polluters to the public, and in this sense it might be seen as a move towards the “socialist” end of the ownership spectrum. Finally, whether the RGGI moves toward the democratic or oligarchic end of the distributional spectrum depends on who bears the final cost of the permits and who gets the money. On the cost side, the effect is likely to be regressive as permit prices are passed through to consumers; but on the benefit side, the recycling of auction revenues to the public via rebates, energy efficiency programs, and public goods can be strongly progressive (Boyce and Riddle, 2010).

In making the environmental case for socialism, Li argues that under capitalism firms must relentlessly accumulate capital, resulting in “uncontrolled growth that in the long run inevitably leads to ecological catastrophes” (Li, p. 95). I do not wish to belittle the environmental damage that has been wrought by capitalism worldwide. But in assessing this argument, it is important to add two caveats. First, investment in human capital and natural capital is capital accumulation, too, although it is not always adequately recognized as such in actually existing capitalist (or, for that matter, socialist) economies. Second, the historical evidence does not clearly show that capitalist economies have grown faster than socialist economies or been more environmentally destructive per unit output.

I think that a compelling case can be made that environmental quality depends on how the economy is organized, and that the environmental challenges of the coming century will require profound changes in our economies. But the connection cannot be reduced to a simple “capitalism = economic growth = ecological collapse” equation. It rests instead on the relationship between the distribution of wealth and power and the magnitude of environmental degradation. In an oligarchy, the wealthy and powerful can reap most of the benefits from environmentally degrading activities while displacing the costs onto others. In a democracy, those who bear environmental costs have greater power to constrain the actions of those who benefit from environmental degradation.

If this is true, then the balances between market and state allocation and between public and private ownership may be less important than the distribution of wealth and power. To put matters bluntly, without a democratic distribution of wealth and power, no amount of state planning or public ownership will suffice to protect the environment.

## 7.4 NEOLIBERALISM AS STATE FAILURE

To say that the state-versus-market dichotomy is less important than the democracy–oligarchy dichotomy is not to say that it is unimportant. On the contrary, the balance between state and market as mechanisms for resource allocation, as well as that between public and private ownership, can have important consequences for efficiency, equity, sustainability, and democracy itself.

In his contribution to this volume, Weisbrot documents the distinct slowdown in economic performance around the world in 1980–2000, the heyday of the policy mix known as “neoliberalism.” These policies—centered on free trade, deregulation, and privatization—led to sharp turns towards market allocation and private ownership. Some countries, such as the United States, also moved towards the oligarchic end of the distribution spectrum (Hacker and Pierson, 2010).

In much of the world, economic growth fell by half or more compared to the two prior decades. A more inclusive measure of economic performance—for example, one that does not count a shift from unpaid care labor performed in the home to wage employment outside the home as a pure gain in national income—would show an even steeper decline. Growth recovered in many countries after 2000, a change that Weisbrot attributes in part to moves away from neoliberal policies.

The economic failure of neoliberalism was rooted in a specific type of state failure: the inability of the downsized state to meet the challenges of economic development. Neoclassical political economy, which provided the intellectual framework for the neoliberal policy agenda, focused on a different type of state failure: the domination of the state by “rent-seeking” pressure groups that pursue their self-interest at the expense of both efficiency and equity (Krueger, 1974; Becker, 1983). The neoliberal prescription was to minimize this failure by minimizing the size of the state.

An alternative prescription is to democratize the distribution of power, so as to minimize the ability of some people—the “one percent”—to wield disproportionate influence on the state at the expense of everyone else (Boyce, 2007). As a remedy to state failure, the democratic solution has several advantages over the neoliberal solution. First, there is an irreducible need for a state, even if its role

is pared to a bare minimum of enforcing property rights and providing crucial public goods, and without a democratic distribution of power these functions will still be afflicted by rent-seeking. Second, states can do some things better than markets. For example, high transaction costs often pose an insuperable barrier to private solutions to negative externalities (Coase, 1960); similarly, states may be better placed to channel investment to uses that generate large positive externalities (Griffin and Enos, 1970). Third, without a democratic distribution of wealth and power, markets, too, will yield inequitable outcomes and fail to operate efficiently due to unchecked market power. Last, but not least, democracy has intrinsic as well as instrumental value: it is an end in itself, as well as a means to economic ends (Sen, 1999).

Taking the state seriously means taking both market failure and state failure seriously. It means thinking not only about the right degree of state control over the means of production and resource allocation, but also about the core issue of control over the state itself. This means engaging with the historic struggle to build and sustain real democracy.

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## 8. The wealth–power connection

**Arthur MacEwan<sup>1</sup>**

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In their introduction to Chapter 6 of the second edition of *The Capitalist System: A Radical Analysis of American Society*, Tom Weisskopf and his co-editors, Richard Edwards and Michael Reich, addressed a question that arises over and over again for those of us who are radical critics of US society: “how [has it been] possible for capitalists, who constitute an insignificant minority of the voting public, to get the state to act on their behalf?”<sup>2</sup> It is a question that needs to be, and is, addressed over and over again, and I will do so one more time in this essay.<sup>3</sup>

My answer to the question does not differ in any fundamental way from what Edwards, Reich and Weisskopf wrote 33 years ago. They identified three mechanisms by which the wealthy exercise power. Although these three mechanisms can be described and defined separately, they are interdependent and mutually supportive—three legs of a stool, if you will pardon the trite metaphor:

- The most mundane and obvious of these mechanisms is the direct role of money in political affairs. It is not only that money tends to win elections, but also that money effectively buys access and influence.
- The most interesting and complex mechanism by which wealth and power are connected is the creation and propagation of ideology. Even an “insignificant minority” can rule if it can get the majority to accept the idea that its interests are the same as those of that minority.
- But the most fundamental basis of the wealth–power connection is the functional role of capital. Our society relies primarily on the decisions of private investors, capitalists, and especially very wealthy capitalists, to generate economic growth and jobs—or at least people believe this to be the case. It is, then, a small step to the conclusion that we must do what is good for capital, for the wealthy, in order to attain economic wellbeing.

As I said, these points, the bones of an analysis, were set out by Edwards, Reich, and Weisskopf in 1978, and others have made them in various ways before and since. My purpose here is simply to put some more meat on those bones, some meat that comes from experience of the last several years. For, certainly, insofar as the basic argument regarding economic, political, and social

dominance of the wealthy is correct, it has become more correct as economic inequality has increased so dramatically and the wealthy have become much wealthier in both absolute and relative terms.

I need to make two caveats before proceeding with my story. First, the reader may notice that I have not listed overt violent repression as one of the mechanisms by which the wealthy rule. One reason I have omitted violent repression is that it is the state, not the wealthy, that usually conducts violent repression. We might see the state as doing this on behalf of the wealthy, but that simply pushes us back to the three mechanisms by which the wealthy get the state to act in certain ways. Another reason I have omitted a discussion of overt violent repression is that, though it has certainly been important at various times, it is not central in the day-to-day exercise of power by the wealthy. Indeed, it is one of the marvels of our formally democratic system that the wealthy are able to work their will with relatively little (by historical and international comparative standards) violence within the country. (The use of violence abroad on behalf of the US wealthy is so widespread as to seem ubiquitous, but what goes on abroad lies outside of the problem I am addressing here.)

The second caveat, which I hope would be obvious, is that, in arguing that the power of the wealthy is highly disproportionate to their numbers, I do not want to suggest that this power is absolute. If I thought it was absolute, I would not bother to write this chapter. Nonetheless, I think it is important to understand the existence of this power and to recognize how it operates in order to establish a more democratic society and secure a more stable operation of our economic lives. Furthermore, not all wealthy people have the same interests, and many business groups have particular interests that are in conflict with one another. However, on broad general issues, such as taxation and regulation, there is a wide commonality among the wealthy and among businesses. It is on these broad issues that they can, and by and large do, act in concert.

## 8.1 MONEY IN POLITICS

One way power is exercised—and the way the wealthy have a distinct advantage—is widely recognized. It is the direct use of money to pay for lobbying and to provide donations to political officials. While lobbying is nothing new, there has been a substantial growth of lobbying expenditures since the year 2000. Between 2000 and 2010, lobbying expenditures (in current dollars) grew from US\$1.56 billion to US\$3.51 billion (a 125 percent increase, while consumer prices rose by only 27 percent). The leading business sectors have been finance, insurance, and real estate (the so-called FIRE sector) and healthcare (including pharmaceuticals, as well as hospitals and various other healthcare firms). Each



of these two sectors spent US\$4.6 billion on lobbying in the 1998–2010 period. In 2010, healthcare firms spent US\$522 million on lobbying and used 3220 lobbyists, while the FIRE sector spent US\$475 million and used 2565 lobbyists.<sup>4</sup>

Although labor unions are often lumped together with business as spending large amounts of money for political influence, unions' lobbying expenditures are dwarfed by business spending. Over the entire 1998–2010 period, unions spent a total of US\$467 million on lobbying, and in 2010 their lobbying expenditures were US\$47 million—that is, about one-tenth of what was being spent by firms in either the FIRE or healthcare sector. As a further contrast to the role of unions, in 2010 the US Chamber of Commerce spent US\$132 million on lobbying, almost three times as much as all of organized labor.

The impact of lobbying rests in part simply on the pressure that lobbyists apply by their regular contacts with legislators, regulators, and other policy officials. Perhaps more important, they are able to supply information, analyses, and arguments to the officials who make and implement policy. Legislators often rely on lobbyists to write legislation, accepting that the lobbyists are highly knowledgeable about the issues of the industry they represent and ignoring the obvious fact that they are there to obtain legislation that is favorable to their employers' interests. Indeed, the effectiveness of business lobbyists is tied closely to and rationalized by an ideology that asserts a congruence between the interests of business and the general interest.

Behind the lobbyists are both contributions to political campaigns and the “revolving door,” whereby politicians, top aides to politicians, regulators, and other policymakers move from their positions in government to often high-paying positions with private firms—and also the other way, from private firms to government positions. Regarding contributions, the Center for Responsive Politics has compiled a list of 159 individuals who “contributed at least \$50,000 to federal candidates and parties during one or more election cycle [since 1989]” and identifies the organization with which each was affiliated when making the contribution. Few of the names on the list are well known, but their organizations are a familiar roster of large firms. Among the 159 individuals are 17 affiliated with Goldman Sachs and an equal number affiliated with Time Warner. Ten on the list are connected to Comcast and ten to Microsoft. Examples of other firms on the list include Walmart, Citigroup, Walt Disney, General Electric, the now-defunct Enron Corporation, and several large financial firms.<sup>5</sup>

Contributions also come directly from corporations and other organizations. Among the top 50 donors in the 2007–2008 period are AT&T, the National Association of Realtors, Pacific Gas & Electric, Goldman Sachs, Citigroup, and JPMorgan Chase. However, this list is where organized labor comes into prominence, with the National Education Association at the top of the list, and a dozen labor unions in the top 50. Still, though unions are not without clout in the use of money to influence political outcomes, their overall role does not

match up with that of the corporate sector. (The list also includes several organizations of Native Americans, political party organizations, and professional associations.<sup>6</sup>) In early 2010, in the Citizens United case, the US Supreme Court struck down limits on corporations' political spending. This will surely have a major impact, leading to great increases of the figures cited here.<sup>7</sup>

With the "revolving door," the corporate sector has unchallenged dominance. In recent years, two well-known figures stand out as prime examples of this revolving door and, thus, of the pay-off that comes to politicians (and other policy officials) who are friendly to business. One is Phil Gramm, a Republican US Senator from Texas from 1985 to 2002 (and a congressman from 1975 through 1985). Gramm was a leader in the effort to deregulate the financial industry and upon departing from the Senate became a Vice Chairman of UBS America, the large Swiss-based financial firm. Another is Tom Daschle, a Democratic Senator from South Dakota from 1987 to 2004, and Minority Leader (and briefly Majority Leader) of the Senate from 1995 to 2004. Leaving the Senate, Daschle became a consultant to InterMedia Advisors, a private equity firm, and chairman of its executive advisory board; he then took up a highly-paid position with a Washington lobbying firm.<sup>8</sup>

The Gramm–Daschle combination illustrates the fact that both major parties are involved in the revolving door and, more generally, in the direct use of money to influence politics. Many firms contributing to political campaigns give to both parties. While the Republicans are often viewed as the party more friendly to business, many large firms lean toward the Democrats. For example, the contributions associated with Goldman Sachs, the firm that had such a prominent role in dealings that precipitated the financial crisis of 2007–2008, have gone largely to the Democrats.<sup>9</sup>

The revolving door, however, does not only operate at high levels with such public figures as Gramm and Daschle. Consider the following from *The New York Times* of August 1, 2011:

A senior lawyer for the Securities and Exchange Commission [S.E.C.] recently took center stage in a major case involving a controversial mortgage security sold by Goldman Sachs.

There was just one slight twist in the legal proceedings. The S.E.C. lawyer was not the prosecutor taking the deposition. He was the witness.

This summer, Adam Glass — who joined the agency two years ago and is now co-chief counsel in charge of helping write the rules for the complex financial instruments known as derivatives — testified in a deposition about Goldman's Abacus, a mortgage investment that the government argues was designed to fail.

It turns out that Mr. Glass has a unique perspective on Wall Street exotica. Before working on the financial crisis cleanup, he helped create the opaque securities that contributed to the mess.<sup>10</sup>

A complementary example is provided by the man who changed his name. According to an August 2011 *Think Progress* report circulated on-line by *Truthout*, Peter Simonyi, a former Goldman Sachs vice-president, changed his name to Peter Haller and has become a staff member of the House Oversight Committee chaired by Representative Darrell Issa. Issa has become a principal opponent of extending the regulation of derivatives, and Haller appears to be the committee’s point person in this effort. According to the *Think Progress* report, “In a few short years, Haller went from being in charge of dealing with regulators for Goldman Sachs to working for Congress in a position where he made official demands from regulators overseeing his old firm.”<sup>11</sup>

While not high-profile operators like Gramm and Daschle, people like Glass and Simonyi/Haller can play significant roles. The writing of the “rules for the complex financial instruments known as derivatives” is one of the important features of the 2010 Dodd–Frank bill, which was supposed to establish regulations on the financial industry that would at least reduce the likelihood of a repeat of the economic collapse that became apparent in 2007 and 2008. The impact of Dodd–Frank, and thus the effectiveness of the new regulations that it would establish, depends to a large extent on how those regulations are written. One of the act’s basic problems, which underscores the importance of how the writing of the rules is done—and who does it—is that, according to one analysis, Dodd–Frank would require 67 new studies and at least 243 new rule-makings.<sup>12</sup> (As more than one person has quipped, perhaps the bill should have been entitled the “The Full-Employment for Lawyers Act of 2010.”)

While the revolving door process has far-reaching implications for the way policies, and ideology, are shaped, these examples demonstrate that the process also has quite direct and immediate policy implications as well.

## 8.2 SHAPING IDEOLOGY

Money in politics is, as I have noted, only the most obvious part of the story of how the wealthy exercise power. The control of wealth is also of considerable importance in influencing how people think—that is, in shaping ideology, the framework that affects how people interpret particular situations and make decisions. One example of a place where the process is both important and readily apparent is in school reform. School reform has been and continues to be greatly influenced by philanthropic foundations, established (and generally controlled) by very wealthy individuals. Not only does this role directly demonstrate the power of the wealthy in affecting an important social structure (the schools), but in addition the particular direction in which these foundations have pushed reform carries with it a strong ideological message.

While major foundations have long been involved in efforts to influence the direction of school reform (the Rockefeller, Ford, Annenberg, and Carnegie foundations, in particular), a number of relatively new foundations have come to play large roles in recent years; examples include the Gates, Walton, and Broad foundations. These foundations have pushed a variety of changes in the schools, some of which have received support from a broad political spectrum of school activists; a prime example is the Gates Foundation's effort to promote smaller schools. However, many actions of these new foundations have shared the common theme of advocating reform that is outside the traditional public school system—especially emphasizing charter schools and sometimes school voucher programs—and that builds on the idea that teachers' unions and excessive constraints of public "bureaucracy" are The Problem. It is an approach that moves towards privatizing the educational system, and often incorporates for-profit companies as the operators of schools. The ideology that both informs this approach to school reform and is generated by this approach is one that sees the Market, unfettered by social controls, as the solution to society's problems. (Some older foundations have also pushed in this direction—for example, Scaife, Olin, and Bradley.<sup>13</sup>)

The effort to undercut the role of teachers' unions is a significant part of the effort to run schools through market relations. According to a May 2011 *New York Times* report:<sup>14</sup>

A handful of outspoken teachers helped persuade [Indiana] lawmakers this spring to eliminate seniority-based layoff policies. They testified before the legislature, wrote briefing papers and published an op-ed article in *The Indianapolis Star*.

They described themselves simply as local teachers who favored school reform—one sympathetic state representative, Mary Ann Sullivan, said, "They seemed like genuine, real people versus the teachers' union lobbyists." They were, but they were also recruits in a national organization, Teach Plus, financed significantly by the Bill and Melinda Gates Foundation.

... [The Foundation's] new strategy [calls for] overhauling the nation's education policies. To that end, the foundation is financing educators to pose alternatives to union orthodoxies on issues like the seniority system and the use of student test scores to evaluate teachers.

In some cases, Mr. Gates is creating entirely new advocacy groups. The foundation is also paying Harvard-trained data specialists to work inside school districts, not only to crunch numbers but also to change practices. It is bankrolling many of the Washington analysts who interpret education issues for journalists and giving grants to some media organizations.

The *Times* story provides a good illustration of the role of the wealthy, the very wealthy, in efforts to shape school policies and demonstrates the ideology

that guides those efforts. It also brings out the lack of transparency in those efforts, and notes: “Few policy makers, reporters or members of the public who encounter advocates like Teach Plus or pundits [advocating Gates supported policies] ... realize they are underwritten by the foundation.”<sup>15</sup>

One of the most publicized efforts by wealthy individuals and foundations to shape ideas about school reform is the documentary film (or what some have called the pseudo-documentary film), *Waiting for Superman*. Financed through Participant Media by, among others, the Gates and Broad Foundations, the film juxtaposes the failures of public schools with a highly idealized and misleading picture of charter schools. For example, while the film provides accolades for the KIPP system of charter schools for sending a high proportion of its graduates on to college, it ignores the fact that the KIPP system has an unusually high rate of attrition—that is, the students who are unlikely to go on to college are elided from the KIPP schools before graduation.<sup>16</sup> The film also ignores research showing that on average charter schools perform no better than public schools. Yet with wide support of various foundations, *Waiting for Superman* has been presented in much of the media as an accurate picture of the debate over charter schools, and the film effectively promotes the move towards privatization of the schools.<sup>17</sup>

The approach to school reforms generally pursued by wealthy foundations and sometimes more directly by wealthy individuals posits a one-way causation from the problems of schools to the problems of society. It largely ignores the impact of our society’s great economic inequalities on what happens in the schools. A prime example is provided by the support of Wall Street billionaires for the much-heralded Harlem Children’s Zone (HCZ). The HCZ is an integrated set of institutions—charter schools, pre-schools, parenting workshops, family healthcare programs—for low-income families in Harlem. This holistic set of services, run by a non-profit organization and provided without charge, is designed to break what many view as an intergenerational cycle of poverty. The HCZ has been touted by President Obama and many other politicians as a model of how to deal with poverty and the poor education of low-income children. One need not question the intentions of the program’s wealthy supporters to recognize, first, that they apparently ignore their own role in generating the economic problems that contribute to the plight of so many of Harlem’s children. Second, good or bad, these efforts of wealthy financiers in Harlem are a prime illustration of the way they can exercise power in shaping both social institutions and influencing the way people think about social reform. That is, instead of focusing on the way the organization of the economy generates poverty, the HCZ approach views poverty as the result of the characteristics of the poor themselves—their lack of good education, health, and proper parenting skills.<sup>18</sup>

Another example of wealthy individuals affecting school reform—operating directly, through foundations, or through some other forum—is provided by the role of the Commercial Club of Chicago in shaping changes in that city. The Club, “an organization of the city’s top corporate, financial and political elites,” promotes a plan that, in its first phase, would close 60 of Chicago’s existing schools, replacing them with 100 new schools, “two thirds of which will be charter or contract schools run by private organizations and staffed by teachers and school employees who will not be [union] members. The schools also will not have Local School Councils ... elected school governance bodies composed primarily of parents and community members ... [that] have power over a school’s discretionary budget, approve the School Improvement Plan, and hire the principal.”<sup>19</sup>

The point here is not that the support of wealthy individuals, corporations, and foundations for school reform always leads in the wrong direction—though that is often the case. Instead, as these examples illustrate, the wealthy are able to use their position effectively to influence social policy and spread an ideology that supports their interests. (Also, when the wealthy endow foundations or donate directly to school reform programs, their tax-deductible contributions mean that for every US\$10 they give, the government loses about US\$4 in taxes. The wealthy are, in effect, giving away the public’s money without public control.<sup>20</sup>)

In spreading an ideology that supports the interests of the wealthy, the school-reform-oriented foundations have a strong partner in the mass media. Indeed, the mass media are prime generators of that ideology. Of course we have a free press in the United States, in the sense that there are very few legal limits on people disseminating information and propagating their ideas. So how is it that the media in general and the press in particular are dominated by the interests of the wealthy?

The answer to this question was implicitly supplied in 2002 by the then President and CEO of The New York Times Co., Russ Lewis. Lewis was addressing the failure of the press to fully examine the implosion of the Enron Corporation and other “corporate disasters,” and also the reason why the press focused so much more attention on government misbehavior than on corporate misdeeds. Lewis wrote:

Historically, the press’s ability to act as a check on the actions of government has been helped by the fact that the two institutions are constitutionally separated, organizationally and financially. The press does not depend on government officials either for its standing or its resources.

But it has a much more intricate relationship with big business. Today’s news media are themselves frequently a part of large, often global corporations dependent on advertising revenue that, increasingly, comes from other large corporations. As public companies themselves, the news media are under the same kind of pressure to create

“shareholder value,” by reducing costs and increasing earnings, as are other public companies. And they face numerous potential conflicts of interest as they grow larger and more diversified.

The First Amendment makes it difficult for government to impede or financially threaten the work of the press. But no such constitutional provision applies to the intersection of the press and big business.

It is both impractical and unrealistic to expect news media companies, including newspaper firms, to retreat from their positions as increasingly large, diversified business enterprises. To do so would not only undermine their financial strength; it would also deprive them and their staffs of the resources needed to perform their increasingly difficult and demanding roles.<sup>21</sup>

Lewis’s statement is useful, first, because it makes clear that press corporations—and the same is true of other media corporations—are themselves large corporations and are enmeshed with, and to a large extent dependent on, other large corporations. The owners of the press are, correspondingly, among the very wealthy. It is, then, hardly a great leap to assert that the press (and the media generally) are dominated by the interests of the wealthy.

The Lewis statement also underscores an aspect of the ideology that is so important to corporate interests—namely the idea that government is corrupt and inefficient while private firms are efficient and the high incomes obtained by their executives and owners are in some sense deserved. The press, as Lewis points out, focuses on the problems of government, while tending to ignore the scandals in the operations of large corporations. (The fact that events of recent years have created at least a partial shift, with the press giving more attention to the outrages committed by large firms that led us into the current economic crisis, is a hallmark of the way a crisis can, at least temporarily, change many well-established practices.)

There is of course the principle espoused by most news organizations that the editorial page is separated from the news pages, and the latter are based on professional (not ideological) judgments of highly qualified journalists. Without impugning the integrity of journalists, it is not difficult to understand how, over time, regardless of the formal separation of editorial and news pages, the interests and ideology of owners have a great impact on the outlook and decisions of those preparers of the news pages. The choice of topics on which to focus and the implicit slant of reporting will tend to conform to—or at least not sharply challenge—the interests of the owners on fundamental issues. The process is more a matter of self censorship than of any overt censorship, as journalists generally internalize the ideology that they disseminate.<sup>22</sup>

### 8.3 THE FOUNDATION: THE FUNCTION OF OWNERS AND EXECUTIVES

Ultimately, however, the power of the wealthy is not based simply on the direct role of money in political affairs and on the shaping of ideology—though both are surely important. The foundation of business power lies in the function of owners and executives of businesses—that is, in our society’s reliance on their private decisions to determine investments and employment. Political authorities at all levels believe that if they are unfriendly to business interests, they will run the risk of slowing business activity, reducing employment, and thus alienating voters. When firms ask for (or demand) tax incentives, looser regulations, or some other favors that will increase their profits, they argue that increased profits will generate more investment and more jobs—and that a failure to grant their requests will do the opposite. Similarly, tax breaks for the wealthy are supported by the argument that putting more income in their hands will lead to more investment and more jobs. To a large extent, money in politics and ideology have their impact in buttressing this argument, this fundamental role of business and the wealthy.

This argument—the claim that policymakers must do what businesses and the wealthy want in order to maintain a high level of economic activity—has an element of truth. If it is not sufficiently profitable for firms to make investments and employ more people, the economy will falter and hardship will be widespread—and the political authorities may well join the growing ranks of the unemployed. This element of truth gives a great deal of power to the wealthy. It has allowed them to propagate the idea of “trickle down economics,” the theory that if benefits are provided to those on top, everyone else, including those on the bottom, will share in the gains. (Although the term “trickle down economics” is the usual one, I favor the term I picked up from the late John Kenneth Galbraith, “horse and sparrow economics.” If you feed the horses well, some will pass through for the sparrows to peck at.) But “an element of truth” is by no means the whole truth, and “sufficiently profitable” is certainly a vague term.

Experience of recent years demonstrates the way in which claims regarding the functional role of business and the wealthy are extended far beyond reality; those claims, then, are driven by ideology and the role of money in politics. The claims for the salutary impact of tax cuts and the detrimental impact of tax increases lack empirical foundation. Perhaps the most obvious, though crude, refutation of the claim is a contrast between the experience of the 1990s and 2000s:

- In 1993, following the recession at the beginning of the decade, Clinton and the Democrats in Congress increased taxes (slightly), mainly on the high



income groups. Republicans screamed that this action would stifle economic growth. The remaining 7 years of the Clinton administration saw the economy grow at the respectable rate of 4 percent per year.

- After the 2001 recession, the Bush tax cuts, focused on the same high income groups, were enacted. Then, between 2001 and 2007, the economy expanded at only 2.7 percent per year, the slowest post-recession recovery on record. (It is worth noting that the title of the Bush tax cuts bill was “The Economic Growth and Tax Reconciliation Act of 2001.”<sup>23</sup>)

So the general experience of the last 2 decades is hardly a brief for the positive impact of tax cuts on economic growth. (In spite of this experience, the Republicans continue to pledge “no new taxes,” and justify their position by the claim that tax increases—even the removal of so-called tax loopholes—would put a damper on incentives for business to invest and more generally on business confidence. The experience of relatively rapid economic growth during the post-World War II era, which began with a very large government debt—as a result of wartime deficits—and continued with high tax rates, is of course lost to Republicans as ancient history. Democrats hardly pay more attention to this experience.)

There is more finely focused evidence that lowering taxes on capital gains and dividends does not have much, if any, positive impact on economic growth. For example, in a 2005 “Tax Facts” piece from the Tax Policy Center, Troy Kravitz and Leonard Burman summarize the evidence with the comment that “Capital gains [tax] rates display no contemporaneous correlation with real GDP growth during the last 50 years.”<sup>24</sup> A useful review of various studies of the Bush tax cuts prepared by Aviva Aron-Dine at the Center for Budget and Policy Priorities reaches a similar conclusion: “The argument that the capital gains and dividend tax cuts have ‘paid for themselves’ or raised revenue hinges on the claim that these tax cuts had large positive effects on the economy and/or have significantly increased revenues as a share of GDP. As discussed above, the best evidence does not support these contentions and in fact indicates that they are not correct.”<sup>25</sup>

Those who support the reduction of taxes on the wealthy, taxes on capital gains and dividends, do tout studies that tend to support their position. And there is no denying the fact that people’s behavior is affected by tax policy, including the investment behavior of those with high levels of income. Yet the existing evidence does not support the argument that tax adjustments of relevant magnitude on capital gains and dividends are major factors affecting the course of the economy.<sup>26</sup>

In any case, tax policy is but one example of the way the functional role of business and the wealthy is used as the basis for economic policy. As the current

economic crisis unfolded in 2008, the “systemic” role of the financial sector was trotted out as the justification for bailouts—of individual firms and of the entire banking industry. For example, the Chairman of the Federal Reserve, Ben Bernanke, justified to Congress the Fed’s first major direct intervention in the banking crisis—the managing of the shut-down of Bear Stearns and the saving of its creditors—by arguing that, had Bear Stearns been allowed to simply fail, the result could have been “a chaotic unwinding” of investment throughout the economy. He added: “The adverse effects would not have been confined to the financial system but would have been felt broadly in the real economy through its effects on asset values and credit availability.”<sup>27</sup>

Later, explaining to Congress the Bear Stearns action, other particular interventions (for example, AIG), and the general bailout of the financial sector under the Troubled Assets Relief Program (TARP), Bernanke stated:

Section 13(3) of the Federal Reserve Act authorizes the Federal Reserve Board to make secured loans to individuals, partnerships, or corporations in “unusual and exigent circumstances” and when the borrower is “unable to secure adequate credit accommodations from other banking institutions.” This authority, added to the Federal Reserve Act in 1932, was intended to give the Federal Reserve the flexibility to respond to emergency conditions. Prior to 2008, credit had not been extended under this authority since the 1930s. However, responding to the extraordinarily stressed conditions in financial markets, the Board has used this authority on a number of occasions over the past year.<sup>28</sup>

The situation that demanded action, in Bernanke’s view, was the trouble faced by the very large financial firms. “Emergency conditions” existed because these firms were “too big to fail,” in the sense that their failure would have spread the damage far and wide, both directly because of their extensive links to other financial and non-financial firms and indirectly because of the severe undermining of confidence that would have followed. Like it or not, Bernanke was arguing that the viability of the entire economy was dependent on government action to secure the position of the financial firms, their executives, and their (wealthy) owners.

The important aspect of these bailouts is that in fact they were based on a reasonable (though perhaps not correct) reading of the implications of allowing major banks to fail. It is highly likely that, had there been no government intervention, the results for the US and world economies would have been catastrophic. The functional role of the banks was a reality. However, while it was necessary to maintain a viable financial system in order to secure economic stability, this does not mean that it was necessary to bail out the bankers along with the banks. At the time, even Alan Greenspan and some other conservatives, to say nothing of various liberal and progressive voices, suggested that short-term nationalization of the failing banks could be a reasonable alternative. Bank nationalizations could have kept the financial industry functioning, but the

bank executives and the shareholders would have lost their incomes and investments—which is what is supposed to happen when firms fail. The government could then have provided capital to the banks, held them until they recovered, and then sold them back to private investors.<sup>29</sup> Yet when the functional role of the banks was combined with an ideology that gives credit to the wealthy, all backed by the direct exercise of their influence (derived from their wealth) in Washington, nationalization was never on the table.

The icing on the cake illustrating the functional role of the wealthy—of the banking sector, in particular—came in the years following the full emergence of the financial and economic crisis. In this aftermath, it has been widely commented upon that there have been virtually no prosecutions for the criminal activity that appears to have been so widespread among financial actors. There are of course various reasons for the lack of prosecutions, including the fact that with lax laws and regulations many nefarious financial acts were not in fact criminal. Yet, the most interesting justification for largely leaving the bankers alone appeared in a July 2011 *New York Times* article.<sup>30</sup> The article reports that the Justice Department was following a policy of “deferred prosecutions.” The department’s guidelines for deferred prosecutions leave

... open a possibility other than guilty or not guilty, giving leniency often if companies investigated and reported their own wrongdoing. In return, the government could enter into agreements to delay or cancel the prosecution if the companies promised to change their behavior ...

Defending the department’s approach, Alisa Finelli, a spokeswoman, said deferred prosecution agreements require that corporations pay penalties and restitution, correct criminal conduct and “achieve these results without causing the loss of jobs, the loss of pensions and other significant negative consequences to innocent parties who played no role in the criminal conduct, were unaware of it or were unable to prevent it.”

By this rationale, one can imagine that virtually any crime by a top corporate executive, given her or his functional role, could be ignored by the Justice Department.

Clearly substantial taxes on the wealthy and substantial regulation of business are possible without stifling business activity. During periods of successful economic growth—for example, during the post-World War II years—tax rates on business and on the wealthy have been much higher than now and regulations have been much more extensive. Also, in earlier periods of financial shenanigans—the Savings and Loan debacle of the 1980s, for example—prosecutions have been quite extensive without stifling economic activity. The direct influence of money on politics and policy, the impact of ideology, and the functional role of business and the wealthy are by no means new. As noted, Edwards, Reich, and Weisskopf delineated these points 33 years ago, and, indeed, they have been

important throughout economic history. Yet it appears that these wealth–power connections have become increasingly powerful in recent years.

Even within the confines of US capitalism, policies that are of immediate benefit to business and the wealthy are often not good for society. In particular, it has become widely recognized that what is good for business—for financial firms in particular—has not been good for the rest of us, not good at all. The past several decades well demonstrate the ineffectiveness of “horse and sparrow economics.” Cutting taxes for the rich and adoption of policies favoring business did not lead to rapid economic growth and provided little if any economic gains for most people. The bailout of the banks did not solve our current economic problems, and there is no reason to believe that the Justice Department’s failure to prosecute criminal action in the financial sector will yield much for “innocent parties.” Current experience, the economic crisis that emerged in 2007 and 2008, best demonstrates the fallacy of the claim that giving business and the wealthy what they want is good for all of us.

## NOTES

1. Paper prepared for “Capitalism on Trial: A Conference in Honor of Thomas E. Weisskopf,” Amherst, Massachusetts, September 30 and October 1, 2011. The author is Professor Emeritus of Economics and Senior Fellow in the Center for Social Policy, University of Massachusetts Boston. This chapter is a revised version of “Appendix A: Brief Notes on Wealth and Power,” from MacEwan and Miller (2011). Used by permission.
2. Edwards, Reich, and Weisskopf (1978, p. 219).
3. Relevant examples, dealing with the same general issue from rather different perspectives, include: Therborn (1977), Bowles and Gintis (1986), and Domhoff (1967).
4. All of these figures are in current US dollars. These data and data noted below on lobbying and political contributions are from the “Open Secrets” website of the Center for Responsive Politics. In 2009, the year that the new healthcare legislation was being considered, the healthcare firms spent somewhat more than in 2010 and used more lobbyists—US\$552 million of spending and 3501 lobbyists. Figures are presented for the 1998–2010 period—rather than, for example, for the last decade—because that is the way they are provided on the “Open Secrets” website of the Center for Responsive Politics.
5. The list is available on the “Open Secrets” website of the Center for Responsive Politics at [www.opensecrets.org/orgs/indivs.php](http://www.opensecrets.org/orgs/indivs.php).
6. Again, the data are from the “Open Secrets” website of the Center for Responsive Politics at [www.opensecrets.org/orgs/list\\_stfed.php?order=A](http://www.opensecrets.org/orgs/list_stfed.php?order=A).
7. People who make large campaign donations expect many things in return for their money. For example: Responding to the “Occupy Wall Street” demonstrations in October 2011, one “long time money manager,” defending the financial services industry, told *The New York Times*, “that he was disappointed that members of Congress from New York, especially Senator Charles E. Schumer and Senator Kirsten Gillibrand, had not come out swinging for an industry that donates heavily to their campaigns. ‘They need to understand who their constituency is,’ he said.” Could we ask for a clearer—or a more crass—statement about the expectations of large campaign donors? See Schwartz and Dash (2011).
8. The Gramm and Daschle details are provided at [www.opensecrets.org/revolving/index.php](http://www.opensecrets.org/revolving/index.php), and Daschle’s involvement with InterMedia Advisors has been widely reported—for example, by ABC News at [blogs.abcnews.com/politicalpunch/2009/01/bumps-in-the-ro.html](http://blogs.abcnews.com/politicalpunch/2009/01/bumps-in-the-ro.html).

9. Once more, the “Open Secrets” website of the Center for Responsive Politics: [www.opensecrets.org/orgs/summary.php?id=D000000085](http://www.opensecrets.org/orgs/summary.php?id=D000000085).
10. See Sorkin (2011).
11. Lee (2011). The report does not explain why Simonyi/Haller changed his name (to his mother’s maiden name), and it may have had nothing to do with the move from Goldman Sachs to the Oversight Committee—though the action did perhaps obscure the revolving door aspect of the move.
12. The analysis is that of the law firm Davis Polk & Wardwell LLP (see DavisPolk, 2010).
13. See Miner (2005).
14. Dillon (2011).
15. The Times piece adds the following interesting bit: “Frederick M. Hess of the American Enterprise Institute... a frequent blogger on education whose institute received \$500,000 from the Gates foundation in 2009 ‘to influence the national education debates,’ acknowledged that he and others sometimes felt constrained. ‘As researchers, we have a reasonable self-preservation instinct,’ he said. ‘There can be an exquisite carefulness about how we’re going to say anything that could reflect badly on a foundation’ (Dillon, 2011).” A nice example of *the market place of ideas*, though this is not the way the term is usually presented!
16. See Hechinger (2011).
17. An effective critique of *Waiting for Superman* is provided by Ravitch (2010).
18. See Tough (2009). It is worth noting that in October of 2010, *The New York Times* reported that the HCZ’s (Otterman 2010):

... charter schools have struggled with the same difficulties faced by other urban schools, even as they outspend them. After a rocky start several years ago typical of many new schools, [the HCZ] schools, featured as unqualified successes in “Waiting for Superman,” the new documentary, again hit choppy waters this summer, when New York State made its exams harder to pass.

A drop-off occurred, in spite of private donations that keep class sizes small, allow for an extended school day and an 11-month school year, and offer students incentives for good performance like trips to the Galápagos Islands or Disney World.

... the Harlem Children’s Zone, enjoys substantial largess, much of it from Wall Street. While its cradle-to-college approach, which seeks to break the cycle of poverty for all 10,000 children in a 97-block zone of Harlem, may be breathtaking in scope, the jury is still out on its overall impact. And the cost of its charter schools—around \$16,000 per student in the classroom each year, as well as thousands of dollars in out-of-class spending—has raised questions about their utility as a nationwide model.

19. Lipman (2005).
20. This parenthetic point is made by Richard Rothstein, former education columnist for *The New York Times* and analyst of the educational system, as quoted in Miner (2005).
21. Lewis (2002) cited by McChesney (2004).
22. The brief statement here of this point is usefully elaborated by both McChesney as cited in the previous note and Herman and Chomsky (1988). There is of course much more to the role of the media in affecting ideology, and the media include much more than the press. McChesney and Herman and Chomsky are good sources for more comprehensive analyses. Also, see the quote from Hess in Note 15 above, which describes a phenomenon that applies to journalists as well as to researchers. Also, while the separation of the news page and the editorial page is often espoused, it is also often ignored—as seems, for example, to be generally the case for newspapers in the Murdoch empire.
23. It might be objected that the Bush tax cuts did not become effective until 2003. However, if the tax cuts’ proponents were to be believed, the cuts would have had earlier impacts because of the boost they should have given to business confidence. More important, the post-2003 growth record is still poor. Between 2003 and 2007 real GDP expanded at an annual rate of 2.8 percent; see Economic Report of the President 2011, Table B-2, available at: <http://www.gpoaccess.gov/eop/download.html>. In the six-year periods after the starts of previous

- post-World War II expansions, the average GDP growth rate was 4.3 percent. See Aron-Dine (2007).
24. Kravitz and Burman (2005). Also, see Burman (1999) and Friedman (2005).
  25. See Aron-Dine (2007), as cited in Note 23 above.
  26. Many of these issues were examined by Joel Slemrod, a leading expert on tax issues, in a 2003 interview in *Challenge* magazine. Slemrod summed up the interview with the statement that "there is no evidence that links aggregate economic performance to capital gains tax rates." See Slemrod (2003).
  27. Bloomberg (2008).
  28. Bernanke (2009).
  29. See MacEwan and Miller (2011), pp. 166–71, for elaboration.
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## 9. The rise and decline of patriarchal capitalism

**Nancy Folbre**

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In 1998, I had the pleasure of collaborating with Tom Weisskopf on an article entitled “Did Father Know Best? Families, Markets, and the Supply of Caring Labor.” In retrospect, it seems the article was not widely read outside my own circle of feminist economists. However, this collaboration shaped my intellectual agenda for most of the intervening period, during which I thought hard and wrote long about the meaning of caring labor and its implications for theories of gender inequality. Tom provided an insight about the economic consequences of cultural norms that proved immediately fruitful: the notion that the supply of unpaid care could be described to some extent as a game of “Chicken” helping explain why concern for others can reduce individual bargaining power through a kind of hostage effect. “Did Father Know Best?” (the answer, by the way, was “no”) also helped explain why capitalist development, with its attendant normative emphasis on the pursuit of individual self-interest, initially had some liberating consequences for women, despite its imposition of new economic penalties on all caregivers, whatever their gender (Folbre, 2009a).

My collaboration with Tom also included some new ideas about the logic of patriarchal systems that were strongly rooted in the tradition of historical materialism, though with distinctly feminist inflections: One was the hypothesis that patriarchal systems predating capitalism evolved partly because they successfully generated an ample supply of caring labor to fuel population growth. The other was the hypothesis that capitalism remained, in many respects, dependent on the very patriarchal structures it tended to weaken in order to address its own problems of social reproduction. Both these hypotheses emerged in the wake of early “domestic labor” debates, and were touched upon to some extent in my earlier work, *Who Pays for the Kids? Gender and the Structures of Constraint* (1994). For whatever reason, attention to them seemed to ebb along with declining interest in the grand themes of historical materialism.

Now drawn back to these themes, I plan to undertake a new book entitled *The Rise and Decline of Patriarchal Capitalism* that will explore them in more detail. The title evokes Edward Gibbon’s classic, *The Decline and Fall of the*



*Roman Empire*. However it is also inspired by Robert Heilbroner's class little book, *The Nature and Logic of Capitalism* (1985), which long ago made me want to pencil in the qualifier "patriarchal" right before that last word. The nomenclature also captures my twisted relationship to the traditional Marxian tradition: On the one hand, I dislike its failure to integrate a theory of gender inequality into its theory of historical change. On the other hand, I admire its attention to basic structures of social organization, including its appreciation of the way that social norms and political ideologies tie institutions together into a coherent, if not always consistent, whole.

Conventional Marxist theory terms such structures "modes of production"—a useful term if and only if, in my opinion, the term "production" is widened to include the production of people and social reproduction of society. The term "social formation," admitting the possibility of overlapping, articulating modes of production, may be more apt (Wolpe, 1980). In any case, I hope to show that the concept of patriarchal capitalism can take us beyond a compensatory analysis of gender inequality to a better understanding of our current economic and political circumstances. I believe my approach can help elucidate persistent social divisions that go well beyond class differences.

At the same time, my approach puts less emphasis on gender differences than might be expected, because it situates these within a larger system of inequality in which age, biological kinship, and metaphorical forms of kinship based on race and citizenship play a central role. Patriarchy means, literally, "rule of the fathers," and it is a system with momentous consequences not merely for mothers, daughters, and sons but also for groups defined in terms of familial allegiance. Competition among kin-based groups helps legitimate patriarchal control over women, much as competition among firms helps legitimate capitalist authority over workers. In their research into the origins of group solidarity, Sam Bowles and others argue that in-group altruism largely represents an evolutionary response to between-group conflict (for example, Choi and Bowles, 2007). I believe that in-group altruism helps facilitate docility to hierarchical control, contributes to the emergence of both patriarchal and capitalist systems and helps explain their gradual but not entirely successful hybridization.

Although I situate this narrative within the tradition of historical materialism, I draw heavily from recent research in institutional and behavioral economics. In the previous paragraph, for instance, I invoked the concept of "docility" because I find Herbert Simon's (1990) discussion of this concept far more useful than the analogous Marxian term "false consciousness." The institutional economists who I draw from include strange bedfellows such as James Buchanan (1980) and Gordon Tullock (1980), traditionally considered members of the pro-market, anti-statist school of public choice. Despite my disagreement with their idealized vision of markets, their analysis of rent-seeking activity parallels traditional Marxian analysis of surplus-extraction in its emphasis on collective action aimed

at appropriation. Building on this tradition, Jack Hirshleifer (2001) shows how different technologies of conflict can affect social outcomes.

Research in evolutionary biology also helps explain the dialectic of cooperation and competition that characterizes human society as part of the larger natural world. Robert Trivers' (1972) characterizations of gender differences in parental investment, parent-offspring conflict, and sibling rivalry resonate with many descriptions of patriarchal societies. Research shows that oxytocin, the "nurturance" hormone, both influences people's propensity to care for dependents (Taylor, 2002) and promotes in-group trust and cooperation (De Dreu et al., 2010).

Serious consideration of both conservative economic ideas and sociobiological research may deter some readers who find them distasteful, if not threatening. However, a structural approach based on a critical analysis of relations of domination can garner insights from this literature. Many critics of capitalism dislike any suggestion that social inequality is deeply rooted in pre-class societies, and cannot simply be explained as a concomitant of the emergence of private property. The longer the history of exploitation, the harder it may seem to eliminate it. On the other hand, the gradual attenuation of gender inequality in human society represents a remarkable vindication of ideals once termed utopian.

## 9.1 WORK, SURPLUS, AND EXPLOITATION

Feminist theorists have long challenged the economic invisibility of women's work, attributing it to the androcentric tradition of classical political economy (Folbre, 2009b). The work of caring for others, in particular, has been treated as a natural activity or form of emotional expression rather than a rational, instrumental, socially-organized form of productive labor. Here, I recapitulate the most important aspects of this feminist critique regarding the concepts of work, surplus, and exploitation.

### 9.1.1 Work

British political economy emerged alongside a liberal political critique of principles of royal authority articulated in Sir Robert Filmer's *Patriarcha*. Kings derived their authority as literal fathers of their subjects (Filmer traced the lineage of the English monarchy to the first father, Adam). Since fathers produced children (via the intermediary of women) they deserved to wield authority over them. To challenge the authority of a king was to challenge the authority of all fathers. John Locke, among others, challenged the view that paternal responsibility should translate into absolute power. The labor theory of value that

he outlined asserted two basic principles: a man should have control over the products of his labor, and a man should enjoy autonomy or self-ownership. If men (understood broadly to include both men and women) produce other men, these principles contradict one another.

The labor theory of value, in all its later incarnations, treated men and women as “non-produced” commodities. Within classical Marxian theory, the value of labor power is defined as the value of the wages earned, the cost of “reproducing labor power.” But no labor seems to be required to convert wages or wage goods into labor power. Nor do any demographic parameters enter the definition of labor power. It does not seem to matter whether workers raise no children, exactly enough children to take their place as adults, or enough children to generate population growth.

In his early writings, Marx describes labor as a fundamental aspect of man’s “species-being,” his engagement with the world. He distinguishes the largely instinct-driven activities of animals from the rational and creative problem-solving activities of men faced with the need to provide for themselves.<sup>1</sup> He never explicitly discusses women’s activities of care for family members, in part because, like most of his contemporaries, he takes these for granted. His omission is rendered particularly obvious in his hallowed distinction between production for use and production for exchange. Production for use is described as production for one’s own use—not for that of family members. Production for exchange is described as sale in a market, excluding the informal non-monetary exchanges that take place within the family. Production *of* family members or *for* family members, whether motivated by love or by reciprocity, does not count as production.

My intent here is not to derogate Marx, who certainly had more respect for the working-class family’s struggle to care for its members than many of his predecessors, including David Ricardo and Robert Malthus. These political economists viewed childbearing and childrearing not only as “unproductive” but also as a major threat to economic growth (Folbre, 2009b). However, I believe that Marx’s androcentric definition of labor unnecessarily constricts his theories of surplus and exploitation, limiting their relevance to the world we live in.

### **9.1.2 Surplus**

Marxian theory defines surplus as the difference between the value of labor power, or what the worker consumes, and the value created by labor power. Hence, the definition of the value of labor power is part of the definition of surplus. Profits—or the difference between wages and other costs of production and total output—are considered the primary form of surplus. This definition is incomplete because the definition of the value of labor power it is based on is incomplete, ignoring both lifecycle costs and population growth.

The simplest way to illustrate this point utilizes the basic corn model that is often used to introduce Marxian theory on an introductory level. Farmers plant corn. At harvest time, they divide the output into three piles: what they need in order to plant a crop for next year, what they need to consume to feed themselves, and what is left over—the surplus. Who controls the surplus? That is the key question in Marxist analysis of social and historical transformation.

But this simple “what’s left over” definition of the surplus falls apart when the phrase “what they need to consume” is unpacked. The amount they need to consume must be more than the adult farmers themselves consume, because these adults were once infants, occasionally become ill and unable to work, and may become unable to provide for themselves in old age. So the farmers must set aside corn to pay for the costs of family members in order to reproduce themselves over time. How will corn be allocated to these family members? Will those who harvest the corn share it equally with those who are providing family care? Some farmers may support ten children, while others raise none at all. Should shares of the corn harvest be based on individual productivity or on family size? Technological change (such as improved health conditions) will affect the amount of corn necessary to reproduce the worker. Children who die before reaching working age consume corn but don’t contribute to it; a decline in infant mortality, therefore, improves reproductive productivity and creates a “surplus” that can be divided among other family members.

In other words, children themselves are like seed corn: the quantity needed to ensure next year’s crop varies according to conditions of production. And just as the production of surplus corn affects farmers’ economic welfare, the production of surplus population—that is, population growth beyond the level required to reproduce the existing population, affects economic welfare. In mercantilist economic theory, unlike classical political economy, population growth was considered a source of economic advantage. Even in classical political economy, it was considered a source of military advantage. The system of outdoor relief that developed in early Britain—later curtailed by Poor Law Reforms—was justified as a means of ensuring an ample supply of soldiers and sailors (Folbre, 2009a).

In retrospect, it seems ironic that a theory so oriented toward the analysis of surplus should ignore the relevance of reproductive surplus. If the wage bundle is sufficient only to provide the minimum level of subsistence to family members, distribution is hardly an issue. But once the family has more than it needs to survive until the end of the next production period, distributional questions loom large. Many of these questions bear on demographic trends, which in turn bear on economic trends. Indeed, many of the major debates of nineteenth century political economy revolved around the advantages of distributing a surplus in the form of higher wages or public assistance to workers versus higher profits. Malthus and Ricardo essentially argued that

any wage surplus would create a demographic surplus that would drive wages back down to subsistence.

Marx ridiculed this argument, insisting that higher wages for workers would not be dissipated by population growth. But he never addressed this issue within the analytical framework he developed within *Capital*. How do “surplus wages” affect family size decisions? Does family size increase, driving population growth? Or does a decline in mortality lead to a decline in fertility, enabling parents to raise fewer children? If average family size declines, do parents devote additional resources to each child, investing more in the development of each one’s productive capabilities? These questions went unasked for a long period of time, perhaps because the statistical infrastructure necessary to perceive and analyse trends in mortality and fertility took a long time to develop. Demographic change (excepting wars and epidemics) follows a longer, slower rhythm than economic change.

Other, more obvious questions regarding inequalities within the family remained politically and culturally taboo. Still, they were raised by the so-called utopian socialists who foreshadowed some other elements of Marxian theory. Robert Owen, William Thompson, and Anna Wheeler all emphasized gender and age-based inequalities within the family, and sought to conceptualize an economic system that would remedy these even as it eliminated class inequalities (Folbre, 2009a). Marx remained uninterested in these dimensions of inequality, which were essentially defined out of analytical existence by his definitions of work and surplus. Nonetheless, the Marxian framework suggests a useful way of thinking about them.

### **9.1.3 Exploitation**

If human history is shaped by struggles over control and distribution of surplus, much depends on the way that surplus is defined. Resources allocated to the care of dependents can be conceptualized as a form of surplus necessary to social reproduction. Collective conflicts over the distribution of the costs of caring for dependents add several layers to the forms of collective conflict that Marx described. The concept of exploitation can be meaningfully applied to intrafamily transfers. This form of exploitation fits easily into the more general critique of exploitation developed in Marx’s account of the process of primitive accumulation and developed in more detail by John Roemer (1988). Furthermore, this approach offers a new way of thinking about the role of the welfare state in transferring resources from the adult working population to help support children, the sick, the disabled, and the elderly.

One can analyse the exchange between a male wage-earner and his wife engaged in unpaid work in the same terms as the exchange between a capitalist and a worker, by comparing the ratio of hours worked to remuneration received

(Folbre, 1982). In both cases, some analytical problems emerge. For instance, we must assume that the amount of labor hours provided is the “socially necessary” amount. If one worker puts in more hours than another worker but spends much of that time loafing, we would not consider that wasted time worthy of remuneration. In the case of the household, an additional complication arrives in the form of public goods: a large portion of the wage bundle goes toward paying for goods or services that are not totally excludable in consumption, such as rent. But it is interesting to ask whether a man who works eight hours a day to support a wife who works eight hours a day to provide domestic services for him should share his wages equally with her. Indeed, much contemporary research on gender inequality focuses on differences in the total amount of time that men and women devote to total work, defined as the sum of paid and unpaid work.

Critical analysis of the exchange of money and services between parents in the support of children, and between parents and children over the lifecycle, is more complex. However, we can still ask to what extent expenditures of time and money on children are shared between mothers and fathers, and to what extent children repay expenditures on them when they become adults, either by supporting their parents in old age or by raising children of their own. Voluntary transfers to family members typically represent a form of unequal exchange. Under what conditions would such forms of unequal exchange be termed “exploitation?”

Marx himself outlined a political theory of exploitation based on differences in the relative bargaining power of participants in voluntary exchange. In particular, his historical account of the process of primitive accumulation emphasized the forcible expropriation of land rights as a precondition for the creation of a proletariat willing to work for exploitative wages. John Roemer develops this theory of exploitation in considerable detail (1988 and elsewhere), based on unfair property rights. He provides a clear analytical definition based on a counterfactual—a “just withdrawal rule.” In highly simplified terms, the counterfactual is this: a class of persons is exploited in an economy if they would be better off (and others worse off) if they could exit the existing relationship taking a per capita share of all alienable assets with them. Roemer does not apply this counterfactual outside a series of stylized “corn economy” scenarios, but it can easily be applied to housewives under capitalism (Goodin, 2005); its application to children, the sick, the disabled, and elderly is less straightforward, but still feasible.

The counterfactual specified depends on political principles, rather than economic analysis. Roemer, like other economists strongly influenced by the Marxian tradition, focuses on the egalitarian distribution of productive assets as the definition of a just society (hence his emphasis on the term “alienable”). But this counterfactual could be expanded to include the egalitarian distribution of opportunities to develop productive capabilities. It could also be expanded

to include the egalitarian distribution of the costs of creating and developing human capabilities. In other words, an individual may be exploited if (a) they lack equal access to society's productive capital, or (b) they lack equal access to a society's reproductive capital, or (c) they are forced to pay an unequal share of the costs of developing and maintaining reproductive capital.

While this is not the place to go into detail, it is worth noting that principles (b) and (c) have played an important role in the development of the capitalist welfare state. The notion that individuals should enjoy equal opportunities to develop their own productive capacities through access to public education and protection against discrimination in employment has clearly shaped public policies in the advanced capitalist countries. Even in the United States, disadvantaged minority groups and women made important relative and absolute gains over the course of the twentieth century. Furthermore, the long-standing feminist argument that men should assume more responsibility for family care has gained at least some cultural traction.

One could argue that the traditional Marxian critique of class based on ownership of the means of production has been displaced by a critique of other forms of inequality based on access to the means of social reproduction. Perhaps it is simply easier to mobilize collective action based on race/ethnicity and gender than on asset ownership and control. But to jump to such conclusions is to ignore important insights that can be gained from reconsideration of the relationship between human capital and financial capital within our larger mode of production.

The traditional Marxian analysis of class remains relevant precisely because it helps explain increased access to the development of productive capabilities. The potential to extract surplus from increasingly well-educated and productive workers in a largely nation-based economic system gave US capitalists a strong incentive to promote public investments in human capital. At the same time, the expansion of wage employment significantly contributed to the empowerment of racial/ethnic minorities and women. Put in terms that resonate with what Marx and Engels wrote in the *Communist Manifesto*, new forms of exploitation helped undermine older forms.

But contrary to the traditional interpretation, the older forms of exploitation were not merely feudal. They were rooted in far more resilient sources of collective identity based on nation, race/ethnicity, gender, and age, relevant to direct appropriation of surplus through military power and the distribution of surplus to the process of social reproduction. As a result they were not immediately displaced by the expansion of wage employment. They continued to shape family life, access to education, training, and jobs, and state policies, with significant impact on the process of accumulation.

The approach I outline differs significantly from efforts to simply acknowledge the importance of "non-class-based" inequalities. Many scholars influenced by the Marxian tradition emphasize forms of distributional conflict other than

those based on class, but restrict application of the concept of exploitation. For instance, Charles Tilly (1999) refers to “opportunity hoarding” as a process distinct from but analogous to exploitation. Erik Olin Wright refers to “nonexploitative economic oppression” (1994, pp. 39–46; 1997, ch. 1).

By contrast, the approach that I have outlined above broadens the definition of exploitation, rejects the notion that one form of exploitation defines a dominant mode of production, and suggests that different forms of exploitation coexist in complex social formations. One precedent for this approach lies in Marxian analysis of inequalities between more developed and less developed nations, especially the work of Andre Gunder Frank (1969) and Arghiri Emmanuel (1972), which describes flows of surplus between nations, rather than classes alone. However, I hope to develop a more general approach, reaching deeper into the history of collective efforts to control and organize resources, and focusing in particular on the emergence and evolution of patriarchal systems. By way of illustration, I conclude with a brief application to the modern welfare state.

## 9.2 RETHINKING THE WELFARE STATE<sup>2</sup>

The market-centric bias of modern economics leads us to see the welfare state, like the family, as a relatively non-economic sphere—in Marxian theory, a sphere of mere distribution rather than production; in mainstream economics, a relatively unproductive institution whose chief role is to correct and adjust but hopefully not otherwise interfere with efficient markets. The market is the horse; the welfare state the cart. The market is the energy source and driving force; the welfare state is simply a device for storing, transporting, and distributing the surplus it creates.

But the private sector is not the only source of horsepower in our economic system. The distribution of the costs of caring for dependents—achieved largely through the family and the welfare state—largely determines the disposable income that individuals have available to meet their personal needs (Folbre, 2006). Investments in human and social capital made both by families and by the state provide the foundation for the accumulation of financial capital and the promotion of technological change.

Women devote considerably more time than men to non-market work, including the care of dependents. Precisely because this work helps “pull the cart,” societies devote considerable effort and attention to ways of harnessing and driving it. Public policies toward family formation, marriage, child care, and elder care are not merely a byproduct of decisions made regarding wage employment. Indeed, in welfare state budgets, expenditures on dependents—



expenditures that essentially replace and supplement those once made within families and communities—far exceed expenditures on job training for adults and social safety net provisions such as unemployment insurance.

### **9.2.1 Welfare State Surplus**

The welfare state does not simply regulate or mediate capitalist relations of production; it regulates and mediates a costly process of social reproduction. It socializes some forms of family support and privatizes others; it promotes health and encourages fertility and defines citizenship and restricts immigration. Its taxes and transfers have huge implications for inequalities based on race/ethnicity and gender as well as class. Indeed, the modern welfare state itself is largely grounded in the exclusion of non-citizens from participation. To gain citizenship in an advanced capitalist country is to gain access to an extremely valuable means of reproduction—access to health services and education for one's children as well as one's self. Indeed, the state represents a family writ large—a unit that pursues its collective interests in ways shaped by the relative bargaining power of its members.

The magnitude of redistribution through the state is huge. Consider the relative size of two different forms of corporate profits and government receipts in the US economy in 2009, based on the most up-to-date data available from the *Economic Report of the President*, 2011.<sup>3</sup>

Profits represent the surplus in traditional Marxian theory, over which owners of capital exercise control. Taxes represent a sum of money extracted and spent in a process governed (theoretically at least) by democratic decisionmaking.

Corporate profits (with inventory valuation and capital consumption adjustments) came to about US\$1.3 trillion in 2009. Total federal, state, and local government receipts (primarily taxes) came to almost three times (2.96 times, to be exact) as much, US\$3.7 trillion. Since 1962, the earliest year for which comparable data is available, the ratio of government receipts to profits has gone up and down over the business cycle, but has never gone below 2 or above 4.2, increasing slightly over time and averaging 3.2.

A large portion of government receipts are invested in human and social capital, as well as other dimensions of productive infrastructure. Yet it is remarkably difficult for individuals (or groups) to calculate their net lifetime benefits, or to estimate the extent to which the taxes they pay are directly transferred to other groups or individuals with whom they are competing for both resources and opportunities. Lack of clear information about net benefits breeds suspicion and resistance to taxation, setting the stage for distributional conflict.

## 9.2.2 The State and Distributional Conflict

The traditional Marxian theory of the state focuses on the ways in which it mediates class conflict, ameliorating problems such as sustained unemployment or environmental damage. A broader view of collective conflict over distribution of the surplus among workers—including its intrafamily distribution—helps explain why a relatively small minority of wealth holders can build alliances with other groups that effectively magnify its influence. It is not hard to find examples of coalitional logic relating to the effects of US global dominance or the history of racial/ethnic inequality in the US. It is important to show how coalitional logic also links the history of patriarchal policies and the specific role of welfare state policies.

The simplest example of coalitional logic based on what might be dubbed “sell out” lies in Lenin’s concept of an “aristocracy of labor.” The argument is straightforward: capitalists can redeploy surplus accumulated through both military/political dominance and international trade to deliver high wages and social benefits to a significant sector of the working class, thereby winning their political allegiance. The political splinter group known as the Weathermen carried this analysis to an extreme in the late 1960s, insisting that the American people as a whole had sold out their ideals in return for relative affluence.

Another example lies in the trajectory of state laws in the Southern United States in the aftermath of slavery. As W.J. Wilson persuasively argues in *The Declining Significance of Race* (1980), white landowners successfully persuaded low-income whites that they stood to gain from strict racial segregation and Jim Crow laws. These are examples of state policies that, independent of employers’ actions, enforced racial inequality. In Wilson’s view, capitalist development itself led to economic changes that rendered racial divisions less directly important, because they came to be reproduced by class relations. In other words, explicit discrimination began to play a less salient role than the inheritance of class-based differences in access to economic opportunity.

A third example is provided in Claudia Goldin’s (1992) account of the role of government policy in restricting women’s economic opportunities as schoolteachers and public employees in the early twentieth century. Her history of the “marriage bars”—policies that forced women to resign positions once they married—provides a clear example of the role of the state in enforcing the gender division of labor. Only later in the twentieth century were women able to mobilize in ways that turned state policies in their favor by prohibiting discrimination against them.

The Civil Rights Act of 1964 and subsequent legislation clearly reduced the relative bargaining power of white men. As long as economic growth remained robust, the absolute earnings of white men continued to increase. Yet wage decline set in for most wage earners lacking a college education in the 1980s

and 1990s. Further, the decline of manufacturing employment through overseas globalization helped gut the trade union movement. As the potential for class-based collective action of workers weakened, the potential for non-class-based forms of distributional conflict intensified. Backlash against affirmative action policies and opposition to public safety-net problems such as Aid to Families with Dependent Children can be explained as a form of “false consciousness.”

Alternatively, they can be considered as a collective effort made by relatively highly-paid workers to protect themselves from competition with more vulnerable wage earners (Bonacich, 1972). Their success does not depend on the adoption of explicit “divide-and-conquer” strategies adopted by employers (Roemer, 1979), though such strategies may reinforce divisions among workers. Bonacich points to use of the state to promote strategies such as immigration restriction and licensing requirements. I argue for more attention to distributional conflict over state spending on health, education, and retirement, rather than wage bargaining alone.

Consider, for instance, the impact of gender differences. A variety of factors may explain why women have different political priorities than men, including gendered norms and preferences. But women depend more on the welfare state than men do for two reasons: they are more likely to take responsibility for children and they are more likely to outlive their spouses in old age. The “social safety net” effect nudges women in the Democratic direction (Deitch, 1988). At the same time, the decline in marriage has de-linked the economic welfare of women and men, pushing women in a more left-wing direction and augmenting a gender gap in political loyalties (Edlund and Pandi, 2002).

Few forms of public assistance other than unemployment insurance or Supplemental Nutritional Assistance Plan (previously termed Food Stamps) are available to men who are not contributing to the support of children. Some public programs, such as child support enforcement, explicitly redistribute money from fathers to their children and their children’s mothers. In 2004, Governor Arnold Schwarzenegger of California famously referred to advocates of a strong public sector as “girlie men.”<sup>4</sup> The so-called “male backlash” effect often takes the form of dismissive criticisms of the maternalist “nanny state.”

### **9.2.3 Political Implications**

The economic crises of the twenty-first century, characterized by severe bubble-bursting recessions in 2001 and again in 2009, have intensified both class and non-class forms of distributional conflict, especially those focused on the role of surplus distributed by the state to spending on education and health. I believe the political impasse of the left reflects the structural dominance of capital, intensified by strategic investments in political and cultural control that make it difficult for most people to perceive and act on their best interests.

However, I think that three other factors play a role. First, the left has consistently underestimated the significance of forms of collective identity and action based on factors other than class, and needs to develop a more comprehensive analysis of distributional conflict. Amid growing evidence from behavioral economics that people often care more about their relative income than their absolute income, we should consider the possibility that people are more likely to compare their position with those they come in contact with on a daily basis than with employers/owners/managers whose lives seem far more remote.

In the current political environment, consider the likely success of two possible political strategies: (1) class-based collective action within the US to reduce the corporate political power and claim a share of its surplus; and (2) race-and-gender-based collective action to improve the relative position of white male workers via cuts in forms of public spending that primarily benefit low-income families of color. The Democratic Party offers weak leadership for strategy 1, but the Republican Party offers strong leadership for strategy 2. The potential gains to strategy 2 may be far lower than those to strategy 1, but they are counterbalanced by huge differences in the relative probabilities of success.

