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The Power of Profit

I FIRST ENCOUNTERED THE WORK OF ROBERT HEILBRONER IN 1967 while I was a graduate student at Columbia University. The history of economic thought was still taught in those days, and *The Worldly Philosophers* was the gravitational center of this enterprise. Still, it may have been a harbinger of things to come that this particular course was taught in the business school rather than in the economics department.

Like countless others, I was swept away by Heilbroner's classic text. Its elegance, its scope, and its grand vision inspired us to look beyond what we were being taught, to the world around us, to other social sciences, and to the classics in these disciplines. It altered the way we saw the world. It was the best kind of education. When I subsequently joined the economics department of the Graduate Faculty of the New School for Social Research, I got to know not only Bob Heilbroner but also his (and subsequently my own) mentor, Adolph Lowe. My education continued apace.

This essay is dedicated to a central question to which Heilbroner returns again and again: Does capitalism have intrinsic patterns, and if so, to what extent can they be modified?

I. PROFIT AS THE DRIVING FORCE OF CAPITALISM

Capitalism is a mysterious entity. It is so easygoing on the surface and so compulsive underneath. What drives this system? This is the central question of political economy.

In his earliest work on the subject, *The Worldly Philosophers*, Heilbroner focused on the overarching visions of the great econo-

mists. The history, structure, and future of capitalism were the main themes. Over time, he turned his attention to developing his own analysis on these same issues (Heilbroner, 1976; 1978; 1993). Like all serious inquiry, this led him backward, at least initially, away from answers towards questions. And so, more than 30 years later, he had moved from concentrating on the past and future of capitalism to writing about its nature and logic (Heilbroner, 1985: 13-14).

Heilbroner tells us that in his earlier writings he tried to avoid the difficulty of defining the term “capitalism” by focusing instead on markets, on commerce, on *business*. But he eventually came to believe that this was insufficient, for while business was “an inextricable part of whatever capitalism is,” it still only “represents [its] outward-facing reality.” What came to interest him was a deeper question, concerning that “netherworld in whose grip the activities of business are caught” (Heilbroner, 1985: 16), and whose influence propels the capitalist system along its fractal path. This is, of course, Adam Smith’s Invisible Hand, the very source of the recurrent economic patterns that are central to classical and Marxian economics.

What drives all of this? Smith says that it is native self-interest, that famous natural “propensity to truck and barter.” Marx disputes this. First, because self-interest, as an overriding attribute, is by no means natural. It must be socially constructed, and socially maintained, in order to be elevated to such an exalted status. Second, because capitalism is ruled by the profit motive, not mere self-interest. The profit motive subordinates self-interest to its own particular goals, even as it represents itself in the guise of self-interest.

On this critical issue, Heilbroner comes down on the side of Marx. “Profit is the life blood of capitalism,” he says. It is the *raison d’être* of individual capitals, as well as the direct measure of their prowess. It is also the dominant organizing principle of capitalist society as a whole, creating an imperative that repeatedly forces capitalists and workers back into the Hobbesian “warre of each against all” (Heilbroner, 1985: 57, 76-77).

Heilbroner is particularly careful to say that recognizing the dominant role of the profit motive does not lead to a reductive reading of capitalism's other attributes. In this, too, he is following Marx.

I repeat that domination is not rigid determination. There have been critical moments in the history of capitalism, as in that of other societies, when decisive blows have descended from unexpected actors, ideas, interests, or accidents. Even then, the milieu into which these blows descend, whatever their explosive power, is not a drama of Pirandello-like characters in search of identities and meanings, but a society engaged in, and enthralled by the nature, and the consequent logic, of its organizing principle.

From this perspective it is a matter of course that capital, as the dominant principle of the society identified by its presence, must color and infiltrate the institutions and beliefs that lie beyond its immediate ambit of operation (Heilbroner, 1985: 84).

The capitalist state is a particularly important example of an institution bathed in the ambient glow of the profit motive. It does not exist at the beck and call of capital. But it does exist within capitalist society, and cannot therefore escape the imperatives of the system. Capital requires the state, but the state requires economic continuity, and this in turn rests on the proper functioning of capital. While the state can modulate the outcomes produced by the profit motive, it cannot set aside the motive itself (Heilbroner, 1985: 84, 93-95, 104). Indeed, it cannot even significantly undermine the continuity of the circuit of capital, for when the latter falters, the whole system shakes. The limits to the state may be less restrictive in good times than in bad, but they remain operative throughout.

