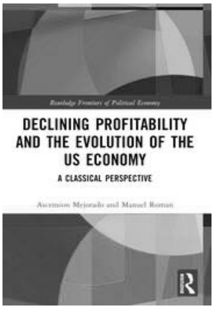
BOOK REVIEW

DECLINING PROFITABILITY AND THE EVOLUTION OF THE US ECONOMY: A CLASSICAL PERSPECTIVE

ASCENSION MEJORADO AND MANUEL ROMAN



London, Routledge, 2024, 310 pp.
DOI: 10.4324/9781003413806

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Declining Profitability and the Evolution of the US Economy addresses a central issue of our times: The slowdown in global growth rates over the past nearly two decades. While the book primarily focuses on the US economy, it also draws comparisons with other major economies experiencing similar trends. Given the US economy's status as the still largest in the world, with significant global interconnections, changes within it have a profound impact internationally.

Unlike other analyses of the slowdown, often referred to as secular stagnation (SS), the authors adopt a classical political economy (CPE) approach to explain this phenomenon. This approach contrasts with the neoclassical approach by drawing on the insights of Classical economists like Adam Smith and David Ricardo, who focused mainly on the determination of equilibrium prices and output and expanded with the ideas of Marx, Sraffa, and other critics of neoclassical orthodoxy. In this broader context, this classical approach includes economists such as John M. Keynes, Joseph Schumpeter,

http://dx.doi.org/10.22201/fe.01851667p.2025.332.89930

John von Neumann, Wassily Leontief, among others.

This book is timely and significant for its examination of SS, a concept initially introduced by Alvin Hansen during the 1930s crisis and largely forgotten during the post-WWII expansion. Recently, Keynesian economists like Larry Summers, Paul Krugman, and Robert J. Gordon have resurrected the topic, attributing the current SS to factors like slow population growth leading to over-saving, and therefore reduced investment and economic slowdowns, with excess savings fueling financial bubbles.

The authors critically evaluate the SS hypothesis and argue that the falling rate of profit is a more comprehensive explanatory variable for many phenomena attributed to SS. Each of the 11 chapters of the book offers valuable insights for readers interested in understanding SS, its origins, and its potential future. The chapters are titled as follows:

1. Introduction
2. Classical Economics, Growth, and the Stationary State
3. Profitability and the Limits of Fordism
4. Productivity and Wages: The Scissors Effect
5. Production, Labor, and Income Trends
6. The Deindustrialization Quagmire
7. Falling Interest Rates, Banking, and Financial Crises
8. Keynes and Secular Stagnation
9. The Neo-Keynesian Retreat
10. The Classical Advance: Schumpeter and Grossmann
11. From Secular Stagnation to Stagflation

In Chapter 2, the authors lay out the theoretical foundations of their argument, using CPE to provide evidence in favor of long cycles based on the movement of the ratio of wholesale prices to the price of gold in the US and UK economies. They also present data on the evolution of the rate of profit and the output-capital ratio of the UK economy, both of which followed a downward path spanning the period from 1760 to 1980, representing the longest available time series data on these variables.

Chapter 3 examines the profit rate and its components, presenting long-term estimates for the US economy within the context of long cycles. The authors identify the first phase of the postwar decline in profitability, which eventually led to the dismantling of Fordism. This transition was marked by deindustrialization, the rise of a service economy dominated by financial activities, globalization, and growing systemic fragility. The analysis extends up to the stagflation crisis of the late 1960s and early 1970s. The explanation is couched upon their view of the falling rate of profit, which led to a slowdown in investment spending, alongside rising demand due to government expenditures and economic intervention. High unionization prevented wage reductions, causing wages to follow the inflation rate rather than productivity. These conditions essentially paved the way for the emergence of neoliberalism from the 1980s onwards. The idea was that both the deregulation of the financial system, resulting in lower interest rates and easier lending and, at the same time, the dismantling of labor unions, leading to lower wages, would together restore profitability to a level that would encourage investment and economic growth.

The discussion of neoliberalism is mainly in Chapters 4 and 5, where the focus is on depressed wages and pro-finance capital legislation of the US economy, which gradually were adopted more or less by other Organisation for Economic Co-operation and Development (OECD) economies. Essentially, the authors argue that the Fed initially sought to control inflation by reducing the money supply thereby increasing the interest rates up until the early 1980s. In so doing the Fed managed to attract the necessary liquidity which was provided by foreign capital. Then the Fed followed a quantitative easing policy, reducing interest rates up until recently with the reappearance of the stagflation kind of crisis in the post-COVID-19 years.