Second, the left has failed to adequately conceptualize the potential for conflict over the distribution of the costs of caring for dependents and developing human capabilities. The responsibility that individuals take—both within the family and through the state—for the wellbeing of others has a fundamental impact on their own standard of living and their economic bargaining power, often yielding public goods that are not captured in market transactions or adequately remunerated through the state. It seems paradoxical to me that so many progressive scholars so convinced of “the limits of the market” continue, nonetheless, to ignore the impact of non-market work and family care on living standards. We are often impelled to defend a welfare state that rests on largely ad hoc policies and provisions rather than a clear or consistent set of principles (see, for instance, my criticisms of family policies in *Valuing Children* (2008)).

Third, globalization has exceeded a threshold sufficient to weaken the incentives for multinational capitalists to support public investments in the health and education of a national labor force. Political and economic changes have combined to generate a huge increase in the global supply of labor even as the cost of capital mobility has declined. As a result, employers have less to gain from improvements in the quality or quantity of local labor power than they once did—they can essentially free-ride on the efforts of other countries. Let the Chinese and the Indians develop their education systems at no cost to the US, allowing top global universities and businesses to cream the very best. In the process, the wage premia that American workers have traditionally enjoyed relative to workers in other countries are also declining, making it ever harder for Americans to pay for their own college education. Large-scale American businesses may also be less concerned about the state of national infrastructure

and the possibility of continued high long-term unemployment than they have in the past. (For more on this theme see my *New York Times Economix* post “Super Sad True Jobs Story” (<http://economix.blogs.nytimes.com/2011/05/02/super-sad-true-jobs-story/>).

### 9.3 IN SUM

And so I return to an argument that Tom and I outlined in our earlier article, one that suggests that capitalism has followed a kind of hump-shaped pattern of success, probably peaking sometime near the end of the twentieth century. At that point in time, capitalist development could claim considerable credit not only for massive development of the forces of production, but also for the weakening of kin-based systems of authority—patriarchal control over women and children and racial/ethnic solidarity largely based on metaphorical kinship. Energized by fossil fuels created in the past, and offloading their climate-changing externalities into the highly discounted future, global corporations appeared to be powerful engines of economic growth.

Now, the externalities, the unanticipated consequences, are beginning to pile up, exacerbating the cyclical instabilities that made capitalism particularly dependent upon both the patriarchal family and the welfare state. As Karl Polanyi (1944) suggested, perhaps prematurely, capitalism may be undermining the very institutions that it depends on for successful social reproduction. Alternatively, it may be moving into a new phase, one in which it simply does not require—and is unwilling to help finance—the successful cultivation of human capabilities outside the narrow wedge of a managerial elite.

### NOTES

1. In the *Economic and Political Manuscripts*, Marx writes, “Admittedly animals also produce. They build themselves nests, dwellings, like the bees, beavers, ants, etc. But an animal only produces what it immediately needs for itself or its young. It produces one-sidedly, whilst man produces universally. It produces only under the dominion of immediate physical need, whilst man produces even when he is free from physical need and only truly produces in freedom there from. An animal produces only itself, whilst man reproduces the whole of nature. An animal’s product belongs immediately to its physical body, whilst man freely confronts his product. An animal forms only in accordance with the standard and the need of the species to which it belongs, whilst man knows how to produce in accordance with the standard of every species, and knows how to apply everywhere the inherent standard to the object.” (See <http://www.marxists.org/archive/marx/works/1844/manuscripts/labour.htm>.)
2. This section draws heavily from a published paper of mine commenting on the “varieties of capitalism” literature (Folbre, 2009b) and one unpublished paper commenting on the work of John Roemer, presented at a conference organized at the Political Economy Research Institute in 2005 by Woojin Lee (Folbre, 2005).

3. See the 2011 Economic Report of the President at <http://www.gpoaccess.gov/eop/tables11.html>, based on Tables B-90 and B-83.
4. [http://en.wikipedia.org/wiki/Arnold\\_Schwarzenegger](http://en.wikipedia.org/wiki/Arnold_Schwarzenegger).

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## 10. Comment on MacEwan and Folbre: reflections on “The Wealth–Power– Inequality–Gender Connection”

**Andrew Zimbalist**

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In his chapter “The Wealth–Power Connection,” Arthur MacEwan sets out to put some meat on the bones of the wealth–power connection in the United States. He begins by outlining the basic argument on the mechanisms of this nexus, as laid out by Edwards, Reich, and Weisskopf, and then proceeds to provide examples and analysis of how this connection has manifested itself and developed over the last 25 years. His chapter is clear and poignant, and I have few issues with the fundamentals of his argument.

I would, however, like to comment on some of its details and on some areas where I believe it would be fruitful to see the argument extended. First, MacEwan acknowledges that there are divisions among the wealthy, but he asserts that “on broad general issues, such as taxation and regulation, there is a wide commonality among the wealthy and among businesses” (p. 124). It seems to me that this formulation obscures too much and, in particular, it glosses over a new dynamic that has infected US society. In my view, the increasing inability of lawmakers to find common ground and the significant emergence of the far right Tea Party represent a new fracturing of the wealthy. The sharpening income inequality that has characterized US society, along with a permissive tax code, increasingly lax rules governing political contributions,<sup>1</sup> and concentration of media ownership, *inter alia*, have made it possible for single individuals (such as Rupert Murdoch or the Koch brothers) to exercise inordinate influence on our political culture. The growing influence of these fringe views appears to be untethered to any underlying theoretical framework or empirical reality and threatens the sustenance of a US economy in dire need of short-term economic stimulus. While the historical conflict within elements of the US ruling class has provided for a flexible policy adjustment between tax giveaways and subsidies for the rich and their businesses, on the one hand, and the necessary redistributive policies, on the other, to preserve system legitimacy and to avoid open conflict, the emergence of the Tea Party seems to have swung the pendulum further away from this delicate balance.



Second, and relatedly, the discussion of the US and world financial crisis during the last few years appears to have focused on the proximate causes of the problem, such as poor oversight by financial regulators, the integration of commercial and investment banking, the explosion of derivatives, government loan guarantees, or the rapid growth of subprime lending. All these factors and more were certainly important contributors to the problem. But underlying the current financial crisis in the United States and Europe, as well as the Latin American debt crisis in the late 1970s and early 1980s, the US savings and loan crisis in the 1980s, the worldwide debt crises infecting Mexico, Brazil, Eastern Europe, Russia, and Southeast Asia during the 1990s, and the collapse of the prestigious hedge fund Long-Term Capital Management in 1998, is inequality. This inequality obliges the large majority of consumers to borrow money in order to meet their needs or their aspirations; businesses, in turn, need financial institutions to provide the consumer credit to sustain demand. This reality obtains whether it is Arab oil money being funneled through the world's money markets to fiscally-strapped Latin American countries or domestic savings being structured into mortgage-backed securities to finance imprudent home purchases.

It is no coincidence that the post-1980 onset of financial crises in the US corresponds with a period of growing income inequality. While between 1947 and 1979 the real income of the bottom fifth of US households grew by 122 percent and that of the top fifth grew by 99 percent, since 1980 the real income of the bottom fifth has fallen by 4 percent and that of the top fifth has grown by 55 percent. Meanwhile, the concentration of income at the very top of the income distribution has grown even more acutely: in 1976 the top 1 percent of income earners received 8.9 percent of national income, while in 2007 the top 1 percent received 23.5 percent of national income.<sup>2</sup> Significantly, Germany, with Europe's strongest economy, has only 11 percent of national income accruing to the top 1 percent of earners—less than half the US level.

Free markets fail in a variety of ways. Market economies need public intervention to provide merit goods, reduce negative externalities, provide public goods, improve information, and promote competition, *inter alia*, but the political shift in the United States today is thwarting this necessary intervention, even beyond its normally limited level. The wealth–power nexus that MacEwan explores calls for a more nuanced interpretation that would shed light on how conflicts among the rich are changing and/or how their expression through the media and in practice is being influenced by new forces. Nancy Folbre's chapter suggests an initial insight along these lines that I shall return to below.

I must also take issue with MacEwan's discussion of the school reform movement. I do not believe that there are only two alternatives: unionized public schools or non-unionized private schools. Nor do I believe that the charter school movement can be dismissed blithely as antithetical to educational success or as simply a tool of the wealthy to promote privatization. I don't think that the

record will support the claim that the idea of charter schools was hatched by wealthy economic interests; rather, I think its intellectual genesis dates to Albert Shanker who grew frustrated with the educational bureaucracy and advocated for teacher-directed schools. It is true, however, that the charter school movement has been heavily financed in recent years by large hedge fund money and by certain conservative interests.

While I understand the potential political importance of the union movement, I believe that public school unions have often put job security above pedagogical progress and, thereby, have thwarted educational excellence (or competence).<sup>3</sup> While charter schools have both positive and negative features, so do public school unions. The charter school movement has at least two aspects: one that centers on providing better schooling for low-income children and another that offers greater choice to middle-income children. I think it is problematic to criticize both aspects with the same broad brush. It is unfortunately true that charter schools sap resources from the public schools; yet it is also true that public schools have been failing to provide a satisfactory educational experience, especially for low-income students. The key to strengthening educational unions is to reform them, not to embrace them uncritically. The historical labor contracts in public schools are no longer fiscally sustainable, nor educationally acceptable. At the same time, of course, the larger solution to our public school dilemma is to reorder our priorities and to devote vastly more public resources to their operation, including higher teacher salaries.

Finally, I want to touch upon one other section of MacEwan's chapter. MacEwan appropriately observes that the Republican cliché that lower taxes produce economic growth finds little empirical support from the US experience over the last two decades since 1990. Of course, other variables, such as the dot.com boom of the 1990s, make simple policy comparisons problematic. But there are two other dynamics that merit discussion. First, there is the matter of incentives and the potential connection between the type of tax levied and economic behavior. It is, for instance, possible that a tax credit for hiring new workers could be effective for promoting employment and growth. It is, however, unlikely in the extreme that lowering dividend or carried interest tax rates—a policy followed by George W. Bush—will promote investment and growth. Part of the problem with the Republican bromide is not that all tax cuts are necessarily bad, but that the Republicans seem to argue that all tax cuts are good and all tax increases are bad for the economy. Second, and relatedly, as I argue above, a well-functioning economy cannot tolerate inequality beyond a certain threshold. Thus, tax increases on the very wealthy, particularly after three decades of growing inequality in the United States, can indeed promote macroeconomic health. The catch here, however, as MacEwan's chapter so ably demonstrates, is that raising taxes on the people with the most political power is not a simple matter. Not everyone behaves like Warren Buffet.

I must begin my comments on Nancy Folbre's chapter with a caveat. I don't know how or why I was selected as a discussant for this chapter. While I enjoyed reading Folbre's ruminations on patriarchy and capitalism, I have but two tenuous claims to legitimacy to comment upon them. The first is genetic: my late sister, Michelle Zimbalist Rosaldo, was a feminist scholar and one of the founders of *Signs* journal. The second is my work on Title IX and gender equity in intercollegiate athletics, an exiguous foundation at best for understanding the historical relationship between patriarchy and capitalism. Having established my dubious bona fides, I now plunge ahead intrepidly with a few brief comments and questions.

One of the chapter's main themes is that non-market and intra-family relations deserve to play a more central role in the analysis of the economic and political development of modern capitalism and that they deserve greater consideration in progressive analyses of US society. I think that Folbre makes this point effectively and persuasively.

Our late friend and colleague David Gordon used to say "Marxist, Schmarxist"—an aphorism that might apply here. Folbre spends a good deal of time explaining why the Marxian framework is deficient. Yet she spends little effort explaining why the Marxian framework is still important for understanding her questions. Given that Folbre finds that (a) class differences play a less prominent role in determining political allegiances, (b) gender differences are best understood "within a larger system of inequality in which age, biological kinship, and metaphorical forms of kinship based on race and citizenship play a central role," and (c) "the traditional Marxian critique of class based on ownership of the means of production has been trumped by a critique of other forms of inequality based on access to the means of social reproduction," would it not be liberating to jettison Marx in pursuing the interesting questions that Folbre poses?

I am puzzled by Folbre's assertion that "it is not far-fetched to suggest that a man who works eight hours a day to support a wife, who works eight hours a day to provide domestic services for him, should share his wages equally with her." If this is an ethical proposition, then I have no problem with it. As an economic proposition, however, it makes little sense to me unless the husband and wife bring equal human capital to their work. This is not to deny the value of housework, it is only to assert that it may have a different value, higher or lower, than different types of work outside the home. Nonetheless, I see no reason why the economic rationale should trump the ethical one.

Folbre has an interesting section where she discusses the increasing role of government in the US economy over the last 50 years. As free markets fail to provide distributional equity, inter alia, there is a larger role for the public sector to hold the system together. I am not sure that it is appropriate to refer to all government revenue as "surplus extracted by the government," as she does. Why is it surplus, when the government collects 10, 15 and 25 percent tax rates

on low- and middle-income Americans, or when state and local governments collect regressive sales taxes?

Folbre argues that women lean more toward Democrats because they are more dependent on the welfare state than men (both because they are more likely to be caring for children and because they live longer.) This may be, but it seems that there may be non-materialist reasons for female political preferences as well. Some of these may derive from women's role as nurturers and their generally less bellicose inclinations.

Folbre offers an interesting materialist explanation for the rightward drift in US politics. She writes: "Globalization has exceeded a threshold sufficient to weaken the incentives for multinational capitalists to support public investments in the health and education of a national labor force." I don't know of an empirical test that would affirm this interpretation, but it is both plausible and interesting. Of course, multinational capital is still dependent on a stable economic, political, social, and legal environment in the United States, and the growing inattention to the remedial distributional role of the public sector may trump multinational capital's preoccupation with short-run cost minimization.

Globalization presents an interesting challenge. Inequality is manifested not only within family units and within countries, but also internationally. Intentionally-designed redistribution mechanisms such as progressive taxation, transfer payments, and social programs, however, exist primarily within countries. Nonetheless, as with the Latin American debt crisis of the late 1970s and 1980s, and today in the eurozone, international redistribution mechanisms can be initially unintended and later forced by a crisis in order to preserve the system. Thus, in the case of the eurozone, the redistribution will occur by creditors accepting substantial discounts on the sovereign debt they hold, as well as by issuing additional credit at discounted rates. This national/international dichotomy suggests that domestic inequality/financial crises can be more readily averted by effective policymaking when allowed by the national political system, but that international inequality/financial crises, absent a more cohesive political integration among countries, will travel closer to the precipice before an adequate resolution mechanism emerges.

The strongest evidence of the right's unrealistic position on income distribution came in September 2011 when Republican leaders protested against Obama's plan to assess a minimum tax (at 35 percent or lower) on the fewer than 450 000 millionaires in the country. The Republicans claimed that this was class warfare. It is hard to believe that such a posture represents the long-term interests of US or multinational capital, let alone the US population.

## NOTES

1. Since the two 2010 Supreme Court decisions, first in *Citizens United* and second in *SpeechNow.org* vs FEC, the practical restrictions on giving to political campaigns (and even preserving anonymity via 501(c)4s) are virtually non-existent. The Supreme Court's obsession with and misinterpretation of free speech and the FEC's and IRS's unwillingness to tightly enforce existing statutes has left us with an unabashed wealth–power connection in the United States. See, for one, Eliza Newlin Carney, "The Deregulated Campaign," *CQ Weekly*, September 19, 2011.
2. See, for instance, Robert Reich, "The Limping Middle Class," *The New York Times*, Sunday Review, September 4, 2011, p. 6.
3. While tenure has its virtues in protecting academic freedom, in my view its costs, in its existing forms, have outpaced its benefits.



# 11. The rising strength of management, high unemployment, and slow growth: revisiting Okun's Law<sup>1</sup>

**Michael Reich**

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## 11.1 INTRODUCTION

In early 2009, just after President Obama was sworn into office and a few months after the financial crisis had erupted, it was evident that the economy was in a full-blown recession. However, the “real-time” GDP data then available indicated that US GDP was falling at only 3.8 percent per year, one of the most moderate rates of any postwar recession. In the same period, employment was falling by nearly 700 000 jobs per month, or over 6 percent on an annual basis.<sup>2</sup> As a result, the unemployment rate rose from 4.6 percent in late 2008 to 10.2 percent in June of 2009. A change of such magnitude had not occurred in over 25 years.

The dramatic increase in unemployment in 2009 took many policymakers by surprise, as it represented a sharp departure from the amount forecast by a relationship known as Okun's Law. Formulated by then Council of Economic Advisers Chair Arthur Okun in 1962, Okun's Law decomposes the historical relationship between unemployment and GDP into a cyclical component and a trend component. The cyclical component represents the estimated responsiveness of the labor market to cyclical (de-trended) changes in GDP. The trend component represents an estimate of what the trend GDP growth rate would be if the unemployment rate was stationary. Of these two components, it is the cyclical relationship that most analysts refer to when speaking of Okun's Law.<sup>3</sup>

Based on historical experience in both recessions and recoveries, Okun's Law posits that a cyclical decline of 1 percent of GDP is associated with an increase of 0.5 percentage points of unemployment one year later.<sup>4</sup> But instead of increasing by 2 percentage points in 2009 in response to the 3.8 percent decline in GDP, the unemployment rate increased by about 6 percentage points. This breakdown of the relationship led many observers to declare that Okun's Law

had disintegrated.<sup>5</sup> As it turned out, data revisions in the intervening time have indicated that the economic downturn was much more severe—GDP declined 8.9 percent not 3.8 percent—than the early data suggested. After the revised data were crunched, it appeared that the Okun's Law relationship might stand intact.

Some observers nonetheless believe that Okun's Law needs revision, pointing to the weak response of the labor market in the economic recovery. According to the econometric estimates of Gordon (2011a), the responsiveness of unemployment to a change in GDP has risen substantially since the mid-1980s.<sup>6</sup> Gordon (2011a; b) suggests that Okun's Law has changed because employers have much greater power and they treat workers now as more disposable than they were before the 1980s. Hence the jobless recoveries since the 1990s, the large increase in unemployment in 2008–2009, and the jobless recovery that began in 2010.

Whether or not Gordon is correct about Okun's Law is of major importance. Five years after the onset of the Great Recession, the weak character of the economic recovery and the even weaker recovery of the labor market continue to raise the question: Why is economic growth so slow and why are we having jobless recoveries? I address this question here by revisiting Okun's Law, focusing not just on the cyclical relationship that is emphasized by Gordon and most economists, but also upon its implied estimates of trend growth.

My main argument concerns the effects of the falling strength of labor since the 1980s upon economic growth and stability in the US. I show that Okun's Law has changed in response to these institutional changes. But unlike Gordon, the part of Okun's Law that my findings revise involves not its cyclical component, but rather the part that has received less attention: trends in growth rates.

It is well known that economic growth since the early 1980s has been slower than in the previous postwar period. Although the number of jobs grew rapidly during the technology boom of the late 1990s, the growth of employment since 2001 has been especially slow. By early 2012, even with the recovery from the Great Recession, employment was essentially at the same level as in 2001. The labor market had already experienced more than a lost decade.

While this slower employment growth is a well-known fact, it is often attributed to globalization and an upsurge in productivity growth, rather than to slower economic growth and the decline of unions. I examine here the implications of the declining power of labor, which I shall also refer to as the rising strength of management. I suggest that the decline of unionism was a major part of a shift to a low-road path of development for the US economy, one in which profitability is enhanced by cutting labor costs rather than by investments in innovation and productivity growth that would be shared with labor. Since the 1980s, large segments of US employers moved away from a mutual-gains relationship with their employees and toward a shorter-run perspective that emphasized cost-cutting at the expense of long-term investments.<sup>7</sup> These developments reduced the growth-rate of the economy as a whole.



My results suggest, somewhat surprisingly, that the cyclical component of Okun's Law has not been changed substantially by the weakening of labor. Unions in the US do protect workers from arbitrary dismissals and they sometimes slow down plant closures, either through collective bargaining agreements or through political pressure. In some cases, unions do bargain over employment levels, as in the cases of airplane crew sizes, nurse-staff ratios or teacher-student ratios. US unions can also, through concession bargaining, be an instrument of nominal downward wage flexibility, and thereby save some of their members' jobs.<sup>8</sup>

But most union contracts contain a management rights clause that gives management the right to set the size of the workforce and to adjust it as needed when business conditions warrant. With a management rights clause, the employer's decisions regarding the size of the workforce adjustment does not require any further justification. Gordon and many other observers thus overstate the extent to which strong unions ever had substantial power in the US to prevent layoffs when the economy turns south.

In addition to reducing the size of their workforce, employers can in principle adjust to downturns in economic activity by cutting their workers' hours. Indeed, as Bernanke (1986) showed, hours reductions that were shared by all employees were quantitatively as important as layoffs in reducing labor input during the Great Depression. Since that time, however, unions have pressed for layoffs rather than hours reductions as the preferred adjustment method. Using layoffs protects senior workers from hours reductions and places more of the adjustment costs on junior workers, who were the first to be laid off. Layoffs in unionized companies are allocated according to rules set forth in the contract, usually involving inverse seniority.<sup>9</sup>

Houseman and Abraham (1994) showed that labor market adjustment in recessions occurs more through layoffs in the US and more through hours reductions in other countries, such as Germany and Japan. As is well known, strong European unions have obtained employment protections for workers on indefinite contracts. These protections make layoffs very costly to employers and have led European employers to greater use of hours reductions as the labor adjustment mechanism in recessions.<sup>10</sup>

Has the US pattern that emphasizes layoffs over hours reductions begun to change? Gordon (2011a, fig. 6) does show that labor hours adjusted much more to GDP changes in the later period than they did in the earlier, while the responsiveness of employment to GDP changes shows only a small increase from the early period to the later one. On the other hand, US employers have been very slow to utilize work-sharing subsidies that are available in over 20 states (Reich, 2012).

My focus on the rising strength of management since the 1980s and its consequences contrasts strongly with Thomas Weisskopf's analysis of the rising strength of labor and its consequences for the period up to 1979. This contrast

does not represent a critique of Weisskopf's study. Rather, it demonstrates how much the dynamics of capitalism have changed in the intervening time.

In Section 11.2 of the chapter I discuss Weisskopf's approach in order to highlight these contrasts. Section 11.3 examines some of the changes since 1980 that have led over time to a low-road business model in the US, one in which managers see workers as a cost to control rather than a partner in growth. Section 11.4 recognizes that the decline of unionism is correlated with the decline of manufacturing in the US, as well as with institutional changes in the National Labor Relations Act and the policies of the National Labor Relations Board, and asks how these two phenomena might be distinguished. Section 11.5 discusses how changes in economic fluctuations and growth of US capitalism can be examined conceptually through the lens of Okun's Law. Section 11.6 provides my empirical identification strategy of the causal changes and Section 11.7 discusses the empirical results. I provide some concluding comments in Section 11.8.

## 11.2 WEISSKOPF'S 1979 ANALYSIS

In his classic 1979 article, "Marxian crisis theory and the rate of profit in the postwar U.S. economy," Thomas Weisskopf analysed the changing economic relationships of the postwar period that gave rise to the long crisis of the 1970s. The postwar period was one of high growth rates, and a shared prosperity among all income quintiles. The postwar system broke down, however, in the 1970s. Weisskopf determined that the growth of business costs—primarily wages but also raw materials prices—had squeezed profits, thereby reducing investment and setting off a period of stagflation (Weisskopf, 1979). The growth of these costs resulted in part from unusually rapid economic growth, especially during the Vietnam War, which increased the demand for labor, raw materials, and other inputs faster than supplies of each could be mobilized. As a result, unemployment rates fell to levels that had not been seen since the Second World War, productivity growth slowed and wage pressures squeezed profits. In other words, the findings supported a "Rising Strength of Labor" thesis.

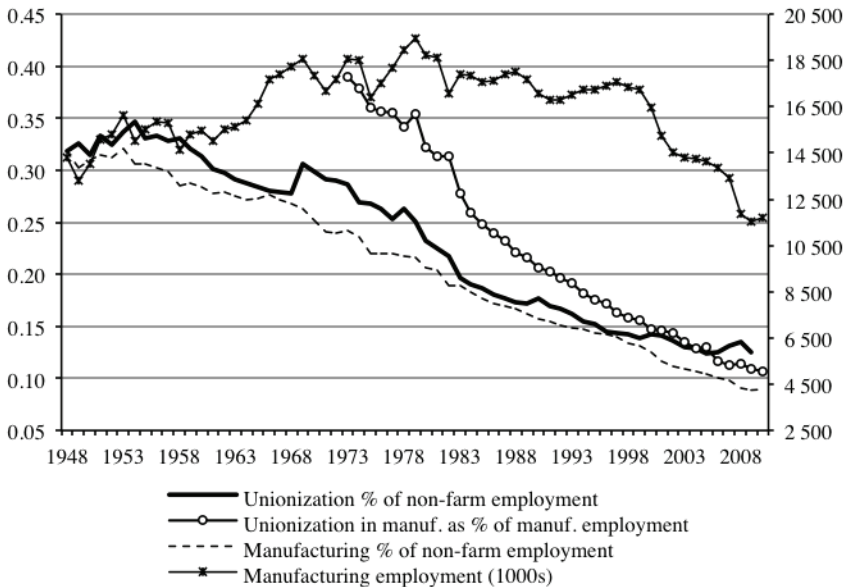
Weisskopf's article made many important contributions to the economic crisis literature. As usual, he provided an extremely detailed and very instructive discussion of each of the data series that he used, the proper price indices needed to measure real quantities, and how to handle such issues as changing relative prices of consumer and capital goods.

But most important, by elucidating the panoply of forces that determine the rate of profit, Weisskopf elegantly brought together into a single framework the variety of conditions that could lead to a sustained economic downturn. That framework encompassed the conditions in which aggregate demand crises, such as the Great Depression of the 1930s, would erupt, as well as the conditions under

which profits could be squeezed on the costs side, especially in the labor and raw material markets. Weisskopf thus provided a means to resolve the then-ongoing debate among the Keynesians, the stagnationists, and the underconsumptionists who emphasized aggregate demand problems, and the profit-squeeze perspectives of those, such as Glyn and Sutcliffe and Boddy and Crotty, who paid more attention to the depletion of the reserve army of the unemployed and the consequent growth in wages and in labor's share of national income.<sup>11</sup>

Was Weisskopf correct to speak of a rising strength of labor in the 1960s and 1970s? The idea that labor once had economic strength, to say nothing of the idea that its strength was increasing in the US into the 1970s, seems remarkable in retrospect. Indeed, private sector union membership peaked at an estimated 21 million members in absolute numbers in 1979, the year Weisskopf's article appeared. On the other hand, union density—the proportion of the workforce represented by unions—peaked much earlier, in 1953; then declined slowly but steadily through the 1970s, before declining further at an accelerated rate, beginning, but not ending, in the 1980s (see Figure 11.1).

Figure 11.1 Manufacturing employment (level and share) and union membership in nonfarm employment and in manufacturing



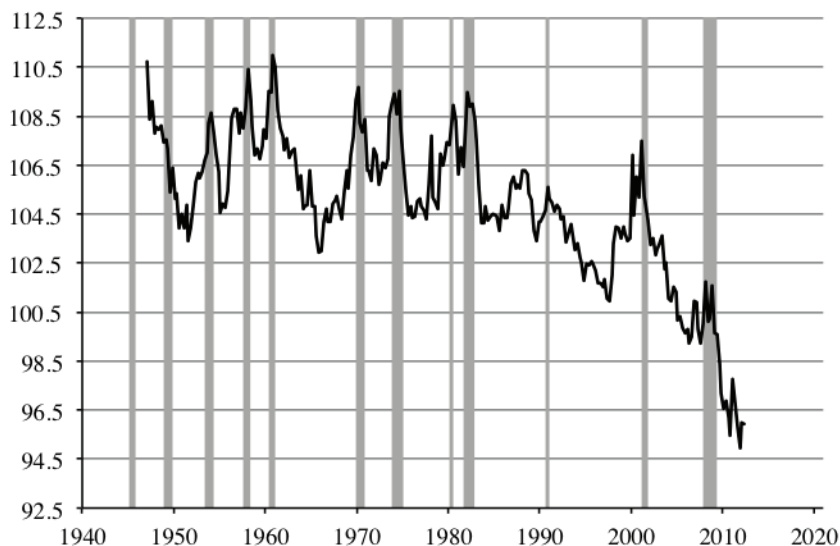
Sources: For employment levels, the US Department of Labor's Current Employment Statistics survey (National). For manufacturing unionization rates, the US Department of Labor's Current Population Survey (CPS): the May files for 1973-81, the Outgoing Rotation Group (ORG) Earnings Files for 1983-2010. There were no union questions in the 1982 CPS. Data on non-farm unionization were provided by Dr. Arindrajit Dube, University of Massachusetts Amherst.

Weisskopf was nonetheless correct to refer to a rising strength of labor because in the period from the early 1960s to the early 1970s falling unemployment rates and rapid economic growth made it more difficult for employers to find workers just when they needed them most. Market conditions thus provided unions with more bargaining leverage. Union strikes became more common, putting more pressure on employers to offer more favorable contract terms, including in many cases generous cost-of-living allowances (Rosenberg, 2010).

This rising strength of labor then translated into a rising share of labor in national income. As Figure 11.2 shows, labor's share of national income contains a strong cyclical component, falling in the first half of an expansion and rising in the second half. Thus, the proportion of national income received by labor rose between the mid 1960s and the business-cycle peak of 1973, recovered after the 1974–5 recession and then increased again in the latter 1970s.

Yet Weisskopf could not foresee in 1979 that labor's strength had peaked and was about to enter a long period of decline. The subsequent changes in labor's share of national income provide one indicator of its weaker power. As Figure 11.2 shows, labor's share has been falling since the mid-1980s, interrupted only temporarily in the second half of the 1990s expansion, and then plummeting in the 2000s.<sup>12</sup>

*Figure 11.2 Labor's share of national income, 1947q1 to 2011q3*



*Notes:* Non-farm business sector. Index 2005 = 100. Shaded areas indicate US recessions. 2012 research.stlouisfed.org.

*Source:* US Department of Labor: Bureau of Labor Statistics.

### 11.3 THE RISING STRENGTH OF MANAGEMENT

The timing of the decline in labor's share coincides with two key changes in labor-management relations that emerged in the early 1980s, each of which had implications for both growth rates and how labor markets absorbed economic fluctuations.<sup>13</sup> First, in response to the stagflation crises of the 1970s, which as Weisskopf showed were related directly to the rising strength of labor, employers mounted a prolonged, multi-pronged, and very successful anti-union offensive. As a result, labor's success in NLRB elections plummeted in the early 1980s and never recovered (Farber and Western, 2002).

Second, in response partly to growing international competition and to challenges from aggressive shareholders, and without the countervailing power of unions, managers became much more oriented toward and rewarded by the short-term buttressing of company share prices.<sup>14</sup> To do this they invested less in research and development and less in their own workforce. This change represented a systemic shift toward managers. Instead of cooperating with workers or their representatives for mutual long-term productivity gains, the emphasis became generating short-term increases in profits that would boost shares at the expense of long-term growth. This shift in the corporate business model meant that employers placed a lower value on long-term employment relations, shifting away from defined-benefit pensions and other benefits that tied employers and employees together and toward the use of shorter-term employees.

Changes since the 1970s in how the stock market responds to layoffs indicate how much the corporate business model has shifted. As Hallock et al. (2011) show, the stock market does not valorize the firm-specific skills of long-term employees and increasingly reacts to layoff announcements as evidence of positive managerial decision-making. In other words, layoff announcements have become interpreted as a sign of increased cost-efficiency rather than one of financial stress. And when layoffs are expected to increase share prices, managers with short-term horizons are likely to overshoot the frequency and size of layoff announcements, even if they destroy long-term assets embodied in their employees, and thereby lower the company's share prices in the longer-run (Love and Nohria, 2005).

Hallock et al. (2011, fig. 7) present annual data on the relationship between large layoff announcements and share prices. In the 1970s, share prices of large companies reacted strongly and negatively to layoff announcements. This pattern began to reverse in the 1980s. By the 1990s layoff announcements were nearly as likely to generate positive effects on share prices as to generate negative ones (see also Uchitelle, 2006). According to Hallock (1998): "Firms that announce layoffs in the previous year pay their chief executive officers more and give them larger percentage raises than firms that do not have at least one layoff announcement in the previous year."

As Hallock et al. (2011) show with annual data, the relationship between layoffs and share prices is highly cyclical. In particular, layoffs still have negative effects on share prices during recessions even as they have positive effects during expansions. However, the magnitude of these cyclical variations has not changed in recent years compared to the 1970s, indicating that the stock market may not have affected the cyclical patterns of layoffs. Interestingly, in addition to the cyclical variations, the annual data display a long-term trend from 1970 through 2007 toward higher share prices after layoff announcements. Put together with the greater proportion of managerial compensation that is share-price related, the result is that employers now are more rewarded by layoffs than they were in the 1970s.

Trends in job tenure indicate how attachments between firms and their workers have evolved. Farber (2010) provides the most thorough study of trends in job tenure; his data cover the period from 1973 to 2008. Farber finds a substantial and steady reduction over this period in the proportion of male private-sector workers who hold a job with the same employer for more than 10 years, confirming the familiar narrative that lifetime jobs are much less common than before.<sup>15</sup> This pattern occurred among men in all age groups and especially for men over 40. Mean tenure fell from 13.5 years to 11.4 years for men aged 50, and from 18 years to 14 years for men aged 60. Changes in employer pensions that reinforced the attachments of workers and firms show similar patterns. Between just 1992 and 2004, the proportion of men aged 48 to 52 with defined benefit retirement plans—which unlike 401k and other defined contributions plans provide benefits based upon length of service with the firm—fell from 41 percent to 24 percent.

Farber also finds that the proportion of workers in short-term jobs—those who remain with the same employer for less than 1 year—increased in the same time period. The proportion of workers in new jobs rose in all age groups, and especially among workers aged 30–39.<sup>16</sup> By 2008 these short-term jobs accounted for one-fifth of total private sector employment.<sup>17</sup> Equally important, by 2008 half of all new jobs ended within the first year, implying that about a quarter of all new jobs end within 6 months.

Some of the decline in long-term jobs reflects the decline of industries, such as manufacturing, that had above-average job tenure levels. Similarly, some of the increase in short-term jobs reflects the rise of industries, such as retail and accommodation and food services, that long had lower levels of job tenure. As Farber reports, however, the shift to shorter job tenure is also visible *within* industries.

In summary, the increased propensity to use layoffs to increase share prices and the declining value placed upon long-term employment relations each suggest that the labor market has become more flexible. What remains open is whether this greater flexibility has affected the volatility of employment with the business cycle and the trend rate of economic growth.

## 11.4 THE DECLINE OF LABOR OR THE DECLINE OF MANUFACTURING?

As Hallock et al. (2011) make clear, a large proportion of layoffs in the US have taken place in manufacturing. Some observers suggest that the decline of manufacturing is the product of globalization, especially illustrated by growing competition in recent decades from low-wage producers in China and Mexico. But as Figure 11.1 shows, manufacturing employment has been declining steadily as a share of total employment since the early 1950s, well before the emergence of international competition from Europe, Latin America, or Asia. It seems more likely that manufacturing employment has declined because of greater productivity growth in manufacturing than in services and because of growth in the demand for services.

On the other hand, the level of manufacturing employment (also shown in Figure 11.1) did increase in the 1960s and 1970s. It then fluctuated in the 1980s and 1990s with the value of the dollar against other currencies and with the growth of the US current account deficit (McKinnon, 2004). According to McKinnon, the steep decline of manufacturing in the 2000s reflects the large increase in the fiscal deficit, which increased interest rates and increased the value of the dollar, thereby increasing the manufacturing trade deficit. For this reason, the decline of manufacturing in other major economies, such as Germany and Japan, has been much less steep than in the US.

Manufacturing jobs are important for economic growth and innovation because they pay much above the economy-wide average and because about 70 percent of research and development takes place in manufacturing. The decline of manufacturing consequently holds implications of its own for long-term economic growth. Manufacturing is also more cyclically sensitive than other sectors of the economy. Therefore, the decline of manufacturing can also affect how much employment responds to fluctuations in GDP.

The decline of manufacturing also has implications for the decline of unionism. Figure 11.1 shows that union density in manufacturing has always been higher than in the economy as a whole. Nonetheless, union density in manufacturing has been declining more rapidly than in the economy as a whole. The decline of manufacturing employment may also hold major implications for labor's share of national income, Weisskopf's measure of labor's strength.

Consider the trend in the level of manufacturing employment displayed in Figure 11.1. Manufacturing employment grew in the 1960s and 1970s, the period when labor's share of national income (shown in Figure 11.2) was also rising. And the rapid decline in manufacturing employment since the 2000 recession coincides with the rapid decline in labor's share in the same time period.

In summary, it is important to distinguish the effects of manufacturing decline from the effects of union decline. I therefore take manufacturing decline into account in the empirical tests that I discuss below.

## 11.5 REVISITING OKUN'S LAW

In the preceding section I reviewed major changes in the US labor market that began in the 1980s: weaker unions, shorter managerial time horizons, a greater propensity to lay workers off, declining employer commitments to employees, and the decline of manufacturing. These changes can be summarized as generating increases in the flexibility of US labor markets.

Has this increase in flexibility since the 1980s changed how the labor market reacts to economic growth and fluctuations? An increase in labor market flexibility could lead to more volatility in employment, as occurred in Spain and other countries that increased their use of temporary contracts (Bentolila et al., 2010). The 1984 to 2006 period of moderation in business cycles, sometimes referred to as the Great Moderation, suggests the opposite occurred in the US, while the large increase in unemployment during the Great Recession of 2007–2009 supports the hypothesis of increased volatility.

An increase in flexibility, if it reduces employer investments in worker productivity, can reduce longer-term economic growth. The European experience with more flexible labor markets suggests just such an outcome, as does the slower rate of growth of the US economy since the 1980s.

Okun's Law, which summarizes both short-run cyclical patterns and longer-run trend growth rates, is well-suited to address the effects of increased labor market flexibility upon short-run fluctuations and longer-run growth. Okun's Law in effect decomposes changes in the unemployment rate into cyclical and trend economic growth rate components:

$$\Delta UE_t = a + b \left( \frac{\Delta GDP_t}{GDP_t} \right) + \varepsilon_t$$

where  $\Delta UE_t$  equals the change in the unemployment rate and  $\frac{\Delta GDP_t}{GDP_t}$  equals the growth rate of GDP. The cyclical (short-run) component of Okun's Law is the estimated  $b$ .

To obtain the estimated trend of GDP growth consistent with no change in unemployment, set  $\Delta UE_t = 0$ . This condition implies:



$$\left(\frac{\Delta GDP_t}{GDP_t}\right)^* = -\frac{a}{b}$$

The trend growth rate (the rate of economic growth consistent with no change in unemployment) thus equals the intercept divided by the absolute value of the cyclical coefficient.

## 11.6 IDENTIFICATION STRATEGY AND DATA<sup>18</sup>

### 11.6.1 First Stage

My first-stage strategy consists of estimating Okun's Law coefficients across the 50 US states over the period 1964–2010. For each state  $i$ , I regress the annual change in the state unemployment rate  $\Delta UE$  against the percentage change in real state GDP:

$$\Delta UE_{it} = a_i + b \left(\frac{\Delta GDP_{it}}{GDP_{it}}\right) + \varepsilon_{it}$$

I then examine whether the coefficients changed in the 1980s and whether they changed more in states that had greater declines in unionization.<sup>19</sup> I do so first by estimating Okun's Law for two different periods and separately for states that had greater or smaller than median declines in unionization over the period.

To estimate these regressions I require only real state GDP, state unemployment rates for each year, and unionization rates for each year and state.<sup>20</sup> State GDP data are from the NIPA regional tables, available in real terms for later years and in nominal terms for earlier years. To obtain real state GDP for earlier years I extrapolated backwards using state-level trends in state GDP price deflators for later years. State unemployment rates are from BLS for later years and from the *Employment and Training Report of the President 1976* for earlier years.<sup>21</sup> Unionization data are from union-stats.com.<sup>22</sup>

It is instructive also to examine directly whether the decline in unionization had a *causal* impact on the changes in the Okun coefficients. A challenge for this exercise is that states differ in their cyclical responses and trend growth rates. For instance, a state producing natural resources such as Texas has somewhat different cyclical responses from the country as a whole—and this may have little to do with unionization as such. To eliminate such confounding factors across states, I focus on comparing *changes* in unionization with *changes* in the cyclical and trend responses. In so doing, I also examine whether the decline in unionization is related to the decline in the share of employment in manufacturing over this period. Thus, in a second stage I regress the estimated state-level

changes in the coefficients upon percentage changes and levels in state-level unionization and manufacturing employment shares.

### 11.6.2 Second Stage

For the second stage of identification, for each state  $i$ , I regress for 1986–2010 the annual change in the state unemployment rate  $UE$  against the percentage change in real state GDP:

$$\Delta UE_{it} = a_i + b \left( \frac{\Delta GDP_{it}}{GDP_{it}} \right) + \varepsilon_{it}$$

Define  $trend_{post,i} = -\frac{a}{b}$  equals the trend growth rate, and  $cycle_{post,i} = b$  equals the cyclical response of unemployment to state GDP change.

For each state  $i$ , I then regress for 1964–85 the change in the state unemployment rate  $UE$  against the percentage change in real state GDP:

$$\Delta UE_{it} = c_i + d \left( \frac{\Delta GDP_{it}}{GDP_{it}} \right) + \varepsilon_{it}$$

Define  $trend_{pre,i} = -\frac{c}{d}$  equals the trend growth rate, and  $cycle_{pre,i} = d$  equals the cyclical response of unemployment to state GDP change.

Then, for each state  $i$ , I calculate the differences in coefficients between the later (post) and the earlier (pre) periods:

$$\Delta trend_i = trend_{post,i} - trend_{pre,i}$$

$$\Delta cycle_i = cycle_{post,i} - cycle_{pre,i}$$

and merge those into a state-level dataset that contains the change and later-period levels of two independent variables:

$$\Delta union_i =$$

percent change in unionization rate between pre and post periods in state  $i$

$$\Delta manuf_i =$$

percent change in manufacturing employment share (pre and post) in state  $i$

$union_{post,i}$  = unionization rate in later period for state  $i$

$manuf_{post,i}$  = manufacturing employment share in later period for state  $i$

I then estimate six regressions:

$$\Delta trend_i = a + \beta_1 \cdot \Delta union_i + \beta_3 \cdot \Delta manuf_i + \varepsilon_i$$

$$\Delta trend_i = a + \beta_2 \cdot union_{post,i} + \beta_4 \cdot manuf_{post,i} + \varepsilon_i$$

$$\Delta trend_i = a + \beta_1 \cdot \Delta union_i + \beta_2 \cdot union_{post,i} + \beta_3 \cdot \Delta manuf_i + \beta_4 \cdot manuf_{post,i} + \varepsilon_i$$

$$\Delta cycle_i = a + \beta_1 \cdot \Delta union_i + \beta_3 \cdot \Delta manuf_i + \varepsilon_i$$

$$\Delta cycle_i = a + \beta_2 \cdot union_{post,i} + \beta_4 \cdot manuf_{post,i} + \varepsilon_i$$

$$\Delta cycle_i = a + \beta_1 \cdot \Delta union_i + \beta_2 \cdot union_{post,i} + \beta_3 \cdot \Delta manuf_i + \beta_4 \cdot manuf_{post,i} + \varepsilon_i$$

## 11.7 RESULTS

The first-stage results are presented in Tables 11.1 and 11.2. I begin with results for all the states in the sample over the entire period. I then consider whether these results vary by time period and by the extent of union decline. Then I discuss the results when I vary both the time period and the extent of union decline.

Table 11.1 presents the estimates over the entire period 1964–2010, without state fixed-effects in column 1 and with state fixed-effects in column 2. In this table and in Table 11.2, the more revealing results are those that include state fixed-effects. My discussion therefore focuses only on those results. Standard errors are clustered at the state level in all the tables.

In Table 11.1, column 2, the estimated cyclical coefficient, which is labeled as GDP percent change, equals  $-0.237$  and the estimated trend growth rate is 3.46 percent.<sup>23</sup> Both are significant at the 1 percent level.

In Table 11.1, columns 3 to 6 divide the entire time period into two parts, 1964 to 1985 and 1986 to 2010.<sup>24</sup> In columns 4 and 6, which provide the specifications that include state fixed-effects, the cyclical coefficients and the trend growth rates remain significant at the 1 percent level in both time periods, but they vary substantially between the two periods. The change in the cyclical coefficient, from  $-0.261$  to  $-0.219$  (a decline of 16.1 percent), indicates that a given decline in GDP has a *smaller* effect on unemployment in the later period than in the earlier period. This result suggests that any increased labor market flexibility in the later period, when unions were weaker, is *not* associated with an increase in labor market volatility, contrary to the suggestions of Gordon and others.

What about the difference in growth rates in the two periods? In Table 11.1, columns 4 and 6 show a decline in the estimated trend growth rate, from 3.75

Table 11.1 Okun's Law, 1964 to 2010

Change in UE rate	1964 to 2010		1964 to 1985		1986 to 2010	
	(1)	(2)	(3)	(4)	(5)	(6)
GDP % change (cycle)	-0.220	-0.237	-0.239	-0.261	-0.197	-0.219
se	(0.006)	(0.006)	(0.009)	(0.009)	(0.009)	(0.009)
Constant	0.798	0.767	0.905	1.051	0.640	0.557
se	(0.028)	(0.130)	(0.045)	(0.220)	(0.034)	(0.160)
Trend growth	3.480	3.460	3.780	3.750	3.250	3.200
se	(0.078)	(0.075)	(0.130)	(0.120)	(0.120)	(0.110)
N	2162	2162	1012	1012	1150	1150
R <sup>2</sup>	0.371	0.401	0.421	0.459	0.301	0.355
State fixed effects	n	y	n	y	n	y

*Notes:* All cycle and trend growth coefficients are significant at the 1 percent level. Excludes outlier states: Alaska, North Dakota, Louisiana, and Wyoming. Regressions performed in R with lm function. Standard errors are clustered at the state level. The standard errors for the trend growth estimates were determined with a bootstrap: for each regression group, sample N=46 observations with replacement from the group data, calculate the trend estimate for the sample, repeat 500 times, determine the empirical distribution of the 500 trend growth estimates for each group.

percent in the earlier period to 3.20 percent in the later period. The increase in labor market flexibility in the later period, when unions were weaker, is thus associated with a somewhat reduced economic growth trend, consistent with the arguments made earlier in this chapter.

I turn next to examining the possible effects of the decline of union density. Table 11.2 presents Okun's Law estimates, but now disaggregated into two sets of states. One set consists of states in which the percentage decline in union density was less than the median (columns 1, 3, and 5), and the other consists of states in which union density declined by more than the median amount (columns 2, 4, and 6).<sup>25</sup>

Consider first the differences between the two sets of states over the entire period of 1964–2010. These results are shown in columns 1 and 2 of Table 11.2. The cyclical coefficient in column 2 is slightly higher than in column 1,

Table 11.2 Okun's Law, by time period and extent of union decline

	1964 to 2010		1964 to 1985		1986 to 2010	
	Union decline group		Union decline group		Union decline group	
	Small	Large	Small	Large	Small	Large
Change in UE rate	(1)	(2)	(3)	(4)	(5)	(6)
GDP % change						
(cycle)	-0.226	-0.246	-0.253	-0.268	-0.206	-0.229
se	(0.009)	(0.009)	(0.013)	(0.014)	(0.014)	(0.012)
Constant	0.820	0.733	1.090	1.038	0.599	0.508
se	(0.192)	(0.189)	(0.316)	(0.318)	(0.235)	(0.218)
Trend growth	3.577	3.349	3.906	3.635	3.264	3.145
se	(0.011)	(0.01)	(0.037)	(0.034)	(0.028)	(0.014)
N	1058	1058	483	483	575	575
R <sup>2</sup>	0.374	0.408	0.437	0.438	0.290	0.371
State fixed effects	y	y	y	y	y	y

*Notes:* All cycle and trend growth coefficients are significant at the 1 percent level. Excludes outlier states: Alaska, North Dakota, Louisiana, and Wyoming. Regressions performed in R with lm function. The standard errors for the trend estimates were determined with a bootstrap: for each regression group, sample N=46 observations with replacement from the group data, calculate the trend estimate for the sample, repeat 500 times, determine the empirical distribution of the 500 trend growth estimates for each group.

suggesting again that greater union decline did not have much effect on the volatility of employment.

The trend growth rates in these two columns show a different pattern. Over the period 1964–2010 trend growth was 3.58 percent in the states with the less rapid decline in unionism and 3.35 percent in the states with the more rapid union decline. States in which labor decline was muted grew moderately faster than those in which labor decline was greater. This result, which is consistent with the finding in Table 11.1, suggests that greater increases in management strength versus labor are associated with lower economic growth.

I turn next to Okun's Law estimates that compare both the earlier and later periods and the states with lesser or greater amounts of union decline. These results are also presented in Table 11.2. Columns 3 and 4 show the results for

both sets of states in the earlier period and columns 5 and 6 exhibit the results for both sets of states for the later period.

The cyclical coefficient in column 4 of Table 11.2 is about 10 percent larger than that in column 3. States with weaker unions had somewhat more cyclical volatility in the 1964 to 1985 period. The same pattern applies in the later period, as shown in columns 5 and 6.

But the more interesting comparisons involve changes over time within each set of states. Consider first the changes in the states with less union decline, as shown in columns 3 and 5. The cyclical coefficient falls by about 20 percent between the two time periods, indicating that cyclical volatility fell within this group of states. Roughly the same pattern obtains for states with more union decline, as shown by comparing columns 4 and 6. Within each group of states, labor markets are somewhat *less* volatile in the later period relative to the earlier one, again contrary to the arguments of Gordon and others.

A different pattern appears for the estimated trend growth rates in Table 11.2. As the results in columns 3 and 4 in Table 11.2 indicate, the estimated trend growth rate in the earlier period is 3.91 in the states with less union decline and 3.64 in the states with more union decline. In the early period, more union decline is associated with lower trend growth.

In the later period, the estimated trend growth is 3.26 in the states with less union decline and 3.15 in the states with more union decline. Thus, in the later period, the estimated trend growth rate is higher in the states with less union decline than in those with more union decline. Comparisons across the two groups of states within each period indicate a higher growth rate where union decline is smaller. Within each set of states, on the other hand, the trend growth rate changes in a similar manner over time. Both sets of states experience a growth rate decline, of similar relative size, from the earlier to the later period.

Summarizing to this point, the results in Tables 11.1 and 11.2 suggest that the cyclical coefficients are relatively unchanged when comparing states with less union decline than those with more union decline. Labor markets have become less volatile over time, however, across both groups of states. Trend economic growth has similarly fallen for both groups of states over time.

The main differences between the two groups of states are that the states with less union decline have a modestly lower level of volatility and a modestly higher trend growth rate, across both time periods. As already mentioned, however, these results may be confounded by heterogeneity across states. The second-stage changes-on-changes regression provides one test of whether this is the case.

I turn next to the results of the second-stage regression. This regression investigates whether the declines in unionism and in manufacturing at the state level can account for the change in the trend and cycle coefficients for each state. To recall, I focus here on changes-on-changes regressions in order to identify the causal effect of de-unionization on trend growth, and to take into account

how heterogeneity across states could confound the comparison of trend growth rates to the change in unionization.

These results are displayed in Table 11.3. As columns 1 and 4 indicate, a greater decline in unionism does not significantly affect the trend growth rate, nor does it significantly change the cyclical volatility of unemployment. A greater decline in manufacturing, moreover, is also not associated with a significant change in the trend growth rate, nor with a significant change in cyclical volatility.

As a check on these results, columns 2 and 5 in Table 11.3 ask whether the state-based levels of unionism and manufacturing in the later period are related to changes in the trend and cycle coefficients. None of the coefficients in these regressions is significant. Finally, the change and level variables are both included in the regressions reported in columns 3 and 6. The results in column 3

*Table 11.3 Effects of unionization and manufacturing on changes in trend and cycle*

N = 46	Change in trend			Change in cycle		
	(1)	(2)	(3)	(4)	(5)	(6)
Percent change						
union <sub>net</sub>	-0.253		-2.203	0.038		0.021
se	(1.646)		(1.852)	(0.104)		(0.123)
Percent change						
manuf <sub>net</sub>	-0.056		0.184	-0.112		-0.105
se	(1.399)		(1.415)	(0.088)		(0.094)
union <sub>mean post</sub>		4.519	6.971*		0.223	0.101
se		(3.646)	(4.218)		(0.241)	(0.279)
manuf <sub>mean post</sub>		-4.533	-6.217		0.015	-0.002
se		(4.616)	(4.917)		(0.305)	(0.325)
Intercept	-0.790	-0.592	-1.824	0.004	0.021	-0.015
se	(1.487)	(0.872)	(1.652)	(0.094)	(0.058)	(0.109)
R <sup>2</sup>	0.001	0.001	0.001	0.001	0.001	0.001

*Notes:*

\* indicates significance at 10% level. Excludes outlier states: Alaska, North Dakota, Louisiana, and Wyoming. Regressions performed in R with lm function. See Table A2 in <http://www.irl.berkeley.edu/workingpapers/134-12.pdf> for details of the independent variables.

indicate that a higher level of union density is significantly related to a higher estimated growth trend rate. This result supports the findings from the first stage.

Column 6 indicates again that both the decline of unionism and the level of unionism are not significantly related to changes in the cyclical volatility of unemployment. A greater decline of manufacturing, moreover, is not significantly related to increased cyclical labor market volatility. This result is surprising, since manufacturing is highly cyclical.

With respect to the question of increased labor market volatility, the second-stage results, which are better designed to identify causation rather than correlation, support the findings from the first stage: declining union density does not seem related to increased cyclical responses of unemployment to changes in GDP. Indeed, as Table 11.1 showed, the cyclical response of unemployment is somewhat weaker in the more recent period.

With respect to the question of changes in trend growth, the second-stage results provide only weak evidence supporting the effects of de-unionization on reducing growth that were found in the first stage.

While the second-stage regressions provide one approach to correcting for state-level heterogeneity, they are not a panacea. Indeed, in previous research on minimum wage effects using similar specifications (Allegretto, Dube and Reich 2011), my co-authors and I found that specifications with state and time fixed effects suffered from omitted variables bias precisely because of spatial heterogeneity. As a final test, I examine the relationship between state productivity growth and union decline across states over the entire 1964-2010 period. The slope of the trend line relating these two measures is -1.457 with a p-value of 0.010.<sup>26</sup> In other words, productivity growth appears slower in states with greater union decline. This evidence thus supports the view that labor's declining strength had negative effects on long-term economic growth.

## 11.8 CONCLUSION

As Weisskopf (1979) demonstrated, the postwar period until the mid-1970s was characterized by a rising strength of labor. During this period of rapid economic growth, shared prosperity raised living standards among all sections of the US income distribution. Strong trend growth did not eliminate periodic business cycles. As Arthur Okun's original formulation showed, changes in GDP were accompanied by predictable changes in unemployment rates. This postwar system collapsed in the 1970s, to be followed by a new one that, among other changes, substituted a rising strength of management for the previous rising strength of labor.

My investigation of Okun's Law finds that the cyclical patterns of the early period persist in the more recent period, but the trend growth patterns are very



different. Trend growth has been slower from 1985 to 2010. It is slower growth, rather than changes in labor market adjustments during recessions, that is responsible for the jobless recoveries from the recessions that have taken place since the 1980s.

What can explain the slower growth? My Okun's Law estimates on the whole suggest that the decline of unions has led to lower economic growth, but that evidence is not entirely conclusive. The longer-term evidence on the decline of unions and lower productivity does buttress support for this argument. De-unionization, on the other hand, has clearly not made the labor market more responsive to cyclical changes in GDP, as some have argued it would. In other words, unions have not played any significant role in preventing employers from responding to business cycles, at least with regard to employment.

In sum, the cyclical component of Okun's Law does not need revision, but the trend growth component has declined substantially. Future research should focus attention on exactly why the overall growth of the US economy has slowed over the last 3 decades, to explain, and thus find policies to change, the relatively recent phenomenon of "jobless recoveries."

## NOTES

1. I am grateful to Jared Park and Lynn Scholl for research assistance and to Sylvia Allegretto, Michael Ash, Gabriel Chodorow-Reich, Arindrajit Dube, Robert Pollin, Jesse Rothstein, and Jeannette Wicks-Lim for helpful suggestions.
2. By comparison, employment fell about 3.1 percent in the early 1980s recession, less than 2 percent in the early 1990s, and about 2 percent in the 2001 recession.
3. Knotek (2007) provides a recent exposition of Okun's Law, including both static and dynamic versions, and a literature review. For insightful international comparisons on Okun's Law in the Great Recession, see International Monetary Fund (2010).
4. In Okun's original formulation, the increase in the unemployment rate was one-third of the decrease in percent decline in GDP. The 0.5 relationship is based on the ten recessions in the period from 1947–2004. See Romer (2006, table 4.3).
5. Another important part of Okun's Law refers to hours per employee. The trend of involuntary part-time employment has exhibited two upward breaks, one in 2001–2002 and a much larger one in the current recession. I suggest below that this part of Okun's Law may also need revision.
6. Gordon (2011a) arrives at this finding using a Kalman filter to detrend changes in GDP, rather than the Hedrock–Prescott filter that is more commonly used by macroeconomists.
7. Some sectors of the US economy, notably information and computer technology, have done very well, but they have become the exception rather than the rule.
8. Downward nominal wage rigidity in the private sector was the rule in the Great Recession. Ironically, it is the union sector that exhibits more wage flexibility in a downturn.
9. On seniority rules regarding layoffs and promotions in the unionized context, see Abraham and Medoff (1984). Mills (1985) showed that seniority rules were just as prevalent in the non-union context. This finding was reversed by Abraham and Farber (1988).
10. Appelbaum (2011) argues that institutional weaknesses in the US labor market have inclined employers to adjust to recessions through layoffs rather than hours reductions, as in Belgium, Canada, Germany, and a number of other European countries that utilize work-sharing policies. This leaves open the question of whether the use of layoffs in the US has increased over time.

11. Weisskopf's model did not distinguish clearly enough between the strength of labor, understood in institutional terms such as union density, and its proxy, the share of labor in national income. But much in Weisskopf's analysis is unchanged if we just redefine his RSL acronym as denoting the Rising Share of Labor.
12. This decline cannot be accounted for by trends in capital-output ratios. After applying a Hedrick–Prescott filter, Heintz (this volume) also finds a declining labor share over this period, compared to a rising share in the earlier period. He therefore characterizes labor's share as relatively constant over the longer run (40 years), while I instead emphasize the different trends in the two periods. The institutional analysis of the Social Structure of Accumulation perspective, which Weisskopf was building upon, also emphasizes the contrasts between the two periods. See McDonough et al. (2010).
13. The discussion in this section presents a very brief summary of a large literature. For details, see the relevant chapters in Reich (2009) and in McDonough et al. (2010).
14. The challenge for corporate control that aggressive shareholders brought to less aggressive managers was resolved in favor of managers in the mid-1980s by various state laws making takeovers more difficult and by the 1985 Delaware case, *Moran vs Household* (Cremers and Ferrell, 2011). But by then, the structure of managerial compensation had become aligned with shareholder value.
15. The trends for women were stable, in large part because increases in the long-term attachment of women to the labor force and to their jobs have offset occupational declines in job duration.
16. Farber uses less than 1 year as his cutoff because information on the distribution of job tenure by months is not available for many of the years in his dataset.
17. As Farber notes, over this period job duration in the public sector increased, especially but not solely among women.
18. A data appendix documenting my data sources and methods is available at: <http://www.irl.berkeley.edu/workingpapers/134-12.pdf>.
19. The operating assumption here is that union membership rates measure labor's strength. But labor's strength is also affected by many other factors. These include the state of the labor market, the degree of solidarity among workers in different unions and those who are not unionized or unemployed, and the financial resources available to management and to labor. These considerations are beyond the scope of this chapter.
20. Since hours per employee are not available at the state level, I cannot test whether hours adjustments have become more responsive to GDP change.
21. Monthly state unemployment rates can be somewhat unreliable because they are calculated from small CPS samples and are sometimes adjusted by models and other data that come from the GDP side. I use only annual rates, which are much less affected by such shortcomings.
22. I start with 1964 because state-level unionization data are available beginning in that year. See the online data appendix ([www.irl.berkeley.edu/workingpapers](http://www.irl.berkeley.edu/workingpapers)) for further details. In order to avoid weighting states by their population, which can exacerbate spatial heterogeneity, I omit four states that are clearly outliers. I measure union decline as the percentage change in the union proportion of the workforce (union density). Using the point change in union density would lead to misclassification of states with strong and weak unions, since states with initially low union density approach a zero lower bound while those with high union density do not. As Table A3 in the online appendix suggests, the states with lower percentage changes in union density are primarily the states with higher initial and final union density.
23. In equations that include state fixed-effects, the estimated trend growth is calculated using the average of the 46 state trend estimates.
24. I use 1985 as the break year for comparability with Gordon (2011b), who identifies a change in Okun's Law then.
25. The median decline in union density from 1964 to 2010 equals 16 percentage points, or about half the level in 1964.
26. For state productivity and union data sources and details, see online appendix at [www.irl.berkeley.edu/workingpapers/134-12.pdf](http://www.irl.berkeley.edu/workingpapers/134-12.pdf).

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## 12. Reducing growth to achieve environmental sustainability: the role of work hours

**Kyle Knight, Eugene A. Rosa, and Juliet B. Schor**

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### 12.1 INTRODUCTION: RADICAL ECONOMICS AND THE QUESTION OF GROWTH

In the 1960s and early 1970s, radical economists were thorough-going critics of capitalism, not only because it was failing on its own terms, but also on the grounds that its objectives were flawed. They were part of a larger counter-cultural movement that stressed non-material values, such as the importance of work satisfaction and economic democracy. They deprecated consumer culture and were generally sympathetic to environmentalists who argued that the basic dynamics of capitalism were incompatible with ecological sustainability. However, by the mid 1970s, capitalism was in economic crisis. The downturns in productivity, profitability, and growth, as well as rising unemployment in OECD countries, led many radical economists, including Thomas Weisskopf, to shift their attention to a different set of questions. They used the analytic tools of Marxism and heterodox economics to analyse what was causing the crisis, how previous crises had been resolved, and what the possibilities for more humane and egalitarian alternatives might be. The turn that Weisskopf, his co-authors, and many of his contemporaries took at that point led to a long and productive research trajectory, the fruits of which are explored in other chapters in this volume. But in the process, the more fundamental critiques of capitalism were left behind.

Economic growth, in particular, became a relatively unquestioned *desideratum*. Radical economists moved closer to social democrats and liberals, for whom growth was rarely a problem, but usually a solution—the means for redistribution, rising standards of living, and in some accounts, more democratic and peaceful societies. As mainstream economists took pleasure in “disproving” the supporters of the *Limits to Growth* school during the falling oil prices

of the 1980s, radicals mainly failed to engage on the question of bio-physical limits to growth. However, through the 1980s and 1990s, Herman Daly and his school of ecological economics argued that ecological limits were being exceeded, and that the central problem of economics should be to manage the economy within them. This view has steadily gained adherents, and in the last 5 years the conversation about growth has re-emerged as a topic of scholarly and political interest.

In this chapter, we attempt to bring the de-growth conversation back into radical economics. We do so by focusing on working hours and, to a lesser extent, productivity, which have been central concerns of Weisskopf and his co-authors. Working hours are a key variable of interest for reducing environmental impact, as we show below. They are also central to managed trajectories of de-growth or the steady-state because with growth in productivity (or the labor force), falling average hours of work are necessary to avoid increases in unemployment. Our research, using a cross-national panel of OECD countries over the years 1970–2007, shows that declines in hours of work reduce ecological footprints and carbon emissions. In the sections that follow we discuss the extent of the ecological challenge and previous research on the drivers of ecological impact, the emergence of the growth critique, the role of working hours in eco-impact, and our results.

## 12.2 ECOLOGICAL DEGRADATION AND THE CRITIQUE OF GROWTH

The global ecological footprint<sup>1</sup> (EF) of humanity now stands at 18 billion hectares of bio-productive land and water area, double what it was in 1966. Current consumption exceeds the sustainable capacity of the Earth by at least 50 percent and is resulting in unprecedented environmental degradation, including climate destabilization and rapid loss of biodiversity and ecosystem functioning (Global Footprint Network, 2010a). York et al. (2003a) found that approximately 95 percent of the cross-national variation in total ecological footprint can be explained by population size and level of economic development (or affluence), variables which have been identified in many other studies of ecological impact (Shi, 2003; York et al., 2003b).

In what is now a considerable literature on the anthropogenic drivers of environmental impacts, much of the focus has been on the promise of economic growth and technological efficiency. Early research indicated the existence of an Environmental Kuznets Curve (EKC) whereby environmental degradation increases with economic development up to a point and then declines with further economic growth (Grossman and Krueger, 1995). This gave some researchers

hope that achieving sustainability would be a painless process involving the encouragement of further growth in both developed and developing countries. However, recent studies of carbon dioxide and the EF find no evidence of an EKC relationship (for example, York et al., 2003a; 2003b; Jorgenson and Burns, 2007; Jorgenson and Clark, 2010). Instead, these studies find that environmental impacts increase with economic growth. Furthermore, Stern (2004) argues that the original EKC studies on local air and water pollutants were statistically flawed and concludes that there is no EKC.