This vision of a hierarchically structured capitalist society stands in sharp contrast to what might be called a "building-block" theory

of society. One such example is Daniel Bell's vision of "contemporary society" as three coequal realms (techno-economic, political, and social realms), each with its own axial principle (Bell, 1976). Heilbroner takes Bell to task for failing to see that the limits to the axial principles come precisely from "their tense containment within the set of economic imperatives" that define capitalism (Heilbroner, 1985: 82). In his opinion, "the failure to accord centrality to one principle and its embodying institutions . . . robs social analysis of its clarificatory potential as gravely as the dogmatic insistence that all attributes of any given society can be explained as mere epiphenomena of its mode of production or of any other organizing structure" (Heilbroner, 1985: 83).

In this regard, it is worth noting that modern economics also represents capitalism as a set of coequal sectors (households, businesses, and the state), each of whose "agents" operates on a distinct principle (profits, utility, and economic management, respectively). Heilbroner's critique is therefore equally valid here.

II. THE PACIFICATION OF THE PROFIT MOTIVE IN MODERN ECONOMICS

In classical economics, and particularly in Marx, the profit motive gives rise to recurrent economic patterns. The profit motive is the source of the pressure to resist wage increases, to seek out cheaper labor domestically and abroad, and to drive down on wages whenever possible. It is also the source of the constant push to mechanize production to lower costs. The Industrial Revolution did not create capitalism; capitalism created the original industrial revolution, and others since then. The process never ends.¹

The profit motive also regulates the competition of capitals, which is truly a war of all against all. Firms struggle to gain profits by taking market share from their competitors, by hook or crook. Cost cutting plays a central role, for it allows price cutting, which is a particularly powerful way to beat out competitors. Technical change, self-initiated and ongoing, is the handmaiden of this process. And binding all of this is profit arbitrage, in which individual capitals rush to take advantage

of areas of higher profitability, and in so doing, eliminate them. Sectors with higher than normal profit rates find their supply growing faster than demand, which pushes down their prices and hence their profits. This process of *turbulent arbitrage* (Shaikh, 1998) regulates not only industrial prices, but also stocks prices and interest rates.²

Wage arbitrage is more complex. The profit motive operates on the side of the buyers (the employers), since the money they expend on labor is part of an ongoing investment in business operation. They therefore seek the cheapest labor of any given quality. But on the side of the sellers (the workers), the wage represents personal income. Hence labor's response to differentials in wage offers is typically more muted, depending as it does on a mix of pecuniary and personal considerations.

Finally, profit also regulates macroeconomic processes. Business investment spending is the advance of money with the aim of making more money—that is, making a profit (Heilbroner, 1985: 33-35). Shorter-run profit expectations also determine the employment that firms offer. The wages paid these workers then determine the vast bulk of consumer spending. Like the aim of a good marksman, these various profit expectations are constantly adjusted in the light of actual outcomes.

All of these gravitational tendencies operate in a highly turbulent manner. Prices and profit rates constantly overshoot their centers of gravity, only to subsequently reverse their course and undershoot. In the same way, growth constantly accelerates and decelerates, giving rise to characteristic cycles, waves, and occasional collapses. There is no such *place* as equilibrium. There is only a *process* that produces balances through constantly offsetting imbalances, growth through perpetual fluctuations, order in and through disorder.

But if organic processes connect opposing poles, then giving too much weight to any one pole over the other will vitiate the analysis. This, I would contend, is what happens in the two dominant schools of modern economics. As a result, each in its own way offers a much tamer vision of capitalism.

Neoclassical economics concentrates on the system's order, minimizing any consideration of its disorders. The notion of competition as war is replaced with that of "perfect competition." Firms are said to passively hew to any given market price, and to hold the belief that they can each sell as much as they want at any price they happen to face. Under these conditions, all that is left for them to do is select their most desirable (that is profitable) level of production and leave the rest to the market. Firms do not even set prices, let alone engage in price cutting and rivalry over market share. This is competition in name only, ritualized and defanged. The action then shifts to the market, where the price automatically moves to balance demand and supply. This applies to all markets, including the labor market where the real wage constantly adjusts to match job offers with job applicants.³ Thus full employment is the norm, unless something happens to impede the proper function of the labor market. Informational deficiencies concerning job offers or labor availability might slow things down but would not block the tendency toward full employment. Market restrictions, however, are a different matter. By raising wages above competitive market rates, unions cause employment to be lower than the competitive level. Since the latter is the full employment level, unions cause unemployment. The same can be said of minimum wage and antipoverty initiatives by the state (Korilas and Thorn, 1979: 285-287; Hargreaves-Heap, 1987). From this point of view, state intervention is justified only in certain limited instances—for instance, when pollution from a factory affects the health of people with no direct connection to the factory (Hunt, 2002: 390-395). Except in the case of such market "externalities," there is no real economic need for the state.