As a result, of pro-capital legislation in the USA and other OECD economies, the deregulation of the financial markets and the reduction of the unionization factor. The details of these changes are discussed in Chapters 6 and 7. In particular, in Chapter 6 the authors discuss the details of the deindustrialization in the USA. Specifically, manufacturing profitability in the post-WWII years was rising and investment spending in this sector led to rising employment and wages. However, from the late 1960s to the present the relative importance of manufacturing in Gross Domestic Product (GDP) steadily decreased, as did its profitability. The robust growth rates of the economy were succeeded by weak ones. This is the period of deindustrialization during which manufacturing's share in GDP decreased, capital moved towards the financial sectors of the economy where profits were more lucrative. The authors back up their arguments by examining the movement of the relevant variables, that is, the share manufacturing rate of profit in the total corporate rate of profit rate of the USA *vs.* the respective share of the financial sector. Clearly, the financial sector's share in the profit rate displays a rising trend with the exception of the recessionary years (2007-2009). It is interesting to note that during this de-industrialization period from the early 1980s to the present, the bifurcation between labor productivity in manufacturing and the real wage becomes particularly pronounced as is argued in the book. The deindustrialization process, the authors posit, is accompanied by financialization since the time that the Federal Reserve adopted a policy of lowering interest rates to increase the net rate of profit. This policy contributed to the expansion of financial, housing, and stock market asset valuations. As a consequence, financialization superseded manufacturing as the driving sector of economic growth. Initially, this policy seemed successful, leading economists and the public to believe that the economy became depressions-proof as back then in the 1960s was the so-called mixed economy. However, the Fed's low interest rates policy led gradually but steadily to the collapse of mortgage-backed subprime housing shares in 2006 culminating in the Great Financial Crisis of 2007-2009.

In Chapter 8, the authors argue that although the SS thesis, both old and new, is often attributed to Keynesian economics, it differs significantly from Keynes's view of stagnation. Keynes attributed stagnation to "vanishing profit opportunities," which preceded the loss of business confidence. Business confidence, in turn, depends on profits, which can only be restored through government spending and related effective demand policies. Government spending increases overall demand and, if the economy is near its full capacity utilization, most likely prices, but slowly rising prices create profit expectations and further strengthen the incentive to invest and so forth. In such an environment, lowering interest rates may also be helpful, but not significantly so when it comes to investment in manufacturing. This combination of falling profit and interest rates is responsible for economic stagnation as well as the shift towards financialization and the creation of a dual economy.

The authors also update the so-called Baumol's thesis, which posits that the economy consists of a progressive sector (manufacturing and information technology) responsible for technological change and rising productivity, and a stagnant sector (health, education, hotels, restaurants, transportation and services) that is labor-intensive and not easily amenable to significant technological changes, resulting in lagging productivity. The expansion of these stagnant sectors leads to the consolidation of the dual nature of the economy and the authors attributed it mainly to the low near-zero interest rates.

In Chapter 9, the authors contrast Hansen's views on SS and its causes with the modern neo-Keynesian interpretation advanced by economists such as Larry Summers, Ben Bernanke, and Paul Krugman. The authors argue that the modern interpretation offers little substantive advancement over Hansen's original conceptualization of SS. They criticize the reliance on the IS-LM model and the natural rate of interest, pointing out the limitations of these frameworks in explaining investment behavior. The authors emphasize Keynes's focus, both in his early writings and in the *General Theory*, on the evolution of long-run profitability as the key explanatory variable for both investment decisions and expectations.

In Chapters 10 and 11, the authors based on their perspective rooted in the long-run decline of the rate of profit and its various stages, analyze the period from 1982 to 2007. They argue that neoliberalism and its associated policies temporarily prevented the falling rate of profit. However, they contend that these policies were insufficient to stimulate the level of investment required to sustain a healthy and robust rate of economic growth.

Consequently, policies aimed at reducing the long-term interest rate were implemented to strengthen firms' profit margins. Initially effective, this strategy proved viable for a limited duration. However, financial institutions found themselves unable to replicate the profits achieved at higher interest rates. To offset their losses, they escalated lending volumes, redirecting funds from progressive sectors to stagnating ones, which held greater promises for higher and short-term returns. This shift gave rise to what became known as financialization, propelling real estate prices and stock market indices upwards. The consequences of neoliberal policies manifested in 2006-2007 with the real estate crisis and in 2008-2009 with the financial crisis. Subsequent to these events, sluggish growth persisted. Furthermore, the COVID-19 pandemic of 2020-2022 and recent geopolitical events have disrupted supply chains, leading to rising prices and the return of stagflation. Ironically, neoliberalism —the ideology and policies implemented in the early 1980s to address stagflation— has become responsible for the return of stagflation through the same mechanism. In particular, the low rate of profit prevents investment growth from absorbing the demand infusion from policies applied in recent years. This excess demand has led to inflation, exacerbated by supply chain disruptions due to various geopolitical events.

This book stands out as a distinctive and innovative contribution in the field of CPE, distinguished by its content and presentation. The discourse is enriched with many illustrations that effectively amplify the authors' viewpoints, facilitating a deeper understanding of their arguments. The writing is eloquent and scholarly, supported by an extensive list of references provided at the end of each chapter. These attributes make the book an indispensable resource for anyone —students, academics and the general public— seeking insights into contemporary crucial matters from a CPE standpoint. ◄