Technological innovation has also been viewed as the key to achieving sustainability, but this approach also has problems. One is that efficiency-oriented technological change often backfires, or leads to what are called “rebound effects.” One such rebound effect is known as the Jevons Paradox. First identified by William Stanley Jevons in the mid nineteenth century, this paradox is based on his finding that increased efficiency in the use of coal led to increased demand and greater overall consumption of coal (Clark and Foster, 2001). This idea has been expanded to argue more generally against the “technological fix” approach to solving environmental problems (Hertwich, 2005; Sorrell, 2007). There is now a considerable literature showing that some portion of the gains in energy efficiency is canceled out by increases in demand on account of the lower effective price. There is still debate about the size of rebound effects, which depend on the type of energy use and whether the analysis is done at the micro or the macro level. However, at the high end of the estimates, macro-level arguments suggest that technological improvements can actually result in increased levels of energy and materials use in production and consumption. For example, York et al. (2009) have documented the Jevons paradox by illustrating that in four major economies increasing ecological efficiency (reduced EF/GDP) led not to reduced total levels of consumption over 4 decades, but rather to increased levels.

The failures of market and technological approaches to stem ecological degradation have led researchers back to a conversation that began in the 1970s with the claim that there are “limits to growth” (Meadows et al., 1974), a perspective which is echoed in an influential 2009 *Nature* paper identifying “safe planetary boundaries.” This perspective argues that human impacts are excessive in scale, thereby “overshooting” the planet’s regenerative capacities. As a growing number of scholars adopt this perspective, they are concluding that achieving sustainability will require that rich nations reduce their planetary footprint through lower levels of materials consumption and perhaps even zero growth in aggregate GDP (Daly, 1977; 1996; Gorz, 1994; Princen, 2005; Jackson, 2009). The conversation has focused on the global North because income, wealth, and ecological impact are so unequally distributed across the globe (Schor, 1991; 2005; Jorgenson and Burns, 2007; Sachs and Santarius, 2007).

In recent years, this work has expanded across various fields and geographic regions. Scholars have been developing a body of literature that calls for reduced

economic growth in rich countries to be achieved through a mix of policies and social structural changes (for example, Manno, 1999; Speth, 2008; Victor, 2008; Jackson, 2009; Latouche, 2009; Martinez-Alier, 2009; Seyfang, 2009; Schor, 2010; Kallis, 2011). These approaches go by a number of names, such as sufficiency, new economics, *decroissance*, or de-growth. In line with traditional Marxian analyses, this approach argues that the logic of growth is at the core of unsustainability and climate change, and rejects the view that technological change will be sufficient to solve those problems within a feasible time frame. At the same time, it tends to reject the pessimism of some versions of Marxism, and offers a set of economic and political pathways that have the potential to reduce ecological impact in advance of a system breakdown. In addition, the new economics/de-growth position is both a scholarly literature and a political program.

The literature on de-growth and new economics has emerged more or less simultaneously in a number of countries. In France, where it is strongest, the most influential proponent has been Serge Latouche (2009), who has drawn from ecological economists such as Georgescu-Roegen (1971) and Andre Gorz (1994) and the 1960s/1970s political economy critique of productivism. *Décroissance* (de-growth) advocates argue that growth is failing on multiple fronts: the ecological (overshoot), the social (excessive inequality), the political (disaffection), and the human (loss of direction) (Baykan, 2007). De-growth involves a socially sustainable (Martinez-Alier, 2009) process of downshifting material throughput (in contrast to involuntary downshifts such as recessions) which relies on policies such as egalitarian income distribution and tax shifting, low hours of work, and high political involvement. In both its versions — radical (advocating a new sector of cooperatives, green enterprises, and localization) and reformist (relying mainly on policy transformation), reduced working hours is at the core of the de-growth agenda.

In the Anglophone world, a similar literature has developed, although with less terminological coherence. *New economics* includes a variety of researchers, think tanks, and advocacy groups that are working for a shift away from the growth-centric society, such as Britain's New Economics Foundation ([www.neweconomics.org](http://www.neweconomics.org) and Sims et al., 2010) and the Commission for Sustainable Development (Jackson, 2009), as well as efforts aimed at the creation of an alternative, local, small-scale economy (Seyfang, 2009). In the US, the work of Herman Daly (1996), who has advocated a "steady state economics," has been most influential, resulting in contributions such as Peter Victor's macro-model of the Canadian economy with zero growth (Victor, 2008), and the Center for the Advancement of the Steady State Economy ([www.steadystate.org](http://www.steadystate.org)). A second strand of work, inspired by E.F. Schumacher's (1973) *Small is Beautiful* and the re-localization movement, includes Thomas Princen's "sufficiency" (2005) and Juliet Schor's "plentitude" (2010), among others. A related body of work looks



at individuals and households who are reducing their ecological and carbon footprints by adopting simple lifestyles or low-impact consumption practices as well as downshifting in hours of work (Schor, 1998; Kasser and Sheldon, 2009). While not directed explicitly at the macro questions of growth, this literature is highly relevant to it, because macro trends are ultimately the aggregate of micro level changes.

The critique of growth has been spurred on by another burgeoning literature, which is focused on the relation between economic growth and human wellbeing that has been scrutinized by social scientists. This issue was famously raised by Richard Easterlin in the 1970s (Easterlin, 1974; 1995; Diener et al., 2010; Layard, 2005). Research has found that economic growth in industrialized countries since World War II has not resulted in substantial increases in subjective wellbeing (Diener and Oishi, 2000). Furthermore, Helliwell (2003) finds that social factors other than affluence such as low corruption, high levels of mutual trust, and effective social and political institutions are more predictive of national-level life satisfaction. Additionally, Inglehart (2009) finds that as national per capita income increases it contributes less to subjective wellbeing. The new “science of happiness” provides an additional argument against growth-centric economic systems.

We take a critical view of economic growth and technological fixes while focusing our attention on a social structural change that has been identified as a key potential policy for achieving sustainability: worktime reduction in high-income countries. We test the effect of work hours on total EF, total carbon footprint, and total carbon dioxide (CO<sub>2</sub>) emissions with panel data on 29 high-income OECD countries.

## 12.3 WORKING HOURS REDUCTIONS

Much of the literature, and particularly empirical research, has largely ignored reduced working hours. In Marxist theory, the imperative to grow results in increases in labor productivity and stable or increasing working hours rather than an increase in leisure (for a discussion of the relationship between work hours and productivity, see Schor, 1992). Technologically-based approaches focus on the eco-efficiency of production (for example, de-materialization or de-carbonization), with little thought about hours of work. Even in the sociological literature that has begun to take household behavior change and sustainable consumption seriously, work hours are not considered (Spaargaren and van Vliet, 2000). By contrast, in the de-growth paradigm, time use, and specifically hours of work, is a key variable (Gorz, 1994; Schor, 2005; 2010; Hayden, 1999; Sanne, 2005; Victor, 2008; Jackson, 2009; Coote et al., 2010). There are a number of reasons for the centrality of working hours, including the factors

having to do with the basic operation of market economies, compositional effects at the household level, the relation between time use and happiness, and the social impacts of time affluent societies.

At the macro-structural level, progressive reductions in hours are necessary in a slow or zero growth economy in order to avoid unemployment. This is because productivity growth is generally occurring in a market economy. When it does, fewer workers are needed at any level of GDP. Ordinarily, GDP growth absorbs some fraction of that displaced labor. Unless population is shrinking, hours of work will need to fall to avoid a mounting problem of unemployment. This can happen by reducing annual hours or reducing lifetime hours (by delaying labor force entry or lowering the retirement age) (Victor, 2008; Schor, 2010). If environmental regulations or investments are simultaneously raising output per unit of natural resources used (that is, the productivity of natural capital), the need for hours reductions may be even greater.

This process can also be described from the consumption side. In a market economy without mechanisms to reduce hours, productivity growth is translated into GDP growth, which in turn is converted into income and consumption. Schor (1992) has described this as a “work and spend” cycle in which employees become locked into a trajectory of fixed hours and rising consumption. In this way, labor market outcomes such as working time are a key factor in the dynamics of spending, and indeed, the operation of a consumer culture. When “work and spend” prevails, advertising and marketing are more effective and competitive consumption is more pronounced. Furthermore, this path leads to higher environmental impact, because productivity growth is converted into environmentally degrading production and consumption. This is what we call the *scale effect*. Looked at from either perspective—growth or de-growth, production or consumption—the dynamics of worktime are central.

There are also links between working hours and environmental impact at the household level. Households have both income and time budgets (Becker, 1965; Lancaster, 1966) and they take both into account when making decisions. Households with less time and more money will choose time-saving activities and products, such as faster transportation. This is what we call the *compositional effect*. It seems to be the case that low impact activities are typically more time consuming, although there is relatively little research on this question (Jalas, 2002). However, transport is a clear case in which speed is associated with higher energy costs. Food preparation is likely another (*ibid.*).

In most de-growth scenarios, shorter worktime functions as a compensation for slower growth in consumption, which adds another potential linkage between hours and environmental impact (Coote et al., 2010; Jackson, 2009; Schor, 2005; 2010). This connection between time use and happiness is supported by a growing literature. Studies of European countries find that longer working hours are associated with lower happiness (Alesina et al., 2005; Pouwels et al., 2008). In

the US, Tim Kasser and his co-authors have found that, even after controlling for income, wellbeing is positively related to “time affluence” and working hours are negatively related to happiness (Kasser and Brown, 2003; Kasser and Sheldon, 2009). Furthermore, gains in happiness associated with increased free time are not affected by relative comparisons to others’ free time. This is not the case with income, for which the associated happiness depends on income relative to others. Thus, the wellbeing benefits of worktime reduction are more durable than those associated with rising income (Schor, 2010; Solnick and Hemenway, 1998; Frank, 1985). This suggests a second potential household level effect in which time affluence reduces consumption desire and environmental impact. If people who have more time are happier, this may reduce their spending, along the lines discussed by Kasser and Brown (2003).

## 12.4 CROSS-NATIONAL VARIATION IN WORKING HOURS

Hours worked varies considerably among OECD nations. According to the most recent data on the countries analysed here, annual hours ranged from 1372 (26.4 hours per week on average) in The Netherlands to 2242 (43.1 hours per week on average) in South Korea (The Conference Board, 2011). Van Ark (2002) identifies work hours as a key contributor to per capita income differences between countries, along with labor productivity and the labor participation rate. Using 2001 data, he estimates that while labor productivity was 13 percent higher in the US than the European Union, per capita income was 33 percent higher; 12 percentage points of the 20 percentage-point difference between the income gap and the productivity gap were attributable to lower working hours in the EU than in the US.

Bell and Freeman (2001) find that most of the difference in annual work hours between North Americans and Europeans is due to the greater hours worked by full-time employees in North America and a substantial portion of the difference between the US and other OECD countries is due to less vacation and holiday time in the US. Bell and Freeman (*ibid.*) also find that income inequality has a significant, positive effect on work hours. Alesina et al. (2005) find that substantial decreases in work hours since 1960 have occurred in European countries with strong labor unions, generous welfare states, high taxation, and social democratic governments, all of which contribute to lower income inequality. In addition, they find that the majority of the difference in work hours between the US and Europe can be explained by European labor market regulations that reduced hours and/or extended vacation time. There is little evidence that these differences are due to national cultures or marginal tax rates (Alesina et

al., 2005; Golden, 2009). Overall, these studies suggest that worktime is a malleable structural factor that could be adjusted by willing governments in order to reduce the scale of natural resource consumption.

Also of interest here are the preferences of workers in high-income nations. Using ISSP survey data for 21 countries at various levels of development, Otterbach (2010) finds that countries with higher GDP per capita have a higher percentage of workers who wish to work fewer hours and earn less money. The same is true for workers who wish to work the same number of hours and earn the same amount of money. In addition, the percentage of workers who prefer to work longer hours and earn more money is higher in countries with lower GDP per capita. Furthermore, evidence has been found for a negative association between work hours and life satisfaction. Results using both cross-sectional and panel data suggest that EU countries with lower work hours tend to have higher average life satisfaction (Alesina et al., 2005). These studies suggest that public opinion might be in favor of reducing work hours.

## 12.5 PREVIOUS RESEARCH

Despite considerable interest in working hours from environmental sociologists and others, the empirical literature on this question is very limited. At the micro level, this is likely due to the absence of datasets that combine time use, expenditure, and environmental impact. One recent attempt (Nassen et al., 2009), using a variety of data sources, looks at Swedish households and concludes that every 1 percent decline in working hours results in a decline in energy consumption and GHG emissions of 0.8 percent. De-composition of what we have called the scale and composition effects finds that the former is much larger, and that the latter, while very small, is positive (that is, more time leads to more energy-intensive activities and impacts). In contrast, a French study finds that households with longer hours of work have higher impact through bigger homes, more transport expenditures and higher expenditures for eating out (Devetter and Rousseau, 2011).

At the macro level, the first attempt to empirically assess the relationship between work hours and environmental degradation was Schor's (2005) bivariate linear regression analysis of the relationship between annual work hours per employee and the EF using data for 18 OECD countries in which the relationship was found to be positive and significant. Shortly thereafter, Rosnick and Weisbrot (2006) examined the relationship with energy consumption. They estimated that if constant energy per hour of work is assumed, and if workers in the European Union worked the same number of hours as in the US, energy consumption would be 18 percent higher in the EU. In a multi-

variate regression analysis using data for 48 countries, they found that annual hours per worker has a positive significant effect on energy consumption per capita even when controlling for labor productivity, labor participation rate, climate, and population. However, this only documents the effect of work hours on energy consumption in terms of its contribution to GDP, not net of GDP. That is, this analysis demonstrates that countries with longer work hours consume more energy because they have greater economic output, but it does not demonstrate how work hours affects energy consumption over and above the contribution to economic output by encouraging unsustainable consumption patterns. Thus, this analysis provides evidence of a scale effect of work hours, but not a compositional effect. The most extensive analysis thus far is that of Hayden and Shandra (2009), whose multivariate analysis of 45 countries revealed that annual work hours per worker has a positive significant effect on the EF, both controlling for labor participation rate and labor productivity among other relevant control variables as well as net of GDP per capita. Their analysis also indicates that the effect of work hours is larger than that of the labor participation rate and labor productivity.

With this study we examine the effect of work hours on three different environmental indicators: total EF, total carbon footprint, and total CO<sub>2</sub> emissions. We test the effect of work hours net of GDP per capita (and additional control variables) to determine if longer work hours result in less sustainable consumption patterns. To assess the environmental consequences of work hours' contribution to overall economic production we disaggregate GDP into three components (annual work hours, labor productivity, and the labor participation rate) and assess the effect of work hours controlling for labor productivity and the labor participation rate (Hayden and Shandra, 2009). In all cases, we expect work hours to have a significant, positive effect on the dependent variable.

## 12.6 DATA AND METHODS

We use data spanning the years 1970 to 2007<sup>2</sup> on 29 OECD member nations classified as high-income by the World Bank in 2007 (World Bank, 2009).<sup>3</sup> Israel is not included in the analysis due to missing data on one or more variables. Our dataset has an unbalanced panel structure and we allow the number of observations to vary across models with sample sizes ranging from 636 to 676.

We utilize the STIRPAT model, developed by Dietz and Rosa (1994) and further elaborated by York et al. (2003a), as our analytical framework. This elasticity model conceptualizes environmental impact (I) as a multiplicative function of population (P), affluence (A), and technology (T) and is used to

test hypotheses regarding the effects of these three factors on environmental impacts. STIRPAT models are estimated by converting the dependent and independent variables into logarithmic form and using linear regression techniques to estimate the coefficients which are interpreted as indicating the percentage change in the dependent variable associated with a 1 percentage point increase in the independent variable. Our models are estimated using fixed effects panel regression. We include unreported dummy variables for each year of data in all models to control for period-specific effects that potentially affect all countries within each year. This reduces the likelihood of spurious results arising from similar time trends among the dependent and independent variables (Jorgenson and Clark, 2010). All models also include a correction for first-order autocorrelation (Knight et al., 2012, unpublished).

### **12.6.1 Dependent Variables**

Total EF (in global hectares) measures consumption-based pressure on the environment and is constructed from five basic forms of human consumption: food, housing, transportation, consumer goods, and services. These data are from the Global Footprint Network (2010b). The footprint is defined by Rees as “the area of land and water ecosystems required on a continuous basis to produce the resources that the population consumes, and to assimilate (some of) the wastes that the population produces, wherever on Earth the relevant land/water may be located” (2006, p. 145). The EF attributes exports and imports to the importing nation by estimating the materials and energy embodied in the traded commodities (that is, consumption = production + imports – exports). A major advantage of the EF is that it is the most comprehensive indicator of resource demands available. The footprint is a widely used indicator in the environmental social sciences (for example, Hayden and Shandra, 2009; Jorgenson and Burns, 2007; Jorgenson and Clark, 2010; York et al., 2003a).

Our second dependent variable is a subcomponent of the EF: the carbon footprint. This indicator measures the area of biologically productive space required to sequester a country’s carbon emissions resulting from consumption. One drawback of this measure, though, is that it includes nuclear energy by counting each unit of energy produced by nuclear power as equal in footprint to a unit of fossil fuel energy.

Our third dependent variable is total carbon emissions measured in thousand metric tons of CO<sub>2</sub> (World Resources Institute, 2011). This is the standard, production-based indicator of CO<sub>2</sub> emissions which accounts for the mass of carbon dioxide produced by the combustion of solid, liquid, and gaseous fuels. It also includes emissions which result from certain manufacturing processes, such as from gas flaring and the manufacture of cement. This measure does not include emissions from land use change such as de-forestation (which re-

leases carbon emissions) or emissions from bunker fuels used in international transportation. Data for this variable end in 2005. The key difference between the carbon footprint and carbon emissions is that the carbon footprint adjusts for carbon embodied in imports and exports so that it better reflects the carbon emissions associated with a country's consumption.

The choice of method for measuring carbon emissions has non-trivial consequences. Wilting and Vringer (2009) found that consumption-based greenhouse gas emissions were greater than production-based emissions in most developed countries. Ahmad and Wyckoff (2003) determined that among the OECD as a whole, CO<sub>2</sub> emissions from domestic consumption exceeded that of domestic production. Emissions embodied in imports and exports are typically greater than 10 percent of emissions from domestic production and in some cases greater than 30 percent. Conservative estimates for 1995 indicate that for the OECD consumption-based carbon emissions were 5 percent higher than production-based emissions in 1995 (*ibid.*). Given the significance of embodied carbon emissions, analyses of the common production-based (that is, territorial) indicators of carbon emissions and alternative consumption-based indicators including embodied carbon may produce divergent results. We have included both in our estimates because both a production-side and a consumption-side measure is of interest.

### **12.6.2 Independent Variables**

As noted above, following Hayden and Shandra (2009), we disaggregate GDP into three components to test the effect of work hours on our dependent variables. First, our key independent variable is the annual hours of work per employee. These data are intended to reflect the actual number of hours worked including overtime and excluding paid hours not worked such as holidays, vacations, and sick days. These data were compiled by The Conference Board (2011) from numerous sources including national labor force surveys, the OECD Growth Project, and the OECD Employment Outlook. Second, labor productivity is measured as GDP per hour of work in 1990 US\$ adjusted for purchasing power parity. Third, the labor participation rate is measured as the percentage of employed persons in the population. The source of data for these three variables is The Conference Board (2011), from whom further information on the detailed sources and methodologies is available.

GDP per capita measured in 2000 US\$ is included to control for the level of economic development (World Bank, 2011). We also control for total population size, the percentage of population living in urban areas, manufacturing as a percentage of GDP, and services as a percentage of GDP (World Bank, 2011).

## 12.7 RESULTS AND DISCUSSION

In order to test for the scale effect, we estimated the effect of work hours—net of labor productivity, the labor participation rate, and other control variables—on the EF, the carbon footprint, and CO<sub>2</sub> emissions. We found that the effect of work hours is significant and positive for all three of our dependent variables, as are the other two components of GDP (labor productivity and the labor participation rate). Furthermore, population and manufacturing as a percentage of GDP are significant and positive in all models while urbanization is not significant in any, and services as a percentage of GDP is significant (and positive) only when predicting total carbon footprint. The coefficient for our variable of interest, work hours, is 1.21 ( $p \leq 0.01$ ) for the EF, 1.46 ( $p \leq 0.01$ ) for the carbon footprint, and 0.42 ( $p \leq 0.05$ ) for the CO<sub>2</sub> emissions. Table 12.1 presents the results of our analyses in terms of the predicted change in the dependent variables for a 10 percent or 25 percent reduction in work hours while holding all other variables constant. (10 percent and 25 percent are somewhat arbitrary reductions, but are used as examples of the size range that would be feasible over the short to medium term.) As this table illustrates, for a 10 percent reduction in work hours, the predicted declines in EF, carbon footprint, and CO<sub>2</sub> emissions are 12.1 percent, 14.6 percent, and 4.2 percent respectively. Reductions of these magnitudes constitute substantial progress. For example, consider that, as of

*Table 12.1 Predicted change in dependent variables for 10 percent and 25 percent reductions in work hours with all other variables held constant*

Reduction in work hours:	Scale effect <sup>a</sup>		Compositional effect <sup>b</sup>	
	10%	25%	10%	25%
Ecological footprint	-12.1%	-30.2%	-4.9%	-12.2%
Carbon footprint	-14.6%	-36.6%	-8.6%	-21.5%
Carbon dioxide emissions	-4.2%	-10.5%	ns <sup>c</sup>	ns

*Notes:*

a “Scale effect” refers to estimates based on models that control for population, urbanization, manufacturing as a percentage of GDP, services as a percentage of GDP, labor productivity, and the labor participation rate.

b “Compositional effect” refers to estimates based on models that control for population, urbanization, manufacturing as a percentage of GDP, services as a percentage of GDP, and GDP per capita.

c “ns” indicates that the estimated effect of work hours on carbon dioxide emissions in this model was not statistically significant at the 0.10 level and is therefore not reported here.



2007, we needed a 50 percent reduction in the EF to get back into line with the planet's global carrying capacity, as noted above in Section 12.2.

In order to test the compositional effect, we estimated the effect of work hours, net of GDP per capita and other control variables, on our three dependent variables. We found that work hours is significant and positive for the EF and the carbon footprint, but not for total CO<sub>2</sub> emissions. GDP per capita, total population, and manufacturing as a percentage of GDP, were found to be positive and significant in all three models while urbanization was not significant in any model, and services as a percentage of GDP was significant (and positive) only when predicting total carbon footprint. The coefficient for work hours is 0.49 ( $p \leq 0.05$ ) for the EF, 0.86 ( $p \leq 0.10$ ) for the carbon footprint, and  $-0.16$  ( $p > 0.10$ ) for the CO<sub>2</sub> emissions. Focusing on statistically significant effects, Table 12.1 shows that, when holding all other variables constant, a 10 percent reduction in work hours is associated with a 4.9 percent reduction in the EF and an 8.6 percent decline in the carbon footprint. Reductions from the compositional effect are more modest than the scale effect but still represent meaningful improvements.

The major discrepancy in our results is that for CO<sub>2</sub> emissions we do not find a significant effect of work hours on carbon emissions net of GDP per capita, but we do for the ecological and carbon footprints.<sup>4</sup> This suggests that the compositional effect of work hours on consumption patterns is not apparent for CO<sub>2</sub> emissions because this variable is production-based whereas the other two are consumption-based. That is, this indicator of CO<sub>2</sub> emissions includes emissions originating from the production of goods that were exported and consumed elsewhere. Footprint measures are consumption-based, meaning that they incorporate embodied energy and materials so that the footprint reflects the consumption of a country, including imported goods but excluding those that are exported. This difference in calculation is the major distinction between these measures, and therefore is likely the source of this discrepancy.

On the whole, the results demonstrate that working time is a significant contributor to environmental problems and thus is an attractive target for policies promoting environmental sustainability. Our findings suggest, though, that decreasing work hours while maintaining current levels of GDP is less effective in reducing anthropogenic pressure on the environment than reducing GDP by lowering work hours. That is, the scale effect of work hours is much larger than the compositional effect. This supports the conceptualization in the de-growth and new economics literatures of the role of work hours and socially sustainable economic de-growth in achieving global environmental sustainability.

## 12.8 CONCLUSION

Many scholars have argued that continued economic growth in the global North is antithetical to achieving global environmental sustainability. An increasingly prominent idea is that developed countries could achieve slower or zero economic growth in a socially sustainable way by reducing work hours. Research suggests that reduced work hours could contribute to sustainability by decreasing the scale of both production and consumption. We tested this idea using panel data for 29 high-income OECD countries. Overall, we found that countries with shorter work hours tend to have lower ecological footprints, carbon footprints, and carbon dioxide emissions. Our results suggest that working hours should be placed squarely at the center of economic analyses and concerns. While the 1970s' shift to focus on productivity, profits, and growth made sense at the time, we believe that a new conversation about growth in wealthy countries is long overdue, given current conditions. These include the environmental degradation associated with growth, the shift to inequality-enhancing growth, and the declining ability of additional GDP to promote human wellbeing in high-income nations. It is our hope that the findings we have presented can help to rekindle that debate among the radical economists who were at the center of thinking critically about growth 40 years ago and the generations who have followed them.

## NOTES

1. The ecological footprint is a comprehensive consumption-based indicator of environmental threats. It is described in more detail in the section on dependent variables (Section 12.6.1).
2. We limit our analysis to 1970 and later because of the paucity of data on important control variables prior to that year. In the case of carbon dioxide emissions, data only extend to 2005.
3. These countries include Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, South Korea, Luxembourg, The Netherlands, New Zealand, Norway, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, the United Kingdom, and the United States. OECD countries excluded because they are not classified as high-income are Turkey, Poland, Chile, and Mexico.
4. Note, however, that while we do not find evidence of a compositional effect of work hours (that is, net of GDP) for carbon emissions, we do find evidence of a scale effect.

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# 13. Comment on Reich, Knight, Rosa, and Schor

**Michael Ash**

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## 13.1 COMMENTS ON REICH

Michael Reich uses Okun's Law measurement of two economic facts to reflect the relative strength of the working class and management: (1) the cyclical component, which expresses how employment responds to short-run (that is, cyclical) changes in output; and (2) the trend component, which expresses the level of GDP growth associated with stable unemployment.

The responsiveness of employment to output reflects two aspects of the state of the class struggle: first, the extent to which employers shed or hoard labor during downturns; and second, employers' ability and incentive to restructure (that is, speed up) the workplace to get more work from the same number of workers. These dimensions reflect workplace power: can the employer impose its goals on workers, for example, to fire without notice or promise of recall, to avoid paying supplementary unemployment compensation, to insist on overtime, and to impose speedup?

However, these dimensions also reflect external pressures on employers. For example, longer and more frequent recessions make labor hoarding unprofitable even if preserving the matches would have been efficient in normal circumstances. For another example, high fixed costs of employment create strong incentives toward getting more hours from the same number of workers (even if they must be fairly compensated). So both macroeconomic conditions and other aspects of the social and policy structure (our health system reflects all of: citizen-state relations, inter-capitalist competition, and labor-capital struggle) will bear on the employment-output workplace relationship measured in Okun's Law.

Exactly how to read the cyclical component of Okun's Law in relation to class struggle is thus ambiguous. Employers would like it both ways: sharp responsiveness of employment to output when they need it (during downturns); and weak responsiveness of employment to output when speedup is possible

(during recoveries). The latter gives rise to the “jobless recovery,” a phenomenon noted widely since the 1990 recession.

Class struggle may also show up in the trend component of Okun’s Law in different ways. Reich tests whether rising management strength, as measured by falling union density, may lead to a low-road path of economic development which then leads to a less robust economy with lower growth overall. An alternative way to think about the trend growth rate—the GDP growth associated with steady unemployment—is as the GDP growth *required* to keep unemployment stable, especially when comparing longer economic periods. Since World War II, unemployment has trended in the US several times, in addition to its cyclical variation. Technology or changes in labor force participation can influence the trend growth rate over time and how class struggle would affect this relationship is less clear.

Reich examines variation in Okun’s Law with two sources of variation in management strength: periodization and state labor markets. Reich uses two periods, 1964–85 and 1986–2012, which I identify with the postwar SSA and low and declining management strength, and the neoliberal SSA and management ascendancy. Business cyclicality differed between the periods, with the former period marked by recessions associated with aggregate demand shortfalls, Fed tightening, and the oil crisis; and the latter by the financial-crisis recessions of 1990, 2001, and 2007.

Reich explores changes in Okun’s Law over time as an indicator of the Strength of Management. Stronger management, Reich argues, may be associated with less responsiveness of employment to output, as firms can enforce speedup with impunity and with lower trend growth. He finds little change in the cyclical component over time or by degree of union decline. Where Reich does observe a change is in the “trend component” of Okun’s Law which expresses the GDP growth rate needed to maintain steady-state unemployment. Reich points to this change in the longer term trajectory of the US economy—slower GDP growth—as the culprit behind jobless recoveries.

In the remainder of the comment I adopt Reich’s periodization but identify the relationship between management strength and Okun’s Law with variation in Okun’s Law over the business cycles within each period. The conflicts involved in labor hoarding and in speedup will manifest themselves at points of stress and will emerge over the business cycle. Labor hoarding or permanent layoff will show up during downturns. The tension between speedup versus recall and new hiring shows up during recoveries.

Table 13.1 shows average GDP growth and Okun’s Law estimates over the business cycle for the two periods using national data. Each quarter is assigned to a segment of the business cycle: normal expansion, recession, and the first six quarters of recovery after the recession trough. (Six quarters, or 1½ years, is arbitrary and results were insensitive to alternative definitions of early recovery.)



Table 13.1 GDP growth and Okun's Law over the business cycle: then and now

	GDP growth (4-quarter percent change)		Okun's coefficient (percentage points of unemployment per percentage- point change in GDP)	
	I	II	I	II
Expansion	4.08	3.20	-0.32 (0.04)	-0.37 (0.04)
Recession	-0.75	-0.84	-0.42 (0.12)	-0.41 (0.08)
Recovery (6 quarters post-trough)	5.79	2.23	-0.29 (0.03)	-0.10 <sup>a,b</sup> (0.07)

Notes:

a Statistically significant difference from Okun's coefficient during Expansion.

b Statistically significant difference from Okun's coefficient in period I.

Period I: 1948:I–1985:IV (148 Quarters); Period II: 1986:I–2012:I (105 Quarters)

Source: Recessions defined by NBER's Business Cycle Dating Committee. Real GDP is GDPC96 (chained real GDP) from BEA via FRED. Unemployment is the not-seasonally adjusted official definition from BLS via FRED. Both are expressed in four-quarter differences.

The Okun's Law results are generally consistent with Rising Strength of Management. The response of employment to output during the decline into recession has neither sharpened nor slackened. However, the responsiveness during recovery has substantially weakened and is consistent with the end of the recall system and employers' capacity to restructure to speed up the workplace. The results are also consistent with the rising importance of fixed costs for workplaces (and capitalist broader ability to resist health care reform).

There are some alternative explanations. First, as the first two columns indicate, GDP growth itself has been less robust in post-trough growth in the latter period than in the former; a dominant feature of the new economy may be the "recoveryless recovery" rather than the jobless recovery. Second, firms as well as workers may be subject to the pressures of the new economy. Fixed costs of employment—in particular, health insurance—make firms prefer to add hours from existing workers rather than to hire additional workers.

Finally, I directly examine the speedup hypothesis with a modified Okun's Law estimation. In Table 13.2, the column headed "Employment" re-estimates Okun's Law using percent change in employment simply to demonstrate similar patterns in responsiveness of employment as unemployment in Table 13.1. As with unemployment, employment response has been similar in expansion and

Table 13.2 *Employment responsiveness: Okun's Law coefficients for employment and hours*

	Employment (percent change per percentage-point change in GDP)		Hours per week (hours per percentage- point change in GDP)	
	I	II	I	II
Expansion	0.73 (0.06)	0.94 (0.07)	0.064 (0.008)	0.090 (0.014)
Recession	0.82 (0.20)	0.85 (0.14)	0.042 (0.028)	0.057 (0.029)
Recovery	0.56 <sup>a</sup> (0.05)	0.22 <sup>a,b</sup> (0.12)	0.096 <sup>a</sup> (0.007)	0.180 <sup>a,b</sup> (0.026)

*Notes:*

a Statistically significant difference from Okun's coefficient during Expansion.

b Statistically significant difference from Okun's coefficient in period I.

Period I: 1948:I–1985:IV (148 Quarters); Period II: 1986:I–2012:I (105 Quarters)

*Sources:* Recessions defined by NBER's Business Cycle Dating Committee.

Employment and Hours per Week are for Nonfarm Business Sector (BLS PRS85006013 and PRS85006023).

recession but markedly attenuated during recoveries. The column headed "Hours per week" examines the responsiveness of average hours per week to changes in GDP. There has been a modest increase in the responsiveness of average hours per week to GDP in the Expansion and Recovery phases of the business cycle, but the increase in responsiveness of hours during recoveries has nearly doubled. That is, while employment (and unemployment) are now less responsive to GDP growth, hours per week are now more responsive.

Okun's Law is a rule of thumb, an empirical regularity, but it offers a window into the relationship between the workplace, where employment and production decisions are made, and the macroeconomy, which both reflects and conditions those decisions. Variation in the institutional setting and the phase of the business cycle makes it possible to gain insight into the strength of management.

## 13.2 COMMENTS ON KNIGHT, ROSA, AND SCHOR<sup>1</sup>

Knight et al. go straight to the heart of some difficult questions for the left. (Reading it in preparation for my comment, I thought, "At least I don't have to

deal with immigration.”) Knight et al. are correct that radical economists need to take on the growth question, and they offer some keen insights into how the question has evolved and what can and cannot be learned from macro analysis.

On the question of growth, radical economists have considered as many as four alternative strategies, which may operate in varying degrees of competition with each other:

1. Environment I: living with less; less is more; small is beautiful
2. Environment II: transition to a sustainable yet high-output economy (renewable, efficient, zero waste)
3. The right to be lazy: the quest to reduce work hours especially as productivity rises, in conflict with capitalists who depend on surplus value
4. The right to livelihood: ensuring meaningful, adequately remunerated work under decent working conditions for everyone capable of performing it; adequate, dignified support for those lacking capacity; and maintenance of this full-employment economy.<sup>2</sup>

It would be a mistake to select one of these threads as the unique true path for radical economics. But further work in the domain of hours and environmental degradation might seek a more complete integration of these four themes.

The macro results of the Knight et al. study do a good job of indicating the problem of a pure macro approach to the growth–environment problem. At the macro level, degradation is more or less proportional to output, which is more or less proportional to total hours worked.

Whence the variation in variables? In these models with country and year fixed effects, identification of the relationship between hours and pollution comes from within-country business cycles and variation in cross-national trends in hours. Although I am not familiar with the data underpinning the Ecological Footprint and the other ecological outcome measurements, I have some reason for concern about these terms. If the ecological and carbon footprints are not from physical measures but are instead estimated from models of the relationship between economic activity and pollution output, then the EF model may be a simple reverse-engineering of the models that constructed EF.

The mechanism at work from accounting relationships (pollution is a function of output which is the product of hours and product per hour) to hope for fulfilling the twin goals of pollution reduction and livelihoods is not fully elaborated. The brightest outlook comes from the analysis that looks at the effect of hours on pollution holding GDP and productivity constant. In this specification, reduced hours modestly reduce pollution even holding GDP (as a proxy for material well-being) constant, which gives cause for hope. But the mechanics of reducing work hours while holding both GDP and productivity constant poses an empirical puzzle, which necessarily points to the composition of economic

activity (not its volume or value). It is possible that these results reflect an option for the time rather than consumption dividend in highly developed economies, but the mechanism needs more elaboration.

In any case, the Knight et al. regression results point up a serious challenge facing us. It is not easy to find a free lunch, or less can't be more, at the macro panel level. Yet some countries have managed a time transition. German and French work hours have actually declined substantially as German and French people have increasingly enjoyed the dividend from higher productivity in leisure time rather than consumption.

The Environmental Kuznets Curve hypothesis (Grossman and Krueger, 1995) posits that while environmental degradation at first increases with economic development, countries eventually demand an improved environment once they become "rich enough." There may be signs of an EKC in the hours-pollution success stories, such as Germany and France, but it is hard to tell with the cross-country panel macro analysis. Case studies of societies that have converted productivity increases into reduced hours and pollution seem like a useful direction for further study.

In a critical re-examination of the EKC, Torras and Boyce (1998) instead find that environmental improvement can come early in countries with egalitarian distributions of wealth and power, and environmental improvement is not guaranteed even in rich countries with insufficient equality. Equality in wealth and power powerfully mediates the relationship between GDP and environmental degradation and protection. The sensitivity of deterministic pollution-growth results to distributional considerations indicates the importance of keeping political economy in the analysis. There are several easy waypoints, including guaranteed incomes and enthusiastic endorsement of "40 hours' pay for 30 hours' work" (via vacations, working-week limits, stricter overtime rules, and worksharing, among other policy approaches).

Knight et al. initiate a potentially fruitful approach to the relationship between economic growth and pollution through the decomposition of the relationship into several effects or pathways. Knight et al. decompose the effect into scale and composition pathways, and Antweiler et al. (2001) add a third, the technology effect. Scale corresponds to the gross macro relationship that more output means more degradation. Composition is largely relevant for shifting the burden among countries, as some countries undergo the transition to post-industrial service economies or actively offshore their polluting activities. Technology, in economists' peculiar use, refers broadly to how economic activity can be organized. The technology pathway points ultimately to political choices of how we produce as a society and a planet with due attention to ecology, distribution, and livelihood.

## NOTES

1. I am grateful to Jeannette Wicks-Lim for her advice to consider the “fundamental issue of how to fit in the argument of a strategy of less work given its potential environmental benefits versus the argument of needing to operate an economy near full employment in order to (a) sustain decent living standards for workers and (b) transition to an economy with the most energy efficient infrastructure and renewable power production in order to protect the environment.”
2. See for example, Pollin (2009).

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## 14. Confronting those affirmative action grumbles

**William Darity Jr**

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Affirmative action is a set of positive anti-discrimination measures aimed at providing access to members of socially excluded groups to preferred positions in a society. It is predicated on the existence of unfair or unjust exclusion of individuals based upon their identity as members of a stigmatized group in the absence of affirmative action. Thus, affirmative action targets groups subjected to discrimination, ridicule, and abuse for special support in their pursuit of preferred positions.

Generally, it takes two forms nicely characterized in Thomas Weisskopf's (2004) important distinction between "preferential boost" systems and "quota" systems. Preferential boosts endow candidates competing for positions with additional points for being members of a target group, either explicitly or implicitly. Quotas set a fixed share of slots that only can be held by members of the target group. While one approach or the other usually is dominant—for example, preferential boosts have primacy in the United States and in South Africa while quotas have primacy in India and Brazil—they are not mutually exclusive. For example, quota systems may be predicated on eligibility thresholds anchored in a minimum qualifying score or standard. Or preferential boosts may operate in such a way that *de facto* give the target population a quota-like share of the available positions.

Affirmative action measures are not intended to produce general equality nor do they constitute an antipoverty program. They are not reparations programs to compensate victim communities for a cumulative history of oppression. Affirmative action measures are intended to promote *intergroup* (interracial or interethnic or inter-gender) equality, and, when deployed effectively, they are a useful instrument for desegregating elites. In short, the objective of affirmative action is roughly to replicate a similar pattern of occupational status, educational attainment, and income stratification across a socially subordinated population that prevails across a socially dominant population.

It is also noteworthy that affirmative action is being adopted more widely internationally as a mechanism for improving the status of stigmatized commu-

nities. Policies of this type are in place in locations as diverse as Brazil, South Africa, Malaysia, Northern Ireland, the USA, India, and Colombia. Regardless of where programs are implemented, a standard litany of complaints is raised—almost as if they have been rehearsed mechanically from a common template of criticisms. In what follows, the standard array of complaints is listed and responses are provided for each, specifically based upon the USA experience and USA data.

The anti-affirmative action case can be best summarized by a set of six standard grumbles. They are the following:

1. Affirmative action violates the principles of meritocracy.
2. Affirmative action lowers productivity.
3. Students from the target population are grossly underprepared for higher education when affirmative action is focused on access to colleges and university.
4. Only the best positioned members of the target population really benefit from affirmative action.
5. The recipients of affirmative action are stigmatized by the preference or quota system.
6. If affirmative action programs are implemented they should be implemented on the basis of class, not race or ethnicity.

1. The claim that affirmative action violates the principles of meritocracy generally is accompanied by the claim that it is unfair to members of non-target groups. They are alleged to have been subjected to reverse discrimination. The existence of preferences or quotas on behalf of a target group ostensibly violates norms of excellence in selection in hiring or university admissions. At the heart of this argument are three related premises: first, that in the absence of affirmative action, purely meritocratic selection would prevail; second, in the absence of affirmative action very few members of the target community would meet the merit standards; third, the prevailing merit standards are fully appropriate to the tasks or activities for which persons are being selected.

In the absence of affirmative action in the USA, rather than a regime of pure meritocracy, the system of exclusion of blacks in particular preserved a privileged world for white (especially male) mediocrity. The black philosopher Lewis Gordon's (2011) recent reflections, reproduced at length here, are telling:

When I was tenured at Brown University [in 1997], the process required evaluations of my work from five referees. Expected performance was a published monograph, several articles, satisfactory teaching, service and signs of international recognition. My dossier had the following: three monographs (one of which won a book award for outstanding work on human rights in North America), an edited book, a co-edited book, 40 articles (several of which had gone in [sic: into] reprint in international volumes),



two teaching awards and service that included heading a committee that recruited 23 scholars of color to the university. This process for my promotion and tenure was dragged out because of continued requests for more referees. The number grew to 17.

There was a comparable white candidate in the philosophy department. He also supposedly worked on existentialism, one of my areas of expertise. His dossier? A contract for his dissertation and a few articles. His case was successful. His contracted dissertation was published several years later. He has since then not published a second book. He is now a full professor at that institution. Over the years I have only met one person in his field who knew of and spoke well of his work. That person was a classmate of his in graduate school.

Was affirmative action necessary for my promotion and tenure? Yes. But as should be evident from this example and no doubt ... many others, there is another truth. Was investment in white supremacy necessary for less than stellar whites to be promoted? Yes.

Affirmative action, which brought people of color to the table to learn first-hand about the level of performance of their white predecessors and contemporaries, stimulated a reflection on standards in many institutions. As more people of color began to meet inflated standards, what were being concealed were the low standards available to the whites who preceded them (and no doubt many who continue to join them as presumed agents of excellence).

So, what is the truth about the qualifications narrative, the claim about having to lower standards for the admission of people of color? It masks racial hegemonic mediocrity. There is another truth. There are few systems that depend on excellence to function. Most of the services we rely on to get through our lives depend on average levels of performance. And that's pretty much it. The rewards lavished on many whites in the modern world have not been based on merit. What many people of color discovered upon entering those previously closed corridors was not white superiority, but for the most part, white mediocrity.

Without affirmative action, "those previously closed corridors" are likely to go back to being closed—not because there are "no qualified" blacks but because there is an abundance of average whites who would have protected access. Indeed, the nation *de facto* long practiced affirmative action for whites in a variety of forms: the racialized distribution of the GI Bill benefits, legacies in college admissions, the racial limitations on the New Deal programs, racial preferences in the provision of home loans (Skrentny, 1996). Because of this process of white protectionism, Major Coleman (2003) argues that there is strong evidence to indicate that if one compares blacks and whites holding the same positions, on average, the black employee will have superior qualifications.

Furthermore, Uhlmann and Cohen's (2005) experimental research demonstrates that the "merit" standards themselves can alter, since those who control them manipulate them to maintain preferred group status at the expense of others; they do not change simply because they are valid indicators of the skills

or abilities needed to perform the tasks at hand. Uhlmann and Cohen's study involved a laboratory experiment with 73 undergraduates who were evaluating male or female candidates for a male-typed job of police chief.

The study participants actually rated the male and female candidates as equivalent on the two clusters of criteria specified for evaluation, being "streetwise" (for example, "tough, had worked in rough neighborhoods, and got along with fellow officers") and being "formally educated" (for example, "well schooled and experienced in administration"). But when the participants were asked to rate the relative importance of specific characteristics within each cluster they gave greater weight to whichever attribute favored the male candidate.

Uhlmann and Cohen (2005, p. 475) report the subtle way in which gender bias, favoring men for the job, emerged in their study as follows:

...educated characteristics were rated as more important when the male applicant possessed them ... than when he did not. ... By contrast, no such favoritism toward the female applicant was evident. If anything, educated characteristics were viewed as less important when the female applicant possessed them ... than when she did not. ... Even stereotypically feminine traits (such as being family oriented and having children) were defined as more important when the male possessed them ... than when he did not ... ; there was no corresponding effect for the female applicants...

In short, the Uhlmann and Cohen study demonstrates that the standards themselves are endogenous, partially changing in response to the demands for maintaining what Gordon terms "racial hegemonic mediocrity." For example, in one of the most blatant instances, as black students' performance on the ACT test rose from a low mean of 7 in 1963 (it was 18 for white students at the time), the state of Mississippi consistently increased the minimum required for university admission to continue to limit blacks' eligibility for the state's public universities (Cross and Slater, 1996, pp. 95–6).

2. Does affirmative action reduce productivity? In a clever study performed in the mid-1990s, Cecilia Conrad (1995) demonstrated at the macro level that variations in the demography of the national work force, both in terms of gender composition and racial composition, had no effect on either GDP per capita nor output per head. In short, there is no evidence of a productivity gain or loss associated with a greater presence of female workers of any race or black workers of any gender in the United States. This, of course, is a disappointing finding to those researchers who have claimed that discrimination produces a deadweight loss for the US economy (for example Brimmer, 1997), which would make it potentially beneficial for all if discrimination were eradicated. Still, while Conrad's finding suggests that affirmative action as an anti-discrimination measure has more of the character of a zero-sum game, it provides no aid and comfort to those who insist that it is economically destructive.

Major Coleman (1999) also repudiates the productivity loss claim in a micro level study. Coleman finds that employer performance evaluations of employees hired under affirmative action arrangements are at least as favorable as those for employees hired via what otherwise would have been the “closed corridor.” Holzer and Neumark (2000) arrive at a similar conclusion after reviewing all the available studies on work performance by affirmative action hires. The preponderance of evidence also indicates that if a black employee gets a position, frequently the employer who was negatively predisposed toward hiring blacks and who would not have hired them in the absence of an affirmative action initiative, revises their prior belief more favorably toward the black employee after seeing them in action (Goldsmith et al., 2006; Fryer et al., 2011).

3. Then, is it the case that colleges and universities are taking sharply inferior black students on board under dint of affirmative action programs? In the US context, it is transparent that there is a substantial gap in academic performance, particularly on standardized tests, between black and nonblack students, particularly white and Asian students. There is, of course, the companion question of whether tests like the SAT or the ACT are legitimate markers for predicting subsequent academic performance for college and university students. But, that issue aside, given a historical discrepancy which intermittently narrows, there can be little doubt that demanding *higher and higher* test scores for admission is a mechanism, a strategy explicitly pursued in Mississippi, for maintaining black exclusion.

An important component of the test score gap is a factor divorced from the skills possessed by the individual black or white student. To the extent that there are widely held beliefs about the cognitive inferiority of blacks, knowledge of the existence of those beliefs—regardless of whether black students share those negative beliefs themselves—can have a depressing impact on black students’ test performance. The now-classic studies by Steele and Aronson (1995), establishing the phenomenon of stereotype threat, are relevant here.

This initial major Steele and Aronson (1995, p. 800) study involved measuring participants’ performance “on 30 verbal items, 27 of which were difficult items taken from GRE study guides (only 30% of earlier samples had gotten these items correct) and 3 difficult anagram problems.” Study participants were given 30 minutes to complete the test. Black students took the test by random assignment under three different conditions: (1) In the threat-condition the participants were told they were taking a diagnostic test that measured “intellectual ability, thus making the racial stereotype about intellectual ability relevant to Black participants’ performance and establishing in them the threat of fulfilling it”; (2) In the non-threat condition the participants were told that “the same test was ... simply a laboratory problem-solving task that was nondiagnostic of ability [which p]resumably, would make the racial stereotype about ability irrelevant to Black

participants”; and (3) The third group was given the same test under “a second nondiagnostic condition ... which exhorted participants to view the difficult test as a challenge” (Steele and Aronson, 1995, p. 799). The critical finding was that, after statistically adjusting for prior SAT scores, black students performed as well as white students under the two nondiagnostic or non-threat conditions and substantially worse than whites under the diagnostic or threat condition. In fact, they performed slightly better under the non-threat “challenging test” condition than they did under the nondiagnostic “problem-solving task” condition.

Steele et al. (2002, pp. 386–9) have argued that in real-world, high-stakes test situations stereotype threat is activated automatically. In the low-stakes tests administered in laboratory settings the threat has to be activated by cues of the type associated with framing the nature of the test. When black students are taking a standardized test like the SAT that affects their college admission, placement, and access to financial support, the threat is omnipresent.

The potential effect of stereotype threat is not trivial. Steele and Aronson (1995) found in their first experimental study that blacks under the threat condition had scores 13 percent lower than comparable black students under a non-threat condition. A 13 percent reduction in a SAT score would mean a drop from 1200 to 1044.

In a second study, black participants under the stereotype threat condition completed about six fewer items than black participants not under the threat condition. In a further study, black students under the threat condition were slower by an average of 23 seconds in answering the first five questions, and answered five fewer questions correctly than black students not under the threat condition. Similar results were reported in Steele (1997): black students alerted to the “diagnostic” nature of a difficult verbal test solved about 4 to 5 fewer items than those given no cue after adjustment for prior SAT scores. To the extent that Steele et al. (2002) are correct that the stereotype threat generally comes into play in high-stakes testing situations, it would suggest that it is legitimate to set a lower score threshold for black students—as is sometimes done for Dalit (“untouchables”) students in India—precisely because the test score is likely to underestimate their academic potential.

Indeed, the more selective the institution—implicitly the greater the role of affirmative action in promoting admission for students from otherwise excluded groups—the better the academic outcomes for both black and Hispanic students in the USA (Alon and Tienda, 2005). At “...all intervals of the SAT distribution, the graduation rates of black students increase as institutional selectivity rises...” (ibid., p. 296).

Still, there are enduring racial/ethnic gaps in graduation rates “*within* selectivity tiers” (ibid., p. 309). But these could be explained fully by differences in socioeconomic status that correlate with race/ethnicity, especially gaps in wealth (Conley, 1999).

4. The fourth standard charge against affirmative action is the “creamy layer” effect: that the authentic beneficiaries from the target population are only persons who already are from the group’s comparatively more affluent middle class. This may be quite true. As noted above, affirmative action is not an antipoverty program, nor is it a program intended to produce greater general or intragroup equality *per se*. Its *raison d’être* is to make the class distribution within the subaltern population roughly similar to the class distribution in the dominant population. Insofar as this involves desegregation of elites, the subaltern middle class will be best positioned to take the positions that will alter elite demography. Affirmative action is well designed to produce and/or enhance the “creamy layer,” so it is unsurprising that when it is effective it may have that consequence.

5. Fifth is the charge that the recipients of affirmative action are stigmatized by the system of preferences or quotas. At the heart of this grumble is the premise that affirmative action is intrinsically anti-meritocratic rather than a means of insuring that those with “merit” from the excluded community do have access to positions commensurate with their abilities and motivation. Lewis Gordon’s extended commentary above takes the contrary stance: affirmative action really promotes meritocratic principles by unsettling the turf that was previously set aside for mediocre whites.

Moreover, affirmative action becomes a policy option precisely because there is a community subjected to stigmatization and discrimination in the first place. What exactly is the marginal increase in stigma from being the recipients of affirmative action benefits for an already stigmatized community? Evidence mentioned above (Goldsmith et al., 2006 and Fryer et al., 2011) that suggests that on net there is a positive benefit on employers’ perceptions from black workers getting a “foot in the door” via affirmative action suggests affirmative action may even be *de-stigmatizing* in a wide range of occupations.

6. The last grumble is not necessarily an argument against affirmative action. It is an argument that the target population is inappropriate, particularly if it is an ethnic or racial group. Here the grumblers propose that affirmative action should set as its target population the poor or the economically deprived. In short, according to these grumblers, affirmative action should be class-based rather than race-based.

These two approaches to affirmative action need not be mutually exclusive. One could have a policy that addresses both communities. Since affirmative action is an anti-discriminatory measure, its target population should be identified on the grounds under which discrimination is taking place. If discrimination occurs on the basis of race and it occurs at the upper end of the occupational structure, solely class-based affirmative action will not be effective in reaching those sites of discrimination. In the United States in particular, class-based

affirmative action cannot replicate what can be accomplished by race-based affirmative action (Darity et al., 2011). Again, its application on a race basis is contingent on the recognition of the persistence of *racial* discrimination.

Lewis Gordon (2011) asks in his essay, “What’s the problem with affirmative action?” He offers two responses. First, when implemented, “it works.” Second, its very existence forces the society that has adopted it to acknowledge that it continues to be a site where racism and discrimination operate—not past discrimination, but current, ongoing discrimination. Making such an admission may be the source of the biggest grumbles of all.

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## 15. Screening for honesty and motivation in the workplace: what can affirmative action do?

**Elaine McCrate**

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The University of Michigan was the belly of the beast during the US Supreme Court's 2003 deliberations on affirmative action in higher education admissions. The screening of applications to Michigan's undergraduate and law programs was the center of the legal controversy, clearly because screening constitutes one of the critical gateways to opportunity in education and employment.

Tom Weisskopf was in the Michigan belly in 2003, as a scholar-participant in the struggle to keep affirmative action alive. Among the many contributions of his work on affirmative action, Tom has advocated more careful and multi-dimensional screening of admissions and employment candidates in order to establish marginalized groups in the economic mainstream, as well as to promote better admissions and business practices overall.

Affirmative action has certainly resulted in more careful scrutiny of candidates; the empirical literature has borne this out repeatedly. Better screening may be one of the reasons that Deshpande and Weisskopf (2010), in their painstaking empirical study of the Indian railways, uncovered no evidence that affirmative action impairs productivity. They concluded that the particularly strong Indian form of affirmative action, reserving jobs for stigmatized groups, may in fact improve economic performance, augmenting the earlier results of others concerning the neutral-to-positive effects of the comparatively weak American style of affirmative action (Conrad, 1995; Holzer and Neumark, 2000).

Yet the perception remains that affirmative action does reduce productivity. There are strong productivity-related stereotypes of both African Americans and Dalits ("untouchables"). These stereotypes often concern cognitive skills. But in this chapter I try to understand how employers screen for some quite different and particularly visceral and stigmatizing stereotypes of blacks—those of dishonesty and poor motivation, attitude, and work ethic; I also inquire how that affects the employment of African Americans.<sup>1</sup> While I will have much less to say about the stereotyping and screening of Dalits, I note in passing that a



growing tendency to stereotype about motivation may be replacing the traditional pollution taboos (Jodhka and Newman, 2007).

Another few words about Tom before I continue: while we are here mainly to honor his distinctive blend of exacting research, unwavering political commitment, and just plain human decency, we should also pay tribute to his teaching, which always incorporated the same values. Tom taught for many years in the Residential College of Literature, Science, and the Arts at the University of Michigan, in the Social Theory and Practice Concentration; he was also the Residential College Director for 10 years. The Social Theory and Practice Concentration describes its mission as “support[ing] students in developing the analytical and practical skills necessary for active engagement in the world and for building careers that promote equality and responsible citizenship”<sup>2</sup>. Tom and the Residential College chose each other because of their mutual willingness to examine questions of power and inequality that don’t get explored in the mainstream economics curriculum.

This chapter is a tribute to Tom’s teaching as well as his research—it’s a compilation of some notes I’ve been accumulating while I’ve been teaching about gender and racial inequality. I like it as a teaching piece first because it leaves some unsettled theoretical questions about statistical discrimination, the theory that I invoke here, and some unsettled practical questions about affirmative action. Moreover, the material helps students understand the ways in which notions about honesty and work ethic, as well as other aspects of merit, are in great part socially determined, selectively bestowing deservingness and social kinship upon different groups.<sup>3</sup> The persistence of these particular stereotypes makes students think hard, which is what Tom always pushed them to do.

I examine stereotypes about honesty and work ethic through the lens of statistical discrimination theory (SDT), for two reasons. First, information about honesty and attitude is exceptionally poor, and as such SDT, with its explicit attention to the screening process, should be informative about the consequences and persistence of these stereotypes. Second, however, there seem to be some empirical anomalies here. The first puzzle is that some common screening devices, such as commercially available integrity tests, give no reason to believe that black workers will steal more from their employers or be less conscientious. The pass rates and mean scores of black and white test-takers are most often statistically indistinguishable (Sackett and Harris, 1985; Sackett and Wanek, 1996; Ones et al., 1996; Berry et al., 2007), yet many employers believe blacks are less honest and motivated than whites. Furthermore employers act on these stereotypes. In an experimental study, testers who mentioned a (feigned) criminal background on their resumes got significantly fewer callbacks than those who did not, and *the effect was stronger for blacks* (Pager, 2007).

Yet (here is the second puzzle) when employers use criminal background checks, they are more likely to hire black applicants, especially black men, even

controlling for the racial composition of the applicant pool (Holzer et al., 2006). The criminal background check is based on a cumulatively biased process of patrolling, arresting, and punishing blacks more than whites for comparable behavior, especially drug offenses. Although black youths are no more likely than white to use drugs (Bureau of Justice Statistics, 2009), the incentives for the police, as well as the relative lack of privacy for poor blacks, result in more drug arrests and more criminal records among blacks (Tonry, 1995). Some day someone should compare actual hiring rates for blacks who have been screened with integrity tests (seemingly racially neutral) rather than criminal background checks (clearly biased), but I have not found a dataset that would make that possible. Nonetheless, it is still curious that criminal background checks seem to promote black employment. Why?

The chapter has five subsequent sections. Because honesty and motivation have remained in the background in economic theory until fairly recently, Section 15.1 summarizes their importance for employers, and employers' stereotypes about them. Because SDT is centrally concerned with the screening process (an aspect of the theory which does not appear in the standard textbook treatments), I summarize and evaluate the most important variants of the theory in Section 15.2. In Section 15.3, I survey the most common mechanisms employers actually use to screen for honesty and motivation, including integrity tests and criminal background checks, and their consequences for black employment. In Section 15.4, I inquire why the market does not punish statistical discriminators. Finally, I return to the question of affirmative action and screening for honesty and motivation.

## 15.1 EMPLOYERS' PERCEPTIONS OF MOTIVATION AND HONESTY

Managers are unequivocal about the significance of work ethic and attitude (Bowles et al., 2001; Huang and Cappelli, 2006). Similarly, businesspeople worry a lot about employee theft, although the threat is often exaggerated, with greatest concern expressed by the retail sales, food service, warehousing, banking, and medical services industries (Sackett and Harris, 1984; Dickens et al., 1989; Murphy, 1993). The National Retail Security Survey placed the value of employee theft in the US retail industry alone at \$15.1 billion in 2001 (about 0.8 percent of sales, and nearly three times the cost of larceny reported to the FBI) (Federal Bureau of Investigation, 2002; Hollinger and Davis, 2002). Anonymous surveys have identified a large number of employees who admit to occasional theft, although it tends to be infrequent and to involve relatively small amounts.<sup>4</sup> Honesty also matters to employers because its measure is strongly

correlated on personnel tests with conscientiousness (which may be part of what employers have in mind when they are discussing motivation, work ethic, or attitude) (Ones et al., 1996; Sackett and Wanek, 1996; Hogan and Brinkmeyer, 1997; Berry et al., 2007).<sup>5</sup>

I note two things about employers' views about the relationship between these characteristics and race. First, their views are quite heterogeneous, but, second, their perception of blacks is decidedly negative relative to other ethnic groups. Interviews in the early 1990s with Chicago employers seeking to fill unskilled, entry-level positions, found that the "employers view[ed] inner-city workers, especially black men, as unstable, uncooperative, dishonest, and uneducated" (Kirschenman and Neckerman, 1991, p. 204). They characterized black workers as having a "bad work ethic", being "lazy and unreliable", and having "a bad attitude" (ibid., p. 213). "When asked directly whether they thought there were any differences in the work ethic of whites, blacks and Hispanics, 37.7 percent of the employers ranked blacks last, 1.4 percent ranked Hispanics last, and no one ranked whites there. Another 7.6 percent placed blacks and Hispanics together on the lowest level; 51.4 percent either saw no difference or refused to categorize in a straightforward way" (ibid., p. 210).

Similarly, in their interviews with employers of entry-level workers in four major US cities, Moss and Tilly (2001, p. 97) found that by far the greatest complaint about black workers was that "blacks have lagging motivation" (33.4 percent of the employers agreed with that). Furthermore, employers viewed black motivation much more negatively than they did that of other ethnic groups. Doubtless many employers portrayed themselves as less disparaging of blacks than they actually were, but the data illustrate the main points: a greater tendency to negatively stereotype blacks, and most likely some heterogeneity in employer views.<sup>6</sup>

## 15.2 THE ROLE OF TESTS IN SDT

All SDT starts with the problem of imperfect information. While most discussions of SDT focus on cognitive ability, it is even more likely that employers cannot directly observe "habits of action and thought that favor good performance in skilled jobs, steadiness, punctuality, responsiveness, and initiative" (Arrow, 1974, p. 97)—and honesty. Even more so in unskilled jobs, these habits are paramount, precisely because there are so few other skill requirements. (Is the night janitor, with keys to all the offices, going to leave valuable property and records alone?) Work ethic and honesty are critical when monitoring is difficult.

An extended digression on SDT is in order, since screening is a central part of the theory, which is not discussed in the standard textbook treatment. There

are two main traditions of SDT, one that focuses on testing error (Phelps, 1972; Lundberg and Startz, 1983), and one that emphasizes prior stereotypes (Arrow, 1973; Coate and Loury, 1993). In each version, costly tests and screening processes are central to the story. Therefore we need to understand the theoretical role of tests—formal and informal—and to explore their actual use and effectiveness with respect to honesty and motivation.

Two of Phelps's three accounts of SDT have received much attention. In his first account, there is no racial difference in expected quality, but the variance of white testing error is lower than the variance of black testing error. In other words, there is a massive communication failure between white employers and black jobseekers. There are several reasons, and some experimental evidence, suggesting why error variance could be higher for blacks on some kinds of screening devices. Personal interviews are particularly susceptible to cultural miscommunication. Blacks are less likely than whites to have personal contacts within firms that could provide information about applicant quality with relatively low error. Finally, social psychologists have found that one of the more automatic components of human cognition is the tendency to see same-group members as more heterogeneous and out-group members as more homogeneous (Fiske, 1998).

Since high-quality blacks cannot communicate their integrity or work ethic to potential employers as effectively as whites, employers weight the individual component of productivity less, and the racial component more, than they would with better signals. Another way to see this is with an extreme example. Suppose that blacks and whites apply for the same job, taking the same test (say, an interview). White employers assume that black and white workers have the same distribution of motivation, but "blacks look alike" to them in the interview. Since white employers can't read black signals at all, black interview scores are all equal to the average (the test is useless in screening blacks), and black productivity is measured with greater error than white. Below-average blacks are rated too high and above-average blacks are rated too low. Since the white employer cannot see the variance in actual black motivation, but does see the variance in white motivation, there will typically be some white workers rated above average, and essentially not forced to compete with above-average black workers who are rated merely as average.

In the second Phelps variant of SDT, employers believe that average black qualifications are lower than white qualifications for a given test score, because of black disadvantages in upbringing. In this case, blacks get fewer offers because, given black social disadvantage, employers believe their test scores are likely to overestimate actual black productivity. Phelps suggested that "skin color or sex is taken as a proxy for relevant data not sampled" (1972, p. 659). In other words, employers believe test scores are biased upward because of omitted variables which are correlated with race.

This version is close to the standard textbook treatment of SDT. As such, it warrants some special scrutiny. No one has made a careful empirical case that low social background (or race) is associated with greater theft or shirking at work. Nor is there ever likely to be a convincing one. Explanations based on social background would have to be distinguished from reasons that are specific to the workplace. Any observed group differences in the probability of stealing or shirking at work would depend on aspects of the employment relationship that are difficult to measure: the fallback position of workers in the event of dismissal, the degree of monitoring and the opportunity for theft, the size and structure of personnel incentives, and workers' perceptions of the firm's commitment to its employees. Each of these is likely to be correlated with race and socioeconomic background.

The correlation between social background and honesty or work ethic is plausibly either negative or positive: social disadvantage can be both a cause of and a deterrent to theft or low effort at work. First consider the case for the claim that social or racial disadvantage is a deterrent to workplace theft: (1) Black alternative employment prospects are worse than those of whites, so the value of the job is likely to be greater for blacks; (2) Blacks are underrepresented in jobs that present lucrative opportunities for fraud (including what fraud examiners ever so delicately refer to as the "misappropriation of assets" for personal use)—bookkeepers, internal auditors, fiscal officers, and executive officers;<sup>7</sup> (3) There is also a racial difference in the probability of detection: blacks work less independently and are monitored more closely than whites, mostly because they have jobs in low-trust occupations. Misconduct is riskier for blacks, who will be caught stealing or shirking more often than whites of comparable rectitude and diligence. Black workers also have less control over their schedules, so they are more likely to be noticed and penalized at work for lapses in punctuality, relative to whites with similar records. Greater monitoring of blacks is an incentive to comply with employers' expectations of honesty and effort (McCrate, 2006). Thus there are several reasons to expect a negative correlation between social or racial disadvantage, and workplace malfeasance. Researchers have found such a negative correlation in laboratory studies of ethical behavior (Piff et al., 2012).

However, disadvantage might also be positively correlated with shirking or theft. Because blacks are monitored more closely than whites, they will be caught and punished more often for the occasional petty theft or slacking that a fairly large number of employees of all descriptions engage in. While punishment sometimes has a disincentive effect, it can backfire when it is frequent or severe: morale falls, and shirking and dishonesty have increased in some reciprocity experiments (Murphy, 1993; Bewley, 1999; Fehr and Gächter, 2000; Nagin, et al., 2002).