Post-Keynesian economics generally takes the opposite tack. Where neoclassical economics celebrates the near-perfect order of capitalism, post-Keynesian economics emphasizes its disorder. Instead of perfect competition, it assumes imperfect competition. In place of competition as the fundamental arbiter of economic outcomes, it substitutes power: oligopoly power, union power, and state power. Oligopolies are insulated from competition, and unlike perfectly competitive firms,

they actively set prices by choosing a desired profit markup over costs. Workers also set prices, in this case wage rates, with the help of unions and related institutions. The resulting economic outcomes are not necessarily optimal, efficient, or even desirable. Unemployment is just as possible as full employment. Given the range of possibilities, system paths are contingent on historically specific forces and balances of power (Dutt, 1991-1992: 221, 223). Hence, there is both need and room for state intervention to regulate business, labor, the environment, and most important of all, to regulate aggregate output and employment itself. Properly utilized, the state can be the tipping force that directs capitalism in socially desired directions.

At first, the two schools seem to offer polar conceptions. Perfect competition versus imperfect competition. “Price taking” versus price setting. Full employment versus persistent unemployment. The inessential state versus the essential state. And market-driven laws of motion versus contingent, state-regulated, historical paths.

But further reflection reveals some fundamental commonalities. Most striking is that both schools promise an essentially similar result: a capitalism that will be more or less efficient, equitable, stable, and socially desirable. The difference is that neoclassical economics puts its faith in the Invisible Hand of the market, while post-Keynesian economics requires the Visible Hand of the state. Almost all modern debates in economics, ranging from the effects of ballooning budget deficits to the consequences of globalization, are conducted within this frame.

There are other commonalities as well. Both schools rely heavily on the notion of equilibrium as an actual state of affairs, as a place, even though they disagree about whether it is short run or long run that is most relevant. Both rely on perfect competition as the fundamental description of competition, even though they disagree about its contemporary relevance. And both end up treating firms as passive: in neoclassical economics each firm takes the selling price for granted and concentrates on choosing its own most profitable level of production; in post-Keynesian economics firms pick a desired profit margin (markup) and then concentrate on supplying whatever the market will

bear. The tactics and strategy of competitive warfare disappear from view in both cases.

Could we recover a fuller picture of capitalist dynamics by combining the two main approaches, perhaps with post-Keynesian theory as the economics of the (disordered) short run and neoclassical theory as the economics of the (ordered) long run? Keynes himself suggested this possibility. In his *General Theory of Employment, Interest and Money* (1936) he insisted that capitalism had no tendency toward full employment. Yet he subsequently conceded that persistent unemployment would drive real wages down in the long run, which would make it profitable for firms to hire more workers and thus eventually bring about full employment (Bhattacharyea, 1987: 276-279). The problem was that any such adjustment process would be protracted and socially painful. It would be far better to achieve full employment by expanding government spending than by impoverishing workers. In this way Keynes was able to retain his original contention that the state intervention was necessary to bring about the world described in neoclassical theory: “if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the [neo]classical theory comes into its own again from this point onwards” (Keynes, 1936: *The General Theory*: 378, cited in Kohn, 1986: 1202).¹

Most post-Keynesians would reject such a synthesis on the grounds that the two theories represent opposing visions of capitalism. After all, if you hold that competition has been supplanted by oligopoly, and laws of motion by historical contingency, then the two approaches cannot be meaningfully combined. So we are left with choosing between these two, or opting for something quite different.