So, returning to Phelps's argument about social disadvantage and testing error, the *prima facie* case for discounting black test scores is not good; there

is ample (perhaps more) reason to think that black social disadvantage leads to underestimates of honesty and work ethic, as well as overestimates. It is clear, then, that *in the interpretation of black and white test scores, observers selectively view the omitted data that is correlated with race.*

Similarly, if intercultural miscommunication makes black signals noisier (Phelps's error variance story), this doesn't mean that anyone's imperfect signals are interpreted through a passive, neutral receiver. The problem is not just high error variance for blacks, but the way that agents handle noise when race is involved. Thus even though observers may not be willing to categorize interviewees as dishonest or lazy solely on the basis of race, they seem to form hypotheses about group-specific dispositions that they then regard as confirmed by ambiguous signals. A listless white job candidate, for example, may be seen as tired or having a bad day, while a similar black candidate may be viewed as unmotivated (Darley and Gross, 1983).

On the subject of *ex ante* stereotypes, Phelps's models are silent. This lacuna is apparent in the error variance model's symmetric treatment of black scores far from the expected value, be they high or low. Because of the high black error variance, the model posits that employers simply weight the individual component of productivity less, and the group component more: high black signals are downgraded, and low black signals are *upgraded* toward the mean. However, social psychologists have also found that perceptions of outgroup homogeneity do not generally revert to the general population mean; rather they are associated with stereotyping. People who believe there is little outgroup variance also make stereotypic judgments about outgroup members more readily than people who perceive more outgroup variance (Fiske, 1998). And these stereotypes strongly influence the interpretation of ambiguous signals.

Arrow's distinctive contribution was the recognition both of the role of costly screening processes and *a priori* stereotypes. Unlike Phelps, Arrow recognized that agents may handle noise differently when race is involved; in his model, stereotypes are independent elements of contemporary racial inequality (Arrow, 1972). The employer does not know whether a worker has invested in necessary work habits or skills; the employer believes that blacks are less likely to have done so; and the employer's investment in a worker (minimally, a screening cost) is wasted if the worker has not made the necessary investment in herself. Under these circumstances, there will be a racial wage or employment differential, and a lower rate of return to investment for blacks. Coate and Loury's model (1993), which also starts with stereotypes as a given component of the economic landscape, concludes with potentially multiple stable equilibria; among these, some subset is discriminatory, with outcomes depending on prior beliefs or stereotypes.<sup>8</sup>

SDT, in all its forms, certainly has its critics. Skeptics maintain that firms still have the incentives, and in the long run the means, to identify individual high

performers regardless of race. Uncertainty should stimulate a market for information, at least some firms will identify productive differences *within* groups, the informational value added by race will approach zero, and competitive markets will punish firms that act on false stereotypes (Darity, 1989 and 1998; Aigner and Cain, 1977; Cain, 1986). There is some empirical support for this. For example, Stoll et al. (2004) and Raphael et al. (2000) found that black hiring officers hire somewhat more black workers (after controlling for the black application rate), despite, or because of, the fact that they are more likely than white hiring officers to work in firms with stricter hiring requirements and screening methods. Black hiring officers may do a better job reading own-group signals, and employers may reduce cultural miscommunication or the tendency to act on stereotypes by using black hiring agents. (There are of course other obvious explanations for this, such as networks.) Since there are some methods for distinguishing between good and bad workers, however imperfectly, and since there is some apparent heterogeneity among employers in their susceptibility to stereotypes, firms who inaccurately stereotype blacks will be at a competitive disadvantage.

The two key questions that arise from this criticism of SDT are: (1) whether any of the tests can override the putative value of race as a signal—that is, whether they can fill the informational vacuum that tends to be filled by race; and (2) whether markets actually punish less discerning firms. I address each question in the following two sections.

### 15.3 NOISY SIGNALS AND RACE

I will consider several of the most common tests that employers use to assess attitude and honesty: interviews, integrity tests, and criminal background checks. I am assuming that the employer is trying to evaluate a job applicant rather than a worker who has been observed on the job for some time.

First, the most common screening device, the ubiquitous personal interview, is also the most problematic. Holzer (1987) found that interviews (as well as reference checks and probationary periods) had little predictive value for a manager's rating of a new hire's productivity relative to other employees; if anything, the relationship was generally negative. In the personnel psychology literature, their validity is also very low, typically below 0.2 (Herriott, 1989; Cook, 1988; Schmitt and Chan, 1998; Arvey and Campion, 1982).<sup>9</sup> However, despite a fair amount of research on bias in interviewing, personnel psychologists have found only weak or contradictory evidence on the possibility of racial bias in interviews. (See Cesare, 1996; Lin et al., 1992; and Campion and Arvey, 1989.)

Next, consider the many commercially available paper-and-pencil integrity tests (also called honesty tests), which proliferated after the national ban on

polygraph testing for employment in 1988. The mission of integrity tests expanded rapidly to include the prediction of a multitude of counterproductive workplace behaviors, not just dishonesty. In the early 1990s, about 6000 organizations administered about 5 million integrity tests annually (Camara and Schneider, 1994). Twenty-eight percent of retail employers responding to the National Retail Security Survey (Hollinger and Langton, 2005) used them. Such tests inquire about past theft, attitudes toward theft, attitudes toward risk, and so forth. Scores on these tests are also associated with conscientiousness (Ones et al., 1993; Sackett and Wanek, 1996; Hogan and Brinkmeyer, 1997; Berry et al., 2007).

The voluminous literature on integrity tests has concluded that there are no significant differences in pass rates or mean scores between blacks and whites (Ones et al., 1996; Sackett and Harris, 1985; Sackett and Wanek, 1996; Berry et al., 2007). While this says nothing about bias, it has been a major selling point for the producers of the tests, since it protects employers from scrutiny by the EEOC. The usual EEOC trigger is a black/white pass-rate ratio lower than 80 percent; sometimes statistical measures of significant difference are used as well (Joy, 1991, p. 82).

But there are lots of questions about the validity of integrity tests. The first limitation of integrity tests is that they only approximate the test characteristic under clinical, not real-life, conditions. There is inevitably an underlying decision rule about how behavior under test conditions corresponds to behavior in specific work environments, with specific technologies, systems of monitoring, penalties for poor performance, work norms, supervisors, and labor market conditions.

Second, the validity of the tests depends critically on the assumption that prospective employees cannot game the test. However, much research shows that many occupational honesty tests are fakeable. Tests often (but not always) include lie scales to catch the fakers (Cooper and Robertson, 1995; Murphy, 1993), but these are vulnerable to manipulation by a skilled test taker.<sup>10</sup> Sackett and Wanek (1996) noted that in several recent studies, when research subjects were instructed to fake an integrity test, they could raise their scores. Guastello and Rieke (1991) found that integrity test scores are positively correlated with scores on lie scales, and that predictive validity fell substantially when correcting for faking.

Good integrity tests are significantly better than alternatives such as personal interviews. But their contributions are modest. In a comprehensive meta-analysis of 180 studies of 25 honesty tests, Ones et al. (1993) found the mean operational validity of integrity tests for predicting supervisory ratings of job performance to be 0.41. However, among the 180 studies of the 25 integrity tests that Ones et al. used (yielding 665 validity coefficients), Sackett and Wanek (1996) considered the most compelling to be those that tried to predict workplace performance, used a job applicant sample, and used non-self-report criteria. Only 79 of the 665 validity coefficients satisfied these criteria, and the average validities of



this subset ranged from 0.09 (for the studies of tests focused most directly on predicting theft) to 0.27 (for tests predicting counterproductive workplace behavior more broadly defined). In the domain of employment testing, these validities are mediocre to bad.

Finally, there has been very little *independent* evaluation of integrity tests for validity. Most validation studies of honesty tests have been conducted by the test publishers themselves (Sackett and Wanek, 1996), and the raw materials of integrity test validation research are in most cases proprietary information (Camara and Schneider, 1995).

To summarize, the common properties of personal interviews and integrity tests are that they are not apparently racially biased (no disparate impact), but they are far from perfect signals. In the face of strong stereotypes about black criminality, are employers really likely to trust these signals?

Maybe employers trust criminal records more. Five-sixths of retail employers conduct criminal background checks, swamping the 28 percent of retail employers who use integrity tests (Hollinger and Langton, 2005). Legal barriers to the use of criminal records for employment screening have been falling and employers have been checking them more. With the pervasiveness of stereotypes about black criminality, the effect of this device on the employment of African Americans is ambiguous: more blacks than whites have been convicted of a crime, but the record check may reduce employers' reliance on race as a signal, which may or may not outweigh the effect of identifying more convicted blacks. According to one study, the net result is that employers who examine these records are 8.4 percent more likely to have hired a black applicant in the most recently filled position than employers who do not check the records, and the effect is stronger for employers who are unwilling to hire convicts (Holzer et al., 2006). This result is possible in a statistical discrimination model only if firms exaggerate the extent of black criminality—that is, only if they hold an erroneous stereotype. This is just one study; its results need to be replicated with other datasets. However, for the sake of argument, I am going to proceed assuming that this result is robust. The fact that employers who use criminal background checks are more likely to hire blacks needs to be compared with the employment practices of employers who use screening devices which seem to be unbiased. However, we do not know whether employers who use criminal background checks hire more or fewer blacks than employers who use interviews or integrity tests.

To summarize, the hiring decision involves a substantial degree of fundamental uncertainty. When screening is especially costly or uninformative (as it is for the young), when workers can't reliably communicate information about their productivity to employers, when the perceptual muck is especially thick, the inclination to rely on cheap and historically salient indices, such as race and racially biased criminal background checks, can be very strong. While interviews

and integrity tests are likely to be preferred when the criterion is disparate impact, their predictive validity is low, and employers may be more likely to hire blacks when the signal is biased against blacks. (This is an unresolved question; no one has compared the hiring record of employers using background checks and the hiring record of employers using interviews or integrity tests.)

## 15.4 WHY DOESN'T THE MARKET PUNISH STATISTICAL DISCRIMINATORS?

Since employers vary in their ability to read and their propensity to discount black signals of honesty and work ethic, those who are more competent observers should reap the reward of lower screening costs and more productive employees. However, this may not actually come to pass, if stereotypes are self-fulfilling. This kind of perverse feedback loop can happen through two different mechanisms. First, because employers expect blacks to perform worse, firms are more likely to hire blacks in low-trust positions, and to monitor them more closely. As a result, employers see more malfeasance by blacks. They see what they expect to see (McCrate, 2006).

Second, Coate and Loury (1993) extended Arrow's insights to develop an account of endogenously self-confirming racial stereotypes in a job assignment model. The employer's judgment that a worker is qualified for a more desirable job with more discretion or autonomy is a function both of the applicant's noisy test score and the employer's stereotype about the probability of satisfactory qualifications among blacks. For workers, the net benefit of investing in the necessary traits depends on the employer's requisite cutoff score for the more autonomous position, which is set higher for blacks when the employer holds a stereotype that they are less likely to be qualified. Coate and Loury assume that there is little point to investing when the cut score is very high or very low, and thus the percentage of workers who are qualified for the more responsible job initially increases, then decreases with the cut score. Equilibrium occurs when employers' expectations about a group's qualifications are consistent with workers' investment decisions given the cut score, which is itself contingent on the employer's prior beliefs about the group's qualifications. There are potentially multiple stable equilibria in the model, and some of these are discriminatory, with different outcomes for different groups depending only on prior beliefs or stereotypes. If firms initially believe that blacks are less motivated than whites, blacks invest so as to confirm the expectations. Blacks come to have the traits that are associated with them, simply because others expect them to be that way. The source of the problem is the stereotype, which causes employers to structure interactions (such as screening) and incentives so as to produce exactly what they expect to see.<sup>11</sup>

For both reasons—greater monitoring of blacks, and different black investment as a result of expectations—we can expect self-reproducing stereotypes. In the words of Judith Butler (2004, p. 206), agents do not engage in “simple seeing, an act of direct perception, but [in] the racial production of the visible, the workings of racial constraints on what it means to ‘see’... a repeated and ritualistic production of blackness.”

If academics can figure out how employers’ stereotypes end up reproducing themselves, one would suppose that an employer, with more at stake, would figure it out too. As the critics of SDT have pointed out, this lack of vision is hardly profit-maximizing behavior. And as Loury (2002) points out, these employers should at least be willing to experiment.

So why the dearth of experiments? This is especially perplexing in the case of stereotypes about work ethic and honesty, since the similarity of black and white integrity test scores should provide additional comfort for those willing to experiment. Part of the problem is that people readily accept stereotype-confirming information as inherent in the nature or basic disposition of the target individual (“that’s just the way they are”); stereotype-discordant anomalies tend to be regarded as situational (Pettigrew, 1979; Fiske, 1998). Hence Loury’s notion of “biased social cognition:” if employers think that blacks are truly and exogenously less honest or motivated, employers do not perceive their own role in contributing to self-fulfilling racial stereotypes. They further see little reason to experiment.

Second, although stopping a self-confirming stereotype in its tracks is Pareto superior to leaving it unchallenged, Loury points out that most firms, as “competitive observers,” cannot affect worker investment incentives by examining their own stereotypes or job assignment practices, because they cannot affect overall social stereotypes by themselves. Loury (2002) further argues that “monopolistic observers,” such as very large firms, who do have the “power to create facts” (p. 40), are typically disinterested in experimenting with alternative explanations of racial inequality. The problem lies not so much at the level of *inference*, “the quantitative calculation of parameters from the available data,” as it does at the level of *specification*, “the qualitative framework guiding an agent’s data processing” (pp. 45–6), which is logically prior to inference.

## 15.5 AFFIRMATIVE ACTION

In the case of honesty and work ethic, there is close to a perfect storm of exceptionally strong stereotypes and exceptionally ambiguous information. The coordination problem stifles experimentation. What can affirmative action do? The literature on affirmative action demonstrates that one of the channels of

higher productivity is better screening methods (Conrad, 1995; Weisskopf, 2004; Holzer and Neumark, 2000). But when the issue is honesty and work ethic, what exactly constitutes better screening?

The criminal background check is one screening device that seems to work as both the proponents and critics of SDT expect—in the sense that it reduces the value of race as a signal, gives employers enough confidence to actually hire more blacks among those who do not have criminal records, and seems to be diffusing as a fairly standard personnel practice, at least in the retail industry. According to Holzer et al. (2006), there is also a positive association between the use of background checks and the practice of affirmative action. However, the fact remains that a criminal background check is racially biased. It may be that a biased signal, if required for all job applicants, is better than an apparently neutral signal, such as an integrity test score, for much the same reason that social scientists often prefer datasets with properties that bias them against the researcher's stated conclusion.

On the other hand, the criminal background check also stigmatizes African Americans. This is most obvious for those with criminal records. Less obviously, as long as employers think of the black applicant with a clean record as the “exceptional” African American, the practice of checking records attests to, and reinforces, the stigmatization of all African Americans.

There may be a couple of ways to improve the tradeoff between employer confidence in hiring blacks and the hardening of racial stigma. The empirical work in cognitive psychology would suggest more effort by whites to differentiate among whites, and to apply exacting tests to them as well as to the members of other groups. Schauer (2003) advocates screening everyone the same in order to avoid stigmatizing some; employers should check white applicants with as much care, and suspicion, as black. Employers could, for example, be required to use criminal background checks for all job applicants if they use them for any.

Weisskopf (2004) argues for a more nuanced and multi-dimensional evaluation system, other than just the mechanical use of a single test. However, this entails costly experiments, which most employers are unlikely to undertake voluntarily in the context of the coordination and specification problems that Loury described. Affirmative action, which has been shown to push employers toward better screening than they would otherwise choose, is one partial way out of the dilemma.

But my sense is that affirmative action will be hobbled in the absence of changes in the criminal justice system. We urgently need to change the entire biased system that generates criminal records. If this were changed, one hopes that employer confidence in criminal background checks does not depend on their racial bias. But if it does, we need to consider other measures. Full employment policies are critical. As labor markets tighten, employers become more willing to hire those with minor criminal records. Tight labor markets make

employers experiment and adopt more nuanced methods of screening that help to overcome stereotypes. In addition, labor market intermediaries such as unions and churches, that work both with employers and clients with criminal records, can promote black employment under conditions of imperfect information and stereotyping. Finally, a strengthened affirmative action, perhaps closer to the Indian system of hard quotas (Weisskopf, 2004), may be necessary to address the dilemma of biased screening methods that promote black employment only because they are biased.

## NOTES

1. I will use the terms “motivation,” “work ethic,” “attitude,” “conscientiousness,” and “honesty” almost interchangeably, partly because employers do (for example, Walmart’s notion of “time theft”), and partly because there is a strong association between “integrity” and “conscientiousness” in formal tests. Integrity test scores, however, are largely orthogonal to cognitive ability scores (Ones et al., 1993).
2. See the University of Michigan’s Residential College webpage that describes the STP curriculum, available at: [http://www.lsa.umich.edu/rc/currentstudents/curriculum/concentrations/socialtheoryandpractice\\_ci](http://www.lsa.umich.edu/rc/currentstudents/curriculum/concentrations/socialtheoryandpractice_ci). Accessed 2011.
3. For example, the putative dishonesty of some working-class people pales in comparison to the mendacity and the fraud associated with most American financial crises since 1980—dishonesty perpetrated by financial officers in the most elite circles of their industry.
4. Hollinger and Clark (1983) found that 41.8 percent of retail workers admitted to stealing; 32.2 percent of hospital employees, and 26.2 percent of manufacturing workers did so as well. See also Slora (1991) and Nagin et al. (2002).
5. Measures of dishonesty and other counterproductive work behaviors are also negatively correlated on these tests with agreeableness and emotional stability. Conscientiousness, agreeableness, and emotional stability are three of the “Big Five” dimensions of personality (Berry et al., 2007).
6. Jodhka and Newman (2007) observed similar regional stereotypes in India. For example, the owner of a small manufacturing firm remarked (p. 4128): “There is a great deal [of stereotyping] about Uttar Pradesh people. There is a constant mimicking of Bihari labourers. Lazy guys, come in drop in without work ... The work I expect to be done in three minutes would probably take an hour and a half.” Also, Jodhka and Newman reported some heterogeneity among employers, with some denying that caste and religion influenced their hiring decisions: “I haven’t seen any kind of correlation between the religion of the person and his work. It is basically his caliber, attitude and his commitment that is seen” (p. 4126).
7. The Association of Certified Fraud Examiners (2004) estimated (very loosely) that employee fraud in the US cost \$660 billion in 2003, about 6 percent of an organization’s total revenues. This dwarfs the magnitude of employee theft in the retail sector (0.8 percent of sales (National Retail Security Survey)). Employee fraud also raises the specter of bankruptcy, financial penalties, and delisting by national exchanges (Committee of Sponsoring Organizations of the Treadway Commission, 1999).
8. The Coate and Loury model involves endogenously self-confirming racial stereotypes. See Section 15.4.
9. In this context, validity means correlation between test scores and performance measures, usually supervisor ratings or specific measures of detected counterproductive activity.
10. Lie scales add up the number of socially approved but implausible responses. For example, a test might ask whether the respondent has ever said anything about someone behind his back that she would not be willing to repeat to his face.
11. A perverse feedback loop also follows from Phelps’s error variance model. Because the relationship between test scores and unobservable productivity is stronger for whites than blacks,

the return to investment in such productivity is lower for blacks. Highly productive blacks are discouraged by their relative position in the hiring queue; these incentives generate lower mean unobservable black productivity endogenously (Lundberg and Startz, 1983).

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## 16. A stimulus for affirmative action? The impact of the American Recovery and Reinvestment Act on women and minority workers in construction

**Jeannette Wicks-Lim**

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### 16.1 INTRODUCTION<sup>1</sup>

The Obama administration's \$840 billion stimulus plan to lift the US economy out of the Great Recession, passed February 2009, provoked early rebuke by feminists. Why? Infrastructure spending, a focal point of the federal spending plan, would pour federal dollars into the construction industry—an industry with a history of discriminating against women and minority workers.

This criticism understandably focuses on the immediate economic turmoil caused by the ongoing jobs crisis. But there is a longer-term challenge: How do we get women and people of color into these jobs? The reality is that the US economy has clear and pressing needs for continued federal spending on construction activities. The nation's infrastructure urgently needs a massive level of repair, on the order of \$1 trillion over the next decade.<sup>2</sup> And the nation needs to significantly reduce its greenhouse gas emissions. To retrofit the country's building stock to be more energy efficient would require roughly \$800 billion.<sup>3</sup> In other words, to marshal sufficient resources to address two critical challenges that the nation faces, the federal government may well need to inject a significant level of spending into the construction industry, now and into the next decade. Policymakers need to figure out how to diversify construction jobs.

Can today's federal affirmative action policies, designed to address exactly this problem, help diversify construction employment? To answer this question, I examine the impact of two nearly simultaneous actions by the Obama administration that sharply increased the role of federal affirmative action policies in the construction industry. First, the American Recovery and Reinvestment Act (ARRA) sharply raised the proportion of the construction sector covered by

Executive Order 11246—the law that requires federal construction contractors to take affirmative action in hiring women and minority workers. It did this by pouring federal dollars into the construction sector as private spending collapsed. By 2010, public dollars came to fund nearly two-fifths (38 percent) of all construction spending—a historic high.

At the same time, President Obama appointed Hilda Solis to head the Department of Labor (DOL). Labor Secretary Solis and her staff shifted the agenda of the DOL towards strengthening federal affirmative action policies and the DOL regulatory agency that enforces them, the Office of Federal Contract Compliance Program (OFCCP). This was made easier by the appointment of Patricia Shiu as the Director of this office who had a quarter century of experience working on employment discrimination cases. The work of the OFCCP became more urgent with the passage of the ARRA: the OFCCP projected that 80 percent of ARRA contracts would be in construction. In other words, these actions of the Obama administration invigorated the OFCCP, and at the same time, substantially increased the share of construction firms this agency would regulate.

I find evidence that the increased role of affirmative action policies in the construction sector due to the ARRA and the greater level of OFCCP activities can be linked to measurable improvements in the share of construction jobs held by women and minorities since 2009. Women experienced a one-half to one percentage point gain in their share of construction jobs after the passage of the ARRA, up from only 2.4 percent of construction jobs. The evidence of any impact for black workers is similar, but less robust.

Latinos gain nearly three-percentage points in their share of construction jobs with the passage of the ARRA, but only in states with the highest concentration of ARRA dollars. This group of workers holds an interesting position in the construction industry. Latinos appear to have plenty of access to the industry—they are highly over-represented in construction jobs. However, these workers do not appear to hold the same privileged position as white men.<sup>4</sup> Similar to African Americans and women, Latino workers appear to be more vulnerable to layoffs during downturns in construction employment than are their white male counterparts. In this context, the impact of the federal affirmative action may be understood as lessening the degree to which Latinos shoulder a disproportionate share of job loss. Finally, as would be expected, the experience of white male workers is a mirror-opposite of these other groups—their share of construction jobs falls after implementation of the ARRA, and most particularly in the states with a high concentration of ARRA spending.

In sum, recent evidence suggests that federal affirmative action policies do create an impetus among employers to change the demographic composition of their construction workforce. This is an important lesson for today. To meet the nation's needs for infrastructure improvements and clean energy projects will require major federal spending in construction activities. Effective affirmative

action policies will help insure that women and minority workers are among the beneficiaries of this federal spending. Such spending could, if unintentionally, serve as a policy tool to help *reduce* discrimination against women and minorities.

## 16.2 EXECUTIVE ORDER 11246 AND AFFIRMATIVE ACTION

In 1965, President Lyndon Johnson enacted Executive Order 11246 that instructs employers to “act affirmatively” to reduce discrimination, and established the federal agency to enforce this policy, the Office of Federal Contract Compliance Programs (OFCCP). Eminent affirmative action scholar Jonathan Leonard provides this useful explanation of the meaning behind these two words:

This language [of affirmative action] imposes two obligations: first, not to discriminate; second, whether or not there is any evidence of discrimination, to take affirmative action not to discriminate. Thus federal contractors are required to develop affirmative action plans (AAPs), including goals and timetables, for good-faith efforts to correct deficiencies in minority and female employment.<sup>5</sup>

The OFCCP treats non-construction contractors and construction contractors differently. Non-construction contractors and first-tier subcontractors with contracts valued at \$50 000 or more and that employ 50 workers or more must produce written affirmative action plans.<sup>6</sup> Due to the “fluid and temporary nature of the construction workforce,” the OFCCP does not require construction contractors to develop written affirmative action programs. Instead, OFCCP has established utilization goals based on civilian labor force participation rates, and has outlined in the regulations good-faith steps for construction contractors to follow.<sup>7</sup> For minority workers, these utilization goals are based on the characteristics of the local labor market. The goal for women, originally established in 1978, is fixed indefinitely at 6.9 percent of work hours. Federal construction contractors and federally-assisted<sup>8</sup> construction contractors with contracts of \$10 000 or more are covered by the Executive Order.

The OFCCP conducts compliance reviews for selected firms during which contractors need to demonstrate their good-faith efforts or face sanctions. Sanctions include disqualification from the federal contract bidding process (debarment), cancelation of contracts, and possible further legal action by the Equal Employment Opportunity Commission (EEOC).

In 2009, the OFCCP put in place a “Recovery Act Plan” that outlines what resources the OFCCP will commit to accommodate the higher number of federal contracts that the ARRA would generate. The Recovery Plan identifies construction contracts as a major source of this new activity:

The emphasis on infrastructure spending under the Recovery Act is expected to increase construction contracts. These types of contracts may represent roughly 80% of all Federal contracts under the Recovery Act. To best ensure the EEO compliance, OFCCP will target the construction industry.<sup>9</sup>

The OFCCP Recovery Plan includes an increase in construction compliance evaluations by more than 75 percent, from 204 in fiscal year 2008 to 360 in fiscal year 2009. Other major activities of the OFCCP's Recovery Act Plan include outreach efforts to educate Recovery Act contractors about their Equal Employment Opportunity (EEO) obligations in order to increase compliance, as well as to provide technical assistance, and the appointment of a Recovery Act coordinator to oversee all such activities.

The ARRA specifically allocated more staff and funds to the OFCCP—equal to a 9 percent expansion. For FY2010, the Recovery Act increased the OFCCP funding by \$7.2 million, up from \$82.1 million. This enabled the agency to add 50 more full-time staff to its previous level of 585.<sup>10</sup>

Past research has found that federal contractor affirmative action policies most consistently improve the representation of black males at workplaces (see, for example, Ashenfelter and Heckman, 1976; Heckman and Wolpin, 1976; Heckman and Payner, 1989; Leonard, 1984a; Rodgers and Spriggs, 1996). Evidence has been less consistent for women. Several studies find either no evidence of an impact or, at best, mixed evidence for women (Goldstein and Smith, 1976; Heckman and Wolpin, 1976; Leonard, 1984a). Meanwhile, other studies (Beller, 1982; Osterman, 1982; Leonard, 1984b) found some evidence that affirmative action policies improve the employment situation for women.

Several key factors make affirmative action policies more effective. First, the level of enforcement activity is a key factor. Finally, some studies found that affirmative action policies have a stronger impact among growing firms (Heckman and Wolpin, 1976; Leonard, 1984b). In other words, affirmative action policies are more likely to diversify their workforce by adding workers, rather than displacing current workers.

## 16.3 TRENDS IN CONSTRUCTION SPENDING

The recent collapse of the housing market dramatically increased the role of public spending in the construction industry. Clearly two factors are at play here. First, the private construction sector underwent a severe contraction: falling from \$911 billion in spending in 2006 to \$588 billion in 2009, a fall-off of more than one-third or \$320 billion. Public spending, on the other hand, climbed steadily despite the onset of the recession of 2008–2009 from \$255 to \$309 billion and then up to \$315 billion in 2009.

The ARRA directly contributed to breaking the construction industry's free-fall. As of March 2011, about \$34 billion federal dollars, paid out in the form of grants, contracts, and loans have funded construction projects. By the time the ARRA spending winds down, the construction sector can expect to have received a total of \$50 billion.

The reach of these federal dollars extends beyond the fraction of total spending that \$34 billion represents. The OFCCP's jurisdiction includes projects partially-funded by federal funds and many projects combine local, state, and federal money. Though it is difficult to say how far such joint projects extend the influence of these federal dollars, one way to gauge this is to look at a combination of federal, local, and state construction spending.

For more than a decade, from 1993 to 2005, public spending in construction as a proportion of total construction spending hovered around or below 25 percent. As the housing bubble reached its peak in 2006–2007 and private spending escalated, public spending fell to nearly 20 percent of total spending. With the crash of the housing market that followed, however, the fraction of construction spending that came from the public sector rose to its highest level in 17 years: 38 percent in 2010. Clearly, the role of the public sector in the construction industry is dramatically larger today. This rise in public spending in the construction industry signals a corresponding substantial widening in the coverage of EO 11246 .

## 16.4 THE IMPACT OF THE EXPANDED FEDERAL ROLE IN CONSTRUCTION ON WOMEN AND MINORITY WORKERS: A FIRST LOOK

If federal affirmative action policies have their intended effect, the passage of the ARRA should cause a relative rise in the proportion of women and minority construction workers, and conversely, a fall in the proportion of white male construction workers.

Figure 16.1 provides a first look at whether these trends coincide with any noticeable improvement in the diversity of construction occupations. Panel A of Figure 16.1 presents the proportion of construction jobs held by women from 1985 to 2010.<sup>11</sup> For context, the figure also presents the trend in construction employment to indicate the overall health of the industry.

Two observations immediately jump out from this figure. First, over the past quarter century, women have only achieved a one-percentage point gain in their representation among construction occupations—an astonishingly small degree of achievement. This despite the fact that, as of 2010, women made up 46.7 percent of the US labor force.

Figure 16.1 Trends in the diversity of construction occupations, 1985–2010

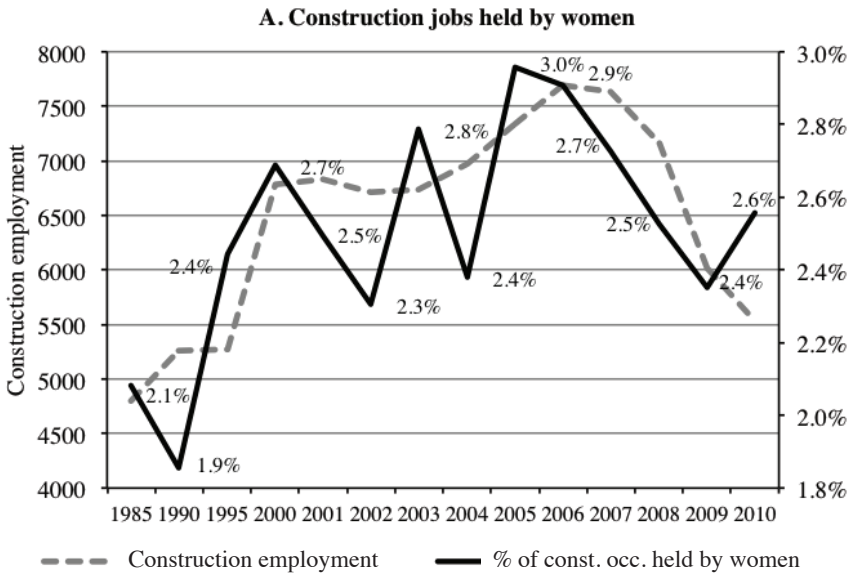
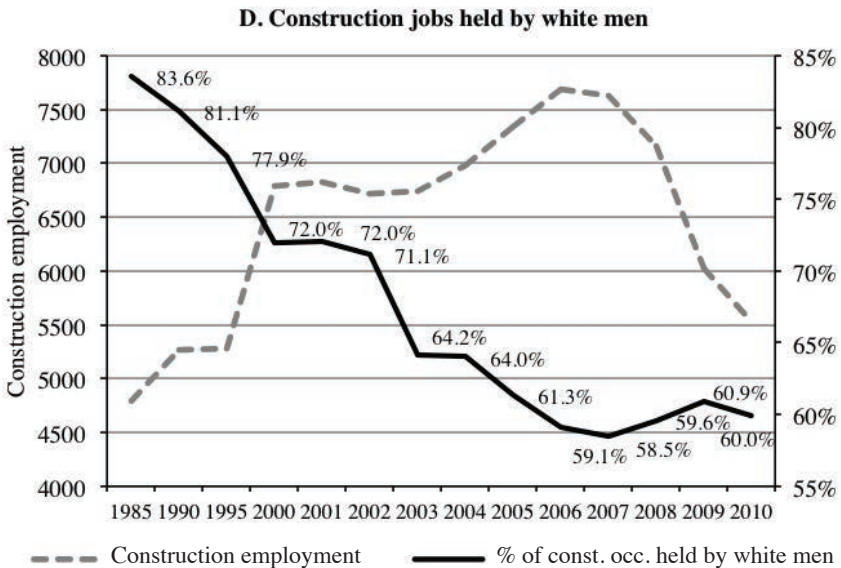
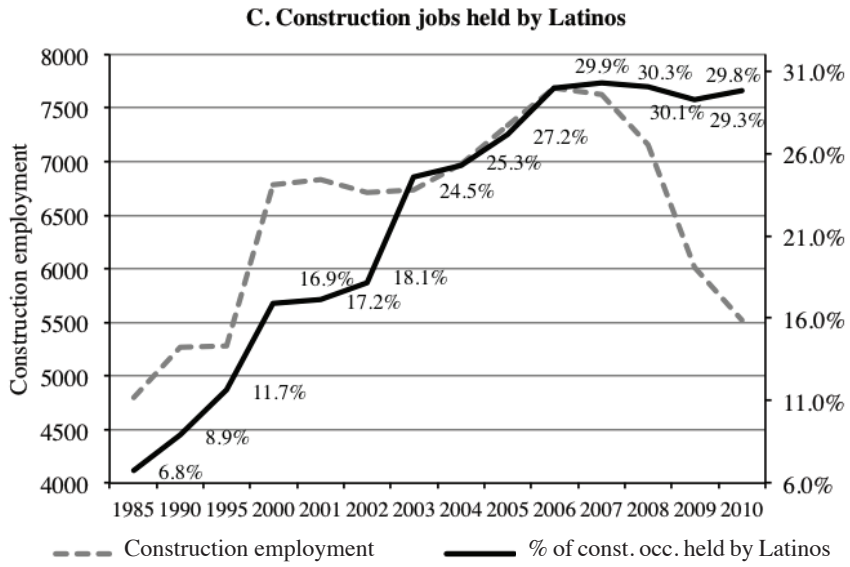


Figure 16.1 Trends in the diversity of construction occupations, 1985–2010, cont.



Sources: Current Employment Statistics and Current Population Survey of the Bureau of Labor Statistics.



Second, the trend in the proportion of women in construction occupations tracks the level of construction employment. This link suggests that the challenge of getting women into construction jobs may be difficult, but not impossible. The fact is that, as the housing market heated up, employers figured out ways to find, hire, and train female workers.

These gains, however, fell away as the construction sector imploded between 2006 and 2009. The beginnings of a reversal appear by 2009 and 2010, the years that coincide with the passage and implementation of the ARRA. During these last 2 years, the proportion of women in construction occupations regained some of this lost ground.

The proportion of black construction workers (Figure 16.1, panel B) does not track construction employment in the same way as the proportion of female construction workers, with the exception of the period after 2006. After 2006, the proportion of black construction workers slides downward to levels even lower than in 1985. In 2010, African American workers held 5.7 percent of construction jobs, markedly lower than their 11.6 percent share of the labor force. An uptick from 2009 to 2010, as with the women workers, suggests that the downward trend may be slowing.

The fraction of Latino workers in construction has been, for the most part, rising rapidly since 1985 (Figure 16.1, panel C). By 2000, their share of construction jobs surpassed their share of the labor force. As a result, from 2000 onward, Latinos are *over*-represented in construction work. This rise comes to a halt after 2006, and then dips slightly with the onset of the recession. In other words, even this group of workers that has seen its share of construction jobs quadruple from 7 percent in 1985 to 30 percent in 2006 has been affected by the contraction of the construction industry. For this group, as with women and African Americans, the downward trend appears to reverse in 2010.

Panel D of Figure 16.1 presents the trends for the proportion of white males in construction occupations—the demographic group historically over-represented among construction workers. The proportion of white male workers has been falling consistently with the exception of the years following the collapse of the housing market, and bottoms out at 58 percent in 2007. Even at this level, these men are over-represented in these occupations. In the same year, white men made up 44.5 percent of all workers. The proportion of white male construction workers then rises a few percentage points as construction employment plummeted through 2009. In 2010, though the number of construction jobs continued to fall, the proportion of white male construction workers declines.

Broadly speaking, then, the construction employment opportunities for women and minority workers appear to rise and fall with the employment levels of the construction industry. A break in this pattern appears around the years that coincide with the implementation of the ARRA, 2009 and 2010. During those years, both women and minority workers appear to regain some of the

ground they lost during the collapse of the housing market.<sup>12</sup> The pattern for white males is the mirror-opposite. These trends provide preliminary evidence that federal affirmative action policies strengthened by the ARRA succeeded in increasing the diversity of the construction workforce.

## 16.5 CAN THE EXPANDED FEDERAL ROLE IN CONSTRUCTION BE LINKED TO GREATER DIVERSITY IN CONSTRUCTION?

How strong is the apparent link between construction employment trends, the diversity of the construction workforce, and the greater coverage and activity of the OFCCP associated with the passage of the ARRA? A couple of simple empirical exercises can help answer this question.

### 16.5.1 Research Approach

First, I compare the trends in the gender and racial/ethnic diversity of two different sets of occupations—construction and production occupations. These two sets of jobs share several important qualities: both require similar levels of educational credentials, both have a predominance of white males, both have a relatively high—if declining—level of unionization, and both have suffered significant employment losses since 2007. The crucial difference between these two sets of occupations—for the purposes of this study—is that only construction occupations should have experienced a substantial increase in EO 11246 coverage and enforcement activities.

Prior to 2009, I would expect the trends across the two occupations to be roughly similar.<sup>13</sup> If the passage of the 2009 ARRA sharply increased the share of construction workers under the coverage of a more rigorously enforced EO 11246, then representation of women and minority workers should rise after 2009. This increase should occur among construction occupations only. If both construction and production occupations experience a similar rise in the proportion of women or minority workers after 2009, this would cast doubt on the possibility that OFCCP affirmative action policies are behind any increase in the diversity of the construction workforce, since production occupations did not undergo a similar set of increased OFCCP coverage and enforcement.

I use regression analysis to isolate the impact of the passage of the ARRA while also taking account of the important influence of employment growth.<sup>14</sup>

This approach has a couple advantages. First, this investigation focuses on the impact of affirmative action policies specifically during a downturn in the economy. Past research has focused on the question of whether affirmative action

policies are more effective when firms expand. Leonard (1984b), for example, finds evidence that when federal contractors are expanding, these employers increase their proportion of black workers in their workforce faster. But this also implies that federal contractors decrease their proportions of black workers faster than other employers when their firms are shrinking. This raises an important policy concern: in order for affirmative action policies to succeed, they need to protect women and minority workers during downturns.

Second, this approach avoids mistaking a simple shift of employers with a more diverse workforce into federal contracts with a rise in the overall diversity of construction workers. Such a shift would occur if construction employers with a more diverse staff succeed in their bids for federal contracts at a higher rate than employers with a less diverse staff. This would increase the diversity of the federal contractor workforce but also decrease the diversity of the non-federal contractor workforce. I can avoid this selection bias problem by looking at the diversity of workers across all construction jobs, regardless of contractor status.

### **16.5.2 Results and Discussion**

In Table 16.1, I present the basic findings from this first difference-in-difference analysis (see columns 1 and 2). I first present estimates of how the fall-off in construction employment affects each group of workers in order to put the impact of the ARRA into context.

The figures in the first column show how the proportion of each group of workers responds to a substantial 10 percent fall-off in employment—an amount roughly equal to the average annual rate of job loss in construction since 2007. The employment share of white men rises by nearly 2 percentage points for every 10 percent fall in employment. In other words, white male construction workers disproportionately avoid layoffs as construction activity declines. These results match the pattern displayed in the descriptive figure above—the share of construction jobs held by white men rose as overall construction employment dipped.

Two of the three other groups—women and Latinos—lost their jobs at a faster rate than other workers during a downturn. This suggests that Latinos do not hold the same privileged position as white male workers, despite their high over-representation.<sup>15</sup> The estimated impact of changes in construction employment, however, for these workers as well as for African American workers, is too imprecisely estimated to be statistically significant.

In the second column of Table 16.1, I show the estimated impact of the passage of ARRA on the composition of construction workers. The estimate for both white male workers and Latinos indicates that their share of jobs shrank slightly—by 0.7 percentage points—after the passage of ARRA and the increase in OFCCP activities. On the one hand, the small magnitude of these estimates

Table 16.1 Changes in the diversity of construction occupations

Change in % of:	Estimates of the impact of ARRA on construction occupations		Estimates of the impact of ARRA on construction occupations by spending level		
	(1) Impact of 10% fall in construction employment	(2) Impact of ARRA	(3) Impact of 10% fall in construction employment	(4) Impact of ARRA in states that received low levels of ARRA funds	(5) Additional impact of ARRA in states that received high levels of ARRA funds
White males	+1.7%*	-0.7%	+1.6%*	-1.7%	-2.4%*
Females	-0.1%	+0.8%*	-0.3%	+0.3%	+0.6%
African Americans	+0.1%	+0.5%	-0.9%*	+1.0%*	-0.4%
Latinos	-0.7%	-0.7%	-0.6%	+0.2%	+2.8%*

*Notes:*

\* Statistically significant at 0.10 level. See Technical Appendix for regression model coefficients and standard errors.

makes them statistically indistinguishable from zero. On the other hand, their losses appear to be women's (and possibly African Americans') gain.

The passage of the ARRA appears to boost the share of construction jobs held by women +0.8 percentage points.<sup>16</sup> For women, a gain of this size is more than enough to make up for the roughly -0.3 percentage-point estimated loss in construction jobs from the recent downturn. A net gain of this size—+0.5 percentage points—is dramatic for women. This is equal to about a 20 percent improvement in their average share of construction jobs over the entire 1985–2010 period. Black workers also appear to experience a similar gain in their proportion of construction jobs after the ARRA, but this estimate is only suggestive.

Overall then, the ARRA and the associated greater affirmative action coverage and enforcement appears to help women in particular. This change, however, is not large enough to create a measurable impact on white male construction workers who appear to be better protected than other workers from layoffs when construction activity falls. The estimates for the other two groups of workers who could also potentially gain from the passage of the ARRA, blacks and Latinos, are too inconsistent to draw any strong conclusions.

### 16.5.3 Does the Impact of the ARRA Depend on How Much ARRA Funding States Receive?

In this second exercise, I focus on construction workers exclusively and compare the employment trends among workers in states that received a relatively high level of ARRA construction dollars, relative to the size of their March 2009 construction workforce, to trends among workers in all other states.

The basic idea here is that the relative concentration of ARRA dollars should reflect the relative increase in the scope of EO 11246 coverage and application. And, if greater levels of EO 11246 activities more effectively diversify the construction workforce, there should be an observably higher level of impact of the ARRA among such “high-ARRA impact” states.<sup>17</sup> I therefore test whether the *difference* in the proportion of women and minority construction workers in “high ARRA-impact” states before and after the passage of the 2009 ARRA is substantively and statistically *different* from workers in other states. I present the basic results in Table 16.1, columns 3–5.

In line with my earlier findings, the figures in the third column of Table 16.1 suggest that poor labor market conditions erode the share of construction jobs held by women and Latino workers. This time, however, the estimate for black workers indicates that they too experience a faster rate of construction job loss when overall construction employment falls. As before, white male workers are more insulated from these job losses—their share of construction jobs rises by 1.6 percentage points when construction employment falls by 10 percent.

In columns 4 and 5 of Table 16.1, I show the estimated impacts of the ARRA on construction jobs in “low to moderate” ARRA states (row 2) and “high” ARRA states (row 3). There is strong evidence that the proportion of white male construction workers shrinks primarily in states with high ARRA spending levels. Their proportion of construction jobs fell by over 2 percent in these states—enough to offset half the share of construction jobs that these workers can be expected to have preserved for themselves when construction employment fell by roughly 30 percent.

The results for women are less clear. The estimates for female workers suggest that more ARRA spending leads to greater gains in construction jobs for women; however, these estimates are too imprecise to draw strong conclusions.

African American workers, by contrast, appear to gain in construction jobs across all states regardless of the ARRA spending level. But this result only weakly supports the possibility that the ARRA benefited African American workers. On the one hand, a possible explanation for these results is that employers in high ARRA-spending states face a relatively bigger hurdle in getting and training black workers. This is because these states have a smaller proportion of black workers generally (8 percent versus 12 percent), and an even smaller proportion of black construction workers (4 percent versus 7 percent).<sup>18</sup> As a

result, more ARRA dollars produce the same results in high ARRA spending states as in low-to-moderate ARRA spending states. On the other hand, a positive impact across *all* states may just reflect general labor market trends rather than an ARRA policy-specific effect. Recall that this exercise identifies the impact of the ARRA policy by detecting a *greater* impact in high ARRA-impact states compared to low ARRA-impact states.

This is, in fact, what I observe for Latino workers. The figures in Table 16.1 show that among high ARRA-impact states, Latino workers gain nearly 3 percentage points in their share of construction jobs after the ARRA—more than enough to offset their losses caused by the overall decline in construction employment.<sup>19</sup>

## 16.6 CONCLUSION

Recent events linked to the American Recovery and Reinvestment Act of 2009 breathed new life into federal affirmative action policies. By March 2011, \$32 billion ARRA dollars substantially expanded the proportion of construction activities that would fall under EO 11246 affirmative action regulations. Newly appointed Labor Secretary Hilda Solis, who has expressed firm support for affirmative action policies, would oversee the affirmative action enforcement agency, the OFCCP, made stronger by the ARRA. I use this set of events to investigate the effectiveness of federal affirmative action policies.

Overall the evidence reported here links the passage of the ARRA most strongly to reducing the extent to which white men were able to hold onto a disproportionate share of construction jobs in the wake of a dramatically shrinking construction sector. This result is matched by measurable improvements in the representation of women and Latino workers among construction workers. The picture for African American workers is less clear.

Though Latinos are over-represented among construction workers, similar to white men, their gains may not be an affirmative action failure. Similar to women and African Americans, Latinos appear to be more vulnerable to layoffs during downturns in construction employment than their white male counterparts. In effect, Latinos' affirmative action gains reduce their disproportionate share of job loss. Still, a more successful affirmative action policy should result in stronger gains for African Americans in particular.

Two other observations come out of this study. First, black workers, and possibly also women, gain access to white-male-dominated jobs when times are good. This is further evidence that when employers have sufficient incentive to do so—in this case, a growing need for workers—they can and do find women and minority workers to hire. Second, these workers need affirmative action

policies to protect them from *losing* ground when times are bad. The absence of such protections will prevent these workers from making progress over time.

The US economy has clear and pressing needs for continued federal spending on construction activities. Strong affirmative action policies coupled with such spending could represent a rare *opportunity* to increase the diversity of the construction workforce.

## NOTES

1. This chapter benefited from the comments on an earlier draft by Randy Albelda and Thomas Weisskopf.
2. See Heintz et al. (2009).
3. See Pollin et al. (2009).
4. Here and throughout this chapter, “white men” refers to white, non-Latino, men.
5. Leonard (1990).
6. Note that employers establish goals, not rigid quotas. Such quotas are not allowed except when court-ordered as part of a lawsuit.
7. See Department of Labor OFCCP regulations for construction contractors: <http://www.dol.gov/ofccp/TAGuides/consttag.pdf>.
8. Federally-assisted contracts include construction work which is “...paid for in whole or in part with funds obtained from the Government or borrowed on the credit of the Government pursuant to any Federal program involving a grant, contract, loan, insurance or guarantee, or undertaken pursuant to any Federal program involving such grant, contract, loan, insurance or guarantee, or any application of modification thereof approved by the Government for a grant, contract, loan, insurance or guarantee under which the applicant itself participates in the construction work.” (See: [http://edocket.access.gpo.gov/cfr\\_2009/julqtr/41cfr60-1.3.htm](http://edocket.access.gpo.gov/cfr_2009/julqtr/41cfr60-1.3.htm).)
9. For more details, see: <http://www.dol.gov/ofccp/OFCCPRecoveryActPlan.htm>.
10. See US Department of Labor “Budget in Brief” ([www.dol.gov/dol/budget/2010/PDF/bib.pdf](http://www.dol.gov/dol/budget/2010/PDF/bib.pdf)).
11. To focus attention on the years leading up to the ARRA, I show figures for every 5 years between 1985 and 2000, and then for every year thereafter.
12. Could the rule of “last hired, first fired” explain the slower pace of job loss among women and minority construction workers after 2009? This almost certainly contributed to the greater pace of job loss among these groups as construction jobs disappeared from 2006 to 2008. However, the extremely small proportions of the construction workforce taken up by women and African Americans make seniority rules an implausible explanation for why they held onto their jobs better after 2009. Even if only high seniority women and minority workers remained after 2009, one would expect that there would nearly always be a white male worker with at least as much as, if not more, seniority. Therefore, on the basis of seniority rules, any jobs saved after 2009 can be expected to be those held by white males. This seniority explanation is more plausible in the case of Latinos, given their large share of construction jobs. However, the fact that all three groups show signs of improvement after 2009 points to an alternative explanation.
13. However, in the model—discussed in more detail in the Technical Appendix to this chapter—I do allow the demographic measures to change at different rates from changes in construction or production occupation employment.
14. I also allow for construction and production employment growth to affect the changes in the proportion of women (or other group) at different rates. The regression controls include regional shifts in employment, changes in unionization rate, seasonality, and time invariant occupation-group characteristics. See the Technical Appendix for the model and full set of results.
15. Note that they are not over-represented in the top ten highest-paying construction occupations as identified by the DOL’s May 2010 National Occupation Employment and Wage Estimates ([http://www.bls.gov/oes/current/oes\\_nat.htm#47-0000](http://www.bls.gov/oes/current/oes_nat.htm#47-0000)).

16. Interestingly, the magnitude of the 0.8 estimate is in line with those estimated by Beller (1982). Beller's estimates imply that a 10 percent increase in the share of an industry's output going to the federal government would raise the probability that a woman would hold a male-dominated job by 1.7 percent. This is about the same size in the gain in the share of construction occupations that I estimate women gain when the share of public spending in construction rose about 10 percent over 2009 and 2010. To see this, consider that 1.7 percent of employed women is about equal to 0.8 percent of all workers. If these women are distributed across male-dominated occupations in proportion to each occupation's share of total employment, then each occupation would see an increase in their share of women by 0.8 percent.
17. These states include: Maine, Vermont, Rhode Island, Michigan, Minnesota, North Dakota, South Dakota, Arkansas, Montana, Idaho, New Mexico, and Alaska. See Technical Appendix for spending levels.
18. This is not the case with regard to women. Women make up similar proportions of the total workforce (50 percent), and the construction workforce specifically (3 percent), in both high and low ARRA-impact states.
19. In results not presented here, I also tested whether the composition of the top ten highest-paying construction occupations changed with the ARRA by using the same model but changing the dependent variable to the percentage of high-paying construction jobs held by each group. I found no evidence that Latinos made gains, with the ARRA, in these occupations or that white men reduced their share. Sample sizes are insufficient to do the same analysis for women or black workers. I identified the top ten occupations as noted in Note 15. In other words, ARRA appears to have helped diversify mainly the lower-paying occupations.

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## A16.1 TECHNICAL APPENDIX

### A16.1.1 Data

For data on the demographic profile of construction and production occupations I use the Current Population Survey (CPS), 2003-10. ARRA spending-per-state data are published at [www.recovery.gov](http://www.recovery.gov). I used state-level construction employment to adjust state-level ARRA spending for the size of each state's construction sector. Estimates of state-level construction employment for March 2009 are published by the Quarterly Census of Employment and Wages program of the BLS which publishes a quarterly count of employment and wages reported by employers covering 98 percent of US jobs.

### A16.1.2 Model 1

To focus in on occupation-specific changes, I use summary measures of the workforce in each occupational group as my unit of observation. In order for the data to be sensitive to the changes that occurred right before and after the ARRA passed in February 2009, I use bi-annual observations. As a consequence of these two priorities, my level of observation must be aggregated above the state level. Therefore, my sample has a small number of observations (28) which limits the number of controls I can use. I use Leonard (1984b) as a guide for the most essential controls for this type of analysis. Finally, note that my post-ARRA control can be thought of as what Kennedy (1998) refers to as a "period-specific" dummy: There are exactly three "post-ARRA" observations for construction workers and three "post-ARRA" observations for production workers.

The first regression analysis is based on the model:

$$\text{Change in \% of jobs held by women}_{t,o} = a + B1 (\text{Construction Occupation}_o) + B2 (\text{Post-ARRA}_t) + B3 (\text{Construction Occupation}_o) \times (\text{Post-ARRA}_t) + B4 (\% \text{Change in Employment Level}_t) + B5 (\% \text{Change in Employment Level}_t) \times (\text{Construction Occupation}_o) + B6 (\text{Half}_t) + B7 (\text{Change in \% union members}_{t,o}) + B8 (\text{Change in \% of Jobs in the Northeast}_{t,o}) + B9 (\text{Change in \% of Jobs in the Midwest}_{t,o}) + B10 (\text{Change in \% of Jobs in the South}_{t,o}) + e_{t,o}$$

where  $t$  indexes the time period and  $o$  indexes the occupational group. The variables Construction Occupation, Post-ARRA, and Half, are indicator variables. The time period studied is between 2003 and 2010. Each time period is 6 months, January-June (Half =

1) and July–December (Half = 0). Therefore, each year has two observations. Change measures, however, are over 1 year to control for seasonal fluctuations in employment (for example, change from January–June 2003 to January–June 2004). Therefore, the total number of observations in this analysis is 28 (14 biannual observations per occupational group). The indicator variable “Post-ARRA” equals 1 for: July–December 2009, January–June 2010, and July–December 2010. I use linear regression with panel-corrected standard errors to estimate this model and assume panel-specific first-order auto-correlation and heteroskedastic errors.

I estimate this model separately for three other dependent variables: “Change in % of Jobs Held by African Americans,” “Change in % of Jobs Held by Latinos,” and “Change in % of Jobs Held by White (Non-Latino) Men.” The full set of results is presented in Table A16.1.

### A16.1.3 Model 2

The second model is analogous to the first model and is estimated using the same assumptions as above:

$$\text{Change in \% of jobs held by women}_{t,s} = a + B1 (\text{High ARRA}_s) + B2 (\text{Post-ARRA}_t) + B3 (\text{High ARRA}_s) \times (\text{Post-ARRA}_t) + B4 (\% \text{ Change in Employment Level of Construction Occupations}_{t,s}) + B5 (\text{Half}_t) + B6 (\text{Change in \% union members}_{t,s}) + B7 (\text{Change in \% of Const. Jobs in the Northeast}_{t,s}) + B7 (\text{Change in \% of Const. Jobs in the Midwest}_{t,s}) + B7 (\text{Change in \% of Const. Jobs in the South}_{t,s}) + e_{t,s}$$

where  $t$  indexes the time period and  $s$  indexes the ARRA-spending level area. The variables *High ARRA*, *Post-ARRA*, and *Half* are indicator variables. “High” ARRA spending is determined by the total level of ARRA funds received for construction activities in each state through March 2011 divided by each state’s total number of construction jobs as of March 2009 (as published by the BLS QCEW program). The spending level therefore is scaled according to the size of each state’s construction sector at the time that the ARRA began implementation. High ARRA equals one for all states that have an above-average spending level (greater than the 75th percentile). All other states make up the “Other ARRA spending” area. Note that the interquartile range for the spending level in the High-ARRA spending areas is \$10 300–\$16 500. The interquartile range for Low ARRA spending areas is \$4500–\$6300. The total number of observations in this analysis is 28 (14 biannual observations for each of the two ARRA spending level groups).

Table A16.1 Regression results

Independent variables:	Model 1		Model 2	
	Coef- ficient	Std. error	Coef- ficient	Std. error
<b>A. Dependent variable: change in % of jobs held by women</b>				
Construction occupations	0.002	0.002		
% Change in employment	0.072	0.025	0.031	0.020
% Change in employment × Const. occ.	-0.060	0.033		
Post-ARRA	-0.005	0.003	0.003	0.003
Const. Occ. × Post-ARRA	0.008	0.005		
High ARRA			0.000	0.002
High ARRA × Post-ARRA			0.006	0.004
Half	-0.001	0.002	0.000	0.002
Change in % Union	0.059	0.081	-0.042	0.051
Change in % Northeast	-0.239	0.162	-0.027	0.150
Change in % Midwest	-0.006	0.161	-0.023	0.076
Change in % South	-0.105	0.117	-0.127	0.078
Constant	-0.002	0.002	-0.001	0.002
<i>Linear combination of :</i>				
% Change in employment +				
% Change in employment × Const. occ.	0.012	0.025		
<b>B. Dependent variable: change in % of jobs held by African Americans</b>				
Construction occupations	-0.001	0.002		
% Change in employment	0.046	0.028	0.088	0.045
% Change in employment × Const. occ.	-0.057	0.038		
Post-ARRA	0.000	0.003	0.010	0.006
Const. Occ. × Post-ARRA	0.005	0.006		
High ARRA			0.002	0.004
High ARRA × Post-ARRA			-0.004	0.009
Half	0.000	0.003	0.000	0.004
Change in % Union	0.014	0.107	0.062	0.118
Change in % Northeast	-0.541	0.184	-0.046	0.338
Change in % Midwest	-0.208	0.191	0.152	0.177
Change in % South	-0.306	0.140	0.054	0.182
Constant	0.000	0.002	-0.002	0.003
<i>Linear combination of :</i>				
% Change in employment +				
% Change in employment × Const. occ.	-0.011	0.030		

Table A16.1 Regression results, cont.

Independent variables:	Model 1		Model 2	
	Coef- ficient	Std. error	Coef- ficient	Std. error
<b>C. Dependent variable: change in % of jobs held by Latinos</b>				
Construction occupations	0.012	0.004		
% Change in employment	-0.106	0.032	0.057	0.038
% Change in employment × Const. occ.	0.177	0.051		
Post-ARRA	0.004	0.004	0.002	0.008
Const. Occ. × Post-ARRA	-0.007	0.008		
High ARRA			-0.012	0.005
High ARRA × Post-ARRA			0.028	0.010
Half	-0.001	0.003	0.001	0.003
Change in % Union	-0.098	0.134	0.220	0.081
Change in % Northeast	-0.332	0.247	-0.223	0.332
Change in % Midwest	-0.073	0.231	-0.614	0.125
Change in % South	0.013	0.199	0.146	0.135
Constant	-0.001	0.002	0.006	0.004
<i>Linear combination of :</i>				
% Change in employment + % Change in employment × Const. occ.	0.071	0.045		
<b>D. Dependent variable: change in % of jobs held by white men</b>				
Construction occupations	-0.011	0.005		
% Change in employment	-0.020	0.041	-0.161	0.049
% Change in employment × Const. occ.	-0.152	0.063		
Post-ARRA	-0.003	0.005	-0.017	0.008
Const. Occ. × Post-ARRA	-0.007	0.010		
High ARRA			0.010	0.005
High ARRA × Post-ARRA			-0.024	0.013
Half	0.000	0.003	-0.002	0.004
Change in % Union	0.024	0.154	-0.283	0.118
Change in % Northeast	0.175	0.306	0.386	0.417
Change in % Midwest	0.078	0.278	0.748	0.175
Change in % South	0.293	0.236	0.051	0.189
Constant			-0.003	0.004
<i>Linear combination of :</i>				
% Change in employment + % Change in employment × Const. occ.	-0.172	0.055		
<i>Note: N = 28.</i>				

# 17. Comment on Darity, McCrate, and Wicks-Lim

**Randy Albelda**

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Tom Weisskopf's book, *Affirmative Action in the United States and India* (2004), represents an intellectually curious contribution to his body of work. This topic appears as a recent research interest, not totally in-keeping with Weisskopf's previous research agenda, especially the focus on a particular policy. This work also appears at a time when discrimination and affirmative action remedies have seemed to have run their course in US academic and policy circles. Weisskopf's interest in the topic is spurred by his personal connections to the issues: the struggle over AA admissions policies at his own institution (University of Michigan) and his life-long connection with India.

Weisskopf defines the societal goals that positive discrimination policies embody (democracy, harmony, efficiency, and distributive equity) and provides a theoretical model for assessing the outcomes of these policies. He limits his discussion to racial and ethnic underrepresented groups and focuses primarily on preferential education admissions policies. But ultimately this work is an empirical assessment of affirmative action education admissions policies, including the almost impossible task of assigning measurements to assess the achievement of the stated goals.

Weisskopf makes clear that affirmative action policies work best when elites are comfortable with employing them. The trajectory of promotion and proactive legal measures from the 1960s through the 1980s was to be followed by a conservative backlash that has watered down if not undermined these policies. This suggests, coupled with a Social Structures of Accumulation (SSA) framework developed by Weisskopf and various co-authors, that affirmative action can be understood as a tool or mechanism for managing race and gender inequality constructed in the post-World War II labor segmentation SSA, which began to unravel in the late 1970s. Not surprisingly, with slowed growth in the 1980s, affirmative action comes under steady attack.

More recently, affirmative action has been rendered moot by its critics in the supposed age of post-racial and post-gender inequality. Yet is it? Three chapters in this section raise key current issues about affirmative action policies in light of

its relatively narrow but important agenda of integrating the higher echelons of both white and blue collar work in view of historic and continuing discrimination.

Affirmative action policies have often been misunderstood and are often criticized for promoting unfair preferential treatment, hurting the people they are intended to help, and targeting the wrong group. Despite several decades of evidence to disprove most of these mischaracterizations, they persist. Thankfully, William Darity Jr has the intellectual patience to summarize some of the research and address what he politely calls “grumbles.” He takes to task six specific claims made against current affirmative action policies.

The first two grumbles are derived from the most fundamental assertions of neoclassical economics: that only unfettered markets assure efficiency and that they are fair. The imposition of affirmative action therefore violates both, not only reducing growth through lower productivity but also is unfair by allowing some people to get ahead of others. Yet, as Darity points out, life before affirmative action was hardly a meritocracy—indeed it was just the opposite. White males from the right class had no or little competition for the best schools and jobs. The popular television show “*Mad Men*” that depicts the world of men and women working at a 1960s Madison Avenue advertising agency reminds us of that every episode, with single white women relegated to secretarial pools while black men run elevators. Meanwhile, in the suburbs, married white women run their children’s lives while black women clean their houses. The issue of lost productivity is often posed as a counterfactual. But there is strong evidence that discrimination was a heavier burden on growth, and studies of employers’ evaluations repudiate that blacks are less productive than whites.

Darity’s remaining grumbles are also addressed by Weisskopf. Two of these assume that beneficiaries of affirmative action policies are *de facto* unqualified: those who benefit from affirmative action policies are unprepared, and, once hired or enrolled, will in turn be stigmatized as only being there due to affirmative action policies. Darity discusses the testing literature around the racial gap to dismiss the first claim and reminds us that the only reason we have affirmative action policies is precisely because the targeted groups have historically been stigmatized. The last two grumbles are not really mischaracterizations of the policies but rather an indication of just how narrow they are. These grumbles are that only the elite benefit from affirmative action and that what we really need are policies implemented on the basis of class. As Darity points out, to argue that only the top tier of underrepresented groups benefits from affirmative action is to actually understand the policy, not to complain about it.

Elaine McCrate’s essay homes in on hiring discrimination and screening mechanisms for honesty and motivation. Because employers want to hire hard-working (that is, motivated) and honest workers, ferreting out this information among all potential hires is important. McCrate argues that there is plenty of evidence from audit studies and interviews with employers and managers to

demonstrate that employers see black workers as the most likely to lack these attributes, especially in the era of wholesale incarceration of black men. McCrate looks to statistical discrimination theory (SDT) as it has the most to say about screening, even though it typically addresses screening mechanisms for more traditional productivity boosters. In systematic fashion, McCrate disassembles SDT arguments that show how employers' screening mechanisms (interviews and tests) can lead to discriminatory outcomes for equally qualified applicants. Miscommunication in interviews and larger variations in test scores provide cover for hiring whites over blacks. But ultimately these outcomes are inconsistent with SDT. What we are left with is employers' social construction of black applicants—that is, racial stereotyping.

McCrate's focus on screening for honesty and motivation is especially well-placed, as it is increasingly likely to become a key race marker for employers. Recent analysis by Loïc Wacquant (2002) and Michelle Alexander (2010) point to incarceration as shaping the neoliberal/post-racial system of racial segregation and inequality. As criminal background checks become cheaper, more commonplace, and increasingly required for some jobs, they will become another seeming "objective" cog in the racial hiring regime. Understanding the mechanisms and their contradictory nature is important. Interestingly, McCrate points to preliminary evidence that finds black applicants who make it through the criminal offense screening processes are more likely to be hired than whites. This suggests criminal background checks may merely become a tool for employers to discern the "deserving" from the "undeserving" applicants. After all, any black man who has not been locked up must have really been able to keep his hands clean. This is cold comfort for the growing number of black men with criminal records. Weisskopf argues that better screening mechanisms make affirmative action policies more effective, but McCrate suggests that affirmative action hiring policies will likely not be very effective without major penal reform. In this new racial order, one wonders what new forms of struggle and policy implementation positive discrimination might take.

Jeannette Wicks-Lim's essay takes a recent snapshot of affirmative action policies at work through federally funded construction projects. The American Recovery and Reinvestment Act (ARRA) of 2009 provided a large-scale federal infusion of construction money as a time when private funds had been drying up. Further, these funds were distributed under the auspices of a Democratic president whose Department of Labor was one of the few executive offices with appointed leaders that include women and men of color whose careers have focused on promoting racial and gender equality.<sup>1</sup> This combination, Wicks-Lim argues, has the potential to revitalize and make more effective the already-existing sets of affirmative action policies in the United States.

Wicks-Lim is among the first to empirically test whether federal dollar infusions and increased compliance enforcement can work to boost women and

people of color's employment in construction jobs. She provides preliminary empirical evidence that they probably can. She finds that women's meager share of employment was boosted with ARRA funds while her data suggest black workers' gains were modest. Since the early 2000s, Latinos have been over-represented in the construction industry, but Wicks-Lim finds that this group also lost jobs at a faster rate than white male workers during the downturn. But, she finds the infusion of ARRA-funded construction work did slightly improve the Latino worker's share of employment, particularly in states with the largest levels of spending.

As Wicks-Lim's essay demonstrates, because federal funds come with federal strings attached, if those strings are actually "pulled" it is possible to better integrate the construction labor force. This represents an important opening, although one that might be rapidly closing by the virulent deficit reduction drumbeat. If there is to be an increased federal role in rebuilding physical infrastructure and to the degree that current Obama administrators can put implant teeth (dentures won't do as the next administration can too easily remove them) into compliance rules, existing affirmative action policies can work to better increase the share of underrepresented groups into relatively good construction jobs. Would it also be possible to rethink affirmative action policies and the role of the federal government in social or human infrastructure jobs, especially those in the bottom rungs? Federal, state, and local government spending creates and sustains a large number of lower-rung jobs in the health and social support/care-giving service sectors (for example, CNAs, home-health aids, childcare providers who primarily serve low-income children) disproportionately filled by poorly-paid women of color. While affirmative action was not created for jobs in which workers of color or women are overrepresented, there may be useful ways of improving these jobs, such as applying living wage ordinances to federally-funded jobs and forced compliance with federally-mandated employment standards, such as the Fair Labor Standards Act.

Despite claims to the contrary, there is abundant evidence that racial and gender discrimination still exists. Positive discrimination policies still seem warranted. However, promoting and achieving diversity at the top-tier schools and in top-level jobs did not and will not get at the root of today's underlying racial and gender divides. The very high cost of higher education, increased labor polarization, and black incarceration rates have transformed the ways race and gender segregation play out at all levels of the labor market. There may be promise in promoting the increased role and need for federal funding in both the physical and the social infrastructure, though the current push for austerity makes it hard to be hopeful.



## NOTE

1. This includes: Secretary Hilda Solis; Women's Bureau Director Sara Manzano-Diaz; Director of the Office of Federal Contract Compliance Programs Patricia A. Shiu; and Assistant Secretary for Policy William Spriggs.

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# 18. Social justice through affirmative action in India: an assessment

**Ashwini Deshpande<sup>1</sup>**

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## 18.1 INTRODUCTION

Affirmative action has been an important part of Tom Weisskopf's academic concerns: his 2004 book, *Affirmative Action in the United States and India*, is now a standard reference for anyone interested in exploring this question further. Over the years, I have had extensive discussions with him on this subject, and benefited a great deal from his keen insights. Both the papers which we have co-authored have been on affirmative action. It is an honor for me to contribute to this festschrift, as it gives me an opportunity to pay tribute to his exemplary scholarship by exploring this theme, which is close to his heart.

## 18.2 INDIA'S AFFIRMATIVE ACTION PROGRAMME

India's affirmative action (AA) programme is primarily caste-based, although there is some AA for women in the electoral sphere. AA in India, as elsewhere in the world, is contentious for three reasons. First, there is considerable debate over the assessment of caste disparities, the *prima facie* reason for the existence of AA—whether these are significant at all; if yes, to what extent and in which sphere; and whether they have been narrowing over time. Second, there is a larger debate about whether caste is the valid indicator of backwardness or should AA be defined in terms of class/income or other social markers, such as religion. Third, there is the overarching debate about whether AA is desirable at all, in any form, regardless of which social identity is used as its anchor.

In the polarized debate around AA, it is either demonized as the root of all evil or valorized as the panacea for eliminating discrimination. It is worth noting at the outset that Dr B.R. Ambedkar, the chief architect of the constitution of independent India, who ensured that AA was constitutionally mandated,

himself did not see AA as a panacea. He did not believe that the caste system could be made less malignant. He said "...my ideal would be a society based on *Liberty, Equality and Fraternity* ... [the caste system] means a state of slavery ... a society in which some men are forced to accept from others the purposes which control their conduct" (emphasis in the original; Rodrigues, 2002). He was constantly engaged with the question of strategies and instruments which would lead to the annihilation of caste altogether.

However, while the debates around AA are emotionally charged, it is important to take stock of AA dispassionately through an evidence-based approach. Available national data on caste are defined by the needs of the affirmative action programme which divides the population into initially three, and now four, broad groups: Scheduled Castes (ex-untouchable jatis, SC), on average about 18 percent of the Indian population; Scheduled Tribes (ST), on average about 8 percent of the Indian population; Other Backward Classes (OBCs, a heterogeneous collection of Hindu low castes, some non-Hindu communities and some tribes which are not included in the STs), not yet counted by the census; however according to the 66th round of the National Sample Survey (2009–10), these constitute 43 percent of the rural and 39 percent of the urban population and "Others" (the residual; everyone else).<sup>2</sup> Given that data do not allow us to isolate the upper castes, it needs to be emphasized at the outset that calculations based on this categorization will underestimate the disparity between the two ends of the jati spectrum. While the term Scheduled Castes is a product of this official terminology, several members of the ex-untouchable jatis prefer to self-identify themselves as "Dalit"—the originally Sanskrit but now Marathi term, meaning "oppressed" or "broken", which is used as a term of pride.

### 18.3 THE CASE FOR CASTE-BASED AFFIRMATIVE ACTION IN INDIA

The idea of preferential treatment for caste and tribal groups perceived to be the lowest in the social and economic hierarchy predates Indian independence. The constitution of newly independent India continued the idea of preferential policies, declared untouchability illegal and espoused the ideal of a casteless society. This section discusses the (contemporary) rationale for affirmative action towards designated castes and tribes. In other words, given that this policy originated in the early twentieth century, the arguments in favour of AA are not restated as they originated, but are being reiterated with contemporary evidence.

### **18.3.1 Systematic Inter-Caste Disparities**

Data from a variety of sources on material standards of living, poverty rates, health status, educational attainment and occupational outcomes indicate that the disparities between SC-ST on the one hand and non-OBC Others (a loose proxy for upper castes) are persistent and systematic, regional variation notwithstanding (see for instance Deshpande, 2011; and Thorat and Newman, 2010).

### **18.3.2 Social Discrimination**

There is sufficient evidence that amply demonstrates the various aspects of stigmatization, exclusion and rejection that Dalits continue to face in contemporary India.<sup>3</sup> In rural India, despite the breakdown of the traditional subsistence economy, caste continues to exert its strong presence in many different dimensions. Shah et al. (2006) document untouchability in rural India based on the results of an extensive survey carried out over 2001–2002 of 565 villages across 11 states. They find that untouchability is not only present all over rural India, but it has “survived by adapting to new socio-economic realities and taking on new and insidious forms”. Navsarjan Trust (2010) is the latest comprehensive study of untouchability in 1589 villages in Gujarat. It documents 98 types of untouchability practices directed towards Dalits by non-Dalits—for instance, tea stalls keeping separate cups for Dalit customers which they have to wash themselves, not buying milk or vegetables from Dalit vendors, making Dalit children sit separately and at the back of the classroom in schools and so on. While the flouting of caste norms for marriage is not very widespread, the worst social punishments are reserved for the alliance between a Dalit man and an upper caste woman. Urban India might have fewer overt instances of untouchability, but for a practice which has been outlawed for over 6 decades, it is remarkably resilient and continues to exist in various forms.

### **18.3.3 Economic Discrimination**

Average wages for SCs and Others differ across all occupation categories, and there are a number of decomposition exercises which divide the average wage gap into explained and discriminatory components (for instance, Madheswaran and Attewell, 2007). The fact that the two groups enter the labour market with substantial differences in education levels indicates pre-market discrimination. There is plenty of evidence which documents the substantial gaps between SCs and Others in access to education, quality of education, access to resources that could enhance learning, and also of active discrimination inside schools by teachers (Nambissan, 2010). Such pre-market discrimination insures that out-

comes will necessarily be unequal, even if there were no active labour market discrimination.

The evidence on persistence of caste-based economic discrimination in rural areas is perhaps not as surprising as the evidence from urban areas, especially in the modern, formal sector jobs. In rural areas individuals are more easily identified by their caste status and presumably are more inclined to pursue caste-based occupations given the correspondingly lower spread of the modern, formal economy. Caste is supposed to be anonymous in urban settings; identification of caste is difficult, since it is not phenotypically ascriptive. Additionally, urban markets are supposed to respond to “merit” and so even if, hypothetically, caste could be identified, it should not matter.

In the first major correspondence study in India, Thorat and Attewell (2007) sent out exactly identical resumes to private companies, both domestic and MNCs, in response to newspaper advertisements in New Delhi during 2005–2006. The only difference in the resumes were the easily identifiable names of applicants: Hindu upper caste, Hindu Dalit and Muslims. The study revealed significant differences in call-backs between Hindu upper castes and the other two categories. These findings are confirmed by Siddique (2009) in a study of Chennai. She additionally tests for the interaction between caste and gender and finds that the lowest call-backs are received by Dalit women.

There are studies of hiring practices which emphasize the role of networks and that of informal and personalized recruitment, where “who you know” is often more important than “what you know”. In a college-to-work study, which tried to uncover the exact pathways through which discrimination manifests itself, Deshpande and Newman (2007) tracked a group of students from the three premier Indian universities in Delhi for 2 years trying to understand what jobs they got, how they got them and what their interview experiences were. It turned out that employers were extremely conscious of the social identity of the applicant, all the while professing deep allegiance only to the “merit” of the candidate. Jodhka and Newman (2007), in an employer attitude survey, found that employers, including MNCs, universally use the language of merit. However, managers are blind to the unequal playing field which produces “merit”. Commitment to merit is voiced alongside convictions that merit is distributed by caste and region.

In view of the unambiguous evidence on discrimination, AA becomes essential to guarantee representation to Dalits in preferred positions. It should be noted, however, that AA in India, due to the specific forms it takes, is not a complete remedy for discrimination, if not for any other reason than the fact that AA is applicable only to the public sector, whereas the evidence of discrimination is overwhelmingly from the private sector, which is becoming increasingly important in the Indian economy.

### **18.3.4 Compensation for Historical Wrongs**

Finally, social policy ought to compensate for the historical wrongs of a system that generated systematic disparity between caste groups and actively kept untouchables at the very bottom of the social and economic order. This argument has been used forcefully in certain international contexts (for instance, in Australia for the “stolen generation” and in South Africa for the injustice to Blacks during Apartheid).

However, given the complex and long history of the Indian sub-continent, the use of this argument in the context of caste-based oppression and untouchability has to proceed with extreme caution, as several right-wing outfits would like to extend this argument to other arenas by invoking completely unsubstantiated, often manufactured injustices against the so-called indigenous inhabitants, and ask for compensation for historical wrongs. For a region marked by large waves of migration over centuries, it is not clear who the original inhabitants of the region are. Thus, the definition of historical “wrongs” is a site marked by bitter contestation, and, therefore, the question of compensation is a fraught one. Coming to the gross violations against particular castes resulting from centuries of untouchability, the argument of compensation for historical wrongs could be, and has been, used as one of the elements in the case for AA. However, the case for AA as a compensation for contemporary exclusion is just as strong, even if one did not view it as necessary to remedy historical exclusion.

## **18.4 IMPLEMENTATION OF QUOTAS**

Overall, the implementation of SC-ST quotas has improved in all spheres, but, despite safeguards, it remains uneven. Given that there is no formal systematic monitoring of the implementation of quotas, they remain subject to the vagaries of political will and an overall lackadaisical attitude.

### **18.4.1 Implementation of Quotas in Government Jobs**

In the topmost categories of officers, Group A or Class I jobs, between 1964 and 1984, the share of SCs increased from 1.6 to only 7 percent. However, the 1994 to 2004 phase saw a sharper increase, such that, in 2004, their share was 12.2 percent. (The corresponding shares for STs are 0.3 and 1.7, which went to 4.1 in 2004, as against a population share of around 7 percent.) Sheth (2004) argues that this reflects the aftermath of the Mandal Commission—the government-established Commission tasked to address caste discrimination—which created the space for a greater assertion of Dalit or low caste activism. One consequence

of these activities was better implementation of quotas. Interestingly, in 2004, only 4 percent of Group A officers were OBCs, which is the same proportion as the STs.<sup>4</sup>

Before the 1990s, for years, quotas remained unfulfilled, for reasons of “indifference/hostility on the part of the appointing authorities, insufficient publication of vacancies and the sheer expense of application” (Galanter, 1984). At the higher levels or promotion stages, formal and informal procedures had operated to keep out the SCs, such as ad hoc and temporary positions, elimination through personal evaluation procedures like interviews, personality tests and unfair adverse entries in confidential records (Guhan, 2001, p. 213).

As one goes down the hierarchy, the representation of SC-ST increases, with as many as 80 percent of cleaners being SC in 2007. Overall, the Group D category has always had more SCs than their share in the population, even excluding sweepers. This suggests that within government, all the low-paid and low-skill jobs are dominated by SCs. In all the opposition to affirmative action, there is never any protest against *over-representation* of low castes in low paying jobs. In other words, as long as Dalits don’t compete in traditional upper caste bastions or “stay where they belong”, it is obviously considered acceptable.

#### 18.4.2 Implementation of Quotas in Higher Education

Access to education by caste can be, and has been, analysed at various levels—literacy rates, quality of education, primary- to middle-school transition and evidence of discrimination inside schools. From the strict point of view of implementation of AA, however, we need to focus on a few key statistics, while recognising that the problem of equitable access and representation across caste groups in the sphere of education is far too large and complex to be captured through these few numbers.

Overall, the Gross Enrolment Ratio (GER) for higher education, which has risen from 0.7 percent in 1950–51, to 1.4 percent in 1960–61, and to 8 percent in early 2000, is still very low (about 10 percent) compared to the world average of 23.2 percent, and an average of 54.6 percent for developed countries, 36.3 percent for countries in transition, and 11.3 percent for developing countries. The existing Enrolment of Eligible Ratio (EER) of roughly 60 percent indicates that 40 percent of students who complete their higher secondary programmes do not go in for higher education.

Within this picture of low overall GER, there is substantial variation by caste and gender, and for both categories, there is substantial regional variation. Thus, data from NSS for 2004–2005 reveals that only 9.7 percent of rural SC men and 3.5 percent of rural SC women in the age group 20–24 are enrolled in higher educational institutions, as compared to 14.9 and 6 percent of rural Other men and women respectively. The corresponding figures for rural STs are 8.6

and 5.2; for OBCs, the figures are 11 and 4.1 respectively (Sahoo, 2009). The major faultlines across which we see marked differences in enrolment rates are rural-urban: in all caste groups, urban participation rates are consistently higher than rural and gaps have widened over time; by gender, in all the caste groups, men have greater representation in higher education than women; and by age groups, across all caste groups, access at the undergraduate level is significantly higher than at the post-graduate level.

### 18.4.3 Political Reservations

The one arena in which quotas have been implemented completely is the sphere of political reservations. In principle, SC and ST candidates are free to contest other, non-reserved seats. However, since the first general elections in 1952, SC-ST elected representatives have virtually no presence in these two elected bodies outside of the reserved seats. This suggests that, if reservations had not been in existence, the probability that these groups would have the representation they currently have would be very low. If the presence of SC-ST legislators and MPs is taken as a measure of political clout, then there is no evidence of an *increase* in their political clout. If anything, there is a marginal decline: in 1952, SCs won 76 seats in the Lok Sabha, against the 72 seats reserved for them, which means they won 4 non-reserved seats. In 2004, SCs won only the 79 seats reserved for them, and none from the non-reserved seats. For STs, the picture is fairly similar; the only election where they won on more seats than were reserved for them was in 1998 (won 49 as against 41 reserved). In 2004, they won only the 41 reserved seats (Sahoo, 2009, p. 88).

The picture in the local bodies is different, underscoring the importance of introducing reservations at this level in 1993, which have managed to achieve a radical transformation in political representation of the marginalized groups. In the early 1960s, when there were no reservations, local bodies in West Bengal with a total of 1081 members contained only 41 SC members (3.8 percent) and 16 ST members (1.5 percent). Among the 66 presidents and chairmen, there were 3 SC members and 1 ST. This was at a time when 19.84 percent of the population of West Bengal was SC, and 5.91 percent was ST. Similarly, in Gujarat, only 35 (0.5 percent) of the 6863 sarpanches (elected heads of village councils) were SC (Galanter, 1984, pp. 50–51).

Reservations in local bodies has increased substantially the SC-ST presence in lower levels of governance, often going beyond the mandated reservations. For instance, in Orissa, Chhatisgarh, Madhya Pradesh and Rajasthan, SCs/STs have between 30 and 40 percent representation at the gram panchayat (village council) level. Even at the level of the district panchayats (council), there are 14 percent SCs and 9 percent STs, which together are marginally greater than their share in the population (Sahoo, 2009, p. 88).



#### **18.4.4 Political Representation of OBCs**

OBCs have no political reservations at the national level, although some state governments (for example, Uttar Pradesh, Karnataka and Tamil Nadu) have reserved seats for OBCs at the level of local self-government. Unlike in the case of SC-ST, very little hard data exists on the proportion of elected representatives who are OBCs at the various levels of government. However, the big difference between SC-STs and OBCs is that the last 2 decades have seen a visible increase in the political clout of OBC politicians and political formations, not uniformly across all regions of India but in a large enough number of pockets. Jafferlot (2003) terms the political ascendancy of the OBCs as the “silent revolution”. The rise of the OBCs as a potent political force, dominating a whole spectrum of political parties, has, in the main, happened without reservations, again suggesting that the stigma of their untouchable status imparts a particular disadvantage to the SCs, which includes, but goes beyond, the economic and social marginalization which the OBCs face.

### **18.5 DEBATES OVER AFFIRMATIVE ACTION**

Quotas are seen widely as unfair, and are condemned for punishing innocent upper castes for the damage done in the past, reinforcing caste lines rather than striving for a caste-free society, and for exempting Dalits from the rigours of market competition. Critics argue that reservations replace one form of discrimination (against Dalits) with another, equally pernicious form (against general category students or workers). There is a view, especially among the upper castes, that they are benefiting a generation whose parents have already moved up in the social structure and have been able to give them benefits denied to other, much poorer and more remote young people. There is also a belief that unqualified students are displacing highly qualified students in the race to the top of the educational heap. Many who share this view argue strenuously that the application of reservations will destroy the competitiveness of the Indian economy and drive away foreign investors because of the privileges insured by reservation. Hence they fuse personal exclusion with a national downfall in the making.

Broadly speaking, Dalits find these perspectives unconvincing. They instead argue that the most powerful special privileges actually accrue to high caste Hindus who can tap into exclusive social networks, bank on the cultural capital their families bequeath to them, or pay the bribes that are demanded by employers for access to jobs. Dalits from remote areas see themselves as doubly disadvantaged, by caste bias and by poverty. They struggle out of rural

areas burdened by social isolation, ill equipped in terms of cultural capital to navigate an urban megalopolis like Delhi, and lacking the social networks that more privileged castes rely on.

Quotas in higher education not only enable the ascent of Dalits in the university world, they literally enable them to “open their mouths”, meaning speak their minds and “go to the centre of society”, where they can “meet other people ... and get a platform” (Deshpande and Newman, 2007). Introducing them to another world and a different future breaks the silence imposed by marginality, caste prejudice (enforced by atrocities—targeted violence against Dalits, such as beating, rape of Dalit women, destruction of their assets, murder and so on, especially in rural areas) and poverty.

For Dalit students, the reservations policy is nothing more than a form of social engineering designed to address centuries of oppression and discrimination, extreme inequities in the distribution of educational opportunity, and the formation of a huge class of Indian citizens who are not equipped to compete without this assistance. These are not matters of history. Dalits cite countless examples from their own experience where they have been interrogated about their caste identities, castigated by prospective employers for their support of reservations, subjected to harassment or disrespect, and denied jobs (as far as they know) solely on account of their caste background. As long as this injustice persists, they argue, reservations will be needed. The policy levels the playing field at the vital choke points of social mobility.

It would be incorrect to portray all upper-castes as unanimously against reservations. There are upper castes, both in universities and outside, for whom equality is a high principle and the barriers to achieving it for historically oppressed peoples clear enough. They embrace the purpose of reservation and see in it the possibilities of upward mobility. Among these supporters, there are differences of opinion nonetheless about the effectiveness of reservations for some of the same reasons that critics voice: lower castes' high dropout rates. The lesson to be learned for these more progressive voices, though, is not to abandon reservations, but to redouble efforts to address educational inequality at much younger ages. Without a massive commitment to improving primary school education, they argue, we cannot really expect reservations to succeed. If not for reasons of equity, then for reasons of efficiency, differential investment is required.

## 18.6 ASSESSMENT OF THE AFFIRMATIVE ACTION PROGRAMME

### 18.6.1 Matters of Merit

The most common criticism of the AA measures is that they go against the consideration of merit and efficiency by allowing candidates access to preferred positions in higher education and public sector jobs that they would otherwise not have access to. The latter part of this statement is obvious—quotas are meant precisely for that. The first part of the statement can actually be verified empirically, and indeed many such empirical studies exist in the US context. However, until recently, there was a surprising dearth of detailed empirical studies on India, and the debate proceeded more on the basis of pre-conceived beliefs, rather than on the basis of hard evidence.

It should be noted as a general point, though, that the discussion on merit is conducted as if merit is a neutral, objective characteristic, independent of the standard used to measure it, similar to height or weight or the number of teeth. Consequently, exam scores are a relatively uncontroversial instrument for allocating scarce seats in institutions of higher education. The reality is that “merit” is extremely hard to measure in a standardized way, and examination results, while widely used as a proxy for merit, may not be the best gauge. Whether every percentage difference in exam scores reflects a qualitative difference in “merit” is a moot point.

Finally, the debate over lower entry scores for SC-ST misses the value added from being admitted to a prestigious institution of learning. The focus on drop-outs of quota students detracts from the success stories—those who successfully complete their programme. Bowen and Bok (1998) document the long-term positive impact of AA on the lives of beneficiaries who successfully graduate from elite universities in the United States, even if they do so with grades lower than their white counterparts. For successful blacks, the transformation in their life chances because of AA is tremendous and the benefits go beyond the final grade they obtained at graduation.

Before the more rigorous empirical studies came into existence, Galanter (1984) had undertaken a rough but comprehensive assessment of the AA programme in India. His main conclusions can be summarized as follows:

- The programme has shown substantial redistributive effects in that access to education and jobs is spread wider in the caste spectrum than previously, although redistribution is uneven throughout the beneficiary groups. There is evidence of clustering, but Galanter believes that these reflect structural

factors, since the better-situated enjoy a disproportionate share of the benefits in any government program, not just in affirmative action programs.

- The vast majority of Dalits are not directly affected by affirmative action, but reserved jobs bring a manifold increase in the number of families liberated from subservient roles.
- In the short run, beneficiaries might get singled out and experience social rejection in offices, college hostels<sup>5</sup> and other set-ups where they are introduced through affirmative action. However, in the long run, education and jobs weaken the stigmatizing association of Dalits with ignorance and incompetence. Moreover, “resentment of preferences may magnify hostility to these groups, but rejection of them exists independently of affirmative action programmes”.
- Reserved seats do provide representation to SC-ST in legislative bodies, but that may not get reflected in enhanced, targeted policies towards these groups for several reasons. First, these candidates are elected by a common electorate and hence SC-ST candidates have to appeal to a wider, multi-group electoral constituency, and tailor programmes accordingly. Second, these candidates typically belong to political parties which have a larger agenda than that of Dalit empowerment, which their elected representatives, including Dalits, have to reflect.
- Affirmative action has kept the beneficiary groups and their problems visible to the educated public, but it has not motivated widespread concern for their inclusion beyond what is mandated by government policy.

Thus, Galanter concludes that affirmative action has been a partial but costly success. It has accelerated the growth of a middle class, and SC/ST members have been brought into central roles considered unimaginable a few decades ago.<sup>6</sup>

Corbridge (2000) gathered a wealth of quantitative and qualitative data over the 1980s and 1990s from the Jharkhand region of South Bihar in order to assess the impact of reservations on the tribals of that region. He finds that the reservation system has benefited mainly the tribal elite, which had formed over the 1940s and 1950s via jobs in the mines, who are mostly men and residing in urban areas. However, the capture of reserved jobs by middle class STs has not been so pervasive that less affluent tribals have no hope of landing a reserved job. In fact, in his study, almost half the jobs available seem to be going to less affluent tribal men (and some women). The reservation system has served to expand the size of the tribal middle class, as well as served to enhance the consciousness of tribals about their rights and about asking for compensation from the authorities.

## 18.7 EMPIRICAL ASSESSMENTS OF AA

### 18.7.1 Productivity Impact of Affirmative Action

In the first empirical study of the effects of AA in the labour market, Deshpande and Weisskopf (2011) focused on the Indian Railways to assess whether AA—that is, the presence of SC-ST employees who have gained entry through quotas—has impacted productivity negatively. Analysing an extensive dataset on the operations of one of the largest employers in the public sector in India, the study found no evidence whatsoever to support the claim of critics of affirmative action that increasing the proportion of SC and ST employees will adversely impact productivity or productivity growth. On the contrary, some of the results suggest that the proportion of SC and ST employees in the upper (A and B) job categories is positively associated with productivity and productivity growth.

The finding of such positive associations in the case of A and B jobs is especially relevant to debates about the effects of AA on behalf of members of SC and ST communities, for two reasons. First, the impact of AA on productivity is likely to be much more affected by the efficacy with which high-level managerial and decisionmaking jobs are carried out than the efficacy with which lower-level semi-skilled and unskilled jobs are fulfilled. Thus, critics of reservations are likely to be, and indeed are, much more concerned about the potentially adverse effects of reservations at the highest decisionmaking levels than at the lower levels. Second, it is precisely in the A and B jobs—far more than in the C and D jobs—that the proportions of SC-ST employees would not have risen had it not been for quotas.

It was beyond the scope of this study to explain just how and why AA in the labour market may have such a favourable effect. However, the answer may be found in one or more of the following suggestions that others have advanced to explain such a finding. Individuals from marginalized groups may well display especially high levels of work motivation when they succeed in attaining decisionmaking and managerial positions, because of the fact that they have reached these positions in the face of claims that they are not sufficiently capable—in consequence of which they may have a strong desire to prove their detractors wrong. Or individuals from marginalized groups may simply believe that they have to work doubly hard to prove that they are just as good as their peers. Having greater numbers of SC and ST managers and professionals working in high-level A and B positions in the Indian Railways might also serve to increase productivity because their community backgrounds make them more effective in supervising and motivating SC and ST workers in C and D jobs.<sup>7</sup> Finally, improvements in organizational productivity may well result from the greater diversity of perspectives and talents made possible by the integration of members of previously marginalized groups into high-level decisionmaking teams.<sup>8</sup>

### **18.7.2 Assessing Affirmative Action in Higher Education**

All available evidence indicates that a large majority of SC-ST candidates owe their presence in institutions of higher education to reservation policies. While empirical studies on effects of AA in higher education are very few, due to lack of data, the few studies that exist point towards the fact that SC-ST students find it hard to succeed in competitive entrance examinations due to past handicaps (lack of good quality schooling, lack of access to special tutorial or coaching centres that prepare candidates for open competitive examinations and so forth).

Evidence presented in Weisskopf (2004) suggests that at least half the seats reserved for SCs and at least two-thirds of the seats reserved for STs remain unfilled, if all institutions of higher education are considered together. He argues that this is because of “wastage” (dropping out) as well as “stagnation” (repeating courses because of failure or attendance gaps) at prior levels of education. While these are very serious problems, the real pity is that a mechanical approach to the issue of AA means that no effort is made to understand the basic underlying factors that cause dropouts and stagnation (which are discrimination and deprivation and lack of access to good-quality education at prior levels), and thus no serious efforts are made to remedy them. Since the overwhelming opinion remains anti-AA, the larger the proportion of dropouts, the more it “proves” the contention of the anti-AA opinion—that quotas are costly and useless. As a matter of fact, there are specific remedial measures that could be applied to address these problems: bridge courses, special courses in mathematics and English (the two areas with the maximum gaps between SCs and Others) and so forth. The University Grants Commission, a government body designed to regulate higher education, has special funds allocated for such remedial measures, but these funds remain unutilized for the most part, both because of lack of awareness about their existence and, more fundamentally, because of a lack of serious will to make the AA programme succeed. Given that there is no monitoring and no penalties for lackadaisical implementation, institutions can turn a blind eye to the issue of unfilled quota seats.

Desai and Kulkarni (2008) examine AA in higher education by focusing on outcomes. In particular, they examine the question of whether educational inequalities between SCs and STs on the one hand and upper caste Hindus on the other have reduced, by using data from successive NSS rounds between 1983 and 2000. They calculate “transition probabilities” across six levels of education (probability of making a transition from primary to middle school, from middle to high school, and so forth). Their study is rich in its detail and its bottom line is clear. The educational inequalities between SC-STs on the one hand, and upper caste Hindus on the other hand, have declined significantly at the primary education stage. For the middle- and high-school levels there is a decline too, but it is unremarkable. At the college levels, the inequalities between

ST men and upper caste Hindus have declined, but for ST women, SC men and SC women, the inequalities have increased.

They attribute these declines to AA. This is suggested by the fact that a similar decline is not seen for Muslims, who suffer similar disadvantages as the Dalits, but do not get any preferential treatment. The authors suggest that the decline in inequalities at the primary level might be due to AA in employment. However, in college education, where AA is directly applicable, they find that inequalities have actually widened, which puts a question mark on the efficacy of AA. Also, they find that after accounting for income and residence, SCs experience greater disadvantage in college education than did STs. The reasons for AA in higher education not being able to successfully narrow these gaps is a cause for concern, but the gaps would, in all likelihood, have been even larger in the absence of AA.

The “mismatch hypothesis” suggests that AA actually harms targeted students by placing them in programmes for which they are academically unsuited and results in the higher dropout rate among reserved category students. To date, only three substantive quantitative studies gauge the impact of AA in higher education by focusing on this mismatch hypothesis.

The first study, by Bertrand et al. (2008), focuses on individuals applying to an engineering college, via a competitive entrance examination, in one Indian state in 1996. Engineering colleges are among the most prestigious educational institutions in India. The authors first took a census of all students applying to this engineering college and found that the qualifying scores for admission were roughly 480 out of a possible 900 for upper caste individuals, 419 for OBC and 182 for SC. These score disparities provide elementary support for the hypothesis that lower-caste students would not be able to perform, and will not benefit from AA because of the mismatch between their basic skill levels and the skill requirements of engineering education. This could lead to wastage and dropouts. To better understand the outcomes across caste groups, the authors then interviewed about 700 households from the census of all applicants between 2004 and 2006 (approximately 8–10 years after the entrance examination). They surveyed both the applicant and their parents to gauge life outcomes including income and occupation, job satisfaction, social networks and caste identity.

Contrary to popular belief, they find that caste-based targeting results in the targeting of economically disadvantaged individuals: the parental income of upper-caste students displaced by AA is Rs. 14 088, compared to Rs. 8340 among displacing lower-caste students. They also find that despite much lower basic skills (as measured by scores on the entrance exam), those who are admitted through AA economically benefit from attending engineering college. They estimate that attending engineering college increases lower-caste members’ monthly income between Rs. 3700 and Rs. 6200. This corresponds to an increase

of 40 to 70 percent. In other words, they find no evidence of the “mismatch hypothesis”. In addition to improving earning potential, they find that AA could also increase access to more satisfying careers, measured in terms of job quality and satisfaction. These two findings (of higher earnings and better job quality) resonate with the findings contained in Bowen and Bok’s (1998) seminal study of the long-term benefits of AA. However, Bertrand et al. also find evidence of the “creamy layer” as well as a gender imbalance within those who benefit from AA, much like the Corbridge study described above. Specifically, they find that those from higher socio-economic backgrounds, and men more than women *within* the lower-caste groups, benefit more.

The second empirical study of the mismatch hypothesis is by Bagde et al. (2011), who analyse data from 214 engineering colleges in one state in India. They have data on student performance on the entrance examination as well as on the high school completion examination. The scores on the high-school leaving examinations and on entrance tests reflect a gradation based on caste: the average scores of STs are the worst, SCs next, followed by backward castes and, finally, the best scores are obtained by the general category students.

This study finds that AA increases college attendance with effects that are proportionately the greatest for members of the most disadvantaged castes. Similarly, it finds that improved priority in college selection improves achievement (measured by scores on a comprehensive examination administered after the first year of the programme), with proportionately greater effects among the more disadvantaged castes. Finally, it finds that the ability to choose a better college because of preferential treatment results in improved academic performance in college. Thus, it finds no evidence of a mismatch—that is, of quotas *harming* intended beneficiaries.

The third study, which is the most recent one (Robles and Krishna, 2012), contrary to these findings, suggests that in highly technical courses, Dalits do not catch up with the non-Dalit students in terms of grades—in other words, they start with lower grades and graduate with lower grades. They measure mismatch by post-college earnings and find that SC students who enroll in more selective majors through preferential policies end up earning less than what they would have earned if they had enrolled in less selective majors. Thus, their results are not directly comparable to the other two studies as mismatch is defined differently. However, the study finds, like the previous studies, that AA targets the population it is designed for: the targeted students are poorer than the average displaced students. Given the larger benefits associated with AA, if the targeting is accurate, then admission to prestigious courses would alter the lives of those who get in through AA despite a gap in the graduating grades between SCs and non-SCs.



### **18.7.3 Impact of Political Reservations**

Pande (2003) examines whether reservation in state legislatures for disadvantaged groups increases their political influence. She finds that political reservations increase transfers (such as welfare expenditure in the state plan) towards groups that are targeted by reservations. Thus, reservation for SCs and STs does provide them with policy influence. Similar conclusions at the village level are seen in a study by Besley et al. (2004), which finds that the availability of public goods for SC-ST households increases significantly if the constituency is reserved, compared to non-reserved constituencies.

Chattopadhyay and Duflo (2004) studied the consequences of mandated representation for women in gram panchayats (GPs) by conducting a detailed survey of all investments in local public goods in a sample of villages in two districts, Birbhum in West Bengal and Udaipur in Rajasthan, and compared investments made in reserved and unreserved GPs (that is, a reserved GP is one that is headed by a woman due to reservations). They find that reservations affect policy decisions in that women's preferences are better represented. This provides strong empirical support to the logic which led to political reservations in the first place.

Jafferlot (2003), in discussing the political rise of low castes in North India, highlights some tensions inherent in what he terms the "silent revolution"—the transfer of power, peacefully, from upper caste elites to various subaltern groups. While his analysis is mainly about the OBCs, the issues he raises have a broader applicability, and the constraints faced by the OBCs would be faced even more strongly by the Dalits, given their traditional subordinate position.

First, he argues that such a transfer of power, in other contexts, would be accompanied by violence. The reason this is peaceful in India, by and large—violent episodes notwithstanding (such as during the Mandal agitation)—is due to the fact that the transfer is incremental. To a large extent, upper castes still hold the reins to power and OBCs (and in some cases, Dalits) form the second rung of leadership. Given the educational and social backwardness of the latter two, they will not be able to dislodge the upper castes for a long time.

He also points out the tremendous unevenness in the rise of low caste politicians—in Uttar Pradesh and Bihar, one sees a much more pronounced rise than in Rajasthan, for instance. Also, the conflict or the transfer of power is not clear-cut; most political parties are not organized solely on upper-caste or lower-caste lines—all, including the Dalit-dominated Bahujan Samaj Party (BSP), have upper caste members. He also suggests that liberalization of the economy has opened up new arenas and opportunities for upper castes, that are more lucrative than government jobs, and thus, they might not regret their traditional hold over bureaucracy being challenged.<sup>9</sup> Such jobs include management jobs in the private corporate sector.

Finally, he suggests that the rise of the lower castes is not linear and irreversible. There is no clear-cut unity among lower caste parties or individuals, made more complicated by the fact that OBCs and SCs are often at odds, given their conflicting class interests (witness the antagonism between the BSP and the Samajwadi Party in Uttar Pradesh).

Keeping this larger picture in mind helps us to understand a critical reality about political reservations: that they will help to increase representation and access of traditionally marginalized groups such as low castes and women. However, the translation of this increased representation into real power is bound to be a long journey, which traverses an uneven, non-linear and rocky road.

## 18.8 RETHINKING AFFIRMATIVE ACTION AS A “QUOTAS PLUS” POLICY

In order to increase its efficacy, AA has to be less mechanical: provision of quotas should be seen as the beginning of AA, not the end, as is the current practice. A big problem with the existing nature of implementation is that there is no monitoring, and there are no penalties for evading AA. Thus, the mere announcement of quotas is seen as sufficient, and very little attention is paid to outcomes.

Further, just providing entry into jobs or educational institutions is not sufficient. There have to be supplementary measures that need to be mandatorily incorporated: remedial teaching, counselling and other measures to lower the incidence of dropouts; skill-enhancing programmes and so forth, which would ensure that the benefits of entry into prestigious jobs and educational programmes are fully utilized.

To be effective, AA should contain self-liquidating and self-perpetuating features: as AA becomes stronger at entry level, it should be gradually lowered at the later stages. But for this, strict monitoring of outcomes, with penalties for non-compliance, are essential. The idea of abolishing quotas can meaningfully be mooted only after they have been implemented in their entirety and have been in place for at least a decade (to follow Ambedkar’s original timeline).

Finally, “outside the box” measures targeted towards Dalits and Adivasis (tribals) must be considered that go beyond the scope of the current AA programme: free, compulsory and good-quality primary education, vigorous expansion of non-farm employment, land reforms wherever feasible, subsidies/support for Dalit business/self-employment. All these will benefit a much larger section of Dalits than the current AA programme.

The important thing to note is that the existing AA programme and these supplementary measures need not be considered mutually exclusive. They can

strengthen and reinforce each other. Admittedly, all these measures have costs, but the benefits of integrating large sections of nearly 160 million Dalits and unleashing the suppressed reservoir of talent is the need of the hour for the rapidly growing Indian economy.

## NOTES

1. Department of Economics, Delhi School of Economics, University of Delhi, Delhi 110007, India. E-mail: ashwini@econdse.org. This chapter is based on the monograph, *Affirmative Action in India* (forthcoming 2013), part of the “Oxford India Short Introductions” series, New Delhi: Oxford University Press.
2. The affirmative action programme in India consists of 22.5 percent quotas in government educational institutions, government jobs and in all levels of elected bodies for SCs and STs. In addition, since 1990, following the implementation of the Mandal Commission Report, there are 27 percent quotas for OBCs in jobs, which in 2006, via the 93rd constitutional amendment, were extended to educational institutions. There are no quotas for OBCs in the electoral sphere. Finally, 33 percent seats are reserved for women in elected local bodies below the level of the state legislature.
3. See, for example, Human Rights Watch (1999) for an excellent documentation.
4. As noted earlier, the Indian Census does not collect data on OBCs specifically. Other survey data indicate that OBCs made up roughly 40 percent of the overall population.
5. There is no explicit affirmative action in college hostels (dormitories); affirmative action in colleges leads to entry of SC-ST students in college hostels.
6. However, even this crude calculation will not work for assessing OBC reservations because, first, OBC quota is much more recent, and, second, OBCs are not stigmatized in the same way as SCs because their traditional occupations do not put them in humiliating and subservient roles in the same way as SCs. Thus, OBC reservations have to be assessed very differently than SC-ST reservations.
7. This recalls the arguments in favour of AA in US educational institutions made to the Supreme Court by US military officers, who want to avoid having just white men in charge of troops that are disproportionately of color (see Weisskopf 2004, preface).
8. Page (2007) shows convincingly how groups that display a wide range of perspectives outperform groups of like-minded experts.
9. In Deshpande (2011), I discuss the issue of the impact of liberalization on inter-caste disparities briefly, and suggest that contrary to wishful thinking, the new opportunities opened up by liberalization might not be available to Dalits to the extent needed to close disparities. In particular, they do not, as yet, have the skills needed to take advantage of the new kinds of jobs which are being opened up due to liberalization and globalization.

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# 19. Comment on Deshpande

**Hwok Aun Lee**

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Ashwini Deshpande's chapter provides a highly informative overview and robust defense of affirmative action in India. She lucidly surveys and discusses the contexts, objectives, mechanisms, and outcomes of the policy.

Having drawn on her collaboration with Tom Weisskopf, we can see his erudition on the subject weaved through the chapter. My reflections will focus on his original, profound, and important contributions, which are cogently researched and presented in his seminal 2004 book, and which have helped form my perspectives on affirmative action.

First, affirmative action emerges out of particular historical conditions and current circumstances that perpetuate group discrimination or disadvantage. These basic premises are often muffled in discourses on affirmative action, especially where there is predilection or haste to pronounce discrimination as a problem of the past. Dominant strains of mainstream theory hold that expansion of labor markets, assuming competitive conditions, will dissipate discrimination and consolidate merit as a determinant of employment outcomes.

The empirical record, however, demonstrates the resilience of social and economic discrimination in contemporary India. Deshpande exhorts us to "take stock of affirmative action dispassionately through an evidence-based approach" and refers to recent studies finding evidence of significant, perhaps less blatant but ever pernicious, forms of discrimination in India. Job applicants with upper caste type names are more likely to be called for interview, compared to those with lower caste or Muslim names. The results are not surprising; numerous field experiments around the world have obtained similar results. However, not all such studies within India have found significant evidence of discrimination (for example, Banerjee et al., 2008); a fuller range of research could be surveyed and critiqued. On balance, the literature corroborating the existence of discrimination will probably continue to heavily outweigh that which reports opposing or inconclusive findings, but in view of the breadth of such research on India, we would gain a greater appreciation of the importance of empirical work in this field.

The Indian case offers another outstanding implication, from an international perspective. Caste discrimination persists despite the lack of distinctiveness in

physical appearance between caste groups, specifically in cities, where diversity might be expected to attenuate links between physiology and opportunity and where ability presumably supersedes identity. This is unlike the situation in many societies that institute affirmative action, where color or other external traits can obviously identify persons and demarcate privilege and prejudice. The persistence of caste-based discrimination in India reinforces the case for coordinated and proactive redress measures.

Of course, the persistence of group discrimination or disadvantage alone, even if empirically corroborated and constitutionally mandated, does not legitimate affirmative action as a necessary and appropriate policy response. The answer to this question rests partly on one's perspective of the key problem that affirmative action aims to solve.

The second major contribution of this chapter stems from conception of the chief objective of affirmative action. We can find an array of approaches to framing the purpose and scope of affirmative action. There is no definitive canon, of course, but variations in perspective and emphasis impact on one's understanding of the policy's purpose and its appropriate design. Among notable works, Fryer and Loury (2005) denote education, employment, and business contracting as the areas where affirmative action objectives are warranted, while ILO (2007) more generally locates affirmative action in areas where a group's participation is limited by disadvantage.

Affirmative action, as articulated in Weisskopf (2004), aims to increase representation of underrepresented groups to "widely esteemed positions," while Deshpande applies an analogous phrase, "preferred positions." These categories generally encompass education, employment, and business; in other words, socioeconomic strata where barriers to entry prevail and where underrepresentation of a disadvantaged or discriminated group is especially acute. These designated areas of intervention do not vary substantially from most definitions of affirmative action. However, their focus on the effect of underrepresentation on the group captures a profound insight missed in much of the literature.

A group that persistently remains underrepresented in positions that confer esteem or that are generally preferred may suffer stigma, exclusion, and discouragement, which moreover can self-perpetuate in the absence of coordinated, corrective action. This reality reverberates in India, with the humiliating and debilitating legacies of the caste system. In addition, the severity of these problems augments the need for the solution to be coherent, practical, and effective.

Thus, the third important contribution of Weisskopf that is apparent in Deshpande is a candid and critical awareness that affirmative action invariably involves preferential selection. To begin with, they recognize the limitations and biases of conventional, "merit"-based measurements of personal achievement, which can serve to perpetuate privilege. This recognition, together with a diagnosis that systemic disadvantage or discrimination lie at the root of the

beneficiary group's underrepresentation, reinforce the argument that efforts to increase the group's participation must depart from narrow merit-based selection.

Undoubtedly, explicit stipulation of preference may contravene constitutional prohibitions or ideological positions. However, one does not need to scratch deeply to realize that affirmative action invariably entails preferential selection. The beneficiary group will not attain the targeted positions at a sufficient pace if evaluated on the strict basis of conventional merit or socioeconomic need. Therefore, some degree of preference must in practice be accorded, to facilitate and accelerate the process.

It is worth noting as well that the notion of preferential treatment is much less problematic when applied to other spheres, indicating that some of the reaction is exceptionally strong when the category involves race or caste. Preferential entry to university based on family income or residency, for instance, is generally not objectionable, even though it similarly sets a lower bar for those from the beneficiary group—poor, rural households.

At this juncture, the question often arises: why not target beneficiaries solely based on need? The argument goes, targeting based on income level will disproportionately benefit persons in the beneficiary group, since they are overrepresented in the low-income categories. Furthermore, persons from middle or upper strata do not need special treatment to enter university or the job market, whereas those from the lower strata do. Deshpande reports studies finding those from higher socioeconomic backgrounds benefiting disproportionately more from affirmative action. We can expect that questions based on this logic will grow in volume.

Weisskopf (2004) addresses the issue more directly, perhaps because it resonates more in societies with more stratified beneficiary groups, such as the United States. He makes a simple and sensible, yet rarely found acknowledgment, which is that students from low-income households are less able to cope with the challenges of upward educational or occupational advancement, especially if accelerated through preferential selection. For affirmative action to be effective, it should select members of the disadvantaged group who are best equipped to perform at university level or in managerial positions—who may come from middle-class or wealthy backgrounds.

This is an uncomfortable position for some, yet it maintains consistency with the primary goal of increasing representation of a disadvantaged group, and avoids conflating it with other distinct policy objectives, such as poverty alleviation and income redistribution. Of course, these developmental goals interact with affirmative action, and are integral to effective and sustained progress, but do not function as substitutes. Indeed, while Deshpande emphasizes the need to improve schooling, training, and human development programs, she clearly regards these as supplementary measures that can reinforce, but not replace, affirmative action.



The outcomes of affirmative action are complex and messy. This is not surprising; the problems it seeks to address are equally complex and decidedly messier. Evaluation of affirmative action, of which there are no standard measures or frameworks, demands clarity and coherence.

A fourth important contribution to understanding affirmative action concerns policy outcomes. Weisskopf (2004) performs a multi-dimensional benefit–cost analysis, producing exceptional breadth and depth of insight. Deshpande refers to studies that have examined the consequences of affirmative action, on productivity, higher education, and political reservations. The range of empirical literature warrants discussion beyond this space. I will take up one salient issue: the time frame of affirmative action.

Even if affirmative action programs achieve modest gains or even endure allocative efficiency costs in the short term, they may yield productive benefits over the long term. The policy ideally empowers the disadvantaged group toward broader participation and self-dependence, rendering preferential selection redundant. The need for expiry dates or sunset clauses pose massive dilemmas to affirmative action. Deshpande adopts a timeline that sets 10 years as the minimum period of intensive affirmative action and supplementary measures before quotas can be scaled down.

The experience of Malaysia is perhaps instructive here, in view of the sluggish continuation of affirmative action with no clear exit plan in sight, in spite of—and in some ways, because of—40 years of extensive and intensive implementation (Lee, 2012). The Malaysian experience raises a cautionary note on the difficulties of phasing out affirmative action, as must be done eventually, as well as the imperative of making affirmative action effective, broad-based, and transitory. A victim of its own success, as it should be.

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## 20. How big is too big? On the social efficiency of the financial sector in the United States<sup>1</sup>

**Gerald Epstein and James Crotty**

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### 20.1 INTRODUCTION

By almost any measure, the size of the financial sector in the United States, and in many parts of the world, exploded over the several decades prior to the financial crash of 2008.<sup>2</sup> In the aftermath of the crisis, many analysts, some in surprisingly high positions of authority in the world of financial governance, have argued that the financial sector has grown too big, that many of its activities have little or even negative social value, and that the productivity and efficiency of the world economy could be improved if the financial sector were to shrink. Lord Adair Turner, Chairman of the United Kingdom's Financial Services Authority, remarked in an interview with *Prospect Magazine* and then in a speech in September 2009, "...not all financial innovation is valuable, not all trading plays a useful role, and...a bigger financial system is not necessarily a better one" (Turner, 2009). Turner later defended his *Prospect Magazine* remarks saying, "...I do not apologise for being correctly quoted as saying that while the financial services industry performs many economically vital functions, and will continue to play a large and important role in London's economy, some financial activities which proliferated over the last ten years were 'socially useless', and some parts of the system were swollen beyond their optimal size" (ibid.). Former US Federal Reserve chairman Paul Volcker was more blunt. He reportedly told a room full of bankers, "I wish someone would give me one shred of neutral evidence that financial innovation has led to economic growth—one shred of evidence" (*The Times*, 2009).

Despite this general and, one might add, increasingly widespread view of the bloated state of the financial sector, until now there has been relatively little research which has tried to analytically frame and carefully estimate the extent

of “unproductive” finance and to estimate the dimensions of financial bloat and its impacts. More recently, though, some economists have been trying to study the topic.<sup>3</sup>

How socially efficient is the financial sector? That is, does the financial sector provide socially useful services commensurate to the economic resources taken up by it? If not, how should we cut the financial sector down to size? In other words, how big is too big? These are all very important questions, not only theoretically and empirically, but they also have important implications in terms of economic policy. For example, the financial transactions tax (FTT) is on the policy agenda in Europe, the US and elsewhere. The financial industry has opposed the tax, arguing that it would reduce the size of the financial sector below its optimal level and hinder useful financial innovation.

Most financial reform legislation, including the 2010 Dodd–Frank legislation in the United States, calls for increased capital and liquidity requirements for investment and commercial banks that may shrink the size of the sector relative to what it would be otherwise. Bankers and others have expressed concern that these need to be levied in such a way as to preserve the “international competitiveness” of the financial sector, and to prevent activities from going “offshore.” But if, at the margin, the financial sector is not socially efficient, then a “lack of competitiveness” which causes the sector to shrink is not socially harmful. Others have called for significant restrictions on the level or form of bankers’ pay in order to generate more fairness and to reduce excessive risk incentives (Crotty and Epstein, 2009a; Crotty, 2009). Critics have responded that these actions might lead to “banker brain drain”—the movement of the most highly-paid bankers abroad. Here again, this is of particular concern only if the activities of these highly-paid bankers are making a significant social contribution. The answers to the questions posed above are obviously relevant to these key policy issues.

The question of the appropriate size, scope and operations of the financial sector from the point of view of social efficiency is obviously a massive one. In this chapter, we present some initial conceptual and empirical work, focusing on the United States in the post-World War II period. We humbly present our empirical work in the spirit of the creative, careful, and important conceptual and empirical work carried out by Tom Weisskopf (see the other chapters of this volume) and hope, eventually, to honor that work in future iterations of our own work.

In what follows, we will first offer some initial definitions with regard to the social productivity of the financial sector. In Section 20.3 we will present a broad overview of the growth of the financial sector in the last several decades and briefly review some literature that has raised questions about the social value of its role. Section 20.4 presents some initial estimates of the social productivity of the financial sector in the US and concludes that despite its declining social

productivity, the rate of income extraction by the financial sector in the US has been rising. We then identify other possible contributions of the financial sector that could account for this increase in the rate of income extraction. These include liquidity provision, financial innovation, and market making. We provisionally conclude that these are theoretically flawed or empirically inadequate to explain the apparent social inefficiency of the financial sector in the US. In the penultimate section we turn to a possible explanation for the increase in the rate of income extraction: the trading, gambling and speculative activities of investment banks. More specifically, we study the sources of income of large investment banks and show that, at the height of the bubble, as much as 60 or 70 percent of some investment banks' incomes derived from trading activities. In light of our discussion of liquidity provision and market making, we suggest that there is no strong theoretical reason to believe these activities are socially efficient. We conclude in Section 20.7.

## 20.2 A SOCIALLY PRODUCTIVE FINANCIAL SECTOR? INITIAL DEFINITIONS

We begin with James Tobin's important essay, "On the Efficiency of the Financial Sector," first published in Lloyd's Bank Review in 1984 and reprinted in *Essays in a Keynesian Mode* (Tobin, 1987). One of Tobin's concepts of efficiency is especially relevant here: the concept of *functional efficiency*.

...the economic functions of the financial industries ... include: the pooling of risks and their allocation to those most able and willing to bear them ... the facilitation of transactions by providing mechanisms and networks of payments; the mobilization of saving for investments in physical and human capital ... and the allocation of saving to their more socially productive uses. I call efficiency in these respects *functional efficiency* ... I confess to an uneasy Physiocratic suspicion, perhaps unbecoming in an academic, that we are throwing more and more of our resources, including the cream of our youth, into financial activities remote from the production of goods and services, into activities that generate high private rewards disproportionate to their social productivity. (Tobin, 1987).

Tobin's concept of *functional efficiency* is thus one way to frame a discussion of the roles the financial sector has been playing in recent decades.

Though it might be a useful starting point, Tobin's taxonomy of different types of financial efficiency is itself problematic. Tobin suggests that the financial sector at worst can be unproductive. But a broader perspective, based in different ways on the works of Karl Marx and Hyman Minsky, would suggest that the financial sector can have more sinister impacts: that it can engage in exploitation and also destroy value. We have certainly seen evidence for this

in the sub-prime lending that stripped households of much of their wealth, and in the costs of the Great Recession which Haldane (2010a), for example, has estimated will cost the world somewhere between \$60 and \$200 trillion.

In what follows, we first present some basic data that show how dramatically the financial sector has grown in recent decades to place the issue of “financial bloat” in an empirical context. Then we move on to a set of measures designed to shed light on the functional efficiency of the financial sector.

### 20.3 A BRIEF OVERVIEW OF RECENT TRENDS IN THE SIZE OF THE FINANCIAL SECTOR

No matter how the size of the financial sector with respect to the rest of the economy is measured, the trend of massive growth is obvious. The financial sector’s total financial assets grew from about one-third of total assets in the US economy during the post-World War II decades to 45 percent of total assets by 2010. The value of the financial sector assets was approximately equal to the US Gross Domestic Product (GDP) in the early 1950s, whereas now it amounts to 4.5 times the US GDP. Financial sector profit has grown from about 10 percent of total domestic profits in the 1950s–60s to 40 percent in the early 2000s.

This massive rise in the financial sector as a whole is accompanied by a dramatic rise in some of its segments. Investment banking has drawn special attention during the 2007–present crisis because these financial institutions were at the heart of creating the new financial products that triggered the crisis. Financial assets of the securities industry, which includes investment banks, amounted to a constant 1 percent of total financial sector financial assets from 1945 until the early 1980s. After that, they rose five-fold and reached the level of 5 percent of the total financial sector financial assets by 2008. Their rise as a share of GDP has been even more pronounced—from 1.5 percent in the post-World War II decades to 22 percent in 2007. Other measures of the size of the securities industry in the US produce even larger figures, with the securities industry’s total assets reaching 45 percent of GDP in 2007.<sup>4</sup>

How much of this increase in the size and share of the US financial sector is socially efficient? What does it contribute to the functioning of the US economy? These are questions to which we turn next.

## 20.4 ESTIMATES OF THE CONTRIBUTION OF THE FINANCIAL SECTOR TO THE REAL SECTOR IN THE US<sup>5</sup>

### 20.4.1 Broad Contribution of the Financial Sector in the US

There are two broad approaches to answering the question of the social efficiency of the financial sector: one is to look at the role of finance from the point of view of the activities of the financial sector; the other is to look at the role of finance from the perspective of the real sector. Here, we present work from the perspective of the real sector. Next, we combine the two by looking at the income extracted by the financial sector for the services it provided to the real sector. As above, we focus on the United States. In future work we plan to expand this analysis to other OECD countries.

### 20.4.2 The Financing Gap

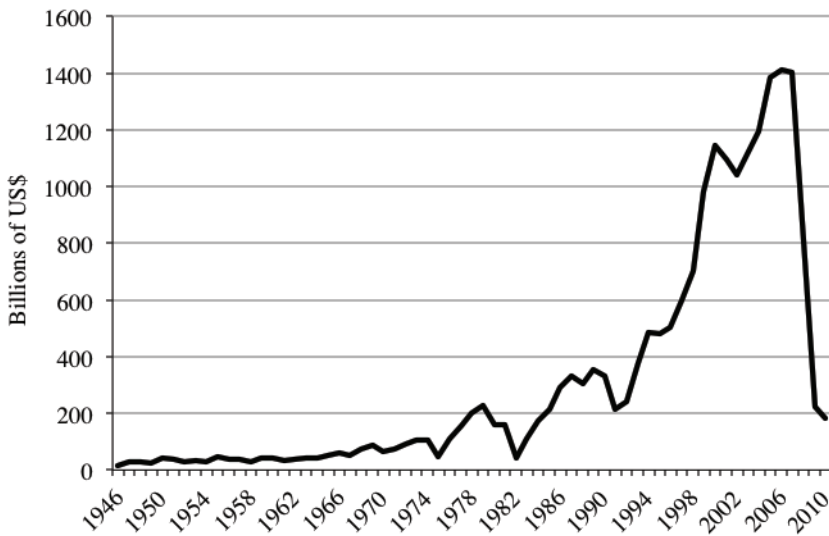
We begin by looking at the “financing gap” of broad sectors of the US economy. The “financing gap” measures the extent to which different sectors of the economy depend on external finance as opposed to financing with internal savings. We assess how this dependence has evolved over the post-World War II period. We then look at the degree to which the financial sector has been able to extract returns for supplying the credit needed to fill these financing gaps.

Lack of space prevents us from presenting data on the sectoral evolution of the financing gap, but we will briefly summarize the results here. Using flow of funds data, we observe three simultaneous trends. First, the non-financial corporate sector reduced its use of external finance over the period in relation to its capital expenditures. At the same time, households moved from being net lenders to the financial sector to being net borrowers, largely to finance the purchase of homes and durable consumer goods. Third, governments (federal, state, and local) increased their dependence on the financial sector for financing their capital expenditures. These trends illustrate a problematic shift of financial activity away from productive investment to lending services that fuel asset-bubbles, such as in the housing market. We explore this shift from various angles in what follows.

Figure 20.1 shows the evolution of the total non-financial sector financing gap from 1946 to 2010, excluding the federal government (we introduce the federal government’s financing gap below).

A surge in mortgages and financing for consumer durables by households explains the great bulge in the financing gap in the later periods. This occurred despite the stagnating demand among non-financial corporations, apart from a brief increase in the late 1990s due largely to mergers, acquisitions, and stock buy-backs.

Figure 20.1 Total US non-financial sector financing gap, billions of US dollars, 1946–2010



Note: Measure excludes the federal government.

Source: Calculations based on Flow of Funds.

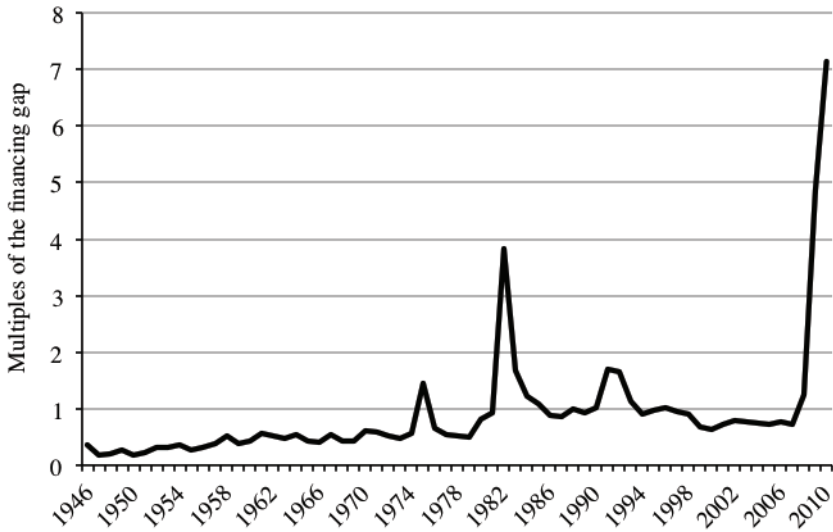
Next we turn to an analysis of the income extracted by the financial sector and compare it with the roles the financial sector plays vis-à-vis the real economy.

Figure 20.2 is the ratio of two variables. The first is the gross value added of the financial sector—that is, the wages and profits received by the financial sector. This is the amount of income the financial sector extracts from the economy, and is divided by the financing gap which, as we saw above, is a measure of the services provided by the financial sector. So the ratio, which is shown in the graph, is a measure of the income extracted by the financial sector, relative to the services it provides (see Philippon, 2011 for a related analysis).

Table 20.1 presents these data averaged roughly by decade from 1946 to 2010. They indicate that the financial sector has extracted more income relative to the financing it provides to the real sector over the post-war period. In particular, for every dollar of financing gap, the financial sector received on average 30 cents in 1946–59, \$1.09 in the 1990s, and \$1.74 in the 2000s. This analysis suggests that the financial sector may be as much as four times as large—relative to the booming 1960s—as required for financing real economic activity.



Figure 20.2 Gross value added of financial corporate business relative to the financing gap



Source: Calculations based on the Flow of Funds and NIPA, table 1.14.

Simply inverting the data presented in Figure 20.2 and Table 20.1 provides a gauge of the financial sector’s “productivity”—that is, the amount of financing gap per dollar of value added extracted by the financial sector (not shown here for reasons of space). Productivity clearly declined over the post-war period, with a significant drop-off occurring during the 2000s. That is, for the same total revenue (value added), the financial sector serviced a declining share of financing gap. In particular, for each \$1 of revenue, the financial sector financed on average \$4–\$6 financing gap after World War II and financed only \$1 of financing gap since 1990.

Thus far we have left the federal government out of the analysis. To be sure, the domestic financial sector has served a role of partially financing the federal budget deficit. However, the matter is complicated by the fact that the federal budget deficit is also financed by the Federal Reserve System and increasingly by foreigners. Moreover, much of the Federal debt is not intermediated by the financial sector but is bought directly by households. For all these reasons, including the entire federal budget deficit is problematic for estimating the rate of income extraction (and productivity) by the financial sector. Still, to look at the outer range of the impact of including the Federal Budget, we present these figures in Table 20.2.

*Table 20.1 Gross value added of financial sector relative to financing gap excluding the federal government decadal averages*

<u>Decade</u>	<u>Simple average</u>
1946–1959	0.30
1960s	0.47
1970s	0.64
1980s	1.32
1990s	1.09
2000–2010	1.74

*Source:* Calculations based on the Flow of Funds and NIPA, table 1.14.

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*Table 20.2 Income extraction by the financial sector relative to financing gap (including the federal government financing gap)*

<u>Decade</u>	<u>Simple average</u>
1946–1959	0.31
1960s	0.44
1970s	0.46
1980s	0.60
1990s	0.73
2000–2010	0.66

*Source:* Calculations based on the Flow of Funds and NIPA, table 1.14.

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When we add the role of federal government borrowing, it changes the quantitative dimensions but not the qualitative dimensions of the analysis. In Table 20.2, we present the decadal averages.

According to these data—which we suggested above is probably an underestimate of the income extraction ratio—we still find that the rate of income extraction by the financial sector relative to the financing gap has doubled since the early post-war period. In this case, for every dollar of financing gap the financial sector received on average 30 cents in the 1950s and almost 70 cents in the 1990s–2000s.

As before, we can look at the mirror image of the amount of resources extracted per dollar of finance gap supplied, by looking at the productivity of the financial sector (again, not shown here for reasons of space). These data suggest a decline in the “productivity” of the financial sector: for \$1 of revenue, the financial sector financed on average \$3–\$5 of financing gap after World War II and only \$1.5 of financing gap since 1980.

## 20.5 DARK MATTER: LIQUIDITY PROVISION, FINANCIAL INNOVATION, MARKET MAKING, AND THE RATIONALE FOR INCOME EXTRACTION BY THE FINANCIAL SECTOR

Of course, the financial sector provides services other than direct provision of credit. These include liquidity provision, risk sharing, provision of information and monitoring, market making, and innovation in all these activities. Any analysis of the impact of finance—and explanations for income extraction by the financial sector—must take these roles into account as well.

Estimating the social contributions of all these activities is not easy. This leaves the terrain ripe for self-serving assessment and interpretation. For example, economists of various stripes and defenders of the status quo in financial regulation and structure have identified a number of presumed contributions of the financial sector to the real economy that are not easily captured by statistics. These are akin to debates over “dark matter”: contributions that are there but are not easy to detect. These include “liquidity provision,” “market making,” and benefits of “financial innovation.”

We briefly summarize some key points in what follows.

### 20.5.1 Liquidity Provision

The mainstream economics literature has developed the concept of liquidity in vague and contradictory ways. Basically, providing liquidity means making the trade of financial assets relatively immediate and low cost. Mainstream economists argue that providing liquidity helps determine the value of an asset (that is, “price discovery”) because each trade provides information about what buyers are willing to pay—and what sellers are willing to accept—for an asset. As these trades take place, the price of the asset should converge to a price that equates the buyers’ level of demand to the sellers’ supply level—an “equilibrium price” that represents the asset’s true value. If this were the case, liquidity provision would be a good thing.

But there is a key flaw in this literature that renders the liquidity-based justifications for financial sector activities highly suspect: this justification depends on the assumption of the existence and “knowability” of the fundamental value of financial assets. This is an assumption that is incorrect (and, of course, is inconsistent with a Keynesian or Minskian approach to understanding financial markets) in a world of fundamental uncertainty that characterizes all modern economies. In this world, liquidity provision is a more complex and dynamic activity, and, indeed, leads to “price creation” rather than price discovery. That is, the activities of financial institutions do not simply provide the liquidity that financial markets need to determine the true value of assets, their activities directly influence what the price will be. In this world, liquidity provision can contribute to a run-up in the price of an asset, creating an asset price bubble. Then, inevitably, some event causes liquidity to dry up and the bubble to burst, triggering a massive freefall (or even non-existence) of asset prices. This is, in fact, what occurred for some assets of the global financial services firm, Lehman Brothers Holdings, Inc., during the 2008 financial crash.