Heilbroner and Milberg (1995) favor the latter. They argue that despite the great need for a new vision of capitalism, nothing viable has emerged. Neoclassical theory has retreated into “an obsession with ‘precision’ to the neglect of . . . a plausible and persuasive explanation of economic phenomena” (101). Meanwhile, institutional economics has not advanced very far, and post-Keynesian and Marxian schools are too internally split to be influential (97-100). They conclude that

capitalism must be reconceptualized in terms of two main actors: “the private sector as a relatively passive, although vitally important player, and the public sector as a strategic, although probably much smaller sector” (122). Their self-described *dirigiste* orientation arises from their conviction that “capitalism is today a social order at bay before forces that require containment or channeling by strong government policy” (123). And with such policies in place, “the behavioral laws upon which economics has built its formidable analytical apparatus” will lose much of their force, and economics will become “a discipline that follows in the wake of sociology and politics.”

I share their belief that something new is needed. But my argument leads me to the opposite conclusion: the problem is not a lack of vision; it is a lack of analysis. As Heilbroner and Milberg note, “vision” cannot be separated from analysis (124-126). In Heilbroner’s earlier vision, capitalism was a society dominated by the profit motive. The business sector was an active player, and however active the state, it was constrained by particular limits. In the new vision, the business sector is the passive, and the public sector the active, player. The previously described limits have faded from view.

The real difficulty in either case is that no practical meaning can be attached to the powers of the state without specifying the limits to these powers. And any such specification is an *analytical* task. Vision can guide this labor, but cannot substitute for it. One needs to identify how state activities will affect employment, growth, inflation, interest rates, exchange rates, and a host of other familiar economic variables.

Consider the question of unemployment. Neoclassical theory tells us that unfettered capitalism will automatically generate the full employment of labor. Post-Keynesian theory disputes this, insisting that only state intervention can guarantee full employment. Both sides agree on the feasibility of the outcome. And both implicitly characterize firms as passive players in this process. The new vision outlined by Heilbroner and Milberg fits within the broad tradition of Keynesian theory, which concludes that the state (and only the state) is capable of attaining and maintaining full employment.

On the other hand, Heilbroner's earlier vision falls within the classical tradition, from which an entirely different result obtains. Here, firms are active, indeed supremely aggressive players. Their immanent desire for profit drives them into battle with each other, and with labor. And in the latter domain, they actively accelerate labor-saving technical change whenever labor becomes scarcer or more expensive. In such a climate, if macroeconomic growth depletes the pool of the unemployed and tightens the labor market, two countervailing forces arise: real wages increase, which decreases profitability and therefore reduces the growth of output and employment; and mechanization accelerates, which reduces the growth of employment even further. Both effects counteract the original tightening of the labor market. The end result is that instead of achieving full employment, the system oscillates around some persistent rate of unemployment (Shaikh, 2003: 137-140).⁴ Moreover, the traditional Keynesian policy response of expanding government spending (or cutting taxes) would only provide a temporary boost. Thus while the unemployment rate would fall in the short run, it would rise to its previous level or to an even higher one after that. At best the gain would be transitory, and at worst, it would come at the expense of a longer term loss.⁵

Similar differences exist between post-Keynesian and classical traditions on other issues, such as the effects of deficits on economic growth. Indeed, equally great differences exist even *within* the broad Keynesian tradition, between post-Keynesian and Harroddian branches. For instance, the former finds that a rise in government spending as a share of output unambiguously raises employment, while the latter concludes that the initial stimulus will dissipate and eventually turn negative because the long-run rate of growth will be reduced (Moudud, 2000). Yet both of these theories qualify for the new vision proposed by Heilbroner and Milberg.

So how do we assess the two visions of capitalism present in Heilbroner's work? It seems obvious to me that we can do so only in the light of their respective analytical contents. For in the end, while vision guides analysis, analysis disciplines vision. The two cannot exist independently.

NOTES

1. The point of view expressed in this section is developed in much greater analytical detail in my forthcoming book, *The Economic Analysis of Advanced Capitalism*.
2. Bond prices and interest rates are merely two sides of the same financial coin. Thus if profit arbitrage regulates the former, it regulates the latter.
3. The secret to the neoclassical story of labor markets is that the real wage is depicted as having one social function alone: that of a market-clearing variable. Once other functions are admitted, then even when the real wage *responds* to the imbalances in the labor market, such flexibility is no longer sufficient to ensure full employment (Shaikh, 2003, sec. 2).
4. The preceding argument is based on Marx's theory of the reserve army of labor, as developed by several authors. See Shaikh (2003) for further details.
5. This point can be made explicit by extending sections 4 and 5 of Shaikh (2003) to encompass government spending and tax rates, as laid out in section 3 of the same paper.

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