Thus, the pathway to understanding the social efficiency of liquidity provision is to ask: liquidity provision for what? This is a question that is rarely asked in the mainstream literature because of the assumption that liquidity provision assists in “price discovery.” The alternative perspective naturally leads to a distinction between “good liquidity” and “bad liquidity” creation mechanisms. In this regard, an analysis of the social efficiency of “liquidity provision” would look at the types of financial products created and traded and what their social impacts are. Price discovery cannot simply be assumed as the obviously “good” outcome.<sup>6</sup>

If one then considers the type of liquidity provision that grew since the early 2000s, how it contributed to the financial bubble and then dried-up after the Lehman collapse, it is difficult to argue that socially useful liquidity provision by the financial sector can explain the large increase in the rate of income extraction by the financial sector (or conversely the decline in financial sector “productivity”) in the recent decade or so.

### 20.5.2 Market Making

As we discuss in the next section, market making—the buying and selling of financial instruments for the purpose of facilitating trade by others—is indeed a major activity of some of the biggest players in the financial sector. The mainstream literature once again assumes that market making is a socially efficient activity of “intermediaries” who bring together buyers and sellers and makes voluntary trades possible more cheaply. This view, however, assumes that investment banks and other financial institutions act as passive intermediaries, as in the case of price discovery. In fact, financial firms engage actively in creating and marketing financial products *and then* search for buyers and sellers.

A good example of what we have in mind is how Citibank and Goldman Sachs created and marketed collateralized debt obligations (CDOs) that were designed to fail and then took out bets against these products. Here, then, “market making” as actually practiced is not a neutral, intermediary action but is a market creation activity that must be judged on the merits of the types of markets created.<sup>7</sup> Here too, the recent history of financial products sold and markets made—the CDOs and credit default swaps (CDSs) that helped to crash the system—raise serious questions about whether the social productivity of such trading can account for the rise of the rate of income extraction received by the financial sector during the post-war period.

### **20.5.3 The Social Efficiency of Financial Innovation**

Bankers often fight against financial regulation by arguing that regulations will stifle innovations. What is the functional efficiency of financial innovations? What is the impact of these financial innovations on the real economy? As a theoretical matter, there is no presumption that more financial innovation contributes to higher social welfare. Mathematical models created to demonstrate how financial innovation operates in an economy have shown that, in principle, they can either increase or decrease social welfare (Elul, 1995; Frame and White, 2004).

While the mainstream authors discussed above have touted the social benefits of financial innovation, heterodox economists have taken a more critical stance toward them. Crotty shows in great detail the destructive nature of many of these “innovations” and how their existence deliberately made price discovery harder, and financial products more difficult to understand. Doing so enabled those creating these new financial instruments to generate even more revenue than would be the case if buyers and sellers better understood the products they were trading. This flies in the face of the justifications for innovation based on efficient markets theory (see Crotty, 2009 and 2010).

Empirically, there has been very little evidence provided on these key questions. Lerner (2006) does find that financial innovation raises the profits of the innovating financial firm, at least in the short run. But what about social impacts? Frame and White (2004) published a comprehensive survey of the determinants and effects of financial innovation. As their paper shows, there has been relatively little study of financial innovation. As a result, there is virtually no evidence that financial innovations contribute to a lower cost of capital, more investment, or higher rates of economic growth. Indeed, in light of the enormous costs associated with the current crisis, we have a great deal of emerging evidence on the high costs associated with some financial innovations.

### 20.5.4 Micro-Level Data

Whereas the studies cited above refer mostly to macro-level (that is, economy-wide) data, there is interesting micro-level (that is, firm-based) data that can be used to assess the nature of financial innovation.

In the most comprehensive studies to date, John D. Finnerty and his colleague Douglas Emery created a list of securities innovations organized by type of instrument and function/motivation of the issuers. The types of instruments studied include: debt, preferred stock, convertible securities, and common equities (Finnerty, 1988; 1992; Finnerty and Emery, 2002). Finnerty's initial study (1988) dealt with both consumer and corporate financial innovations and listed 11 motivations/functions: (1) tax advantages; (2) reduced transaction costs; (3) reduced agency costs; (4) risk re-allocations; (5) increased liquidity; (6) regulatory or legislative factors; (7) level and volatility of interest rates; (8) level and volatility of prices; (9) academic work; (10) accounting benefits; and (11) technological developments. In his later work, Finnerty reduced the functions to six: (1) reallocating risk; (2) increasing liquidity; (3) reducing agency costs; (4) reducing transaction costs; (5) reducing taxes; and (6) circumventing regulatory constraints. One should add two other motives: first, firms have a motive to create a proprietary innovation that is complex and murky enough to give it proprietary advantages for at least an initial period of time (Tufano, 2003; Das, 2006). We will call this: (7) the "proprietary" or "redistributive" motive. An eighth motive, implicitly proposed by James Tobin, is to open new ways to gamble on trends or to limit losses when such gambling occurs. We will call this: (8) the "gambling" motive. Clearly, many of these have nothing to do with reducing transaction costs or increasing social efficiency.

Table 20.3, taken from Crotty and Epstein (2009b) uses the three Finnerty studies to calculate the number and percentage of innovations that are at least partly motivated by tax, accounting, and/or regulatory "arbitrage" or "evasion." Our estimates reveal that roughly one-third of these "innovations" are motivated by these factors, rather than efficiency improvements. This estimate, in fact, is almost certainly a gross underestimate of innovations motivated by tax and regulatory arbitrage, since Finnerty and Emery presented a selected set of innovations which they suggested would have "staying power" due to their "addition to value." Their list is not anywhere near a complete list of new types of securities.

We believe that the data in Table 20.3 are likely to be an underestimate of the socially inefficient share of financial innovations because these data do not look at the actual impact of these innovations. For example, they do not capture the destructive effect of CDOs and CDSs since it is an accounting exercise with respect to what motivated the innovations, rather than a study of their actual effects. The latter will have to wait for future research.

*Table 20.3 Financial “innovations” motivated by tax or regulatory evasion*

Study	Total number of security innovations (1)	Number motivated at least partly by tax or regulatory reasons (2)	Percentage of total innovations motivated by tax or regulatory reasons $(2)/(1) \times 100$ (%)
Finnerty (1988)	103	45	44
Finnerty (1992)	65	21	34
Finnerty and Emery (2002)	80	25	31

*Sources:* Finnerty (1988); Finnerty (1992); Finnerty and Emery (2002); and authors’ calculations (Crotty and Epstein, 2009b).

## 20.6 WHAT DOES FINANCE’S INCOME DERIVE FROM? A CASE STUDY OF US INVESTMENT BANKS<sup>8</sup>

So how is finance managing to extract so much income relative to the apparent services it is providing to the real economy? This is, of course, a very difficult question. But to begin to answer it, we “follow the money.” That is, we look at the income accounts of major investment banks in the US, and ask: what activities have generated their incomes? This is of particular interest given that investment banks were at the heart of the recent crisis.

Specifically, we will look into the composition of the revenue-generating activities of investment banks and how this composition changed over time. The composition of investment banking revenues can proxy for the composition of activities investment banks perform. Growing components of revenue should reflect the types of activities accounting for the overall growth in investment banking business.

Investment banking is a highly concentrated industry with the top five investment banks receiving up to 65 percent of total revenues. Because of this, the revenue structure of the top five investment banks should give us important information about the activities of the investment banking industry, at least in the large-bank segment.

### **20.6.1 Functional Efficiency of Investment Banking: Trading vs Non-Trading Activities**

Of course, it is very difficult to identify all the activities undertaken by investment banks that are socially useful versus those that are not. But as a first approximation, we will identify trading and trading-related activities, versus non-trading activities which would typically include market-making activities, hedging (that is, trades made for the purpose of reducing risk), and other asset management services for customers. These are distinctions that very roughly parallel the notions of “proprietary trading” vs hedging, market-making activities and asset management as defined in the Dodd–Frank Act. But as noted above, “market making” during some periods primarily facilitated the creation and selling of highly speculative and ultimately destructive products.

We construct a dataset for the five largest investment banks for 2006–2008. To show the evolution of the structure of investment bank activities, we need to compare these measures to an earlier time period. Table 20.4 presents the results of our calculations of trading as a share of net revenues for the five largest US investment banks.

Take, for example, Goldman Sachs. In 2008, trading income as a share of net revenue was, according to our figures, about 56 percent. But if one goes back to the boom years of 2006, it was nearly three-quarters of net revenue, or 74 percent. For these banks, the share of their income from trading activities was roughly 50 percent or more during the height of the bubble just before the crash of 2007.

Thus, these data suggest that the massive increase of income extraction by the financial sector relative to the provision of services to the real sector can conjecturally be explained by the explosion in revenue generated by trading activities as a share of investment banks’ income-generating activities. This is reflected in the activities of major commercial banks as well, such as Citibank and Bank of America (see Crotty et al., 2010, for a discussion of Citibank).

Given the doubts raised earlier about the concepts of liquidity provision and market making, and given what we know about the etiology of the financial crisis of 2007–2009, it is reasonable to be skeptical about the social efficiency of such activities. Of course, future work must pin down the costs and benefits of these trading activities much more precisely.



Table 20.4 Trading vs non-trading activities at five large US investment banks (in millions \$)

**(a) GS (Goldman Sachs)**

	1998	1999	2000	...	2006	2007	2008
Commissions	1 368	1 522	2 307		–	–	–
Trading and principal investments	2 379	5 773	6 627		25 562	31 226	9 063
Securities services	730	772	940		2 180	2 716	3 422
Net revenue	8 520	13 345	16 590		37 665	45 987	22 222
“Trading” as a share of net revenue, %	52.5	60.4	59.5		73.7	73.8	56.2

Note: Trading = commissions + trading and principal investments + securities services, for 1998–2000, and Trading = trading and principal investments + securities services, for 2006–2008, due to a change in methodology.

**(b) MS (Morgan Stanley)**

	1994	1995	1996	...	2006	2007	2008
Commissions	874.3	1 022.5	1 163.1		3 770	4 682	4 463
Principal transactions	421.9	478.9	449.3		13 612	6 468	1 260
Other	101.9	93.5	107.8		545	1 161	6 062
Net revenue	5 554.1	6 419.6	7 462.4		29 799	27 979	24 739
“Trading” as a share of net revenue, %	25.2	24.8	23.1		60.2	44.0	47.6

Note: Trading = commissions + principal transactions + other.

**(c) BSC (Bear Stearns)**

	1993	1994	1995	...	2005	2006	2007
Commissions	421	483	547		1 200	1 163	1 269
Principal transactions	1 157	1 134	860		3 836	4 995	1 323
Net revenue	2 143	2 417	2 075		7 411	9 227	5 945
“Trading” as a share of net revenue, %	73.6	66.9	67.8		68.0	66.7	43.6

Note: Trading = commissions + principal transactions.

*Table 20.4 Trading vs non-trading activities at five large US investment banks (in millions \$) cont.*

**(d) LEHM (Lehman)**

	1989	1990	1991	1992	1993	...	2005	2006	2007
Commissions	1 858	1 508	1 649	1 677	1 316		1 728	2 050	2 471
[Market making and] principal transactions	1 269	1 199	1 696	1 697	1 967		7 811	9 802	9 197
Net revenue	4 892	4 016	4 905	5 426	5 218		14 630	17 583	19 257
“Trading” as a share of net revenue, %	63.9	67.4	68.2	62.2	62.9		65.2	67.4	60.6

*Note:* Trading = commissions + [market making and] principal transactions.

**(e) MER (Merrill Lynch)**

	1991	1992	1993	...	2006	2007*	2008*
Commissions	2 166	2 422	2 894		5 985	7 284	6 895
Principal transactions	1 906	2 166	2 920		7 248	-12 067	-27 225
Other	340	281	285		2 883	-2 190	-10 065
Net revenue	7 246	8 577	10 558		33 781	11 250	-12 593
“Trading” as a share of net revenue, %	60.9	56.8	57.8		47.7	-62.0	241.4

*Notes:* Trading = commissions + principal transactions + other.

\* Losses (negative numbers) require cautious interpretation.

## 20.7 CONCLUSION

Tom Weisskopf has shown us, among many other things, the power that comes from the careful development of well-designed descriptive statistics to help us understand the underlying structures and dynamics of our economy. In this chapter we have made an initial attempt to do just that, with respect to the question of the social efficiency of the US financial sector.

A very preliminary range of estimates presented in Tables 20.1 and 20.2 above suggests that the financial sector in the United States is extracting 2–4 times as

much income relative to the services it provides to the real sector in the decade of the 2000s as it did during the high growth period of the 1960s. This suggests that the financial sector may need to be only one-half to one-quarter as large as it is currently to serve the existing needs of the real sector.

Of course, these are very crude estimates. We must do much more work on the “dark matter” functions of the financial sector, as well as understand better the impacts of financial innovations, before we can present such estimates of financial bloat with a great deal of confidence. Still, these preliminary discussions are telling. They suggest that financial bloat is real and that, with further efforts, we can make our estimates of its size more precise.

We can also say that next time apologists for the financial sector criticize an attempt at reasonable financial regulation or restructuring by claiming it will cause harm at the margin of the financial sector, reduce liquidity provision, or hinder market making—it’s time to reach for our computers and fire back about the reality of “financial bloat.”

## NOTES

1. We thank Leila Davis, Nina Eichacker, and Iren Levina for excellent research assistance, John Miller for very helpful comments, the Editors for helpful editorial suggestions, and INET for financial support. We are responsible for all errors.
2. See some summary data in Section 20.2; see MacEwan and Miller (2011) and the papers in Wolfson and Epstein (2013) on the role of finance in the crisis.
3. See, for example, Arcand et al. (2011) and Panizza (2011), for recent work. The work by Turner (2010), Haldane and colleagues in the same 2010 volume, is also of significant interest here, as is that of Philippon (2011); for earlier important work, see Zhu et al. (2002).
4. These data are based on the Board of Governors Flow of Funds Accounts, Bureau of Economic Analysis (BEA) National Income and Product Accounts (NIPA), and Securities Information Financial Analysis (SIFMA). Iren Levina gathered these data and performed these calculations.
5. Iren Levina and Leila Davis, who served as research assistants on this project, developed the data presented in this section.
6. See Mehrling (2011) for an important discussion on the nature of liquidity which informs our analysis as well.
7. We discuss this further in the section on income estimates of investment banks below.
8. Iren Levina carried out the data collection and analysis for this section. For more discussion see Crotty et al. (2010).

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## 21. Unpacking the US labor share

**James Heintz**

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In his classic paper, “Marxian crisis theory and the rate of profit in the postwar U.S. economy,” Thomas Weisskopf presented a detailed empirical decomposition of the factors behind the declining rate of profit observed at that time (Weisskopf, 1979). A decline in the rate of profit is central to Marxian crisis theory and to radical analysis of US economic history, specifically the collapse of the “Golden Age” of US capitalism. Weisskopf found that the rising strength of labor, as captured by the distribution of income between capital and labor, was a critical determinant of the falling rate of profit. However, Weisskopf also found that labor’s strength at this time was “defensive” as opposed to “offensive,” in that labor was able to preserve its income in the face of adverse terms of trade movements. Put another way, labor did not aggressively raise its real wage, but rather prevented a deterioration when price changes began to threaten the profitability of US producers.

In the spirit of Weisskopf’s detailed analysis, this chapter examines trends in the US labor share since the 1960s. In so doing, it extends the empirical analysis into the era of neoliberal dominance, deregulation, and concerted attacks on the bargaining strength of labor. However, it also takes seriously Weisskopf’s insistence in his earlier paper that aggregate trends need to be unpacked to get at the distributive dynamics behind macroeconomic variables such as the profit rate or labor’s share of income. Therefore, I dissect the US labor share in three ways: (1) like Weisskopf, the chapter looks at how price movements affect the interpretation of the functional distribution of income between labor and capital; (2) it examines what happens to labor share if we focus on production and non-supervisory workers, as opposed to labor income broadly construed; and (3) it explores how fundamental structural changes to the US economy—deindustrialization and the rise of a service economy—have affected the share of income going to labor.

## 21.1 BACKGROUND

An enduring observation about the US economy is that the labor share of national income appears to remain remarkably constant over long periods of time, despite significant shifts in economic performance, policies, the distribution of power, and institutions. The constancy of the labor share seems to contradict other trends that would lead us to expect a deterioration in the position of working people as a whole. For example, real hourly wages of non-supervisory workers peaked in the early 1970s and subsequently declined on average throughout the 1970s and 1980s. Only in the 1990s did this trend begin to reverse itself, but not enough to return real wages to their earlier heights. Similarly, fewer workers have access to job-related benefits and the quality of those benefits has been declining. Alan Greenspan, former Chairman of the US Federal Reserve, pointed to the role of growing insecurity among American workers as an explanation of subdued rates of inflation in the 1990s, the so-called “traumatized worker” hypothesis.<sup>1</sup> However, it is difficult to tease out these developments from the patterns observed in the labor share. This raises questions about the use of the labor share as an indicator of the relative strength of labor.

The apparent consistency of the labor share is not a new phenomenon. Keynes, writing about the British and US labor shares in the late 1930s, observed that “the stability of the proportion of the national dividend accruing to labor, irrespective apparently of the level of output as a whole and of the phase of the trade cycle ... is one of the most surprising, yet best-established, facts in the whole range of economic statistics” (Keynes, 1939, p. 48). Michal Kalecki (1938) argued that the labor share was held constant by two trends that, in his estimation, directly offset one another: (1) the growing monopoly power of business, which would reduce labor share by raising the ability of capital to claim a larger income share; and (2) the fall in the price of raw materials relative to value-added, which raises labor share by lowering the value of capital’s claim on output.<sup>2</sup>

In neoclassical theory, constant returns to scale production functions, such as the commonly used Cobb–Douglas formulation, yield constant labor shares of income when firms maximize profits in competitive markets. The constant labor share has also been seen as an indicator of the existence of a “natural” rate of unemployment—higher wages are offset by growing unemployment which eventually disciplines wage demands, keeping overall labor share constant in the long run (see, for example, Layard et al., 1991). Both equilibrium unemployment and the factor shares of income remain constant in the long run and are independent of both capital accumulation and technological progress.

Still others emphasize the need for a capitalist economy to balance productivity improvements with broad-based income gains in order to avoid a crisis

in which too much is produced and too little sold. For example, many theorists operating broadly in the framework of the French *régulation* school suggest that, during the “Golden Age” of US capitalism, there was a need to balance productivity improvements, which lower unit labor costs and raise profitability, with wage growth, which potentially squeezes profits but supports aggregate purchasing power, in order to avoid a crisis of over-production or under-consumption (Aglietta, 1979; Boyer and Juillard, 2002). When wages grow at the same rate as labor productivity, the labor share remains constant.

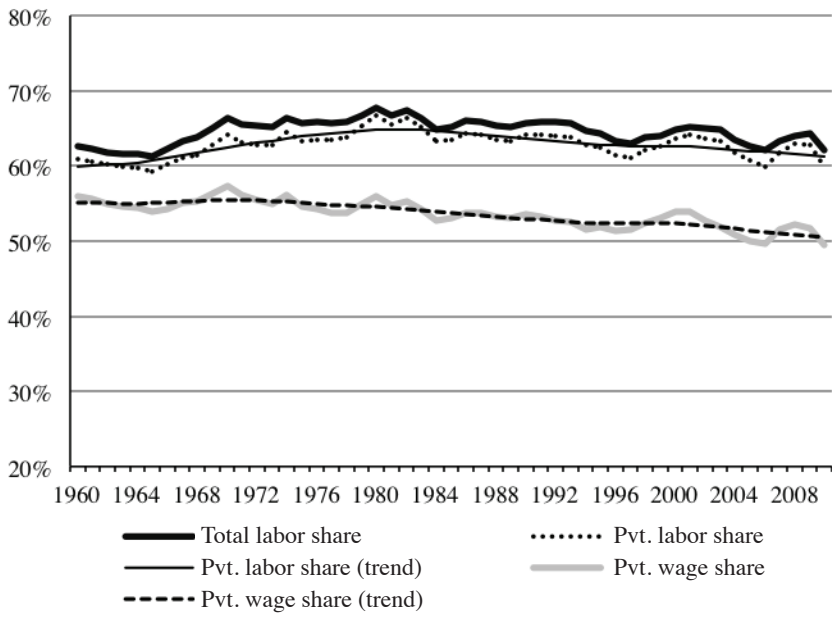
This chapter takes a different approach and argues that the empirical premise of these explanations—that the constant long-run labor share reflects a stable distribution of income among factors of production—is misleading. Behind the seemingly unperturbed trends in labor’s share of national income lurk dramatic changes in the US economy and its labor markets: a shift towards non-wage forms of compensation; a deterioration in the “terms of trade” for US workers; important structural changes in the composition of national income; and a redistribution of labor income between segments of the labor force. This chapter documents these dynamics and reflects on their implications for the wellbeing of workers and their families.

## 21.2 THE US LABOR SHARE: BASIC TRENDS

Aggregate labor share is typically measured as total compensation of paid employees expressed as a percentage of national income. Compensation includes non-wage benefits in addition to wages and salaries. The definition of “employee” is broad, and includes highly remunerated managers in addition to rank and file production workers. The definition of compensation used by the US Bureau of Economic Analysis in compiling these data therefore includes realized stock options and taxable fringe benefits which are not part of the pay package of a typical worker (Krueger, 1999). Figure 21.1 shows trends in the aggregate labor share for the US economy from 1960 to 2010. The chart also includes the labor share of the private business sector—excluding the public sector. In the system of national accounts, the labor share of the public sector is, by definition, 100 percent, since public production is valued at its labor input. As a consequence, an expansion of the size of the state in the economy raises the labor share.

Figure 21.1 incorporates an estimate of the long-run trend in the private labor share, calculated by applying a Hodrick–Prescott filter to the series. The total share for the entire economy lies above the labor share for the private business sector, as expected, but the two series follow each other closely. There is evidence of a modest upward trend during the 1960s and much of

Figure 21.1 US labor share and wage share, economy-wide and private business sector, 1960–2010



the 1970s, and a modest downward trend beginning in the 1980s. The upward movement is consistent with Weisskopf's 1979 analysis of the labor share during the 1960s, but the long-run trend suggests a decline in the labor share since the 1980s.<sup>3</sup>

Figure 21.1 also shows trends in what I will call the “wage share”—total wages and salaries paid expressed as a percentage of national income, excluding non-wage compensation. We see a gradual downward trend in the wage share over this same period—and, at least in the initial decades, a widening gap between the labor share and the wage share. The expansion of non-wage compensation kept the labor share relatively steady despite a modest downward trend in the wage share of national income. This suggests a substitution from wages to non-wage compensation, a shift supported by favorable tax treatment for certain categories of benefits. Beginning in the first half of the 1980s, the compensating support from an expansion of non-wage compensation drops off. Both the labor share and the wage share start falling—admittedly at a slow rate.



## 21.3 PRICE MOVEMENTS AND LABOR'S TERMS OF TRADE

In his analysis of the role that changes in the strength of labor play in influencing profit rates, Weisskopf (1979) stressed the importance of taking into account movements in the price of wage goods and movements in the price of output. The average price of the goods and services which workers consume can behave differently from the average price associated with productive output for a number of reasons. Wage goods may be imported or their prices strongly influenced by the presence of economic rents, disproportionate to the existence of such rents in the output produced. As Keynes wrote in a 1939 article, "Relative movements of real wages and output":

Our argument assumed that, broadly speaking, labour is remunerated in terms of its own composite product, or at least the price of wage goods moves in the same way as the price of output as a whole. But no one has supposed that this was strictly the case or was better than an approximation; and it may be that the proportion of wage goods, which are not the current product of the labor in question and the prices of which are not governed by the marginal costs of such product, is so great as to interfere with the reliability of our approximation. (Keynes, 1939, p. 43)

The labor share is typically measured as *nominal* value of labor compensation divided by *nominal* national income. However, the real value of labor income, defined in terms of the purchasing power of wages, depends on a different set of prices than the real value of output, or in the case of national income, value-added. Labor share can therefore be defined as:

$$L_S = \frac{P_w WN}{P_Y Y} \quad (21.1)$$

in which  $L_S$  is the labor share,  $P_w$  is the price of wage goods,  $W$  is the average real wage rate,  $N$  is the level of employment,  $P_Y$  is the price of output (or, in this case, value-added), and  $Y$  is real national income. It is commonplace to assume that  $P_w = P_Y$ , as described in the passage by Keynes above, in which case labor share reduces to:

$$L_S^{real} = \frac{WN}{Y} \quad \text{if } P_w = P_Y \quad (21.2)$$

Labor share is often interpreted as if the expression in Equation 21.2 holds—a constant labor share means that labor has maintained its share of real income. However, in reality, labor share is more correctly defined by the expression in

Equation 21.1. In this case, differential movements in prices have important implications for how we interpret the labor share.

These shifts in relative prices can be thought of as changes in “labor’s terms of trade.” Workers sell their labor, the value of which derives from the value-added that they produce. Workers then take the income generated by the sale of labor and purchase goods and services to sustain themselves and their families. When the prices of wage goods rise relative to the price of the value added produced, labor’s “terms of trade” can be said to be deteriorating. Falling terms of trade have important implications for how we think of the labor share of national income. A constant labor share—measured as nominal compensation divided by nominal national income—can be associated with worsening living standards when the workers’ terms of trade are falling. Based on this discussion, labor’s terms of trade ( $\lambda$ ) can be expressed as:

$$\lambda = \frac{P_y}{P_w} \quad (21.3)$$

This gives us the following general expression for deriving the “real” labor share from labor’s terms of trade and the nominal labor share.

$$L_s^{real} = \frac{P_w WN}{P_y Y} \lambda \quad (21.4)$$

To explore how labor’s terms of trade may have changed over time, and the implications for our interpretation of the US labor share, indices for national income and wage goods need to be identified. The price index for national income—based on value-added—is the most straightforward, and I use the GDP deflator as a measurement of  $P_y$ . For the price of wage goods, there exist a broader set of choices. In this chapter, I consider two price indices: the CPI for all urban consumers and the price index associated with personal consumption expenditures (PCE) in the national accounts.

The choice of a price index for wage goods is not trivial. The CPI-U is based on a fixed consumption basket, but the nature of goods and services which households consume has changed over time. In recent years, the CPI-U has been adjusted to reflect changes in quality (so-called “hedonic price adjustments”) and some degree of substitution within categories of goods and services. In contrast, the PCE price index is based on a variable basket of goods and services—specifically, the actual expenditures made. This reduces the challenge of accounting for quality changes and substitution possibilities associated with fixed basket indices. However, if households react to higher prices by purchasing inferior substitutes, the PCE will exhibit a smaller price increase due to the increased prevalence of inexpensive goods. Unlike the CPI-U, the PCE

includes both purchases made by households and purchases made on behalf of households. As a result, healthcare expenditures carry more weight in the PCE than the CPI-U. This is particularly relevant given the expansion of non-wage compensation previously discussed.

The use of two price indices for consumer goods provides us with a range of estimates for the trend in labor's terms of trade. Figure 21.2 plots the ratio of the GDP price deflator to the PCE index and the ratio of the GDP price deflator to the CPI-U from 1960 to 2010, with the ratio of the two indices set equal to one in 1960. If the price of wage goods changed at the same rate as the price of value-added, we would expect these ratios to be equal to one and remain constant. However, in both cases, the ratio of the GDP price deflator to the relevant index of wage goods fell over time—indicating a deterioration in labor's terms of trade. The fall is much more pronounced for the ratio based on the CPI-U compared to that based on the PCE, reflecting differences in the way the prices of wage goods are measured.

Interpreting the trends in Figure 21.2 along with the relationship presented in Equation 21.4 suggests that differences in the relative rates of change of the price indices would have contributed to a decline in the real labor share relative to the nominal labor share. The decline attributable to price movements would be most pronounced beginning in the 1980s—the same time period in which the nominal labor share begins to exhibit a long-run downward trend.

What do these trends shown imply about our interpretation of the labor share? Profit-seeking businesses will care more about the price of output or value-added than the cost of living and, from this perspective, the nominal labor share provides guidance of whether capitalist firms are feeling a profit squeeze. Since the labor share computed from nominal values of compensation and national income is relatively constant (rising modestly in the initial decades and falling slightly afterwards), there is no evidence of a significant profit squeeze, particularly in the later decades. However, in terms of labor's wellbeing, the real labor share provides a better guide. Here there is clear evidence of a decline, once price movements have been taken into account. Had labor been able to defend its living standards so as to keep the real labor share constant, this would have meant that the nominal labor share would have had to increase, causing a pronounced profit squeeze. This did not happen over the period examined here. The defensive strength of labor, identified by Weisskopf in his analysis of the profit share, has evaporated.

What is behind the fall in labor's terms of trade? Table 21.1 shows the annualized change in average prices, derived from both the PCE index and the CPI, for specific categories of goods and services consumed by households over the two most recent trough-to-trough business cycles (1991 to 2009). Consumer durables and certain categories of non-durable goods (for example, clothing) actually show a nominal price *decrease* over this time period. The

Figure 21.2 Labor's terms of trade index, based on the personal consumption expenditures (PCE) price index and the consumer price index, 1960–2010

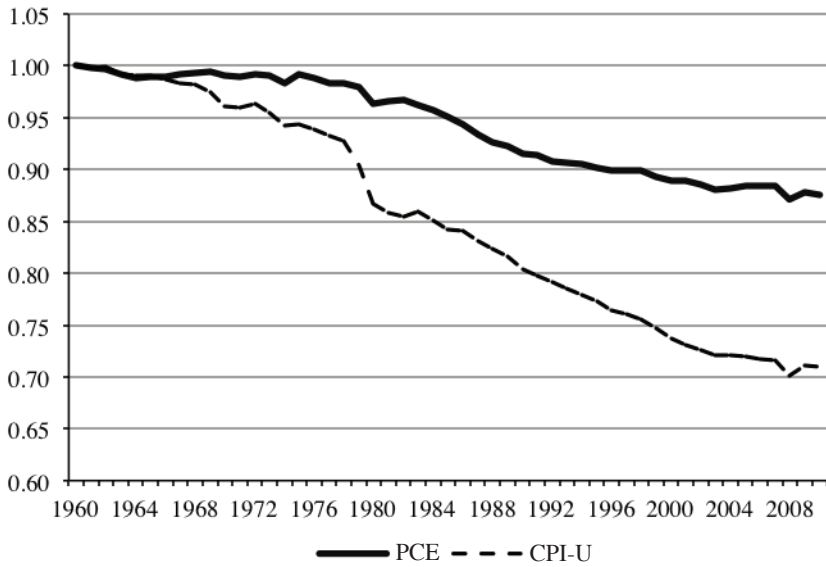


Table 21.1 Change in the personal consumption expenditure (PCE) price index and the consumer price index (CPI-U), 1991–2009, annualized rates of change

	PCE	CPI
Durables	-1.4%	-0.3%
Non-durables	-0.5%	2.4%
Clothing	-1.1%	-0.4%
Gasoline	4.2%	4.0%
Housing/shelter	3.0%	3.0%
Healthcare	3.3%	4.3%
Financial services	3.0%	3.8%
Whole index	2.1%	2.6%

Note: Aggregate categories of goods and services are not fully comparable between the PCE and CPI series.

Source: US Bureau of Economic Analysis and US Bureau of Labor Statistics.

prices of these goods have been subject to growing international production and imports from outside the US. Therefore, imports of consumer goods, specifically manufactured goods, do not appear to be driving the reduction in labor's terms of trade. However, a number of categories of goods and services do show above-average price increases over this period: housing, gasoline, medical care, and financial services. The price dynamics of these goods are subject to economic rents of various kinds. It appears that pressure from economic rents for critical consumer goods and services have pushed up the cost of living for US workers. These higher costs have not squeezed profits, but rather reduced the real income of working people.

## 21.4 WHO COUNTS AS LABOR?

As others have noted (Phillips, 1960; Krueger, 1999), the category of labor used to calculate the US labor share is broad: ranging from top-level management to low-paid contingent workers. Wage inequality—for example, between high-skilled and low-skilled employees—has been on the rise since the 1980s. Therefore, a constant labor share could mask long-run distributive shifts in the US economy. There is also the issue of the self-employed, whose income is treated as proprietor's income, despite the fact that a share of the income of most self-employed individuals is derived from their own labor. This latter issue was a particular concern in the first half of the twentieth century when there was ongoing migration from family farms into urban wage employment. This would be treated as a transfer of national income from capital to labor, even if the quantity and value of labor services remained the same. Some have suggested using a rule of thumb, counting about two-thirds of proprietor's income as labor compensation (Johnson, 1954).<sup>4</sup> Doing so helps explain some of the increase in labor share in earlier decades. However, over the period of time considered in this chapter, proprietor's income, as a share of national income, has remained relatively constant (that is, averaging 10.8 percent of private national income from 1960 to 1984, and 10.7 percent from 1985 to 2010), and standard adjustments for self-employed labor income would not affect the observed trends.

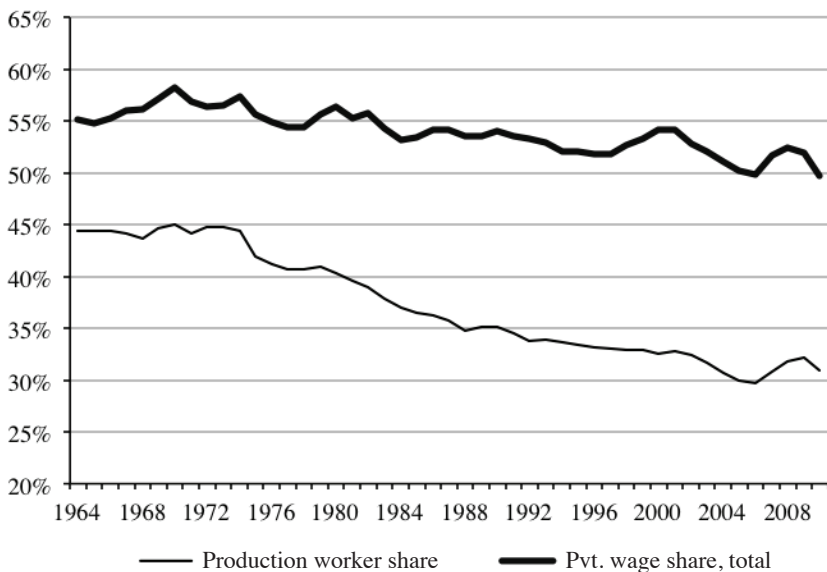
Greater inequality between categories of wage employees has become a more significant phenomenon since the 1980s. One approach to take this into account is to analyse trends in the compensation of production and non-supervisory workers relative to national income. Detailed information on the contribution of production and non-supervisory workers to national income is not readily available. Therefore, construction of a labor-share estimate for this group of workers is not a simple task, and would be sensitive to the methodology used to allocate national income between different groups of workers. Instead, the

labor income of production workers can be expressed as a share of *total* national income, and trends in this measurement tracked over time. Some have argued that the salaries of supervisory and management staff are better classified as a general overhead expense or as a component of capital income (Kalecki, 1938; Weisskopf, 1979; Mohun, 2006). Therefore, the labor share of production workers could be considered a better measure of the “true” labor share, in the sense that it better reflects payments to labor as a factor of production, rather than payments to individuals who oversee the labor process or manage various aspects of a capitalist firm.

To identify the trends in the labor share of production workers, we focus on the wage share of income. The limited availability of data on non-wage compensation for production workers over a relatively long time period makes this simplification necessary. Data on the hours and earnings of non-supervisory production workers from the Bureau of Labor Statistics were used to estimate total wage income of production workers in the non-farm private sector. Total income for the equivalent segment of the economy was taken from the system of national accounts.<sup>5</sup>

Figure 21.3 shows trends in the total wage share of the private business sector and the wage share which can be attributed to production and non-supervisory

*Figure 21.3 Total wage share and wage share of production workers, 1964–2010*



workers. Beginning in the early 1970s, the wage share of production workers, relative to total national income, began to exhibit a downward trend. This trend is more pronounced than the downward movement in total wage share. Indeed, the gap between the total wage share and the production worker share widens over this period, indicating that non-production, supervisory workers account for an increasing share of labor's wage income.

The fall in the wage share of production workers reflects the combined effects of several changes in the US economy. First, real wages of production workers declined over much of this period. Downward pressure on the wages of production workers and growing inequality among labor as a whole have contributed to the observed trends in wage share. However, labor share is not solely determined by wages, but also by the level of employment. The downward trend in the wage share of production also indicates that employment of production workers has lagged behind the growth in employment of non-production and supervisory workers. Such a change could be driven by an increase in the intensity of management over the labor performed by production workers (see, for example, Bowles and Jayadev, 2006). Alternatively, in an increasingly globalized economy, the US producers have been specializing in high value-added segments of the production chain which use non-production workers more intensively (for example, engineering or research and design), while the actual production is subcontracted out to producers around the globe (Feenstra and Hanson, 2001). Such specialization would also increase the ratio of non-production to production workers.

Others have pointed to similar dynamics lurking behind a nearly-constant labor share. For example, Krueger (1999) uses regression analysis to control wages for potential experience and education. He shows that the labor share based on his estimate of "raw" labor, purged of human capital type variables, has also declined. Analysis along these lines demonstrates that labor's share of income is itself unequally distributed and this reality must be taken into account when making claims about the functional distribution of national income and other indicators of inequality.

## 21.5 LABOR SHARE AND STRUCTURAL CHANGE

Changes in the total labor share might not simply be a reflection of a changing distribution of income between capital and labor. Instead, they can also represent a change in the composition of industrial sectors in the economy (Dunlop, 1966). Different industrial sectors exhibit a wide range of labor shares. If a low-share sector expands relative to a high-share sector, then total labor share will fall, even if there has been no other change in the dynamics governing the distribution

of income. Such structural shifts can be important to take into account when interpreting movements in the aggregate labor share.

If we examine average sectoral labor shares over the period 1991–2010, the lowest labor shares are in agricultural activities and finance. Durable goods manufacturing and some categories of private services have the highest average labor shares. Historically, durable goods manufacturing jobs were well-paid and often unionized. The category “other private services” includes higher-end service jobs—for example, various professional services (such as accounting, legal services, etc.). Within the broad sectors used in the US national income and product accounts, labor shares range widely—from a low of 31 percent to a high of 84 percent. An analysis of aggregate labor share will hide this diversity.

Overall changes in total labor share can be decomposed into various components to assess how important changes in industrial composition really are in influencing the observed trends. We separate two components of the overall year-to-year changes in the labor share: (1) changes that can be attributed to shifting industrial composition; and (2) changes that can be attributed to shifts in the labor share within a particular industry.<sup>6</sup> The sum of these changes gives us a measurement of the total contribution of these two components. Table 21.2 presents the sum of these annual changes over each trough-to-trough business cycle from 1961 to 2009, as determined by the National Bureau of Economic Research, with the cut-offs expressed as specific years. From 1971 to 1982 there were three business cycles. For the purposes of this exercise, I sum across the three cycles from 1971 to 1982 to keep the time periods in Table 21.2 roughly the same length.

Beginning with the effect of within-sector changes in the labor share, the calculation in Table 21.2 shows that, over the full period 1961–2009, a 2.3 percentage-point increase in the total private labor share can be attributed to changes in the labor shares within each sector. Put another way, if industrial composition had not changed, the labor share would have been 2.3 percentage points higher today than it was in 1960. However, the increase in labor share occurred during the first two periods shown in Table 21.2—from 1961 to 1982. In later periods, including the most recent business cycle, labor share has fallen, holding industrial composition constant.

Turning to the effect of changes in industrial composition, we find that the aggregate impact, summed across all sectors, is relatively modest. For all years, the total impact of changes in sectoral composition sum to a fall of 1 percentage point. However, these aggregate effects hide the sector specific changes. The rapid expansion of “other” services (that is, primarily the higher end of service activities) would have raised labor share by nearly 18 percentage points—even if within-sector labor share did not change. However, this is countered by the contraction of manufacturing activities—both durable and non-durable goods. A 16.1 percentage-point reduction in labor share can be attributed to the decline



Table 21.2 Decomposition of changes in total private labor share over recent business cycles

Sector	1961–70	1971–82	1983–91	1992–2001	2002–09	All years
<i>Change attributable to within sector shifts in labor share</i>						
Agriculture & forestry	0.1%	0.0%	0.1%	0.1%	-0.1%	0.3%
Mining & extraction	0.0%	-0.4%	0.3%	-0.3%	0.1%	-0.3%
Construction	0.1%	-0.1%	-0.2%	-0.4%	0.3%	-0.3%
Durable goods manufacturing	1.1%	1.0%	-0.9%	0.6%	-0.8%	1.0%
Nondurable goods manufacturing	0.4%	-0.5%	0.2%	-0.3%	-0.4%	-0.6%
Transportation/communication	0.2%	0.1%	-0.6%	1.2%	-1.0%	-0.1%
Trade, wholesale and retail	0.4%	0.9%	-0.4%	-0.8%	-0.2%	-0.1%
Finance, insurance, real estate	0.5%	0.4%	0.2%	0.6%	-0.1%	1.6%
Other private services	0.6%	1.1%	-0.1%	-0.3%	-0.4%	0.9%
Total	3.3%	2.5%	-1.4%	0.4%	-2.6%	2.3%
<i>Change attributable to shifts in industrial composition</i>						
Agriculture & forestry	-0.3%	-0.1%	-0.2%	-0.3%	0.1%	-0.7%
Mining & extraction	-0.2%	1.1%	-1.1%	0.0%	0.1%	-0.1%
Construction	0.5%	-0.7%	-0.1%	1.0%	-0.8%	-0.2%
Durable goods manufacturing	-1.3%	-2.9%	-1.9%	-3.0%	-1.2%	-10.3%
Nondurable goods manufacturing	-1.0%	-0.9%	-1.3%	-2.0%	-0.4%	-5.8%
Transportation/communication	-0.2%	0.1%	-0.4%	-0.1%	0.1%	-0.5%
Trade, wholesale and retail	0.5%	-0.9%	0.0%	-2.0%	-0.6%	-3.0%
Finance, insurance, real estate	0.2%	0.5%	0.7%	0.3%	0.0%	1.7%
Other private services	1.8%	2.5%	4.2%	6.3%	3.1%	17.9%
Total	0.0%	-1.2%	-0.3%	0.2%	0.3%	-1.0%
Combined change from both sources across all sectors	3.3%	1.2%	-1.6%	0.6%	-2.3%	1.2%

Source: US Bureau of Economic Analysis.

in these two sectors' share of national income. The changes associated with the remaining sectors are more modest. The aggregate result appears to show little contribution to labor share dynamics from structural changes in the US economy, but this hides a very dynamic story at the sectoral level.

## 21.6 CONCLUSIONS

This chapter had one central objective: to unpack the aggregate labor share and to look behind the common assumption that the US labor share has remained relatively constant during large stretches of the country's history. What I have tried to show is that a number of dynamic factors have been operating behind the aggregate indicator. These factors are not trivial and have enormous importance for how we interpret movements, or lack of such movements, in the labor share. Specifically, behind the seemingly mild upward or downward trends we observe since the 1960s lies a sizeable redistribution of labor income, significant structural changes, and critical movements in labor's terms of trade.

Weisskopf had shown that labor's defense strength contributed to a falling rate of profit from the mid 1960s to the mid 1970s. However, the analysis presented here indicates that the defense strength of labor is gone. The relatively stable labor share, measured using nominal values of compensation and income—both nationally and sectorally—imply that there is little ongoing pressure on profitability. If anything, profit shares have been growing in recent years. However, labor's real income has fallen, due to the more rapid increase in the price of wage goods. These adverse price movements have largely been due to the role of rents in the economy. The distributive adjustments that have been made in response to the pressures from economic rents has fallen on the shoulders of labor, not capital.

This chapter has highlighted the fact that labor income is unequally distributed and has become more so. This makes it increasingly difficult to draw clear welfare conclusions from changes in the functional distribution of income. A constant labor share may simply mean that the best-paid employees have seen their incomes rise at the expense of more vulnerable workers. These distributive dynamics can be characterized in multiple ways: from low-skilled to high-skilled workers, from production workers to the non-production, supervisory class of employees, or from traditional manufacturing to high-end services.

At the time of this writing, the US continues to struggle with a prolonged economic crisis, triggered by the meltdown in financial markets which became evident in 2007 and 2008. Looking to the future as the US economy emerges from the crisis, we can speculate on how the dynamics discussed in this chapter may play out. Although the crisis had its origins in the financial sector, finan-

cial institutions have recovered and are well placed to continue to seek out and protect the rents on which they flourish. This crisis, like no other recession in recent history, has led to claims that this downturn marks the beginning of the end of US economic dominance. The rise of China and other emerging economies foreshadow a different economic future, with a redistribution of economic power around the world. Such a reshuffling of the global order will undoubtedly involve large-scale adjustments in the US economy. Who will bear the brunt of adapting to these structural changes? If labor's defensive strength is gone, what does this imply for the future? Grappling with these questions is well beyond the scope of this chapter and would be inescapably speculative. Nevertheless, what this chapter can contribute is an insistence, à la Weisskopf, that macroeconomic analysis of distributive conflict remains essential; but we need to look into, behind, and beyond the usual variables to really see what is going on.

## NOTES

1. Alan Greenspan noted that growing insecurity among workers, due in part to technological changes, would have contributed to wage moderation and less inflationary pressure, despite low unemployment, in his monetary policy report to Congress in July 1997 (<http://www.federalreserve.gov/boarddocs/hh/1997/july/testimony.htm>).
2. In Kalecki's framework it is a reduction in the ratio of "turnover" (the total value of output including intermediate inputs) relative to income (total value-added) that lowers capital's share. This occurs because Kalecki defines the degree of monopoly power in terms of capital's ability to claim a particular share of total turnover, not income. Therefore, if turnover falls at a given level of monopoly power, the labor share of income rises.
3. This analysis is based on the long-run trends in the labor share, derived from observed values of the labor share over 5 decades. The chapter by Michael Reich, this volume, discusses recent trends in the labor share in which he emphasizes the decline in the labor share since 2001.
4. Johnson (1954) assumed 65 percent of proprietor's income represented labor income.
5. The BLS series on employment, hours of work, and wages of production and non-supervisory workers excludes work done on farms. Therefore, the contribution of farms to private national income had to be removed. To do this, the non-farm fraction of total proprietor's income was used to estimate compensation of employees among non-farm proprietorships and other contributions to national income from non-farm proprietorships.
6. The change in labor share that can be attributed to shifts in industrial composition is computed as the change in share of national income from time " $t-1$ " to time " $t$ ," multiplied by the industry-specific labor share in time " $t-1$ ." The change in labor share that can be attributed to shifts in the industry-specific labor share is computed as the change in the industry-specific labor share from time " $t-1$ " to time " $t$ ," multiplied by the income share in time period " $t$ ." The sum of these two terms is equal to the total change in labor share from time " $t-1$ " to time " $t$ ."

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## 22. Comment on Epstein, Crotty, and Heintz: humanizing political economy

**John Miller**

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When Charles Dickens launched his popular weekly, *Household Words*, he issued a plea for political economists to humanize their discipline. In his inaugural essay, Dickens wrote that, “Political economy is a mere skeleton unless it has a little human covering, and filling out, a little human bloom upon it, and a little human warmth in it.”<sup>1</sup> Humanizing political economy is surely a goal that we have all embraced. But few of us have contributed as much to reaching that goal and inspiring others to join in the effort to humanize political economy as Tom Weiskopf has.

The two chapters in this section take up important dynamics of the US macroeconomy in the spirit of humanizing political economy. In “How big is too big? On the social efficiency of the financial sector in the United States” Gerald Epstein and James Crotty ask how much of the activity of the US financial sector is “socially useless,” and how to reduce the US financial sector to a size that effectively serves the broader economy. In “Unpacking the US labor share,” James Heintz examines the multitude of factors that determine labor’s share of the income generated by the US economy.

### 22.1 EPSTEIN AND CROTTY: “HOW BIG IS TOO BIG?”

This is an ambitious chapter. Epstein and Crotty take up the multifaceted problem of determining the appropriate size of the financial system relative to services it provides to the “real economy,” and which of its activities are “not socially useful.” That is a huge undertaking that required some intense data grubbing. But with the help of “well-designed descriptive statistics,” much like those Tom Weiskopf often used to great effect, Epstein and Crotty make some real progress in making the case for performing the sort of liposuction on the bloat of the financial sector we all would like to see happen.

### **22.1.1 What Counts as Socially Useless Financial Activity?**

Epstein and Crotty, of course, are far from the first to point out that the US financial sector is “too big” and that much of what it does is “socially useless.” But unlike the others, Epstein and Crotty measure how much of financial activity is not functionally inefficient —a precondition for determining what it would mean to cut the financial sector down to size.

Epstein and Crotty have got at this question in two ways. They begin by describing how the ratio of the income extracted by the financial sector to the financing that the sector provides to the real economy (measured by what they call “the financing gap”) rose dramatically, beginning in the 1980s and reaching its peak in the 2000s (see Table 20.1).

Then using their micro-level data, Epstein and Crotty estimate wasteful financial sector activities by examining the five largest investment banks. Investment bank trading and trading-related activity—more or less their proprietary trading—serve as their first approximation of socially useless financial activity. That trading typically neither makes markets nor provides hedges for customers. Not socially useful financial activity turns out to be a surprisingly large share of the net revenues of those investment banks. In addition, the authors find that the losses on that proprietary trading, which constituted one half or more of the income of many of these banks just before the crash of 2007, were a main component of the losses that led to the financial crisis and the financial bailout.

But to what extent are Epstein’s and Crotty’s results peculiar to investment banks or the five large investment banks in their study? If data were available, would similar results hold for smaller investment banks or the rest of the financial sector—for instance, for the large commercial banks that dominate derivatives trading?

The answer to that question has important policy implications. For instance, should investment banks, or particular segments of the financial industry that are the locus of gambling, be the target of financial taxes such as transaction tax, or should those taxes be levied more widely across the financial sector?

### **22.1.2 Socially Destructive or Socially Useless?**

Epstein and Crotty also estimate that about one-third of financial sector innovation is “motivated by tax, accounting, and/or regulatory, ‘arbitrage’ or ‘evasion,’” rather than “simple efficiency improvements.” But the authors believe that these figures underestimate the socially inefficient share of financial innovation because they do not capture the destructive impacts of innovations such as CDOs. In addition, as they point out, their own earlier research shows “in great detail the destructive nature of many of these innovations.”

So how is it that we are to regard the CDOs and CDSs that, as Epstein and Crotty say, “helped to crash the system” and played such a key role in pushing up the rate of income extraction enjoyed by the financial sector in recent decades?

Is the trading of these financial instruments socially useless or socially destructive or both? And what exactly is the relationship between socially useless financial trading of investment banks and socially destructive financial innovation?

Consider for a minute a collateralized debt obligation, CDO, whose value is derived from the value of the mortgage-based securities on which it is based (which in turn derive their value from the value of the mortgages they contain). Is the buying and selling of such derivatives socially useless financial activity in the way Epstein and Crotty have defined the terms? Their first approximation suggests that CDOs are socially useless if they are part of the proprietary trading by an investment bank, but that they are otherwise socially useful.

But if CDOs (along with CDSs) “helped to crash the system” and are therefore socially destructive, does that obviate the need to sort through whether CDOs or their ilk are part of proprietary trading and therefore socially useless?

Would it not be better to consider the vast array of derivatives spawned by financial innovation, including CDOs as transaction costs—the costs of buying and selling financial instruments, or as a public finance economist would put it, “the costs associated with exclusion?”<sup>2</sup> And compared with many other commodities are not the transaction costs associated with selling financial services unusually high? Take groceries for instance. The salaries of the checkout clerks, the cost of cash registers, and the inconvenience of long lines are all transaction costs associated with selling groceries. But no checkout clerk gets paid what the buyers and sellers of securities do. And no checkout clerk ever contributed to a financial crisis like that of 2008. And if the level of waste and destruction that Epstein and Crotty report is endemic to the buying and selling of financial instruments, then doesn’t the public finance prescription for commodities with prohibitively high transaction costs apply: provide those commodities through the public sector?

## 22.2 HEINTZ: “UNPACKING THE US LABOR SHARE”

Heintz’s chapter responds to “Marxian crisis theory and the rate of profit in the postwar U.S. economy,”<sup>3</sup> Weisskopf’s classic article. Beyond that, Heintz manages to reproduce much of what was so influential about the Weisskopf article: its sharp insights rendered highly accessible through an extreme clarity.

In his article, Weisskopf examined the impact of three ratios on the US rate of profit from 1949 to 1975. Each ratio is drawn from a different strand of Marxist crisis theory, the rising organic composition of capital, a realization failure,

and the rising strength of labor. The labor share, which Heintz unpacks in his excellent chapter, is meant to be both a barometer of the strength of labor and labor's ability to squeeze profits.

Heintz concentrates on Weisskopf's finding that workers were able to push up their wage share by defending their position through improving terms of trade with the capitalist class and in that way squeeze profits in the period from the mid 1960s to the mid 1970s. There is nothing arbitrary about Heintz's emphasis. He has tackled what Weisskopf called "the most interesting of the empirical results" of his paper. Weisskopf summarized those results as follows:

The long-term decline in the rate of profit from 1949 to 1975 was almost entirely attributable to a rise in the true share of wages, which indicates a rise in the strength of labor. This rise, however, was largely defensive in nature. The working class did not succeed in making true real wage gains commensurate with the growth of true productivity; it merely succeeded in defending itself somewhat more successfully against a long-term deterioration in the terms of trade than did the capitalist class.<sup>4</sup>

I had two questions about Heintz's unpacking of the US labor share, and a comment about his chapter.

### **22.2.1 Heintz and Weisskopf on the Defensive Strength of Labor**

My first question is about Heintz's finding that "the defensive strength of labor ... has evaporated." Heintz points out that the "relative rates of change of prices indices [the CPI-U and PCE prices indices] would have contributed to a decline in the real labor share relative to the nominal labor share." He adds that "the decline attributable to price movements would be most pronounced beginning in the 1980s."

But to what extent do Heintz's results differ from the results in the Weisskopf paper for the years their studies overlap, from 1960 to 1975? And are the differences attributable to the choice of price indices or other factors strong enough to suggest that Weisskopf's finding that the defensive strength of labor lies behind the fall in the profit rate from the mid 1960s to mid 1970s does not hold and labor's defensive strength was already on the wane by then?

### **22.2.2 Changing Capitalism and the Real Labor Share**

One of the most impressive things about "Unpacking the US labor share" is how Heintz incorporates the changing contours of US capitalism into his analysis of the real labor share. Two of those trends are especially worth mentioning:

First, Heintz finds that the growing internationalization of production and the increased imports of consumer goods, specifically manufactured goods, into the United States were not driving the reduction in labor's terms of trade. The



prices of consumer durables and certain categories of non-durable goods—for example, clothing—actually decreased over the time period from 1991 to 2009. On the other hand, several categories of goods and services did show above-average price increases over this period: housing, gasoline, medical care, and financial services. Heintz attributes those rising relative prices to “pressure from economic rents.” Those rents reduced the real income of working people but “did not squeeze profits.”

Second, the dramatically worsening inequality of the last few decades, especially among wage workers, prompts Heintz to turn to the real labor share of production workers to gauge the strength of workers. Incorporating the rising inequality into any analysis of the real labor share is crucial at this moment. Despite a rising average income in the years before the crisis, most people experienced a virtual stagnation in their income and relied more and more heavily on credit to meet their needs.

### **22.2.3 How to Assess the Strength of Labor in an Era of Extreme Inequality?**

That brings me to my other question. Just how much does rising inequality alter Heintz’s analysis of the aggregate real labor share? In the current period, how useful is “the aggregate labor share” as a gauge of the strength of labor, either its offensive or defensive strength? Does “the aggregate real labor share” explain the declining strength of labor in today’s economy as well as “the aggregate real labor share” captured the rising strength of labor and its squeeze on the profit rate in the period from the mid 1960s to the mid 1970s?

Or should we concentrate on the labor share of production workers, as Heintz seems to suggest at some points, as the appropriate gauge of labor’s strength and labor’s impact on profitability?

## **22.3 RESTORING FINANCIAL STABILITY AND THE LABOR SHARE**

The Epstein and Crotty chapter and the Heintz chapter both expose the failure of the US economy to serve humanity. One estimates just how much of financial sector activity is socially useless and in some cases socially destructive. The other unpacks the trends that have left an ever-smaller proportion of national income devoted to the real labor share, especially of production workers.

Cutting down the financial sector to its functional size would help open up the space for the real labor share to rise again at the expense of profits and the rents extracted by the financial sector. That would help to restore macroeconomic

conditions like those that prevailed between the mid 1960s and mid 1970s when financial regulation was more extensive, financial crises were less frequent, and the real labor share was far greater than it is today.

## NOTES

1. As quoted by Sylvia Nasar in *Grand Pursuit: The Story of Economic Genius* (New York: Simon & Schuster, 2011), p. 10.
2. Joseph E. Stiglitz, *Economics of the Public Sector*, 3rd edn (New York: W.W. Norton and Company, 2000), p. 135.
3. Thomas E. Weisskopf, "Marxian crisis theory and the rate of profit in the postwar U.S. economy," *Cambridge Journal of Economics*, 1979(3), 341–78.
4. *Ibid.*, p. 370.

## 23. Social Structures of Accumulation, the rate of profit, and economic crises

**David M. Kotz**

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### 23.1 INTRODUCTION

From the early 1980s through the early 1990s, Thomas Weisskopf published a series of articles and two books—most of them co-authored with Samuel Bowles and David Gordon—that analysed the crisis of the postwar Social Structures of Accumulation (SSA) in the US in the 1970s based on movements of the profit rate.<sup>1</sup> The earlier SSA literature had viewed the relation between an SSA and capital accumulation as centered around the problem of instability in a capitalist system (Gordon et al., 1982). The central role of the profit rate in Weisskopf's work brought the SSA theory closer to traditional Marxist crisis theory (see Weisskopf, 1979).

Weisskopf and his co-authors' work in the SSA literature introduced the idea that an SSA, when it is working effectively, promotes a high rate of profit and that a structural, or SSA, crisis results from a profit-rate decline stemming from problems that arise in the SSA and its relation to capital accumulation. In the traditional Marxist crisis theory literature, one finds various possible causes of a decline in the rate of profit, such as a rising organic composition of capital (ratio of value of means of production to labor power) or a rising wage share. In one widely-cited empirical study, Weisskopf found the latter, often called the "profit squeeze" crisis tendency, to be the main explanation for a long-term fall in the rate of profit in the postwar decades in the US. This suggested an explanation for the 1970s crisis of the post-World War II SSA (Weisskopf, 1979).

Many analysts view the current crisis, which began in 2008, as the structural crisis of the neoliberal SSA.<sup>2</sup> Most analysts view the current crisis as having rather different causes from that of the previous SSA crisis. However, this chapter goes further, arguing that the current crisis cannot be effectively analysed by focusing on movements in the rate of profit. Instead, this crisis results from unsustainable trends that were produced by the neoliberal SSA, which led to

a crash in 2008 that ended the ability of the neoliberal SSA to any longer effectively promote capital accumulation.

The analysis presented here draws on strands in Marxist crisis theory that approach crisis not within a rate of profit framework but within a circuit of capital framework. The circuit of capital framework has the advantage of effectively integrating within a single framework several crisis tendencies in capitalism including those not based on profit rate movements. A key lesson drawn from this analysis is that differences between particular SSAs imply a different process of SSA breakdown and different causes of the SSA crisis.

Section 23.2 uses a circuit of capital framework to consider two different kinds of crisis, one due to a problem in the creation of surplus value and the other due to a problem in its realization. Section 23.3 considers the role of movements in the rate of profit in the crisis of the 1970s and that of today in the US. Section 23.4 examines the main features of the last two SSAs, the postwar regulated capitalist SSA and the neoliberal SSA. Section 23.5 analyses the crises of the last two SSAs in the US, showing why the rate of profit was central to the first crisis but not to the second (current) one. Section 23.6 offers concluding comments.

## 23.2 THE CIRCUIT OF CAPITAL, THE RATE OF PROFIT, AND REALIZATION PROBLEMS

The most comprehensive framework for analysing accumulation and crisis is the circuit of capital framework. Developed by Marx, the circuit of capital is represented by the symbols  $M-C-C'-M'$ .<sup>3</sup> This process has three steps. The first is an exchange of money capital ( $M$ ) for productive commodities ( $C$ ), with no change in value. The second is the production (or labor) process, in which the productive commodities give rise to new commodities ( $C'$ ), whose value exceeds that of the productive commodities due to the appearance of surplus value at this step. The third and last is another exchange, in which the final commodities are sold for money ( $M'$ ), which in Marxist terminology is referred to as the *realization* of the value (and surplus value) “contained in” the final commodities.

The capitalist accumulates (uses part of the surplus value to enlarge the capital) to gain increased surplus value in the future. However, the capitalists as a group do not always accumulate; whether they do depends on the conditions. An interruption of accumulation—an economic crisis—can result from one of two different types of problem in the circuit of capital. First, a problem in the creation of surplus value—at steps 1 or 2—can reduce the surplus value created relative to the capital invested. In that case, the profit rate would decline, and, it is assumed, if the decline is big enough, the capitalists may “put their money

in the bank” rather than throwing it back into the production and accumulation process, waiting for profitability conditions to improve.

The second type of problem is one that arises in the realization of value. If the capitalists as a group cannot realize all of the value, there are two consequences. First, the “realized rate of profit,” measured by the ratio of the amount of surplus value realized to the capital invested, would fall below the rate of profit in production. The second is that the very appearance of a realization problem implies that too much has been produced. This in itself would tend to cause the capitalists to immediately reduce the quantity of output. A realization gap would produce some combination of price decline and decline in the quantity of output sold. The latter implies that unwanted inventories of finished goods remain on hand, which would indicate that production should be decreased.

A realization problem cannot be adequately taken into account in an analysis of crisis tendencies by focusing only on the rate of profit, even the realized rate of profit. A realization problem would reduce the realized rate of profit below what it would have been had there been full realization, but it would not necessarily reduce it below the previous period’s realized rate of profit. In the face of a realization problem, even if the realized rate of profit has not fallen, the capitalists would have good reason to cut back on production. Furthermore, a mild fall in the realized rate of profit due to a realization problem may be associated with a big drop in the incentive to produce, stemming from unsold goods.

Thus, a decline in the rate of profit in production, due to a problem in step 1 or step 2, can set off an economic crisis. However, if the initial problem is in the realization of surplus value, then the crisis is set off by the direct effect on production/accumulation of the realization problem rather than a decline in the rate of profit, either in production or realized.

We will argue below that, for the first postwar SSA in the US, the structural crisis that arose in the late 1960s/early 1970s was due to a problem in the creation of surplus value. As a result, a profit rate framework is suitable for determining the underlying cause of the crisis. However, we will argue that, for the neoliberal SSA, the problem was realization rather than creation of surplus value, and hence a profit rate analysis is not appropriate for determining the underlying cause of the structural crisis.

### 23.3 THE RATE OF PROFIT IN TWO SOCIAL STRUCTURES OF ACCUMULATION

Most SSA analysts view the postwar SSA in the US as starting to effectively promote accumulation around 1948, which is conveniently a business cycle peak year. SSA analysts generally view 1966 as the year after which the SSA

began to encounter problems, reflected initially in a steep decline in the rate of profit (see Figure 23.1). Some date the SSA “peak” at 1966, while others choose 1973 on the grounds that severe macroeconomic problems began after the latter year. From 1973 to 1979 both inflation and unemployment showed rising trends, the international monetary system exhibited increasing instability, and the dominant Keynesian economic management policies proved unable to rectify the situation. Also, the growth rate of output per hour in the non-farm business sector, which slowed only modestly from 2.92 percent per year in 1948–66 to 2.46 percent per year in 1966–73, dropped by more than half to 1.14 percent in 1973–79, a fact that was widely noticed at the time (US Bureau of Labor Statistics, 2009). The period 1973–79 is usually viewed as the heart of the postwar SSA crisis phase.

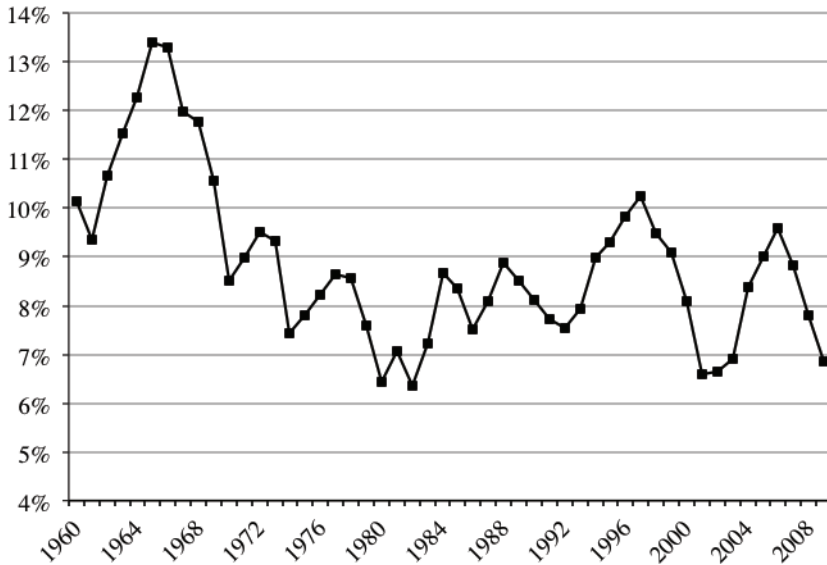
Neoliberal restructuring began around 1979, and we view the neoliberal SSA as established by the early 1980s.<sup>4</sup> The main institutions of the neoliberal SSA had all been put in place by the early 1980s (Kotz and McDonough, 2010; Kotz, 2009a). Inflation was conquered by 1983, and the long-run profit rate trend shifted from down to up after 1982 (see Figure 23.1). Three long economic expansions followed, in 1982–90, 1991–2000, and 2001–2007. In our view, the neoliberal SSA entered its crisis phase abruptly in 2008.

Figure 23.1 shows both the relevance of the movement of the profit rate for the initiation of the crisis phase of the postwar SSA, as well as the failure of the profit rate to register a structural crisis prior to 2008. After 1966 the profit rate fell steeply despite continuing rapid GDP growth through 1969. The extent of the long-term decline can be seen by examining profit rate peak-to-peak declines from 1965–81. From its peak in 1965, the profit rate fell by 30.0 percent from 1965–72, which was just before the heart of the SSA crisis phase began in 1973. The profit rate declined by another 9.2 percent from 1972–77, and by 18.3 percent from 1977–81. Over the whole period 1965–81, the profit rate fell by 48.0 percent, which is quite a significant decline.

From Figure 23.1 we can see that no such sharp long-term profit-rate decline preceded 2008. Again using a profit rate peak-to-peak measure, the profit rate rose from 1981–84, 1984–88, and 1988–97. During the last profit rate peak-to-peak period before 2008 of 1997–2006, the profit rate fell but only by 8.3 percent.

Figure 23.1 suggests that the profit rate did not play the same key role in the crisis of the neoliberal SSA as it did for that of the postwar SSA. We now turn to an analysis of the two SSAs and their crises to discover why the profit rate played different roles in the two cases.

Figure 23.1 The rate of profit of the US non-financial corporate business sector



*Note:* Pretax profit with inventory valuation and capital consumption adjustments plus net interest and miscellaneous payments divided by produced assets (structures, equipment and software, and inventories) at reproduction cost.

*Source:* US Bureau of Economic Analysis (2011b), Fixed Asset table 4.1, table S.5.a, and NIPA table 1.14.

## 23.4 TWO DIFFERENT SOCIAL STRUCTURES OF ACCUMULATION

The US (and the global capitalist system) has had two quite different SSAs since World War II. The postwar SSA is often called the “regulated capitalist SSA,” since economic relations and behaviors were subject to significant regulation, not just by market forces, but by the state, trade unions, and large corporations. The neoliberal SSA has been characterized by a much smaller role for such institutions in regulating economic relations and behaviors, with a correspondingly larger role played by market forces.

The postwar regulated capitalist SSA had five key features. First, the capital–labor relation was based on a compromise that granted significant rights and powers to organized labor. Second, the state played an active, interventionist role in the economy through policies to promote growth, high employment, and

low inflation; through various forms of regulation of business; by provision of public goods; and via income supplementation programs. Third, capital–capital relations were characterized by a restrained, co-respective form of competition among large corporations. Fourth, the relation between the financial and non-financial sectors constrained the financial sector to mainly provide financing for productive activity by the non-financial sector of capital. Fifth, the dominant ideology was that of the “mixed economy,” which, while claiming the superiority of a “market economy,” also viewed an active state and strong trade unions as necessary to achieve good economic outcomes and to avoid such potential disasters as another Great Depression.

While one can describe the postwar SSA by giving a long list of institutions, the above characterization of it indicates that it had a definite coherence. That is, the various institutions tended to reinforce one another and to work together in promoting accumulation. While in some sense the centerpiece of the postwar SSA was the capital–labor compromise, the principle of coherence of that SSA was active regulation of economic relations and behaviors by various types of institutions other than market forces. The capital–labor compromise would not have been viable without the other features mentioned above.

The neoliberal SSA was so different from the previous SSA that, at first, no one thought it was a new SSA. Instead, many SSA analysts at first viewed neoliberal policies as temporary expedients intended to weaken labor, preparing the way for a future new SSA that would be again based on active state regulation.<sup>5</sup> However, by the late 1990s it became apparent that neoliberal restructuring had created a coherent, long-lasting institutional structure that appeared to be promoting capital accumulation, and the SSA literature swung toward viewing neoliberalism (or the institutions associated with it, such as globalization) as a new SSA.

The neoliberal SSA also has had five key features, each more or less the opposite of the five that characterized the preceding regulated capitalist SSA. First, capital strived to fully dominate labor and increasingly succeeded in doing so over time. Second, the state withdrew from the economy to a significant extent, via renunciation of the pursuit of high employment, deregulation, privatization, reduction in the provision of public goods, and elimination of or cutbacks in income maintenance programs.<sup>6</sup> Third, capital–capital relations shifted to unrestrained competition among large corporations, bringing price wars back to the world of the large corporation. Fourth, the financial sector, rather than directing funds into productive uses, increasingly separated from the non-financial sector to pursue speculative profits via purely financial operations (Kotz, 2011b). Fifth, the dominant ideology was a revived and somewhat updated liberal ideology that glorifies individualism, unfettered competition, and market relations, while viewing state intervention as a threat to individual liberty and economic efficiency.



The neoliberal SSA also has a principle of coherence, which is the expansion of market relations at the expense of other forms of economic regulation. In the neoliberal era, market relations have penetrated institutions from which they had previously been largely excluded, including states and educational institutions. Even the management structure of large corporations, previously governed by bureaucratic relations, was significantly marketized, as top managers came to be hired from the outside in a market for corporate executives, replacing the old bureaucratic system of promotion from within.

## 23.5 TWO DIFFERENT CRISES

Weisskopf and his co-authors argued that the regulated capitalist SSA was undone by successful resistance to exploitation/oppression by workers, other countries that had been dominated by US imperialism, and US citizens who demanded an expansion of their rights including increased state regulation of capitalist activities that negatively affected the citizenry. These three forms of resistance raised costs for capital, driving down the profit rate after 1966. Capital was unable to successfully beat down this resistance, and begin to restore profitability, until the early 1980s by using contractionary fiscal and monetary policies—which we view as a part of the construction of the new neoliberal SSA.

How should one regard this process of declining profitability? It is a kind of “profit squeeze,” but not the cyclical variety that results from a temporary decline in unemployment. One can argue that the manner of the demise of the regulated SSA was not an accident.

The regulated capitalist SSA empowered labor. It enabled the trade union movement to grow stronger. It enabled labor to win victories not only through economic strength but through political action, expanding social welfare programs that in turn contributed to greater economic bargaining power. Similarly, the acceptance in this SSA of the principle of active state regulation of business provided an opportunity for citizen groups to steadily push back against corporate efforts to impose external costs of production on the citizenry. On the other hand, it is not obvious how the uprising of Third World raw material suppliers can be fitted into such an “endogenous” story. The latter appeared to result from a weakening of US power in the world as US forces became bogged down in Vietnam at the same time as US economic prowess was declining relative to that of its advanced capitalist rivals. But at least a large part of the profit squeeze can be attributed to the normal working of a regulated capitalist SSA over a period of several decades.

In any event, the crisis of the regulated capitalist SSA was clearly a crisis of profitability due to rising costs—that is, a problem in the creation of surplus

value. This has implications for the nature of the structural crisis. A decline in profitability does not set off an immediate crash of the economy, as we can observe during 1966–79. The US economy continued to expand from 1966–69, apparently due to demand stimulation from rising Vietnam War spending.<sup>7</sup> Three years later, in 1969, the economy hit a business-cycle peak when fiscal policy turned contractionary, and a mild recession followed in 1970 (GDP fell by only 0.6 percent). The next recession, in 1974–75, was more severe, with GDP falling by 3.2 percent and the unemployment rate reaching 9.0 percent.<sup>8</sup> But the peak-to-peak GDP growth rates of this period were well above stagnation level: 3.6 percent per year in 1969–73 and 3.0 percent per year during the heart of the crisis from 1973–79. The crisis of the regulated capitalist SSA, set off by a decline in the rate of profit, appeared in the macroeconomic indicators in the form of secularly rising unemployment and inflation, and growing international monetary instability, with a modest reduction in the long-term rate of growth and capital accumulation but not a crash of either the financial or real sector.

That the crisis of the regulated capitalist SSA was a profitability crisis also has implications for the appropriate framework for analysing the crisis. The regulated capitalist SSA tended to generate rising aggregate demand over time. This was one factor accounting for its inflationary bias. The capital–labor compromise enabled workers, through collective bargaining (and its pressure on non-union employers), to raise their real wages over the long run in step with rising labor productivity. From 1948–73, real wages of non-supervisory workers rose at 2.2 percent per year while output per hour rose only slightly faster, at 2.4 percent per year, indicating that productivity gains were almost equally shared by labor and capital (US Bureau of Labor Statistics, 2009). Household income distribution became somewhat less unequal over the period, as the share of income received by the top 5 percent and top 20 percent fell slightly, while that received by the bottom 20 percent rose slightly from 1948–73 (US Bureau of the Census, 2010). At the same time, government spending on social programs and public goods grew rapidly. The result was that there was not a long-run problem in the realization of surplus value under that SSA. Since realization was not a problem, that leaves only a problem in the creation of surplus value as a potential cause of long-run crisis. Hence, a rate of profit framework is suitable for analysing the source of the crisis for the regulated capitalist SSA.

The neoliberal SSA was a quite different type of SSA. All of its institutions produced favorable conditions for the creation of surplus value (Kotz, 2009a). However, at the same time, the institutions of the neoliberal SSA created a problem for the realization of surplus value. From 1979 to 2007 the real average hourly earnings of non-supervisory workers declined slightly, while output per hour rose at an annual rate of 1.91 percent, for a total increase of 69.8 percent over the 28-year period (Kotz, 2009a, p. 308). Total real profit rose at 4.6 percent per year while total real employee compensation rose by 2.0 percent per year over

the same period, and the gap between the two grew over time—in 2000–2007, profits rose more than eight times as fast as compensation (Kotz, 2009a, p. 310). Household income became much more unequally distributed over the course of the neoliberal era, reversing the equalizing trend of the regulated capitalist era and, by the mid 2000s, reaching levels not seen since 1928 (Kotz, 2009a, p. 310). Also, cutbacks in state social programs and public goods provision were unfavorable for the realization of surplus value.

At the beginning of the neoliberal era, many Marxist analysts wondered how such a form of capitalism could bring accumulation at all in light of such an apparently severe realization problem. However, the neoliberal SSA did promote accumulation and even particularly long economic expansions, as was noted above. The recessions of 1991 and 2001 were both relatively mild. This record indicated that in some way the neoliberal SSA was resolving, or postponing for decades, the realization problem. Indeed, it must have done so in order to be an SSA.

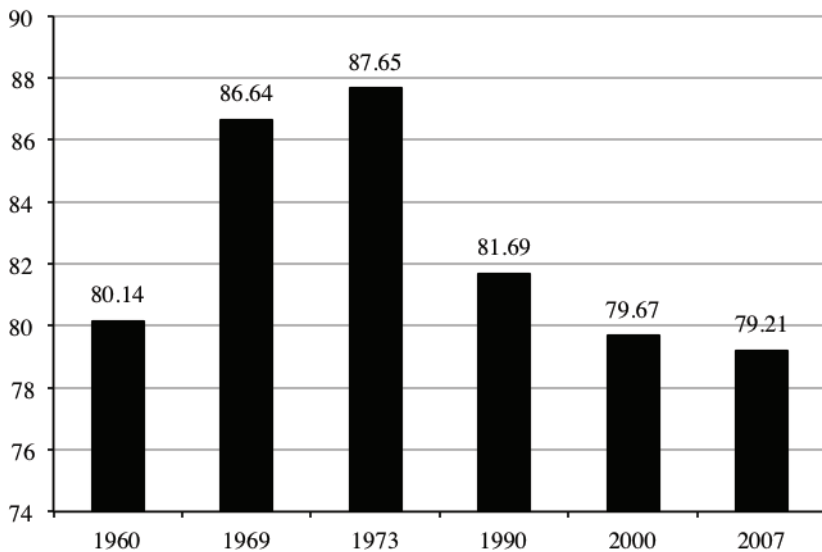
The key to resolving the realization problem in the neoliberal SSA was that the same institutions that created favorable conditions for the creation of surplus value also produced two features that together resolved—or rather postponed—the realization problem created by those institutions. Those two features were a financial sector that became engaged in increasingly speculative and risky activities and a series of large asset bubbles. These features of the neoliberal SSA and their role in postponing the realization problem are described in detail in Kotz (2009a). Briefly, the growing inequality of the neoliberal SSA generated a surplus of investable funds, relative to available productive investment opportunities, that tended to find its way into purchasing assets. That tended to produce asset bubbles. However, a big asset bubble requires a financial sector prepared to finance the speculative, risky activity of investing in an asset whose market price is rapidly rising above what appears to be its economic value—and the deregulated financial sector of the neoliberal SSA was prepared to do just that. Thus, in every decade of the neoliberal era there was a large asset bubble in the US: in the 1980s in Southwestern commercial real estate; in the 1990s in the stock market; and in the 2000s in real estate as a whole.

The asset bubbles postponed the realization problem by enabling a major part of the population to increase its consumption over time based on the rising paper wealth created by the asset bubble. This process also required an accommodating financial sector, ready to lend money to households based on their asset bubble wealth, since if households had to sell the assets to spend their rising value, the bubble would immediately deflate. The asset bubbles also tended to directly promote business investment, by creating an atmosphere of euphoria and confidence about future profits. This process occurred in the US in the 1990s expansion based on the stock market bubble (Kotz, 2003) and in the 2000s expansion based on the real estate bubble (Kotz, 2009a).

The rate of profit, shown in Figure 23.1, shows no sign of a long-term problem during 1979–2007. While the rate of profit fell after its peak in 1997 through 2001, it then recovered, slowly at first and then steeply through 2006, reaching a level in 2006 that was 92 percent of its 1997 high for the neoliberal era. However, a problem can be seen in the series on capacity utilization.

Figure 23.2 shows the capacity utilization rate in manufacturing, which rose from peak to peak for the last three peaks of the regulated capitalist era. By contrast, for the last three business-cycle peaks of the neoliberal era, the pattern is the reverse, declining from peak to peak. In addition, Figure 23.2 shows that the rate of capacity utilization in 2007 was substantially lower than it had been in 1973, the last year before the start of the heart of the crisis of the regulated capitalist era.<sup>9</sup> This suggests that, while demand growth was not a problem in the regulated capitalist era, it was increasingly problematic over the neoliberal era. While mainstream economists have touted the disappearance of any significant inflation in the neoliberal era, it probably mainly reflected the realization problem endemic to that era, which had been only partially postponed through the bubble and borrowing process described above.

*Figure 23.2 Capacity utilization rate in manufacturing*



*Note:* The years shown are the last three business cycle peak years of the regulated capitalist SSA and of the neoliberal SSA.

*Source:* US Federal Reserve System, 2011.

The structural crisis of the neoliberal SSA finally arrived, not due to a falling rate of profit, but due to the collapse of unsustainable trends that were essential features of the neoliberal SSA and of its ability to promote capital accumulation. Several decades of long expansions made possible by household borrowing, in the face of slow or no growth of household income, produced a long-term increase in household debt relative to household income. In the period 1965–79 the ratio of household debt to disposable income showed no trend, rising in expansions and falling in recessions. However, after 1979 it began a long-term climb, more than doubling from 63.9 percent of disposable income in 1980 to 128.8 percent in 2007 (Kotz, 2009a, p. 314). This unsustainable trajectory was driven by the series of asset bubbles; once the real estate bubble collapsed in 2006–2007, it was bound to reverse as households would have to then pay down their debt. Thus, once the housing bubble burst, consumer spending was bound to decline, setting the stage for a sharp recession.<sup>10</sup> From 2005 to 2009, consumer spending as a share of disposable income fell from 95.1 percent to 90.6 percent, eliminating virtually all of the rise in that ratio that had been produced over 2 decades by the two big bubbles (Kotz, 2011a, p. 15).

Kotz (2011a) examined quarterly GDP data, showing that the 2008–2009 recession, which started in the first quarter of 2008, began with a decline in consumer spending in the first quarter of 2008 while business fixed investment spending was still rising.<sup>11</sup> As would be expected, business fixed investment quickly followed, starting to decline in the second quarter of 2008 and continuing to decline at an accelerating rate through the first quarter of 2009 and starting to rise only in 2010-I (Kotz, 2011a, p. 19). Since the recession officially ended after 2009-II, GDP growth has been tepid, at 2.5 percent per year (through 2011-II), with 40 percent of the growth due to inventory accumulation rather than rising final demand (US Bureau of Economic Analysis, 2012).

What can we conclude about the ultimate cause of the structural crisis of the neoliberal SSA? The collapse of the unsustainable trends, that were necessary for the neoliberal SSA to promote capital accumulation, has rendered that SSA no longer able to promote accumulation. Households cannot take on further debt to raise their spending. The financial collapse of 2008 left the financial sector no longer able to promote large asset bubbles. Among the remains of the neoliberal SSA is its continuing ability to repress wages, and this has led to some increase in profits. However, without a means to further postpone the realization problem, the neoliberal SSA cannot bring high profits and accumulation over the long run. The rate of industrial capacity utilization, which reached a low of 67.7 percent in 2009—the lowest rate on record—had recovered only to 78.0 percent by the fourth quarter of 2011 after 2.5 years of “recovery” (US Federal Reserve System, 2012).

The realization problem of neoliberal capitalism might appear to fit the traditional Marxist crisis tendency of underconsumption. The latter crisis tendency

occurs when rising profits and stagnating wages lead to inadequate consumer demand. However, based on the above analysis, it was not underconsumption that led to the structural crisis of neoliberal capitalism, since the neoliberal SSA provided a means to avoid underconsumption through rising debt.

The crisis tendency that appears to explain the structural crisis of the neoliberal SSA is a form of over-investment. During the neoliberal era, rising debt maintained consumer spending on a rising trajectory despite stagnating wages, and the capitalists increased productive capacity to serve the rising consumer demand. The data cited above, indicating a long-term decline in capacity utilization at least in the industrial sector, suggest that the series of asset bubbles also directly stimulated business investment, causing the creation of even more productive capacity than was needed to satisfy final demand. Once the last asset bubble burst, causing consumer spending to fall toward a normal relation to disposable income, what had seemed to be necessary productive capacity during the bubbles, or only slightly more capacity than was necessary, suddenly turned out to be greatly excessive productive capacity. Business fixed investment dropped by 22.4 percent in the recession of 2008–2009, and by 2011-IV it was still 7.6 percent below its previous peak, indicating a seriously depressed incentive to invest on the part of capital 2.5 years after the cyclical trough in 2009 (US Bureau of Economic Analysis, 2012). This is consistent with a large overhang of unusable productive capacity due to excessive investment prior to the crisis.

## 23.6 LESSONS FOR THE SSA THEORY OF CRISIS

A common refrain in the SSA literature is that every SSA, and every SSA crisis, is unique. This chapter argues that it is possible to say more than that about SSAs and their crises. If SSAs are either of the regulated or liberal type, as has been suggested here, then we can say something more definite about SSA crises, since a regulated SSA and a liberal SSA each appear to have a characteristic type of crisis.

An earlier paper by this author (Kotz, 2009b) found evidence that the periodic business-cycle recessions in the US during the regulated capitalist SSA were all caused by a profit squeeze due to real wages rising faster than labor productivity in the late stage of each cyclical expansion, as the unemployment rate fell and labor's bargaining power rose. However, there was no late expansion profit squeeze in the neoliberal era through 2001 (the limit of the data for that paper), but, instead, each cyclical recession was found to be due to over-investment.

This chapter suggests a hypothesis about the form of the structural crisis for each type of SSA. The structural crisis of a regulated SSA takes the form of a profitability crisis stemming from the capital-labor relation and perhaps

the relation of capital to other groups, as over time a regulated SSA leads to a loss of power on the part of capital. The resulting crisis tends to involve rising unemployment and inflation and various forms of economic instability rather than a sudden economic collapse. This is not the same as the cyclical profit squeeze due to a declining unemployment rate, although it is in some respects similar to that crisis tendency.

On the other hand, the structural crisis of a liberal SSA is set off by the bursting of a large asset bubble that had been a critical underpinning of economic expansion. The bursting bubble suddenly turns what had been sustainable debt levels into unsustainable ones, and what had been necessary productive capacity into excess capacity. The result is both a financial crisis and a collapse in aggregate demand. The crisis of a liberal SSA takes the form of a big bang followed by stagnation rather than a period of economic instability.

It must be admitted that the above hypothesis cannot be definitively demonstrated empirically at this time. There has been only one fully-developed regulated capitalist SSA in the US, and generalizing from a single example is hazardous even for an economist. One can argue that there have been two liberal SSAs in the US since the start of the twentieth century, the first one in the 1920s. The 1920s SSA had many of the same features as the neoliberal SSA, and of course it ended with a collapsing asset bubble and severe depression. However, of course, even two examples do not provide a firm basis for generalizations, so the argument of this chapter does not yet have strong empirical support. Perhaps the strongest conclusion to be drawn is that any effort to analyse capitalist crises should not be restricted to factors that are expressed through a fall in the profit rate. While a falling profit rate can be the key to a crisis, it is not the only source of either cyclical or structural crises. Crisis analyses should consider possible realization problems as well as profit-rate problems if they are to be adequate for explaining the variety of ways capitalism can produce crises.

## NOTES

1. As is noted below, what is often called the economic crisis of the 1970s had its roots in the late 1960s.
2. It is too early to be certain that the neoliberal SSA entered its crisis phase in 2008. However, several developments suggest that 2008 marks the beginning of the crisis phase, including the following: (1) the dramatic financial and economic collapse of 2008–2009; (2) the foreclosure of the possibility of continuing rapid growth in household debt which had been a key part of the neoliberal SSA; and (3) the economic stagnation that has gripped the developed capitalist countries since 2009.
3. See Marx (1957).
4. There is significant disagreement in the SSA literature about the starting date of the neoliberal SSA, or even whether the contemporary SSA should be identified as “neoliberal.” See Kotz and McDonough (2010) for a detailed argument in favor of defining the contemporary SSA as neoliberal.

5. For example, this author held that view through the mid 1980s. See also Bowles et al. (1983).
6. The state did not go back to its role prior to the Great Depression, when state spending was a tiny percentage of GDP. Some parts of the state budget have grown rapidly in the neoliberal era, including military spending (following a brief reduction upon the end of the Cold War), social security pensions (which so far have survived the neoliberal assault on income maintenance programs), public medical expenses, and incarceration expenses.
7. A number of economic indicators suggest that in 1966 the economy was poised to head into a recession, but military spending postponed the recession for 3 years.
8. The GDP declines are from the peak quarter to the trough quarter. The recession of 1982 was even more severe by some measures, but it was caused by extremely high interest rates, not a falling profit rate. As Figure 23.1 shows, the profit rate actually rose in 1981, the year before the 1982 recession.
9. The broader series for the industrial capacity utilization rate, which includes mining and power utilities as well as manufacturing, shows the same trends as the series for manufacturing alone. However, the broader industrial utilization rate series begins only in 1967.
10. Financial sector debt grew even faster than household debt, as financial institutions used more and more leverage to take maximum advantage of the enormous flow of profits they were gaining during the real estate bubble. This was a major factor in the financial crisis that broke out following the deflation of the housing bubble.
11. A major revision in GDP series back to 2003 by the US Bureau of Economic Analysis, released on July 29, 2011 (US Bureau of Economic Analysis, 2011a), produced some change in the consumer spending and business fixed investment series. In the newly revised series, in 2008-I consumer spending started to fall, at a 1.0 percent annual rate (revised from a 0.8 percent rate of decline). However, business fixed investment, instead of continuing to increase at a 2.0 percent annual rate in that quarter, was found to decline slightly at a 0.8 percent annual rate. The decline in consumer spending in 2008-I contributed 38.9 percent of the decline in GDP in that quarter, while the decline in business fixed investment contributed only 5.6 percent of the decline in GDP.

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## 24. Exploitation without subsumption: the scope and limits of proto-industrial exploitation<sup>1</sup>

**Gilbert L. Skillman**

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My purpose in this chapter is to begin an investigation of the microeconomic logic underlying the Marxian concept of *subsumption of labor under capital* (SLC), understood as the imposition of capitalist control over the process of commodity production. Although Marx did not extensively analyse SLC as such until the second draft of *Capital* (the sprawling Economic Manuscript of 1861–63<sup>2</sup>), the notion that capitalists exercise direct and historically progressive control over the labor process is fundamental to the Marxian critique of capitalism, and informs other core aspects of Marxian theory such as the respective distinctions between labor and labor power and absolute and relative surplus value. Marx omitted most of his discussion of the concept from the published editions of *Capital*, Volume I, despite having carried over the core elements of his theory of SLC to the penultimate draft in a chapter called “Results of the immediate process of production” that he also dropped from the published version. Since Marx’s pre-publication drafts of *Capital* were not widely available until the last third of the twentieth century, his definition and analysis of this concept has consequently not received as much attention as other aspects of his economic theory.

There is, of course, a large and growing literature that analyses capitalist production within a Marxian framework, broadly conceived. Beginning with the seminal contribution of Marglin (1974) (see also Gintis, 1976; and Reich and Devine, 1981), there have been a number of efforts within the heterodox literature inspired by Marx’s critique to account for the specifically economic logic of capitalist control of commodity production, perhaps the most developed of these being Bowles and Gintis’s (1990) analysis of capital–labor relations as “contested exchange.” While this literature has contributed greatly to our understanding of the economic consequences of SLC at a relatively advanced stage of capitalist development, contributions in this area have tended to take the fact of capitalist ownership and control of commercial enterprises as given,

and thus do not seek to establish the systemic preconditions for SLC or the basis for its progressive historical development. This latter-day approach is consistent with Marx's narrative in the published version of *Capital* Volume I, which focuses solely on capitalist production employing wage labor as the vehicle for exploitation in private ownership economies.

But in his historical discussion of capitalist exploitation in the three drafts of *Capital* prior to the 1867 publication of Volume I, Marx consistently acknowledged cases in which capitalists exploited labor and appropriated surplus value without directly controlling the production process, subject to the caveat that these "antediluvian" forms of the circuit of capital (in which usury or merchant capital was used to finance commodity production) faced limitations that are surmounted by capital-labor relations premised on SLC. This possibility of capitalist exploitation via purely contractual means of control is also affirmed in another strand of the Marxian literature originated by John Roemer's *General Theory of Exploitation and Class* (1982) and based on an analysis of exchange relations under conditions of perfect competition, and, in particular, perfect or frictionless contracting. Under these conditions, Roemer derives a quantitative isomorphism between exploitation based on loan capital (in which "labor hires capital" rather than vice versa) and that based on capitalist-owned production processes. Ironically, much of the criticism of Roemer's analysis and conclusions in the Marxian literature starts from the premise, contradicted by Marx's historical analysis, that capitalist control of production is categorically necessary for the existence of capitalist exploitation (see, for example, Anderson and Thompson, 1988).

The present chapter explores this theoretical clash on the basis of an analytical middle ground in which neither direct capitalist control of production nor the scenario of ideal contracting is assumed in exploring how capital suppliers attempt to secure surplus value in exchange relationships with suppliers of labor. More specifically, a core assumption of the analysis presented here is that capitalists undertake this pursuit under conditions of imperfect information in which key aspects of the relationship (such as the worker's effort level) are either known only to the labor supplier or unknown by both parties at the time the contract governing the transaction is established. The chapter then considers the extent to which the capital supplier can extract a surplus—and in so doing, exploit labor—via purely contractual means in exchange relations, on the presumption that any limitations in this regard suggest a concomitant economic motivation for SLC. Conversely, scenarios in which maximum feasible exploitation is achieved despite such informational imperfections extend the scope of Roemer's conclusions about the economic basis of exploitation derived on the basis of ideal contracting conditions.

The general economic problem of transacting under conditions of imperfect information is explored in depth in the mainstream literature on the "principal-agent problem" (see for example Holmstrom, 1979; and Holmstrom and Mil-

grom, 1991 for important contributions), and the analytical approach taken here makes significant use of this framework. The approach taken in the present line of research, however, is to customize the general principal–agent framework so as to address the specific concerns and variables of Marxian theory, which focuses, as does Roemer’s more recent work, on the implications of wealth inequalities along class lines for the manner and extent to which capital exploits labor.

Primarily for illustrative purposes, the analysis in this chapter also draws on the historical literature concerning *proto-industrial* forms of production that preceded capitalist industrialization. In particular, the theoretical cases considered below are framed in terms of the so-called *Kauf* and *Verlag* modes of capital-financed production that preceded the factory system and in many instances persisted alongside it (Ogilvie and Cerman, 1996, p. 4). The analysis developed here provides tentative answers to certain important and enduring questions in the historical literature on proto-industrialization; for example, the argument identifies conditions informing the relative viability of these proto-industrial forms, and offers an explanation for why they were able to continue into the era of capitalist production.

## 24.1 CAPITALIST EXPLOITATION WITHOUT CAPITALIST PRODUCTION

### 24.1.1 Marx’s Historical Account of Capitalist Exploitation

Marx first introduced the notion of subsumption of labor “into the process of capital” in *Grundrisse* (1858 [1993]), the first draft of the analysis that would eventually be published as *Capital*. He did so, however, in the context of noting historical cases in which usury and merchant capital exploited labor without directly controlling the labor process and thus constituted “exploitation by capital without the mode of production of capital” (p. 853). Marx reasserts this assessment in the second and third drafts, the latter providing the material Engels edited for publication as Volume III of *Capital* after Marx’s death. For example, treating the case of usury capital in the latter work, Marx discusses cases in which it financed commodity production and appropriated “*all* surplus-value save that which accrues to the state” (1894 [1991], p. 730) and thus constituted “capital’s mode of exploitation without its mode of production” (p. 732). Marx repeats this conclusion in a chapter entitled “Results of the immediate process of production,” intended for Volume I of *Capital* but excluded from the published version (1867 [1976], Appendix, p. 1023).

Having acknowledged the capacity of “antediluvian” forms of the circuit of capital to appropriate surplus value and exploit labor in cases when they financed

commodity production, Marx stipulates that there are important limitations in this capacity: first, they are not sufficient to develop the forces of production in the manner associated with the capitalist mode of production based on SLC (1894 [1991], pp. 730–31); and second, the power of usury capital to exploit labor “comes to an end” once workers are completely expropriated of the means of production (p. 730). On the other hand, he allows that exploitation via these pre-industrial forms can persist into the era of capitalist production, albeit in restricted form and extent (1858 [1993], p. 853; 1894 [1991], pp. 730–31).

In sum, Marx’s historical account of capitalist exploitation suggests that the connection between capitalist exploitation and direct capitalist control of production (SLC) is contingent rather than categorical, and is in any case a matter of degree rather than necessity.

#### 24.1.2 Proto-Industrial Production and Exchange Conditions

The conclusions of Marx’s account are mirrored in the more recent historical literature on proto-industrialization, which discusses the economic viability and persistence of commercial production arrangements predating the capitalist factory system. This literature has distinguished two forms of proto-industrial production which correspond to Marx’s representation of the “antediluvian” forms of usury and merchant capital that financed commodity production. In the *Kauf* system, corresponding to Marx’s representation of usury capital, loan capitalists financed commodity production via labor processes “in which rural producers retained autonomy over production and selling,” purchasing their own inputs and selling their output directly in product markets. In contrast, merchant capitalists in the *Verlag* or “putting-out” system of production provided raw materials to the producers and paid them by the piece for their output, which the merchants then retailed themselves. According to the original statement of the proto-industrialization hypotheses, these two forms, along with the subsequently emerging factory system, represented successive stages of industrial organization (Ogilvie and Cerman, 1996, p. 4).

Further historical investigations of the proto-industrialization hypothesis challenged this stadial conception of industrial development. In particular, subsequent research on this hypothesis established that in many cases the *Kauf* system did not wither away upon the advent of the *Verlag* system in given regions (see for example Hudson, 1996, p. 57), and furthermore that both proto-industrial forms often persisted well into the era of capitalist production (for example Berg, 1986, p. 19). These historical findings, then, mirror Marx’s account in rejecting the categorical superiority (from the capitalists’ viewpoint) of industrial over pre-industrial forms of commercial production, and extend this more nuanced assessment to the comparative viability and persistence of alternative proto-industrial forms.

## 24.2 A FORMAL ANALYSIS OF CAPITALIST EXPLOITATION WITHOUT SUBSUMPTION

In this section, I analyse a scenario in which capitalists appropriate surplus value in the absence of SLC. In this context, capitalist control over productive outcomes is exerted solely via contractual means, such as the form of payment (more specifically, the combination of interest charges and piece rates).

As noted earlier, the analysis developed here is based on the framework of principal–agent theory, but differs from standard principal–agent analysis in three key ways, informed in part by Marx’s particular theoretical concerns. First, and primarily, whereas the standard principal–agent model focuses on differences in risk preferences (and the corresponding problem of Pareto-optimal risk-sharing given asymmetric information and the need to provide effort incentives), the model developed here investigates the implications of systematic differentials in productive wealth between otherwise risk-neutral capital suppliers and commodity producers. As such, it provides a natural extension to Roemer’s analysis of the systemic basis of exploitation under perfect contracting conditions. Second, the analysis is *historical* in the sense of focusing successively on alternative historical forms of capitalist response to the problem of exploiting labor under imperfect contracting conditions, starting with the case of no SLC.

The third departure from standard principal–agent analysis is that the analysis limits attention *a priori* to *linear* payment schemes involving piece rates and interest payments. However, this limitation is not as restrictive as it might appear, given the first assumption of risk neutrality. In this case, the functional form of the payment scheme becomes less relevant than the information on which it is based. While the linear form is not uniquely optimal under such conditions, it is often among the set of optimal compensation schemes.

### 24.2.1 The Basic Model

Consider the relationship between a representative worker or commodity producer L and a capital supplier K who, in anticipation of a profitable return, finances production beyond the level that L could produce using her own means of production. This return can only be realized after production is completed and the product is sold. *Ex ante*, however, output is stochastic, so that gross returns are uncertain. Taking  $x$  to denote the market value of the worker’s output and  $(e \geq 0, \theta \geq 0, k > 0)$  to denote, respectively, the worker’s effort level and realized productivity level (understood to be a random state variable), and the quantity of capital borrowed from the capitalist. For simplicity, I’ll take the required level of capital as fixed, and not represent it explicitly hereafter.

### Endowments

The worker has an exogenously-given, non-depreciating asset valued at  $W > 0$  that can be used in production or sold at value to finance the worker's consumption or (as discussed below) to satisfy the terms of the contract with the capitalist. The capitalist is endowed with an asset  $A \geq k$  that can be lent to the producer to enable additional production via the function described next.

### Payoffs

Let  $y(x)$  be the net income received by the producer given output  $x$ . Then her payoff conditional on  $x$  is indicated by the function  $v = W + y(x) - c(e)$ , where  $c(e)$  denotes the monetary value of the disutility or discomfort incurred by the worker in producing the output financed by the capitalist. Let  $c(\bullet)$  be a twice continuously differentiable function that is strictly increasing and strictly convex in its argument with  $c(0) = c'(0) = 0$ , where the prime denotes the first derivative. The capitalist's payoff is simply the return yielded by the transaction with the worker net of the capital advanced, denoted  $\pi = A + x - y(x) - k$ . Note that both actors are risk-neutral with regard to variations in income.

### Production

Let the worker's production possibilities be expressed by the twice continuously differentiable function  $x = x(e, \theta)$ , assumed to be strictly increasing and strictly concave in its arguments such that  $0 = x(0, \theta) = x(e, 0) < x_{e\theta}(e, \theta)$  for all admissible values of  $(e, \theta)$ , and assume that  $[x_e(e, 0) / x_\theta(e, 0)] > 0$  for all positive levels of effort. The random productivity state variable  $\theta$  is distributed according to the continuously differentiable density function  $f(\theta)$  defined on the support  $[\underline{\theta}, \bar{\theta}]$ , where  $\bar{\theta}$  is finite and strictly greater than zero. Let  $\underline{\theta}$  be normalized to 0. It is convenient to let  $f$  be strictly positive everywhere on the support of the distribution. The production technology is said to yield a surplus if it is possible to generate an expected output value which exceeds the sum of capital and effort costs incurred in producing it. This definition is embodied in the following assumption.

**Assumption A1** (*Potential surplus*) There exists a value of  $\bar{e} > 0$  such that

$$E\{x(\bar{e}, \theta)\} - c(\bar{e}) - k = \int_0^{\bar{\theta}} x(\bar{e}, \theta) f(\theta) d\theta - c(\bar{e}) - k > 0$$

In addition, let there be a value of effort  $\bar{e} > \bar{e}$  such that  $E\{x(\bar{e}, \theta)\} - c(\bar{e}) = 0$ . The latter assumption justifies restricting attention to effort choices drawn from the compact set  $[0, \bar{e}]$ .

### Information

The informational conditions of the problem are such that the capitalist cannot directly observe the worker's effort choice  $e$  or output  $x$ , and neither actor observes the realization of the random variable  $\theta$  when making his or her economic choices. Below I'll consider alternative scenarios affecting the worker's willingness to report output truthfully (and then deliver it) to the capitalist.

### Contracted payments and net returns

Since the capitalist cannot observe labor effort or the random productivity parameter, the net payment contractually demanded of the worker (and thus, the net return contractually assured to the worker) can at most be conditioned on the worker's reported output. The modeling strategy pursued here is to allow the endogenous realization of either pure "lender-borrower" contracts consistent with Marx's scenario of usury capital or "piece rate" contracts consistent with the putting-out form of merchant's capital. Thus, let the net return to the worker be given by the affine function  $px - R$ , where  $p$  can be interpreted as a piece rate and  $R$  can be interpreted as an interest payment to the capitalist or a (possibly negative) fixed component of the net return to the worker in a piece rate scheme.

This net return is negative for low values of  $x$  if  $R$  is positive. Thus, to define the exchange terms between capital supplier and worker completely, it is necessary to specify the transfer that occurs if, given observed or reported  $x$ ,  $px - R < 0$ . Toward this end, suppose that the worker's endowment can be used as security for the capital advance, so that the capitalist can appropriate  $W$  whenever given contractual terms are not fulfilled. The role of  $W$  as collateral or security on contracted terms in the determination of contingent and expected net returns will be discussed further in Sections 24.2.2 and 24.2.3 below, which address the respective informational scenarios introduced above.

### Class conditions

Assume that the balance of class power in this economy is such that the worker is on the "long side" of the market and thus receives no economic rent under perfect contracting conditions. Let the worker's reservation payoff, corresponding to the situation in which she does not transact with the capitalist, be given by her exogenously determined endowment  $W$ , and refer to the requirement that the worker receives at least her reservation utility the *participation constraint* on the capitalist's contracting choices. The capitalist, being on the "short" side of the market, receives all of the economic rents under perfect contracting conditions. This corresponds to the condition of *capital scarcity* identified by Roemer (1982) as a necessary condition (along with differential ownership of productive assets) for the existence of exploitation in private ownership market economies. Of course, this condition does not necessarily dictate that the worker receives only her reservation utility in a scenario with imperfect contracting



conditions, and one issue in the analysis to follow concerns the possibility that certain forms of informational imperfections allow workers to accrue rents in the absence of some form of labor subsumption.

**The capitalist’s optimization problem**

In light of the foregoing considerations, the capitalist’s problem is to choose the piece rate  $p$ , the interest rate or fixed component  $R$ , and the worker’s effort level  $e$  to maximize expected profit  $\Pi(e, p, R) = E\pi = E\{x(e, \theta) - y(x(e, \theta))\}$  subject to the following constraints:

(Participation constraint)  
 $V = Ev(y(x), e) = W + pE\{x(e, \theta)\} - R - c(e) \geq W ;$  (24.1a)

(Securitization constraint)  
 $y(x) = \max\{px - R, -W\}$  for all  $\theta \in [0, \bar{\theta}] ;$  (24.1b)

(Revelation constraint) For any realization of  $(e, \theta)$ ,  $v(y(x(e, \theta), e) \geq v(y(x(\tilde{e}, \tilde{\theta}), e)$  for all  $\tilde{e} \in (0, \bar{e})$ ,  $\tilde{\theta} \in [0, \bar{\theta}]$  such that  $x(\tilde{e}, \tilde{\theta}) \leq x(e, \theta)$ ; and (24.1c)

(Incentive compatibility constraint)  
 For given  $p, R$ ,  $e \in \underset{\hat{e}}{\arg \max} W + E\{y(x(\hat{e}, \theta))\} - c(\hat{e}) .$  (24.1d)

**24.2.2 Maximal Exploitation and Surplus Maximization**

To establish a reference case for the analysis to follow, first consider the maximum surplus that can be induced and appropriated by the capitalist, given capital scarcity, if it were possible for him to observe or verify the worker’s effort and output levels and thus to stipulate these levels as part of the transaction. In this scenario, in other words, the capitalist maximizes expected profit subject only to the worker’s participation constraint. Simply put, since the capital scarcity condition ensures that the capital supplier receives the entire economic surplus, the level of effort is that which maximizes that surplus. Thus, maximum feasible exploitation corresponds to the surplus that results from the solution to the following optimization problem:

$$\underset{e \in (0, \bar{e})}{Max} S(e) = E\{x(e, \theta)\} - c(e).$$

Assumption A1 ensures an interior solution for this problem. The first-order necessary condition for an interior optimum at  $e^*$  is given by

$$S'(e^*) = E\{x_e(e^*, \theta)\} - c'(e^*) = 0 \quad (24.2)$$

Given the curvature conditions on the production and payoff functions assumed above, the surplus function  $S(e)$  is strictly concave in effort, implying  $S''(e^*) = E\{x_{ee}(e^*, \theta)\} - c''(e^*) < 0$  and guaranteeing that  $S(e)$  attains a unique global maximum at  $e^*$ .

The capitalist could hypothetically appropriate this maximal surplus under perfect contracting conditions through the use of a *forcing contract* in which the worker is guaranteed a net return just sufficient to attain her reservation utility of  $W$  so long as she chooses the surplus-maximizing effort level  $e^*$ , but otherwise incurs an unpleasantly harsh penalty (debtor's prison, say, or a monetary penalty that drives net income below subsistence) enforced by a judicial system.

In anticipation of the analysis to follow, it is useful to note here that if the capitalist could accurately monitor output (so that the revelation constraint is irrelevant), then he can always induce the worker to choose the surplus-maximizing effort level  $e^*$  via a linear compensation scheme by setting  $p = 1$  and setting  $R$  so that it does not exceed the lower of the boundaries established by the participation or the securitization constraint. In this case, the worker chooses labor effort  $e$  to maximize  $W - R + E\{x(e, \theta)\} - c(e)$ , which is readily seen to yield the same first- and second-order conditions as for the surplus maximization problem noted above. However, the participation and securitization constraints may preclude the capitalist from appropriating the entire resulting surplus from the worker, and the capitalist may be further restricted in this regard if output levels can be known or verified only by the producer. The latter case is considered next.

### 24.2.3 Exploitation without Output Monitoring: Unrestricted Outside Sales

In the absence of capitalist subsumption, the production process is under the control of the worker and the capitalist is merely the outside financier, although it may be possible for the latter to provide production incentives through contractual means such as piece rates. This is subject to an important caveat, however. Since the worker controls the production process, the realized output level is her private information, and the presumptive case is that the capitalist can only infer the output level from information reported by the worker. This case corresponds descriptively to the historical stage of proto-industrialization known as the *Kauf* system.

More specifically, it is assumed in this section that the worker can always choose to sell her output directly (and report correspondingly less output) rather than delivering it to the capitalist for the contractually stipulated return  $y(x)$ ,

subject only to the penalty of losing  $R$  up to the value of the worker's endowment  $W$ . Given the realization of  $x$ , the worker always chooses the option that yields her the highest *ex post* payment. Consequently, to induce the worker to report and deliver the true output, the payment scheme must satisfy

$$y(x) = \max\{px - R, -W\} \geq y(\tilde{x}) + x - \tilde{x} = \max\{x + (p - 1)\tilde{x} - R, x - \tilde{x} - W\} \quad (24.3)$$

for all  $\tilde{x} \leq x$ . Satisfying this constraint is easily seen to require that  $p \geq 1$  and  $R \leq W$ .

These constraints on the terms of the payment scheme have the following implications for the capitalist's optimization problem. First, since  $R \leq W$ , the default constraint on the minimum net payment to the worker is never binding for any value of  $x$ . Consequently, the capitalist's expected profit is given by

$$\Pi(e, p, R) = E\pi = R + (1 - p)E\{x(e, \theta)\}, \quad (24.4)$$

which he maximizes subject to the worker's participation and incentive compatibility constraints as well as the conditions and implied by the revelation constraint in the scenario of unrestricted outside sales. The solution to the capitalist's problem is characterized in the following proposition.<sup>3</sup>

**Proposition 1** *The capitalist's optimal contract entails  $p^* = 1$  and  $R^* = \min\{W, S(e^*)\}$ , which induces the worker to choose effort level  $e^*$ . The capitalist's expected payoff is  $\min\{W, S(e^*)\}$ , and the worker receives economic rent if  $W < S(e^*)$ .*

The message of Proposition 1 is that the capitalist pays a price for the inability to monitor or directly infer the producer's output levels, once the interest payment is limited by the worker's wealth level. Furthermore, this cost increases as the worker's wealth level falls. Applied to the historical context, the corresponding hypothesis is that *Kauf* system transactional arrangements became less attractive over time as workers' collateralizable wealth levels fell relative to the surplus achievable by proto-industrial production, either because producers were becoming progressively expropriated or increasingly productive in the latter processes. The corollary is that the relative benefit of alternative arrangements in which capitalists can either observe output levels or else induce commodity producers to report these levels accurately at less cost increases with either of the noted changes. The next section considers the scope for exploitation when the latter conditions hold, but still in the absence of capital's subsumption of the labor process.

#### 24.2.4 Exploitation without Output Monitoring: Restricted Outside Sales

As noted above, the *Verlag* system is distinguished from the *Kauf* system in that the former, rather than simply involving the loan of financial capital at interest, has capitalists supplying the inputs to be used in production and paying by the piece for the producer's output, which the capitalist then sells. In light of the analysis of the preceding section, it must then be explained how the capitalist can induce truthful revelation of output while retaining the flexibility of setting piece rates at values other than one (in other words, letting the worker keep the value of all output produced). In this section, it is ultimately assumed that the worker can only sell her output independently after incurring a fixed cost  $C > 0$ . In the historical context of the *Verlag* system, this cost might be associated with difficulties small domestic producers face in supplying products to foreign markets, or with expected legal costs of selling outputs commissioned by capital suppliers.

To analyse the effects of restrictions on outside sales on the capitalist's problem, I first consider the extreme case in which the cost to the worker of accessing external markets is prohibitive, so that it is always in her interest to report and deliver her true output level to the capitalist; that is, I first assume that  $x \leq C$  for all attainable levels of output, and characterize the optimal contract for the capitalist under these conditions. I then contrast the case in which the cost to the worker of directly accessing markets is not so prohibitive as to automatically preclude outside sales.

In the former case, since the worker always prefers to report and deliver actual output to the capitalist, the worker's payment is given by  $y(x) = \max\{px - R, -W\}$ , with a corresponding expected payoff, given the compensation terms set by the capitalist, the worker's endowment  $W$ , and effort level  $e$ , of

$$V(e, p, R, W) = E\{\max[0, W - R + px(e, \theta)]\} - c(e). \quad (24.5)$$

The capitalist's expected payoff, given the compensation scheme and the worker's effort level, is

$$\Pi(e, p, R, W) = E\{\min[W + x, (1 - p)x + R]\}. \quad (24.6)$$

In the problem under study, the capitalist can by assumption infer the worker's true output level, but cannot observe and therefore cannot contractually stipulate the worker's effort level. Rather, taking the values of  $p$ ,  $R$ , and  $W$  as given, the worker chooses  $e$  to maximize  $V(e, p, R, W)$ . Denote the optimal value of effort for the worker by  $\hat{e}$ .

Unless the piece rate is set at 0, the commodity producer’s compensation will depend on output level, and will thus be a random variable depending on the realization of the parameter  $\theta$ . Note further that, whatever the value of  $R$ , the worker has no incentive to expend positive effort if the piece rate is zero, since there is no gross marginal payoff to increasing effort. Note further that the capitalist has no incentive to reduce  $R$  below the minimum of  $W$  and  $S(e^*)$ , since raising  $R$  has no disincentive effects on the worker’s effort choice so long as it remains the case that  $R \leq \min \{S(e^*), W\}$ , since the worker then always receives the marginal value of output weighted by the piece rate. Assuming, therefore, a strictly positive value of  $p$ , and given  $R \geq \min \{S(e^*), W\}$ , let  $\hat{\theta} = \theta(e, z)$  denote the continuously differentiable implicit function that ensures

$$x(e, \hat{\theta}) - z = 0 \tag{24.7}$$

for all  $e \in \{0, \bar{e}\}$  and  $z = (R - W) / p \geq 0$ , noting that for any positive level of effort,  $\hat{\theta}_e = -x_e / x_\theta < 0$ ,  $\hat{\theta}_z = 1 / x_\theta > 0$ , and  $\theta(e, 0) = 0$ . If  $\hat{\theta} < \bar{\theta}$ , the worker receives a net income of zero in those states of the world in which  $\theta \leq \hat{\theta}$ , and  $W - R + px(e, \theta)$  otherwise. Thus the worker’s expected payoff defined in Equation 24.5 can be rewritten

$$V(e, p, R, W) = (1 - F(\hat{\theta}))(W - R) + \int_{\hat{\theta}}^{\bar{\theta}} px(e, \theta) f(\theta) d\theta - c(e), \tag{24.5a}$$

and similarly the expected payoff of the capitalist defined in Equation 24.6 can be expressed as

$$\begin{aligned} \Pi(e, p, R, W) &= \int_0^{\hat{\theta}} [W + x(e, \theta)] f(\theta) d\theta + \int_{\hat{\theta}}^{\bar{\theta}} [R + (1 - p)x(e, \theta)] f(\theta) d\theta = \\ &F(\hat{\theta})W + (1 - F(\hat{\theta}))R + \int_0^{\bar{\theta}} x(e, \theta) f(\theta) d\theta - \int_{\hat{\theta}}^{\bar{\theta}} px(e, \theta) f(\theta) d\theta. \end{aligned} \tag{24.6a}$$

Assuming an interior solution for the worker’s optimization problem, and utilizing the condition shown in Equation 24.7, the associated first-order condition for an interior maximum reduces to

$$V_e = \int_{\hat{\theta}}^{\bar{\theta}} \{px_e(e, \theta)\} f(\theta) d\theta - c'(e) = 0. \tag{24.8}$$

Assuming that the second-order condition is satisfied with strict inequality, there is a uniquely optimal value of effort for the worker’s problem, and the capitalist’s problem is to choose  $R, p$ , and the unique value of  $e$ , consistent with these magnitudes so as to maximize the expected profit shown in Equation 24.6 subject to the worker’s transformed incentive constraint shown in Equation 24.8, the securitization constraint shown in Equation 24.1b, and the participation constraint shown in Equation 24.1a, requiring that the worker’s expected payoff

shown in Equation 24.5 is at least as great as the reservation level of utility  $W$ . To facilitate the statement and proof of the next proposition, it will be useful to characterize, for a given effort level, the loci in  $(R, p)$  space corresponding respectively to the worker's incentive compatibility condition shown in Equation 24.8, and given iso-payoff contours for the capitalist and worker. These contours completely overlap, having identical slopes and curvature at any given combination of  $R$  and  $p$ .

For a given level of worker effort  $e > 0$ , one can invoke the implicit function theorem to establish the unique existence of a continuously differentiable function, denoted  $\rho^{V_e}(R, e)$ , representing the locus of  $(R, p)$  combinations satisfying the incentive compatibility condition shown in Equation 24.8. Substituting this function into Equation 24.8 and totally differentiating with respect to  $R$  yields the slope of the function, given by

$$\rho_R^{V_e}(R, e) = \alpha(e, \hat{\theta}) / [\alpha(e, \hat{\theta}) \cdot z + \int_{\hat{\theta}}^{\bar{\theta}} x_e(e, \theta) f(\theta) d\theta], \quad (24.9)$$

where  $\alpha(e, \hat{\theta}) = x_e(e, \hat{\theta}) f(\hat{\theta}) / x_{\theta}(e, \hat{\theta}) > 0$  and  $z$  is defined as in Equation 24.7. Differentiating again with respect to  $R$  yields  $\rho_{RR}^{V_e}(R, e) = [\int_{\hat{\theta}}^{\bar{\theta}} x_e(e, \theta) f(\theta) d\theta] \cdot \alpha_{\theta}(e, \hat{\theta}) \theta_z z_R$ , which has the same sign as  $\alpha_{\theta}(e, \hat{\theta})$ . I'll assume in what follows that  $\alpha_{\theta}(e, \hat{\theta}) > 0$ , implying that  $\rho^{V_e}(R, e)$  is strictly convex in  $R$  for any given positive level of effort.

Parallel reasoning is used to establish the unique existence of a continuously differentiable function  $\rho^{\bar{V}}(R, e)$  representing a given iso-payoff contour for the worker selecting a given positive effort level, using the expression shown in Equation 24.6a, and then using the definition shown in Equation 24.7 in deriving the slope of the contour:

$$\rho_R^{\bar{V}}(R, e) = (1 - F(\hat{\theta})) / \int_{\hat{\theta}}^{\bar{\theta}} x(e, \theta) f(\theta) d\theta > 0, \quad (24.10)$$

and can be applied again to show

$$\rho_{RR}^{\bar{V}}(R, e) = [(1 - F(\hat{\theta})) \cdot x(e, \hat{\theta}) - \int_{\hat{\theta}}^{\bar{\theta}} x(e, \theta) f(\theta) d\theta] \cdot f(\hat{\theta}) \hat{\theta}_z z_R / (\int_{\hat{\theta}}^{\bar{\theta}} x(e, \theta) f(\theta) d\theta)^2 < 0$$

indicating that this function is strictly concave in  $R$  for any given positive value of  $e$ . Furthermore, the expression shown in Equation 24.10 and its corresponding second derivative also represent the slope and curvature, respectively, of a given iso-payoff curve for the capitalist, indicating that the respective curves coincide (although representing different payoff levels for the two actors). With these results in mind, now consider the following proposition.

**Proposition 2** *In the optimal contract  $(\hat{e}, \hat{R}, \hat{p})$ , the capitalist's expected payoff is non-decreasing in  $W$ . In addition,*

(i) If  $W \geq S(e^*)$ , the capitalist achieves the surplus- and exploitation-maximizing solution with  $p^* = 1$  and  $R^* = S(e^*)$ , resulting in  $\hat{e} = e^*$ .

(ii) If instead  $W < S(e^*)$ , there are two possible outcomes, determined by the level of  $W$  and the form of the production function. In one scenario, there is at least one value of the duple  $(R, p)$  that satisfies the incentive compatibility constraint for the efficient effort level  $e^*$ , and at the same time satisfies the participation constraint with equality. In this case, the participation constraint is binding, the incentive compatibility constraint is not binding, and the solution is such that  $\hat{e}_1 = e^*$ ,  $\hat{p}_1 > 1$ , and  $\hat{R}_1 > W$ . The worker receives an expected payoff equal to her reservation utility and the capitalist receives an expected payoff equal to  $S(e^*)$ . In the alternative scenario, there is no value of the duple  $(R, p)$  that simultaneously satisfies the two constraints with equality for effort level  $e^*$ . In this case, the incentive compatibility constraint is binding, and the solution entails  $\hat{e} < e^*$ ,  $\hat{p}_2 \leq \hat{p}_1$ , and  $\hat{R}_2 \geq \hat{R}_1$ .

The proposition can be interpreted to have the following implications for capitalists' efforts to appropriate surplus value in the historical era preceding SLC (and, potentially, for contemporary efforts to appropriate surplus value from, say, worker-owned firms on the basis of interest capital or payment by the piece). The first case considered by the proposition, such that  $W \geq S(e^*)$ , can be thought of as an instance of Roemer's "mixed borrower" or "small peasant" class. Workers in this class have sufficient wealth to finance independent production, but not so much that they are completely independent of borrowing from capitalists in order to finance their production and consumption plans. Given sufficient wealth, capitalists are in effect able to demand collateral for their production loans without thereby infringing on the incentives to maximize the available surplus. If competitive conditions are such that workers in this class have no bargaining power to gain more than their reservation payoffs, the capitalists appropriate the entire surplus, as indicated. This suggests that production arrangements corresponding to the *Kauf* system would be optimal for capitalists under the stated condition. However, a consequence of the probabilistic forfeiture of collateral over time is the progressive proletarianization of this class, with implications considered in the second part of the proposition.

In the second case considered, workers are more proletarianized, in the sense that they depend on borrowing for a relatively larger share of their production and income streams. In this case, capitalists may still be able to extract maximal surplus even though workers are unable to provide collateral for the full amount of this surplus. This is the case if the worker's wealth constraint is not so severe as to preclude providing the worker full incentives even though limiting the worker to his or her reservation utility. If this does not obtain, capitalists seeking to exploit labor face a tradeoff, as appropriating a surplus in excess of the value

of the worker's (smaller) endowment requires curtailing incentives and thus reducing the potential surplus to be appropriated. Nevertheless, as demonstrated by the optimization analysis, the capitalist always gains more at the margin by increasing appropriation, even at the cost of reducing the surplus to be appropriated. The latter two solution cases are illustrated in Figures 24.1 and 24.2 below.

Figure 24.1 Solution case 1: participation constraint binding

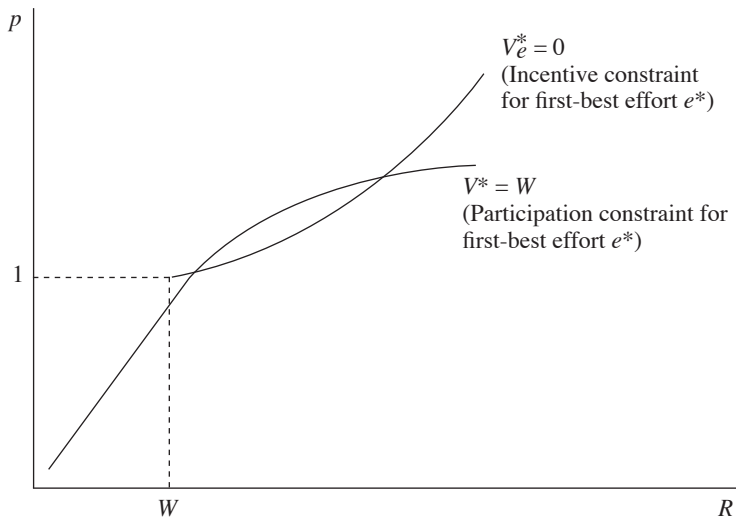
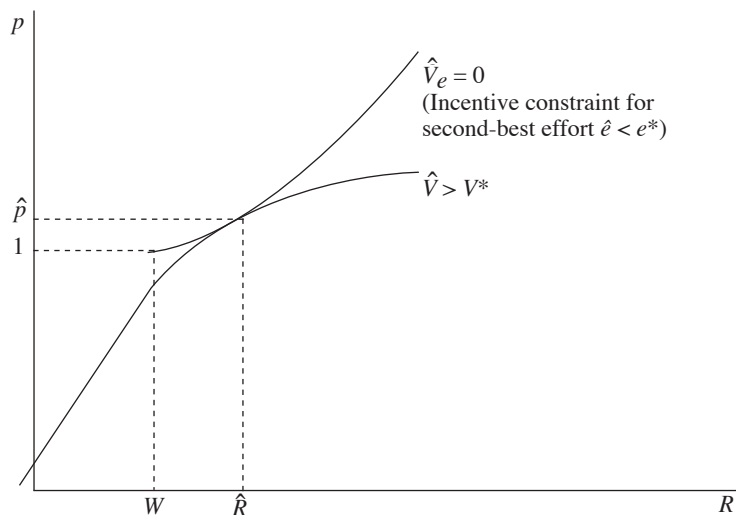


Figure 24.2 Solution case 2: participation constraint non-binding





Now with Proposition 2 in mind, return to the capitalist’s optimization problem in the case that the worker’s fixed cost of accessing markets directly is not prohibitive; in particular, assume for what follows that  $C < x(\hat{e}, \bar{\theta})$ , where  $\hat{e}$  is the second-best level of output corresponding to the second scenario in case (ii) of Proposition 2. In this case, the condition for truthful revelation and delivery of output is that for any feasible  $x$  to be achieved in the transaction between the capitalist and the worker,

$$y(x) = \max \{ px - R, -W \} \geq y(\tilde{x}) + x - \tilde{x} - C = \max \{ x + (p-1)\tilde{x} - R - C, x - \tilde{x} - W - C \} \tag{24.11}$$

for all values of  $\tilde{x} \leq x$ . The presence of the positive fixed cost implies that this constraint is less restrictive than that implied by the condition shown in Equation 24.3 for the case of unrestricted outside sales. In this new case, the condition shown in Equation 24.11 implies the following constraints on the capitalist’s contract choices:

$$p \geq 1 - C / x(e, \bar{\theta}) \tag{24.12a}$$

and

$$R \leq W + pC . \tag{24.12b}$$

The implications for the capitalist’s optimized payoffs are recorded in the final proposition.

**Proposition 3** *In the presence of fixed cost C for the worker’s outside sales, optimal contract  $(\hat{e}, \hat{R}, \hat{p})$  is identical to the contract described in Proposition 2 if  $W \geq S(e^*)$ . If instead  $W < S(e^*)$ , the constraint shown in Equation 24.12b is binding for sufficiently small values of C. In that case, the capitalist selects  $\hat{e} < e^*$ ,  $\hat{R} = W + \hat{p}C$ , and sets  $\hat{p}$  lower than would obtain under the conditions of Proposition 2 for the selected level of effort. In addition, the shadow price to the capitalist of the agent’s endowment is higher when the constraint is binding.*

When it is costly, yet not prohibitively so, for small commodity producers to gain access to outside markets, the power of proto-industrial capital to extract surplus value is further restricted relative to the case that outside sales are economically unviable. However, it is under some conditions still possible for capitalists to extract the maximum possible surplus, and this is the case even if collateralizable worker endowments fall short of the optimal surplus to be realized.

These results provide foundations for Marx’s key claim, mirrored by the historical record discussed in the literature on proto-industrialization, that the connection between direct capitalist control of production and capitalist exploitation is contingent and a matter of degree rather than categorical and a matter of necessity.

### 24.3 CONCLUSION

This chapter has framed Marx's historical account of exploitation in terms of the problem of extracting profit-maximizing levels of labor effort in the face of imperfect information and limited worker wealth. Viewed from this perspective, capitalist control of production is a potential strategic substitute for arranging the terms of labor exchange by purely contractual means. Given imperfections in the latter option due to imperfect information or other transactional barriers, capitalists might wish to resort to (possibly costly) forms of direct control in order to ensure the desired production conditions. This stage of the formal analysis demonstrates conditions under which capitalists can extract maximal surplus without SLC. The analysis presented here bears extending in the following directions. First, given that the use of collateral raises questions regarding intertemporal allocation, it would be useful to embed the analysis in an intertemporal optimization framework. Similarly, endogenizing the worker's income parameter  $W$  by linking it to underlying wealth endowments and the prospects for pursuing income-generating production activities would facilitate making a more immediate connection of this analysis to Roemer's treatment of the systemic basis of exploitation.

The next major step in the argument would be to analyse the considerations informing capitalists' choice to subsume the labor process under direct capitalist control, in the sense of at least *formal* SLC. At least two key questions arise in contemplating the latter scenario. The first concerns the new transactional and informational issues arising from the possibility that capitalists might monitor worker effort in the production process. On one hand, monitoring may provide capitalists with informative signals about worker effort, making it easier to direct that effort and thus appropriate surplus without curtailing effort incentives. On the other hand, capitalists' use of monitoring signals introduces the prospect of a new form of moral hazard, since there might be an incentive for production overseers to misrepresent what they observe.

The second issue concerns the connection of monitoring to the allocation of ownership or control rights in the firm. In principle, for example, capitalists might insist on monitoring provisions in otherwise arm's-length contracts with worker cooperatives, and thus accrue the informational advantage of monitoring. The transactional question is thus why capitalist ownership rights—and thus, in Marxian terms, commodification of labor power—might serve as a strategic complement to the use of monitoring. These are issues to be pursued in subsequent work.

## NOTES

1. I thank Roberto Veneziani and Fred Moseley for extensive helpful comments on a previous draft, without implicating them in the form or conclusions of the analysis presented here.
2. The notebooks comprising this manuscript are reproduced in the International Publishers' edition of Marx and Engels's *Collected Works*, volumes 30–34.
3. Proofs of propositions are available upon request from the author.

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## 25. Morally arbitrary economic advantage<sup>1</sup>

**Frank Thompson**

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Doubtless humans have employed notions of morally arbitrary advantage (and disadvantage) for millennia. The locus classicus for these phrases is John Rawls's *A Theory of Justice*—for example, “factors so arbitrary from a moral point of view” (1971, p. 72; 1999a, p. 62) and “arbitrary from a moral perspective” (1971, p. 74; 1999a, p. 64). (For this notion, Rawls's quotes are surprisingly sparse considering their prodigious subsequent impacts.) The general idea is that there are some properties of each human individual that are not (or not at all easily) mutable by that individual but which can have profound effects—for example, confer advantages and disadvantages—on that individual. Such properties are morally arbitrary in the simple sense that an individual cannot reasonably be held morally responsible for having (or for the consequences of having) such characteristics. Paraphrasing Rawls's related metaphor, we are all participants in social and natural lotteries we did not choose to play. Our individual starting points, opportunities, and outcomes depend in part on a social lottery (the political, social, and economic circumstances into which each of us was born) and a natural lottery (the biological potentials each person is born with).<sup>2</sup>

Needless to say, there is a voluminous philosophical literature addressing whether, and if so how, these notions can be made precise, and considering what implications employing these notions may have for moral (and especially political) philosophy. It would be inappropriate to review that literature in this setting.<sup>3</sup> Here, the project is much less general: to consider a matter of what is arguably morally arbitrary *economic* advantage or disadvantage—that is, the amount of physical capital and the level of technology one works with.

Thus, consider two individuals,  $i$  and  $j$ , supplying labor input  $L_i$  and  $L_j$  in perfectly competitive economies.

Where  $A_i$  and  $A_j$  are the levels of technology and  $K_i$  and  $K_j$  are the stocks of capital individuals  $i$  and  $j$  respectively work with, and  $h_i$  and  $h_j$  are their respective levels of human capital, their respective outputs will be  $Y_i = A_i F(K_i, h_i L_i)$  and  $Y_j = A_j F(K_j, h_j L_j)$ .

Intended is a neoclassical aggregate production function with the standard formal properties (constant returns to scale with increasing but diminishing returns to factors, and the Inada conditions) augmented with a level of technol-

ogy shift parameter and with a human capital index qualifying the labor input. Calling the shift parameter “technology” is of course sloppy (but common). It is the Solow residual, “total factor productivity,” and thus “a measure of our ignorance.”<sup>4,5</sup>

Under perfect competition, each will be paid per unit of their labor supplied its marginal product—that is,

$$w_i = \partial Y_i / \partial L_i = A_i \left( \partial F(K_i, h_i L_i) / \partial (h_i L_i) \right) h_i$$

and

$$w_j = \partial Y_j / \partial L_j = A_j \left( \partial F(K_j, h_j L_j) / \partial (h_j L_j) \right) h_j$$

Now suppose that  $A_i > A_j$  and  $K_i > K_j$ —for example, individual  $i$  works with better technology and more capital than does individual  $j$ , but that  $h_i = h_j$ —that is,  $i$  and  $j$  are clones in the quality of the labor they supply.

Under these circumstances it will be the case that  $w_i > w_j$ . Does individual  $i$  somehow deserve the extra  $w_i - w_j$  per each unit of labor worked? (John Bates Clark would have thought so.)

More concretely, consider a Cobb–Douglas specification in which,  $A_i = 2$ ,  $A_j = 1$ ,  $K_i = 2$ ,  $K_j = 1$ ,  $h_i = h_j = 1$ , and  $F(\cdot, \cdot) = (\cdot)^{1/3} (\cdot)^{2/3}$ . Then  $Y_i = 2 \cdot 2^{1/3} \cdot L_i^{2/3}$  and  $Y_j = L_j^{2/3}$ , and  $w_i = ((4/3)2^{1/3})L_i^{-1/3}$  while  $w_j = (2/3)L_j^{-1/3}$ . If these clones,  $i$  and  $j$ , supply equal amounts of labor,  $w_i/w_j = ((4/3)2^{1/3})/(2/3) = 2 \cdot 2^{1/3} = 2.52$ —that is, individual  $i$  receives a 152 percent higher return to labor supplied than does individual  $j$ .

Does individual  $i$  somehow deserve to enjoy a 152 percent higher return to labor supplied than individual  $j$ ? Does individual  $j$  deserve to receive a 60 percent lower return to labor supplied than individual  $i$ ? As Lant Pritchett frames it, “The question is, how does the massive differential treatment of people who are alike in every respect except their affiliation with a particular nation-state, an essentially arbitrary condition of birth, square with any theory of justice?” (Prichett, 2010, p. 281).<sup>6</sup>

Of course comprehensive data on the capital or technology used by individual workers is not available.<sup>7</sup> There is some sectoral data at least for the capital/labor ratio (the ratio is higher in petroleum refineries than in childcare facilities, and the level of technology is doubtless higher as well), but there seems to be no comprehensive dataset presenting the different capital/labor ratios (not to mention levels of technology) by sectors in different countries. To move to international comparisons, we must make do with country averages (even though software engineers in Bangalore doubtless work with technology and capital much more like that used in Silicon Valley than the Indian average) and thus move to the per-unit-of-labor version of the neoclassical production function with technology and human capital. Thus, in the Cobb–Douglas specification, output-per-unit-of-labor is:

$$\begin{aligned}
 Y &= AK^\alpha(hL)^{1-\alpha} \\
 Y/L &= \left( AK^\alpha(hL)^{1-\alpha} \right) / L = A(K/L)^\alpha h^{1-\alpha} \\
 Y/L &= y; K/L = k \\
 y &= Ak^\alpha h^{1-\alpha}
 \end{aligned}$$

And the marginal product of labor is:  $mpl = Ak^\alpha(1-\alpha)h^{1-\alpha}$ .

More concretely, consider first only a couple of country comparisons, normalizing,  $A_{US} = k_{US} = 1$  and assuming (a standard stylized fact) that uniformly  $\alpha = 1/3$ .<sup>8</sup> A worker with country  $C$ 's average level of technology and capital but supplying labor with the same level of human capital as a worker enjoying the US average level of technology and capital, will receive a wage rate only of that  $A_C k_C^{1/3} \cdot 100\%$  of the US worker.

For India  $A_{IN} = 0.39$  and  $k_{IN} = 0.04$ . (Data sources below.) Thus an Indian, supplying the same labor with the same level of human capital as a worker in the US, would receive a (marginal product) wage rate only 13.3 percent of that of the Indian's US clone. Or consider Zimbabwe with  $A_{ZW} = 0.03$  and  $k_{ZW} = 0.07$ . A Zimbabwean, supplying the same labor with the same level of human capital as a worker in the US, would receive a (marginal product) wage rate only 1.2 percent of that of the Zimbabwean's US clone.

It is not generally customary to place a relatively large spreadsheet in the body of the text of a chapter instead of in an appendix, and it won't be done here. But in this case it is tempting to do so, since understanding how the sheet is constructed (and pondering it) is crucial to understanding how the form of morally arbitrary economic advantage (and disadvantage) here at issue can be theorized and made empirically tractable (and to diminish page-flipping). In the appendix:

$h'$  is average years of schooling of the population aged 15–64 (not studying) in 2010. Extracted from 2669521.xls at www.oecd.org. This seems to be the best comprehensive dataset available, proxying for national average levels of human capital.<sup>9</sup>

$h$  is the  $h'$  for each country divided by the  $h'$  for the US.

$y'$  is GDP (PPP) per capita in 2010. Extracted from the IMF World Economic Outlook Database, April 2011.

$y$  is the  $y'$  for each country divided by the  $y'$  for the US.

$k'$  is physical capital per worker in 2000. Extracted from the Online Data Plotter (www.aw-bc.com/weil) accompanying Weil (2009).

$k$  is the  $k'$  of each country divided by the  $k'$  of the US.

$\alpha$  is the capital share of GNI;  $(1-\alpha)$  is the labor share. Numerals not in italics are extracted from Bernanke and Gurkaynak (2002). The numeral in italics—that is, *0.35*—is the world average according to Bernanke and Gurkaynak (2002).

These  $y'$ ,  $k'$ ,  $\alpha$ , and  $h'$  data provide most of the empirical basis for this chapter.

$A$  is the Solow residual, total factor productivity, calculated from  $A = y / (k^\alpha h^{1-\alpha})$ .

$mpl'$  is the marginal product of labor, calculated from  $mpl = Ak^\alpha(1-\alpha)h^{1-\alpha}$ .

$mpl$  is the  $mpl'$  of each country divided by the  $mpl'$  of the US.

$mplc$  is the marginal product of labor relative to a US worker with the same human capital—that is, a US clone—calculated from  $mplc = Ak^\alpha$ .<sup>10</sup>

For the present topic the most interesting numbers are those for  $mplc$ , the marginal product of labor relative to a US worker with the same human capital—that is, a US clone. (This is the source of the numbers for India and Zimbabwe in the example above.) Only Norway has a higher  $mplc$  than the US, and Zimbabwe has the lowest in the sample. (Keep in mind that these numbers are derived in a model counterfactually assuming perfect competition.)

In order to have some idea how the output of this perfectly competitive market model compares to actuality, one would like to compare the  $mpl$  of the model with the country average wage data. Unfortunately there seems to be no such dataset covering even most of the countries here under consideration. There is, however, a usable dataset for the OECD countries.

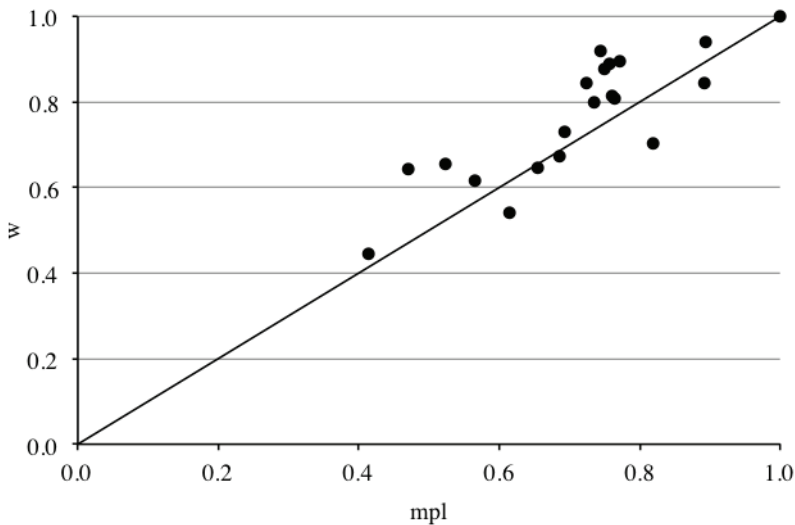
$w'$  is average annual wages (PPP) (full-time and full-time equivalent in total economy) in 2009. Extracted from OECDStatExtracts.

$w$  is the  $w'$  of each country divided by the  $w'$  of the US.

There is a reasonably good fit between  $mpl$  and  $w$  for the OECD data set (see Figure 25.1, and data in appendix).

But there is no strong reason to suspect it holds up so well for the larger sample including non-OECD countries.

Our consideration thus far has been static. A dynamic puzzle is that although inequalities in educational achievement have been broadly and dramatically diminishing both between countries and within individual countries for decades (see World Bank, 2005, fig. 3.4, table 3.2, and fig. 3.5; and Barro and Lee, 2010, fig. 1), international income inequality (an index constructed from country average incomes weighted by country populations) has been declining, but only because of the growth of average incomes in China and India—that is, international inequality aside from China and India has grown precipitously in recent decades (see Milanovic, 2005, fig. 8.3). And global income inequality (which in contrast to international income inequality takes into account within-country inequality) has been nearly level because of increasing within-country inequality (see World Bank, 2005, figs 3.9 and 3.10). The model here employed dictates that diminishing international inequality in human capital and increasing international inequality in income (setting China and India aside) are possible

Figure 25.1 Scatterplot of  $mpl$  and  $w$  for OECD countries

only if international inequality in technology levels and/or capital/labor ratios have increased. There seem to be no comprehensive empirical investigations of whether this has actually occurred. Such a study would be extraordinarily challenging to carry out.

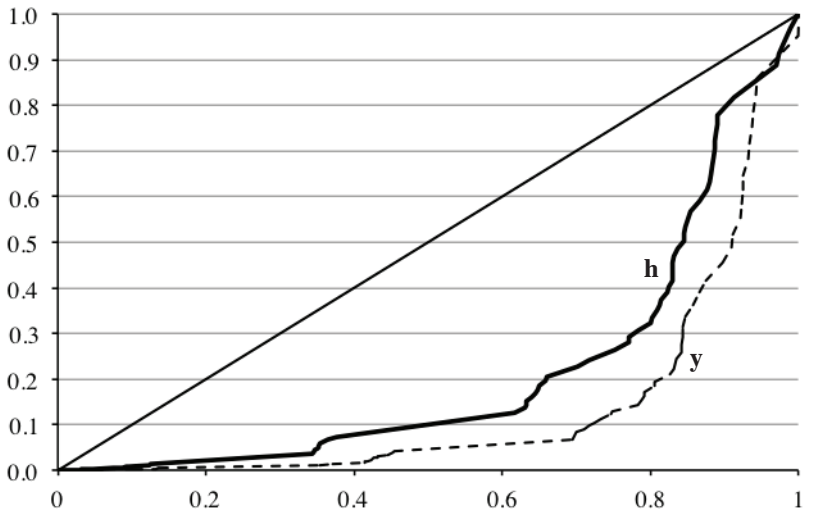
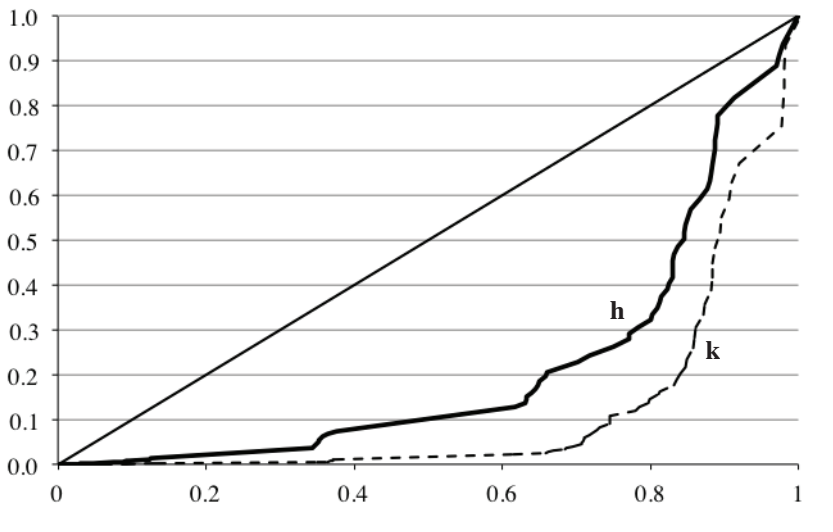
Data are available to explore the current (static) relationships between inequalities in the international distribution (country averages) of  $y$ ,  $h$ ,  $k$ ,<sup>11</sup> and  $A$ . (It would be fascinating to do a similar study for a single country—for example, the US—at the state, county or congressional district, or even postal code level, if only the requisite data were available.)

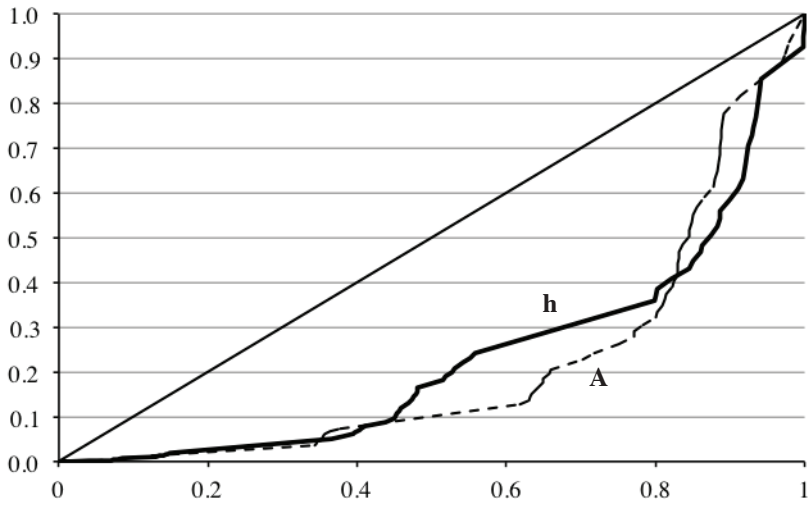
One can construct and compare Lorenz curves for the distribution of each of  $y$ ,  $h$ ,  $k$ , and  $A$ . That is, where  $N$  is the population of each country,<sup>12</sup> for each variable  $x$  one plots  $N/\text{cum}N$  on the abscissa and  $(x/\text{cum}x)(N/\text{cum}N)$  on the ordinate.<sup>13,14</sup> Figure 25.2, which compares the Lorenz curves for income and human capital, demonstrates that income is much more unequally distributed than human capital.

Figure 25.3, which compares the Lorenz curves for physical and human capital, demonstrates that physical capital is much more unequally distributed than human capital.

And finally, Figure 25.4, which compares the Lorenz curves for human capital and productivity, demonstrates that human capital is somewhat more unequally distributed than productivity in the middle of the distribution, but less unequally distributed higher in the distribution.



Figure 25.2 Lorenz curves for  $h$  and  $y$ Figure 25.3 Lorenz curves for  $h$  and  $k$ 

*Figure 25.4 Lorenz curves for h and A*

That human capital and total factor productivity track each other fairly closely is no surprise. One needs the human capital in order to operate the technology. Profoundly, what explains the fact that income is much more unequally distributed than human capital is the inequality in the distribution of physical capital. Of course, levels of human capital should be increased, which historically has been accompanied by decreasing inequality in the distribution of human capital. But one should focus on the fact that inequality in the distribution of physical capital available to workers is what fundamentally determines inequality in the distribution of income.

Reflecting now on this rudimentary model of the relation between levels of human capital and the return to labor and its application statically to a substantial set of recent data (as well as the suggestion for applying the model longitudinally—difficult as such a project would doubtless be empirically), one can reasonably ask what the significance might be of such exercises.

Thus, considering Rawls further: the most extensive exposition of his position on global justice (a term he would not accept for it) is Rawls 1999b, his last work. Famously and controversially Rawls rejects general claims that morally arbitrary facts of nationality and access to technology and capital associated with nationality are morally problematic.<sup>15</sup> At the left pole on the spectrum from Rawls's nationalism are cosmopolitan positions. (To characterize Rawls's position as the right pole elides the fact that it is surely far to the left of median public opinion on global justice.) Positions between these poles are influentially occupied.<sup>16</sup>

The post-Rawlsian cosmopolitan locus classicus is Pogge 1989 (based on his 1983 doctoral dissertation for Rawls<sup>17</sup>). Pogge's views have continued to evolve (see Pogge, 2008). Another especially influential proponent of cosmopolitanism is Darrel Moellendorf (see Moellendorf, 2002). Of course, there is a variety of positions which can be characterized as cosmopolitan. What they have in common is according to most instrumental importance to nationality in formulating a defensible theory of justice. Recent literature on global justice is enormous.

I'll slip now, at the end, to the first person (which is not my wont; surely science should be third person—though a colleague now at Yale from Michigan, Steven Darwall (2009), argues that some moral science is essentially second-person).

Most of this chapter is (at least putatively) positive economics: math (thanks to Bob Solow) and stats (thanks to a horde of colleagues doing work I could not imagine doing). The positive part is (at least to me) quite fascinating—for example, showing that differences in capital/labor ratios and levels of technology account for far more of the differences in workers' outcomes than their differences in human capital. Another positive topic of great interest is the effect of the relation between the evolution of levels of international and global income inequality and the evolution of levels of human capital on migration pressures.<sup>18</sup>

But what are we to make of this, normatively? (I am a moral realist; ethics is also—at least potentially—science.) I've thought about the normative part far more, over a long time, than I have the positive part. But I've made much less progress in coming to broad conclusions on the former.<sup>19</sup> My gut normative intuition is that, *ceteris paribus*, human capital clones should have the same opportunities to flourish. But many disagree. And whether such equal opportunity is somehow feasible is questionable. It might be only an optimistic hope that such can be.<sup>20</sup>

## NOTES

1. I am grateful for comments on earlier drafts by Tom Weisskopf, Fred Moseley, Jeannette Wicks-Lim, Amitava Dutt, and others.
2. Many have come up empty-handed in a search for a definitive passage in Rawls's work specifying morally arbitrary characteristics. But the notion is there, and many have tried to paraphrase it. A good attempt: "[I]n the distribution of income and wealth people should not benefit from, or be held morally responsible for, natural or social advantages or disadvantages they are born with." (Freeman, 2007, p. 443.)
3. Perhaps the most influential work since Rawls in this stream is that of Ronald Dworkin, especially his distinction between "option luck" (with hypothetical insurance against bad outcomes) and "brute luck" (no insurance) (Dworkin, 2000). A more radical critique of Rawls's position (from the left) is that of G.A. Cohen—for example in Cohen, 2001 and 2008. Also essential for understanding this terrain is work by Amartya Sen—for example Sen, 2011.
4. Of course some very interesting work is ongoing in the attempt to decompose the Solow residual into components less opaque and perhaps independently measurable. An approach is to set  $A = T \times E$  where  $T$  is the level of technology and  $E$  is (residual) efficiency, but measuring  $T$  is problematic. (See Weil, 2009, p. 276.)

5. Some vehemently reject use of the Solow aggregate production function framework. But no other comparably general and elaborated approach to matters here considered exists. And it does rather well in explaining the facts.
6. The current chapter and Pritchett 2010 are complements, not substitutes.
7. But one strongly suspects what it would show. If one's clone has a better computer (higher  $A$  and  $K$ ), one's clone can create more output per unit of labor expended.
8. For an interesting look at  $\alpha$  for the US, see Norris (2011).
9. Thanks to Marcelo Soto at the Instituto de Análisis Económico at UAB (Barcelona) for the lead.
10. This formula assumes that countries have the same  $\alpha$  as the US, which is never quite the case. Dropping this assumption makes the formula more complex—that is,  $(AK^\alpha(1-\alpha)h^{\alpha_{US}-\alpha})/(1-\alpha_{US})$ , which is a function of  $h$  (increasing if  $\alpha_{US} > \alpha$ , decreasing if  $\alpha_{US} < \alpha$ ) and could be consequential when  $\alpha$  varies substantially.
11. In poor countries most ditches are dug with shovels, in rich countries rather with (air-conditioned-cab) backhoes.
12. Most recent estimate. Extracted from [wiki/List\\_of\\_countries\\_by\\_population](#).
13. Cumx is the cumulative amount ordered (lowest to highest) of the variable up to  $x$  for this 79-country (80 percent of world population) sample.
14. The underlying Excel and Mathematica files are available from the author.
15. Rawls does argue that wealthy peoples (societies, not individuals) do owe a duty of assistance to “burdened societies” too poor to rise by their own efforts. Perhaps the most persuasive defense of Rawls’s position is Freeman 2007 (ch. 10).
16. *The Stanford Encyclopedia of Philosophy* entry “Cosmopolitanism” is helpful here (<http://plato.stanford.edu/entries/cosmopolitanism/>).
17. Revised and published as Pogge 1989, providing an especially accessible exposition of Rawls’s conception of “justice as fairness,” while criticizing especially Rawls’s restriction of the domain of justice as national.
18. See for example World Bank (2005, fig. 10.1), for evidence that wage rate differentials between countries net exporting workers and those net importing workers were enormously greater in the 1990s than in the 1870s.
19. If one holds that the technology and capital available to individuals is morally arbitrary, the case for loosening immigration barriers is prima facie very powerful. See Pritchett (2010) and Clemens (2011). Of course, there are other arguments for restricting immigration—for example, that it can endanger the viability of unique national cultures—which must be considered. Perhaps the most influential proponent of the national cultural argument is David Miller (Miller, 2007).
20. Cf. “Although a form of altruism circumscribed parochialism is in our legacy, it need not be our destiny. The fact that altruism and parochialism may have a common evolutionary origin, whether cultural or genetic, does not mean that the two are inseparable” (Bowles and Gintis, 2011, p. 147). That is, can we become nonparochial in our judgments of whether arbitrary differences in our access to capital and technology should affect the expected returns for using our human capital?

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## A25.1 DATA APPENDIX

Table A25.1 Country data

Country	h'	h	h <sup>2</sup>	y'	y	y <sup>2</sup>	k'	k	k <sup>2</sup>	α	A	A/ sumA	mpl'	mpl	mplc	w'	w
Algeria	7.23	0.55	0.012	6 950	0.15	0.006	26530	0.18	0.007	0.39	0.417	0.009	0.07	0.10	0.228		
Argentina	8.80	0.66	0.014	15 854	0.34	0.014	54440	0.36	0.015	0.35	0.623	0.014	0.19	0.26	0.437		
Australia	13.25	1.00	0.021	39 699	0.84	0.035	1E+05	0.87	0.036	0.32	0.879	0.020	0.57	0.77	0.836	45 385	0.894
Austria	11.70	0.88	0.019	39 634	0.84	0.035	2E+05	1.01	0.042	0.30	0.911	0.021	0.57	0.76	0.915	41 109	0.809
Bangladesh	5.03	0.38	0.008	1 572	0.03	0.001	3408	0.02	0.001	0.35	0.234	0.005	0.02	0.02	0.062		
Belgium	11.42	0.86	0.018	36 100	0.76	0.032	2E+05	1.06	0.044	0.26	0.840	0.019	0.54	0.73	0.856	40 616	0.800
Benin	2.73	0.21	0.004	1 451	0.03	0.001	2149	0.01	0.001	0.35	0.378	0.009	0.01	0.02	0.086		
Bolivia	8.74	0.66	0.014	4 592	0.10	0.004	8006	0.05	0.002	0.33	0.337	0.008	0.06	0.08	0.121		
Brazil	8.19	0.62	0.013	11 239	0.24	0.010	31560	0.21	0.009	0.35	0.560	0.013	0.13	0.18	0.325		
Burkina Faso	1.50	0.11	0.002	1 360	0.03	0.001	2373	0.02	0.001	0.35	0.506	0.011	0.01	0.01	0.119		
Burundi	2.41	0.18	0.004	411	0.01	0.000	945.7	0.01	0.000	0.25	0.111	0.003	0.00	0.01	0.019		
Cameroon	4.92	0.37	0.008	2 170	0.05	0.002	4458	0.03	0.001	0.35	0.299	0.007	0.02	0.03	0.087		
Canada	13.30	1.00	0.021	39 057	0.83	0.035	1E+05	0.89	0.037	0.32	0.856	0.019	0.56	0.76	0.821	41 312	0.813
Chile	10.77	0.81	0.017	15 002	0.32	0.013	44280	0.30	0.012	0.41	0.590	0.013	0.17	0.23	0.386		
China	6.79	0.51	0.011	7 519	0.16	0.007	10130	0.07	0.003	0.35	0.630	0.014	0.08	0.11	0.246		
Colombia	7.81	0.59	0.012	9 566	0.20	0.009	16640	0.11	0.005	0.35	0.615	0.014	0.11	0.15	0.285		
Costa Rica	7.65	0.58	0.012	11 216	0.24	0.010	28840	0.19	0.008	0.27	0.552	0.013	0.15	0.20	0.310		
Côte d'Ivoire	3.74	0.28	0.006	1 681	0.04	0.002	3749	0.03	0.001	0.32	0.273	0.006	0.02	0.02	0.075		
Denmark	12.32	0.93	0.020	36 450	0.77	0.033	1E+05	0.89	0.037	0.29	0.839	0.019	0.54	0.72	0.806	42 829	0.843
Dominican Republic	6.43	0.49	0.010	8 836	0.19	0.008	14240	0.10	0.004	0.35	0.680	0.015	0.09	0.13	0.299		
Ecuador	8.82	0.67	0.014	7 776	0.16	0.007	22190	0.15	0.006	0.55	0.564	0.013	0.06	0.08	0.289		
Egypt	8.04	0.61	0.013	6 354	0.13	0.006	6875	0.05	0.002	0.23	0.401	0.009	0.09	0.12	0.136		
El Salvador	5.53	0.42	0.009	7 430	0.16	0.007	9663	0.06	0.003	0.42	0.824	0.019	0.06	0.09	0.316		
Ethiopia	2.60	0.20	0.004	1 016	0.02	0.001	757.2	0.01	0.000	0.35	0.393	0.009	0.01	0.01	0.062		
Finland	12.28	0.93	0.020	34 585	0.73	0.031	1E+05	0.86	0.035	0.29	0.807	0.018	0.51	0.69	0.765	34 241	0.674

Country	h'	h	h/sumh	y'	y	y/sumy	k'	k	k/sumk	$\alpha$	A	A/sumA	mpl'	mpl	mplc	w'	w
France	11.35	0.86	0.018	34.077	0.72	0.030	1E+05	0.96	0.040	0.26	0.816	0.018	0.51	0.69	0.805	37 050	0.730
Gabon	6.18	0.47	0.010	15.021	0.32	0.013	22330	0.15	0.006	0.35	1.014	0.023	0.16	0.21	0.521		
Ghana	5.64	0.43	0.009	2.615	0.06	0.002	2134	0.01	0.001	0.35	0.426	0.010	0.03	0.04	0.096		
Guatemala	5.32	0.40	0.008	4.885	0.10	0.004	9537	0.06	0.003	0.35	0.489	0.011	0.05	0.07	0.187		
Honduras	5.71	0.43	0.009	4.417	0.09	0.004	9551	0.06	0.003	0.35	0.423	0.010	0.05	0.06	0.161		
India	5.32	0.40	0.008	3.339	0.07	0.003	6270	0.04	0.002	0.35	0.388	0.009	0.03	0.05	0.128		
Indonesia	7.99	0.60	0.013	4.394	0.09	0.004	12650	0.08	0.003	0.35	0.306	0.007	0.05	0.07	0.129		
Iran	6.66	0.50	0.011	10.865	0.23	0.010	34650	0.23	0.010	0.35	0.599	0.014	0.12	0.16	0.359		
Ireland	10.59	0.80	0.017	38.550	0.82	0.034	1E+05	0.68	0.028	0.27	1.063	0.024	0.56	0.76	0.931	45 166	0.889
Italy	11.02	0.83	0.018	29.392	0.62	0.026	1E+05	0.90	0.037	0.29	0.729	0.017	0.42	0.57	0.704	31 290	0.616
Jamaica	9.05	0.68	0.014	8.727	0.18	0.008	17570	0.12	0.005	0.40	0.546	0.012	0.10	0.13	0.258		
Japan	13.11	0.99	0.021	33.805	0.71	0.030	2E+05	1.16	0.048	0.32	0.686	0.016	0.48	0.65	0.723	32 816	0.646
Jordan	10.18	0.77	0.016	5.644	0.12	0.005	19580	0.13	0.005	0.36	0.294	0.007	0.07	0.09	0.144		
Kenya	6.52	0.49	0.010	1.662	0.04	0.001	2407	0.02	0.001	0.35	0.236	0.005	0.02	0.02	0.056		
Korea	13.34	1.01	0.021	29.836	0.63	0.027	91410	0.61	0.025	0.45	0.784	0.018	0.35	0.47	0.660	32 638	0.643
Madagascar	4.07	0.31	0.006	911	0.02	0.001	771.8	0.01	0.000	0.35	0.262	0.006	0.01	0.01	0.041		
Malawi	5.31	0.40	0.008	827	0.02	0.001	1507	0.01	0.000	0.35	0.158	0.004	0.01	0.01	0.032		
Malaysia	10.22	0.77	0.016	14.670	0.31	0.013	51180	0.34	0.014	0.34	0.530	0.012	0.19	0.25	0.364		
Mali	1.60	0.12	0.003	1.252	0.03	0.001	1659	0.01	0.000	0.35	0.504	0.011	0.01	0.01	0.104		
Mauritius	8.19	0.62	0.013	2.093	0.04	0.002	36390	0.24	0.010	0.43	0.107	0.002	0.02	0.03	0.065		
Mexico	8.43	0.64	0.013	14.430	0.31	0.013	42990	0.29	0.012	0.45	0.685	0.016	0.14	0.19	0.443		
Morocco	4.50	0.34	0.007	4.754	0.10	0.004	13400	0.09	0.004	0.42	0.518	0.012	0.04	0.05	0.223		
Mozambique	2.45	0.18	0.004	1.010	0.02	0.001	988.8	0.01	0.000	0.35	0.371	0.008	0.01	0.01	0.064		
Nepal	4.57	0.35	0.007	1.271	0.03	0.001	4746	0.03	0.001	0.35	0.179	0.004	0.01	0.02	0.054		
Netherlands	11.50	0.87	0.018	40.765	0.86	0.036	1E+05	0.91	0.037	0.33	0.978	0.022	0.55	0.74	0.946	46 615	0.918
New Zealand	12.48	0.94	0.020	26.966	0.57	0.024	98160	0.66	0.027	0.33	0.682	0.015	0.37	0.51	0.588		

(continued on next page)

Table A25.1 Country data cont.

Country	h'	h	h'	sumh	y'	y	sumy	k'	k	sumk	$\alpha$	A	sumA	mpl'	mpl	mp/c	w'	w
Nicaragua	7.08	0.53	0.011	3.045	0.06	0.003	8301	0.06	0.002	0.35	0.266	0.006	0.03	0.05	0.097			
Niger	1.25	0.09	0.002	755	0.02	0.001	1399	0.01	0.000	0.35	0.380	0.009	0.00	0.01	0.074			
Nigeria	4.37	0.33	0.007	2.422	0.05	0.002	2741	0.02	0.001	0.35	0.427	0.010	0.02	0.03	0.105			
Norway	12.71	0.96	0.020	52.013	1.10	0.046	2E+05	1.14	0.047	0.39	1.070	0.024	0.66	0.89	1.122	42.921	0.845	
Panama	9.12	0.69	0.015	12.578	0.27	0.011	34460	0.23	0.010	0.27	0.519	0.012	0.18	0.24	0.311			
Paraguay	7.03	0.53	0.011	5.202	0.11	0.005	16680	0.11	0.005	0.51	0.459	0.010	0.04	0.05	0.213			
Peru	9.01	0.68	0.014	9.330	0.20	0.008	27350	0.18	0.008	0.44	0.517	0.012	0.09	0.13	0.285			
Philippines	8.62	0.65	0.014	3.737	0.08	0.003	13490	0.09	0.004	0.41	0.273	0.006	0.04	0.05	0.118			
Portugal	7.89	0.60	0.013	23.223	0.49	0.021	79050	0.53	0.022	0.28	0.852	0.019	0.31	0.41	0.682	22.666	0.446	
Romania	10.99	0.83	0.017	11.860	0.25	0.011	26890	0.18	0.007	0.35	0.516	0.012	0.15	0.21	0.283			
Senegal	2.96	0.22	0.005	1.819	0.04	0.002	2930	0.02	0.001	0.35	0.403	0.009	0.01	0.02	0.102			
South Africa	8.83	0.67	0.014	10.498	0.22	0.009	22700	0.15	0.006	0.38	0.584	0.013	0.12	0.16	0.302			
Spain	10.27	0.78	0.016	29.742	0.63	0.027	1E+05	0.75	0.031	0.33	0.819	0.019	0.39	0.52	0.742	33.193	0.654	
Sweden	12.11	0.91	0.019	38.031	0.80	0.034	1E+05	0.75	0.031	0.23	0.920	0.021	0.61	0.82	0.833	35.672	0.702	
Switzerland	12.57	0.95	0.020	41.663	0.88	0.037	2E+05	1.16	0.048	0.24	0.885	0.020	0.66	0.89	0.932	47.800	0.941	
Syria	7.59	0.57	0.012	5.208	0.11	0.005	12900	0.09	0.004	0.35	0.373	0.008	0.06	0.08	0.158			
Tanzania	3.74	0.28	0.006	1.413	0.03	0.001	2051	0.01	0.001	0.35	0.305	0.007	0.01	0.02	0.068			
Thailand	8.50	0.64	0.014	9.187	0.19	0.008	34090	0.23	0.009	0.35	0.435	0.010	0.11	0.15	0.259			
Trinidad & Tobago	9.85	0.74	0.016	20.329	0.43	0.018	29980	0.20	0.008	0.31	0.868	0.020	0.27	0.37	0.495			
Turkey	6.89	0.52	0.011	13.464	0.28	0.012	28670	0.19	0.008	0.35	0.776	0.018	0.15	0.20	0.435			
Uganda	4.71	0.36	0.007	1.241	0.03	0.001	579	0.00	0.000	0.35	0.359	0.008	0.01	0.02	0.051			
United Kingdom	13.34	1.01	0.021	34.920	0.74	0.031	99520	0.67	0.027	0.25	0.813	0.018	0.55	0.75	0.705	44.580	0.878	
United States	13.24	1.00	0.021	47.284	1.00	0.042	1E+05	1.00	0.041	0.26	1.000	0.023	0.74	1.00	1.000	50.787	1.000	
Uruguay	8.98	0.68	0.014	14.296	0.30	0.013	30790	0.21	0.008	0.42	0.735	0.017	0.15	0.20	0.423			
Venezuela	7.25	0.55	0.012	11.829	0.25	0.011	32460	0.22	0.009	0.47	0.706	0.016	0.10	0.13	0.414			
Zambia	6.45	0.49	0.010	1.512	0.03	0.001	3647	0.02	0.001	0.28	0.152	0.003	0.02	0.03	0.041			
Zimbabwe	8.82	0.67	0.014	4.34	0.01	0.000	9816	0.07	0.003	0.35	0.031	0.001	0.01	0.01	0.012			
SUM		47.43	1.000		23.67	1.000		24.26	1.000		44.12	1.000						



## 26. Comment on Kotz, Skillman, and Thompson

**Fred Moseley**

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### 26.1 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 chapter. 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 capitalists to *restore the rate of profit* back up to its early postwar level. The neoliberal 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 of 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 this 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.

## 26.2 COMMENT ON SKILLMAN

The main purpose of Gil Skillman's chapter is to provide theoretical support for Marx's claim that capitalist production is not necessary for exploitation; that is, 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 chapter employs a principal-agent model, with two key assumptions: (1) that capitalists can choose whatever payment scheme they want; that is, they can choose any combination of interest payments (on loans to the producers) and piece rates; and (2) that 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 (that is, 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—that is, 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 he makes the even greater mistake of doing theory without history.

### 26.3 COMMENT ON THOMPSON

Frank Thompson’s chapter 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 chapter 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 chapter 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. Second, there is no reason to expect that an aggregate function (if it existed) would have a Cobb–Douglas functional form. Third, 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 0.68 to 0.74. 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 dataset 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 chapter 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?

## 27. Presentation to the Festschrift Conference at the Political Economy Research Institute of the University of Massachusetts Amherst, October 1, 2011

**Thomas E. Weisskopf**

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### INTRODUCTION

First, I want to say that I'm delighted to have provided an excuse for bringing us all together here this weekend. For me, it's been like a great reunion, as well as a highly stimulating intellectual experience.

I am enormously grateful to Bob Pollin, Jeannette Wicks-Lim, and the Political Economy Research Institute for this great honor. When I first got the word, it came as a complete surprise! I think that most of you in this room are more deserving of a festschrift conference than am I.

In one of my favorite quotations, Yogi Berra once said that he always made a point of attending the funerals of his friends, so as to ensure that they would attend his. What I can say is this: your coming to my festschrift conference ensures that I'll come to yours!

I have found every one of the conference papers stimulating, and I want to thank all of the authors as well as the discussants for their work. I am especially grateful to Bob for taking on the challenge of reviewing my own work, and for having done it so insightfully. And I am indebted to Sam Bowles for giving me a chance to revive my widely unknown stage career—and as the hero of his play!

Preparing for this conference has given me an opportunity to reflect both on my career and on the role of radical political economy more generally. My presentation here will be in two parts: a retrospective look at some of my past work, and some observations on what I think radical political economy has and hasn't accomplished.

## RETROSPECTIVE

At this conference people have touched mostly on some of the highlights of my past work. I'm going to draw attention mostly to some of the lower lights. I've always felt that I was not that great a creative thinker, but that my strength—if any—was as a careful reader and constructive critic of the work of others. I think I should now apply that approach to my own work too.

My interest in economics is well summarized by the familiar 11th thesis of Karl Marx on Feuerbach: "*Philosophers have only interpreted the world, in various ways; the point is to change it.*" As I wrote in an article contributed to the festschrift for Howard Sherman, "*like my generation of radical political economists, he was highly critical of actually existing capitalism (especially as it manifested itself in the US), he sought to change it for the better, and indeed he expected that it would be changed for the better within our lifetime.*" And I think that is true of most of us here—and in the Union for Radical Political Economics.

As I look back at my career, I can see how I was for much of the time...

### *Chasing Socialism—Unsuccessfully*

Since my college days I have always been searching for better alternatives both to American-style capitalism and to Russian-style socialism. Over time I concentrated on different apparent historical opportunities for developing a viable superior alternative.

First I focused on India, attracted by the promise of a "socialistic pattern of society" articulated by Prime Minister Jawaharlal Nehru. Over 4 years in the 1960s I was affiliated with the Indian Statistical Institute, headed by P.C. Mahalanobis, an eminent statistician and advisor to Nehru, who sought to steer Indian economic policy well to the Left.

Then in the late 1960s I returned to the US and participated in the founding and development of URPE, when as part of the New Left we were envisaging a revolutionary transformation of American capitalism into a new and distinctive form of socialism.

In the early 1970s I turned my attention briefly to socialism in China—among other things participating in the "First Friendship Delegation of Radical Political Economists to the People's Republic of China." It was on that trip that I really got to know David Gordon, who would become an inspiring friend and co-author over the next 25 years.

By the late 1970s I had shifted my focus to the US, then mired in stagflation, and throughout the 1980s I worked with David and Sam on the social-structure-of-accumulation approach to analysing the US economy and on what we called "a democratic alternative to economic decline."

During the 1980s I was also attracted by the promising Rehn–Meidner Plan and I studied its potential to generate a democratic transition to socialism in Sweden.

As actually-existing socialism in Eastern Europe and the former Soviet Union began to collapse in the late 1980s, I turned my attention to the potential for democratic market socialism as a path out of bureaucratic socialism, if not a future for Western capitalism. Throughout the 1990s I worked on issues of transition in Eastern Europe and especially Russia.

Finally, from the late 1990s up to the present, I worked and spoke out on affirmative action in the US and in India. This topic obviously does not involve an alternative to capitalism, but it does go counter to capitalist logic and — among other things — I hoped to have some impact on ongoing struggles over affirmative action at the University of Michigan and in the State of Michigan.

Obviously things have not turned out in a way that I had hoped and worked for. Almost everywhere in the world the trend is not in the direction of any kind of socialism, but strongly in the direction of American-style capitalism (if not worse). Even social-democratic capitalism is on the defensive, though it remains fairly robust in much of Western Europe — especially in the Nordic countries. In the realm of affirmative action, the 2003 US Supreme Court decisions on the lawsuits against the University of Michigan gave affirmative action a continued lease on life, but voters in the State of Michigan rejected it (in public institutions) via a 2006 ballot proposition.

These unhappy real-world trends were clearly beyond my control; but what about my academic work? I think I have had some success; but I have also been in many ways...

### *Wrong In Analysing Long-Run Trends In Capitalism*

Ironically, my first major book (jointly produced with Michael Reich and Rick Edwards) — *The Capitalist System* (1972, 1978, 1986) — critiqued US capitalism when it was actually at its most social-democratic, in the late 1960s and early 1970s. We argued that capitalism generates a litany of bad outcomes, threatening long-run capitalist hegemony. Much of our criticism is actually far more apt as applied to today's US. That's probably not true of racism or sexism, where things have arguably improved; but it is certainly true of inequality, militarism, waste, and irrationality. We also implied that things could — and maybe would — get a good deal better in the future. In many ways, however, the US capitalism of that earlier period looks now like a pretty attractive goal to return to!

I'd like now to consider briefly three rather speculative articles of mine, written at successive intervals of roughly a decade — around 1980, 1990, 2000 — as well as the two Waste Land books written in the early and late 1980s with David and Sam, taking these publications in chronological order.

In “The current economic crisis in historical perspective” (1981), I suggested that major institutional changes would be required to overcome the crisis of stagflation of the late 1970s, and that this could lead to a revitalized capitalist structure or possibly to a fundamental transformation of the capitalist mode of production. I outlined five alternative scenarios: “conservative market-based” and “conservative corporatist,” with the burden of restructuring falling largely on poorer, weaker classes; “social-democratic,” with the burden widely shared; and “authoritarian socialist” and “democratic socialist,” with the burden on the capitalist class and the well-to-do.

I then argued that it would be impossible to succeed in revitalizing US capitalism with the market-based strategy, because that would defy the long-run trend in capitalist societies of increasing political intervention into markets. I wrote that the most likely strategy to emerge eventually was the corporatist one, which would tend to be both economically inegalitarian and politically authoritarian.

Although we’ve seen all too much increasing inequality since 1980, I was quite wrong about the nature of the new capitalist order that emerged in the 1980s with Reagan in the US and Thatcher in the UK. Later characterized as a transnational or neoliberal social structure of accumulation, by David Kotz among others, this SSA was clearly much more market-based than corporatist, and it was quite consistent with the same kind of liberal–democratic political institutions that were in effect during the postwar era of a more state-influenced and regulated form of capitalism.

My books with David and Sam—*Beyond the Waste Land* (1983) and *After the Waste Land* (1991)—focused on the macroeconomic contradictions of capitalism, in particular the post-World War II SSA. Among other things, we argued that the continuing popular struggle to maintain and extend past gains would make it difficult for Right-wing politicians to turn back the clock in a democratic context; only a fundamentally altered, more authoritarian form of capitalism could avoid a major failure of market-based economies. And we proposed a much-reformed, much more egalitarian economic system, which would be truly compatible with political democracy.

I think we got a lot of things right in our analysis of the postwar SSA, but we were wrong about the growing incompatibility of a capitalist economy with at least a formally democratic political system. (One could argue that the US political system is now no longer democratic, but that would be to redefine democracy as “genuinely democratic,” whereas our argument was couched in terms of actually-existing democracy.) And we were wrong in implying that a return to a much less regulated and more market-oriented SSA was not a possibility.

In “Marxian crisis theory and the contradictions of late 20th century capitalism” (1989/91), I argued that traditional Marxian crisis theories had become increasingly irrelevant, mainly because they are too narrowly economic in analytical orientation. I suggested that in the future the two most basic sources



of capitalist contradictions—likely to promote major crises requiring fundamental structural change—were “New Ricardian”—the deterioration of the natural environment and consequent depletion and destruction of ecological assets—and “New Polanyian”—the deterioration of the social environment and consequent growth of civil unrest and conflict. I thought that ultimately the ecological contradictions would likely be more challenging than the social contradictions, given the great difficulty and high cost of dealing with them on a world scale. And I wrote that the required structural changes must substitute cooperative approaches for individualistic market logic and change fundamentally the whole capitalist structure—keyed as it is to ever more growth of production and consumption—into a system that prioritized conservation, redistribution, and quality of life over quantity of goods.

Now I may well have been right about the ultimately fundamental ecological challenge to capitalism. But I believe I was wrong on a number of counts. First, the current economic crisis is in considerable part a crisis of underconsumption, consistent with the Marxian crisis theory of realization failure—though to the Marxian emphasis on economic inequality as a source of realization failure must be added a critical role for financial excess and instability (along lines pioneered by Hyman Minsky and developed in a contemporary context by people like Jim Crotty, Jerry Epstein, and Bob Pollin here at U-Mass). Second, I think that I overemphasized the likelihood of a “New Polanyian” crisis, in that resistance on the part of the many groups marginalized by contemporary capitalism has not posed—and seems unlikely in the foreseeable future to pose—a serious threat to ruling elites in the capitalist world, except perhaps in some of the relatively peripheral countries like Greece.

In “Left perspectives on long-term trends in capitalism” (1999), I raised the question: “How can capitalism be changed for the better, given the enormous power that the pro-capitalist side can and will bring to bear in any struggle over the shape of society?” Many of us radical political economists had been arguing that there was a link between the unjust and the contradictory nature of capitalism, in that its failure to make life better for a substantial majority of the people would lead them to resist the rule of capital and thereby intensify challenges to capitalist hegemony.

In this article I noted that our radical critiques of capitalism had become all the more applicable, yet capitalism had become much more dominant—at least in the US. It turned out not to be difficult for Right-wing politicians to turn back the clock, even in a formally democratic context. I suggested that what needed explanation was perhaps not the return to a less fettered form of capitalism but the unusual postwar SSA of regulated capitalism. The success of the latter might be explained in terms of factors such as the strength of labor and social-democratic political movements in an industrial context, the appeal of Keynesian macropolicies and social programs as a means to enhance national capitalist

vitality and stability, and a growing ability of less privileged classes to force their agenda on ruling groups. Lurking in the background was also the threat of a socialist alternative—credible in the context of a powerful Soviet Union.

The demise of regulated capitalism in the US—and elsewhere, though the trend in other affluent nations hasn't gone anywhere near as far as in the US—could then be explained in terms of a decline in the significance of the nation state in the context of globalization. What happens to domestic markets and the domestic labor force matters much less; the strength of unions and citizens' groups erodes; the growing heterogeneity of national populations weakens solidarity and aggravates racial intolerance. The collapse of actually-existing socialism in the Soviet Union and Eastern Europe reduces the credibility of a socialist alternative and helps to steer political support away from Left-wing social reformers to Right-wing nativist populists.

In this rather pessimistic context, I suggested that the most that could be hoped for in the foreseeable future was the development of new kinds of more locally-based alternative institutions—perhaps arising from living wage campaigns and efforts to democratize enterprises (such as those highlighted by the Solidarity Economy Network). But such movements are necessarily limited in scope, so the struggle against transnational neoliberalism would for some considerable time be defensive in nature. Finally, grasping at straws, I evoked Gramsci's famous exhortation to exhibit "pessimism of the intellect but optimism of the will."

All of the above sounds reasonable in the context of the turn of the century. Yet even those few radical political economists who foresaw the economic crisis that has engulfed much of the capitalist world since 2008—far more serious than the crisis of stagflation in the late 1970s and early 1980s—would never have thought that the latest SSA could survive it. We would have expected a huge challenge to the previously ruling authorities and a period of civil unrest, if not chaos, leading to fundamental change. Some of us even thought that the election of Barack Obama in 2008 might constitute a critical turning point, leading to the replacement of the latest SSA by a new and more equitable one—if not a form of socialism.

Something like that may still happen, if the crisis becomes even more profound in the coming years. Maybe capitalism will be increasingly discredited by the inadequacy of the response to the current economic crisis by the powers-that-be. Maybe the crazy rejection of Keynesian macropolicy principles—what Jim Crotty labels "The Great Austerity War"—will make things so much worse that deepening economic crisis will lead to fundamental change. Certainly the prospect of someone like Rick Perry as our next president evokes thoughts along these lines!

But how many of us would have predicted that the popular rage against the perpetrators of the economic crisis—Wall St gamblers and global financiers, government deregulators and non-regulators, et al.—would in the US be

harnessed by the Right wing (via the Tea Party) rather than by the Left? And how many of us would now confidently predict that we will emerge from the current crisis with a new economic and political order more congenial to our values and our hopes? It now seems at least—if not more—likely that in the US an ever-more powerful Right-wing ruling elite, pouring money into election campaigns, dominating the media and the shaping of a national ideology (along lines articulated by Arthur MacEwan), will succeed in establishing an even more oppressive form of capitalism in the US.

## WHAT IS TO BE DONE?

So what should we radical political economists do about all this? I will deliberately state my views rather baldly, in the hope of provoking a more lively discussion—kind of a dialectical approach!

First, I think we need to be realistic about what the world is like now and what can actually be accomplished in the foreseeable future.

In the long run, capitalism may well be doomed (as Minqi Li has suggested) by a fundamental contradiction between economic growth—necessary for the stability of a capitalist economy—and the ecological constraints of a finite Earth. But I believe that for the foreseeable future the real battle—at least in the more affluent nations, if not everywhere in the world—will not be to bring about some form of socialism to replace capitalism, but to establish or maintain a form of social-democratic capitalism. This has been achieved at least in Northern Europe, though there has been some retreat from the achievement even there.

Here and now in the US we are of course far from even a half-decent form of social-democratic capitalism. We are struggling to defend the achievements of the New Deal and the 1960s, as Right-wing moneyed elites and the politicians they control have gained predominant power in the political arena, and unions have suffered greatly diminished numbers and influence. Things have gotten bad, and they threaten to get much worse—while popular rage against the system that brought us the current economic crisis has been captured by the far Right, not by the Left.

In a review of Tony Kushner's latest play, Fran Lebowitz wrote: "*In the Soviet Union, capitalism triumphed over communism; in [the United States], capitalism triumphed over democracy.*" That is something of an exaggeration: democracy is not dead in the US. It has, however, been increasingly compromised. And it is now under greater threat of a Right-wing stranglehold than at any time in my life—if not even longer.

I think radical political economists have done and continue to do an excellent job in analysing capitalism, shedding light on its functioning and its problems—

as this conference has amply demonstrated. And we have done very good work in spelling out how institutions and policies need to be changed to build a much more humane and just society. For example, the kind of economic policy research done at PERI (and at other Left organizations such as the Center for Economic and Policy Research, GDAE, EPI, and CAP) is extremely useful. It does not involve building a new economic paradigm, but it brings together progressive values and sound economic techniques to weigh in on ongoing economic policy debates. Likewise, the dissemination of progressive economic analysis by organizations such as the Center for Popular Economics and Dollars & Sense, and by people like Mark Weisbrot and Dean Baker, is very valuable, spreading sensible progressive economics to the general public and to Left activists.

The fact that trends in capitalism have not gone in the direction we expected or hoped they would is certainly not our fault; obviously we are not in control of political-economic developments around the world. We have tried in many ways—as teachers, researchers, and activists—to keep up the momentum for building a better society, if not a movement for fundamental change. And perhaps we have helped in small ways to prevent US capitalism from getting even worse than it has. Still, I think that there are some ways in which we might be able to do a somewhat better job in the future.

1. In the past, I and many other radical political economists sought to build a new Marx-inspired economics paradigm and to spell out what a truly humane and just socialist society would look like and how it would work. Perhaps it is because, having reached an advanced age, my time horizon has become considerably shorter. But I now believe that much of Marxist theory, as well as the modeling of various forms of socialism, is of little relevance to the contemporary challenges faced by much of the world—except insofar as they foster the valuing of social justice and an understanding of the importance of collective action. Especially here and now in the United States, we need to focus on how we can turn back the Right-wing anti-democratic thrust of the past few decades and rebuild and strengthen the social-democratic elements of US capitalism.

2. We need to do a better job of analysing contemporary capitalism, its weaknesses and its potential contradictions, in such a way as to gain more understanding of where it is going and how its direction can be changed. The research many of us have done within the framework of SSA analysis has been very insightful when it comes to interpreting past history, but it has provided little guidance when it comes to predicting future developments, or forming effective political strategies to promote egalitarianism and social justice. I think we need new research—perhaps in conjunction with political scientists—that would inform the development of ways to oppose more effectively the political and economic trend to the Right of recent decades.

3. Many of us have held that radical political economy constitutes an analytical approach that is distinct from and superior to that of mainstream economists; but I think we have overstated this—at least since 1980, as Gil Skillman and Frank Thompson, in different ways, have suggested. I believe it is less our methods of economic analysis and more our values—and our urge to see them realized in contemporary societies—that distinguishes us from much of the mainstream. And it does not distinguish us sharply from some who have never been considered radical political economists, but who have become outspoken proponents of much that we favor. I'm thinking of people like Paul Krugman, Joe Stiglitz, Robert Reich, and Jeffrey Sachs (in his new incarnation). I suspect that now there are many more mainstream economists who share our views on the threat of the Right and on some basic elements of a more humane and just society.

I believe what most fundamentally distinguishes us as radical political economists from the mainstream is not so much that we find different economic issues worth researching, writing, and teaching about, or that we use different methods in doing so. Instead, I think what is most fundamental is that we see researching, writing, and teaching on these issues not simply as an intellectual challenge, but as a challenge to make things better. In other words, the point is not just to understand the world, but to change it. What is really important is: how to understand the world in a way that is more useful in figuring out how to change it!

4. I believe that, in fighting against the powerful forces arrayed against us, particularly in the US, we must recognize the need for allies. I think we should try to get the relatively reasonable fraction of mainstream economists to see that they need to get more involved in and better at informing public discourse, if we are to prevent the Right-wing crazies from completely taking over. As basic economic verities are routinely rejected by powerful politicians, even many activism-averse mainstream economists can surely see the need not to leave policymaking to the politicians, but to take a stand against unreason!

5. By the same token, I think that the progressive movement should not only seek to aid and strengthen our traditional allies, such as the labor movement, but we should also look for allies across a broader swath of US society. For example, we could make a greater effort to bring on board those elements of the capitalist class who are far-sighted enough to see that many of the economic policies now being pursued in the United States, ostensibly in their class interest, are in fact counter to almost everyone's long-run interest. Within the more domestically-based non-financial business sector there must be some businessmen and women who see the desirability of supporting employment-generating and energy-saving programs, public spending on education and infrastructure,

limits on financial speculation, etc. Let's try to divide the potentially progressive business interests from the financiers and the Tea Party!

6. Finally, and this is more of a long-run task, I believe that we must find a way to get the general public—young people in particular—to see the reduction of inequality as a compelling moral issue and the social-democratization of American capitalism as an important goal. This is a question of basic values more than one of analytical methodology. Certainly as university teachers of radical political economy we are doing good work in promoting the values of a good society—both in our teaching of economics and in our mentoring of progressive students and their organizations. This we must continue to do—especially, perhaps, among undergraduates, much more numerous and possibly more open-minded than most graduate students. But I believe we should devote more attention to high school students. Working on high school economics texts, and with high school social science teachers, might well be especially valuable.

In sum: We radical political economists have put capitalism on trial, and we have found it sorely wanting—in many respects. But capitalism has proven remarkably resilient and persistent, and I see no realistic hope of replacing it in the foreseeable future. Over the past 3 decades, US capitalism in particular has taken a significant turn for the worse. I believe that here and now our most urgent task is to devote our teaching, our research, and our activism to reversing this alarming trend.

# Biography of Thomas Emil Weisskopf

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## DATE AND PLACE OF BIRTH

April 13, 1940 in Rochester, New York.

## ACADEMIC TRAINING AND DEGREES

Harvard University, 1958–61, BA (Summa Cum Laude) in Economics, June 1961  
Massachusetts Institute of Technology, 1962–66, PhD in Economics, September  
1966

## EMPLOYMENT HISTORY

Research and Teaching Associate, Indian Statistical Institute, Calcutta, India,  
1961–62

Assistant Research Economist, Massachusetts Institute of Technology, Sum-  
mer 1963

Junior Fellow, American Institute of Indian Studies, New Delhi, India, 1964–65

Visiting Professor of Economics, Indian Statistical Institute, New Delhi, India,  
1966–68

Assistant Professor of Economics, Harvard University, 1968–72

Associate Professor of Economics, University of Michigan, 1972–79

Director, Residential College, University of Michigan, 1996–2001, 2002–2005

Resident Director, Academic Program in Aix-en-Provence, France, operated by  
the Universities of Wisconsin, Indiana, and Michigan, 2006–2007

Professor of Economics and in the Residential College, University of Michigan,  
1979–2010

Professor Emeritus of Economics and in the Residential College, University  
of Michigan, 2010–

## GRANTS, FELLOWSHIPS, AND AWARDS

- Twentieth Century Fund, Research Grant award, 1970–74  
University of Michigan Center for Research on Learning and Teaching, Faculty Development Fund, 1983, 1990, 1994  
German Marshall Fund of the United States, Research Fellowship award, 1984–85  
US National Science Foundation, Research Grant award, 1985–88  
University of Michigan, Committee on International Studies, Faculty Enhancement Fund award, 1990  
International Research and Exchanges Board (IREX), Developmental Fellowship award, 1991–92  
University of Michigan, School of Business Administration, Center for International Business Education, Faculty Research Grant, 1992  
University of Michigan, University Council on International Academic Affairs grant, 1993  
University of Michigan, International Institute, Faculty International Travel Grant, 1993  
Entry in Simon Jones and Mark Blaug (eds), *Who's Who in Economics, 1700–1995* (MIT Press, 1996) and *Who's Who in Economics, 1700–1998* (Edward Elgar, 1999)  
University of Michigan, Office of the Vice-President for Research, Horace Rackham Graduate School, and International Institute grants, 2000  
University of Michigan, College of Literatures, Science and the Arts, Center for South Asian Studies and the Residential College grants, 2009

## SENIOR HONORS THESIS

- Price Movements Within the Manufacturing Sector of the United States Economy, 1921–1929 and 1947–1957*

## PHD DISSERTATION

- A Programming Model for Import Substitution in India*



## ACADEMIC SERVICE TO THE UNIVERSITY OF MICHIGAN ANN ARBOR

College Referee (for student grievances), College of Literature, Science and the Arts  
Coordinator of the Social Science Program, Residential College  
Member, Michigan Minority Merit Fellowship Selection Committee  
Member, Ad Hoc Committee on Faculty Grievance Procedure, College of Literature, Science and the Arts  
Member, Executive Committee of the Residential College  
Faculty Mentor, Summer Research Opportunity Program, Graduate Office of Minority Affairs  
Member, Faculty Advisory Committee for the Comprehensive Studies Program  
Member, Educational Policies Committee, Residential College  
Member, Committee for the Pre-Concentration Years, College of Literature, Science and the Arts  
Member, Evaluations Committee, Residential College  
Member, Rackham Grant Award Committee  
Member, Literature, Sciences and the Arts/Residential College Liaison Committee  
Member, Residential College Advisory Committee  
Member *ex officio*, Literature, Sciences and the Arts Curriculum Committee  
Member, Academic Services Board  
Member, Planning Committee for the Winter 1999 Theme Semester on “Diversity: Theories and Practices”  
Member, Provost’s Working Group on Undergraduate Teaching and Learning  
Member *ex officio*, Literature, Sciences and the Arts/ Residential College Liaison Committee for Long-Term Planning  
Member *ex officio*, Provost’s Committee on Michigan Living-Learning Communities  
Chair, Search Committee for the Vice-President for Student Affairs  
Member, International Institute Graduate Board  
Member, Literature, Sciences and the Arts Admissions Advisory Committee  
Member, Admissions and Fellowship Committee, Center for South Asian Studies  
Member, University Shared Governance Task Force  
Member, Literature, Sciences and the Arts Divisional Evaluation Committee for the Social Sciences

## PROFESSIONAL SERVICE

Associate Editor, *Quarterly Journal of Economics*  
Associate Editor, *International Economic Review*

Associate Editor, *Review of Radical Political Economics*

Associate Editor, *Journal of Development Economics*

Member, Committee on Political Discrimination, American Economic Association

Associate Editor, *Bulletin of Concerned Asian Scholars*

Referee, *Cambridge Journal of Economics*

Editor of a special double-issue of the *Review of Radical Political Economics*, XVIII(1–2), Spring & Summer 1986, on “Empirical Work on Marxian Crisis Theory”

Associate Editor, *International Review of Applied Economics*

## OTHER PROFESSIONAL ACTIVITIES

Consultant and Workshop Leader, United Nations Industrial Development Organization, 1966–68

Course Director, the American Association for the Advancement of Science / National Science Foundation (AAAS/NSF) Chautauqua-type Short Course, 1979–80

Visiting Lecturer at Lviv State University (Ukraine), May 1992

Visiting Lecturer at the Russian State University for the Humanities (Moscow), October 1993

Visiting Lecturer at the International University (Moscow), September and November 1994

Collaborator on and consultant to the project on “Developing Economics Curricula for New Market Economies,” initiated by Dr Neva Goodwin of the Global Development and Environmental Institute (Tufts University) to prepare an introductory economics textbook for use in Russia, starting in 1994

Expert witness on the effects of a “living wage” in the case: *New Orleans Campaign for a Living Wage et al. vs City of New Orleans*, Civil District Court No. 2002-1824 and 1840; presented testimony on March 20, 2002

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2. Edited with Hollis Chenery et al., *Studies in Development Planning*, Cambridge, MA: Harvard University Press, 1971.
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7. Edited with Samuel Bowles, *Economics and Social Justice: Essays on Power, Labor and Institutional Change*, Cheltenham, UK: Edward Elgar Publishing, 1998.
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9. With Neva R. Goodwin, Frank Ackerman, and Julie A. Nelson, *Microeconomics in Context*, Boston, MA: Houghton-Mifflin, 2005; 2nd edition 2009, Armonk NY: M.E. Sharpe.
10. *Affirmative Action in the United States and India: A Comparative Perspective*, London: Routledge, 2004; South Asian edition 2005, New Delhi, India: Foundation Books (the Indian Associate of Cambridge University Press); Paperback edition 2006, distributed by Routledge Press via their "Paperbacks Direct" program.

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2. "Alternative Patterns of Import Substitution in India," in Hollis Chenery, Samuel Bowles, Walter Falcon, Carl Gotsch, David Kendrick, Arthur MacEwan, Christopher Sims, and Thomas E. Weisskopf (eds), *Studies in Development Planning*, Cambridge, MA: Harvard University Press, 1971, pp. 95–121.
3. "Capitalism, Underdevelopment and the Future of the Poor Countries," in Jagdish Bhagwati (ed.), *Economics and World Order*, New York: Macmillan and Co., 1972, pp. 43–77.
4. "Capitalism and Inequality," in Richard Edwards, Michael Reich, and Thomas Weisskopf (eds), *The Capitalist System*, Englewood Cliffs, NJ: Prentice-Hall, 1972, pp. 125–132.
5. "The Problem of Surplus Absorption in a Capitalist Society," in Richard Edwards, Michael Reich, and Thomas Weisskopf (eds), *The Capitalist System*, Englewood Cliffs, NJ: Prentice-Hall, 1972, pp. 364–373.
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7. "Dependence and Imperialism in India," in Mark Selden (ed.), *Remaking Asia: Essays on the American Uses of Power*, New York: Pantheon, 1973, pp. 200–246; reprinted in the *Review of Radical Political Economics*, 5(1), Spring 1973, 53–96.
8. "Capitalism, Socialism and the Sources of Imperialism," in James Kurth and Steven Rosen (eds), *Testing Theories of Economic Imperialism*, Lexington, MA: Lexington Books (D.C. Heath), 1974, pp. 57–86.
9. Comments on Harold M. Hochman and James D. Rogers, "The Simple Politics of Distributional Preference," in F. Thomas Juster (ed.), *The Distribution of Economic Well-Being*, New York: National Bureau of Economic Research, 1976, pp. 107–114.
10. "The Irrationality of Capitalist Economic Growth," in Richard Edwards, Michael Reich, and Thomas Weisskopf (eds), *The Capitalist System* (2nd edition), Englewood Cliffs, NJ: Prentice-Hall, 1978, pp. 395–409.
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13. "Patterns of Economic Development in India, Pakistan and Indonesia," in Robert F. Dernberger (ed.), *China's Development Experience in Comparative Perspective*, Cambridge, MA: Harvard University Press, 1980, pp. 38–90.
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