The origins and evolution of the debate on wage-led and profit-led regimes

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2nd Kazimierz Łaski Lecture

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Kazimierz Łaski and me !

- Krakow, EAEPE, 2012
- Buenos Aires, CBRA, June 2015
- Łaski and the wage-led profit-led controversy

Why wage restrictions?

- The neoclassical substitution effect: lower the relative price of labour; more labour, less capital; short run, long run
- The profitability effect: It raises the profit margin of firms: dubious effects on production and investment, bad effects on consumption demand
- Globalization: competitive gains vs the external sector; boom of foreign demand for domestic products; but price competitiveness vs structural or product competitiveness

Based on the Bhaduri and Marglin 1990 theoretical model

EMPIRICAL PRELIMINARIES

Effect on GDP: 1% point increase in wage share

Country	Domestic demand	Total demand
Austria	+0.28	−0.12
Belgium	−0.05	−0.11
Denmark	+0.00	−0.20
Finland	+0.24	+0.17
France	+0.22	+0.08
Germany	+0.40	+0.35
Ireland	+0.07	0.00
Italy	+0.25	+0.12
Netherlands	+0.24	+0.17
Spain	+0.32	+0.21
United Kingdom	+0.25	+0.11

Source: Onaran and Obst 2016

Effect on GDP: 1% point increase in wage share

Country	Domestic demand	Total demand
Eurozone	+0.14	+0.08
Turkey	+0.49	+0.21
United Kingdom	+0.18	+0.03
USA	+0.43	+0.39
Canada	+0.14	−0.12
Mexico	+0.29	−0.10
Argentina	+0.14	−0.05
Australia	+0.08	−0.19
Japan	+0.07	+0.01
South Korea	+0.42	+0.06
China	+0.41	−1.57
India	+0.29	−0.02

Source: Onaran and Galanis 2013

Effect on GDP: 1% point increase in wage share

Country	Isolated effect, with multiplier	Joint effect, with multiplier
Austria	−0.12	+0.18
Belgium	−0.08	0.00
Denmark	−0.24	−0.11
Finland	+0.22	+0.30
France	+0.13	+0.23
Germany	+0.40	+0.44
Ireland	0.00	+0.06
Italy	+0.17	+0.24
Netherlands	+0.14	+0.19
Spain	+0.45	+0.54
United Kingdom	+0.13	+0.20
EU15		+0.30

Source: Onaran and Obst 2016

Effect: Global 1 % point increase in wage share

Country, total demand	Isolated effect, with multiplier	Joint effect, with multiplier
Eurozone	+0.13	+0.25
Turkey	+0.46	+0.72
United Kingdom	+0.03	+0.21
United States	+0.81	+0.92
Canada	−0.15	+0.27
Mexico	−0.11	+0.11
Argentina	−0.07	+0.10
Australia	−0.27	−0.17
Japan	+0.03	+0.18
South Korea	+0.12	+0.86
China	−1.93	−1.11
India	−0.04	+0.03

Source: Onaran and Galanis 2013

But other researchers disagree…

- Using a different econometric method, with income distribution being impacted by economic activity, Kiefer and Rada (2015) find that ‘*Economic activity appears profit-led during the bottom part of the business cycle, and profits get squeezed during the upper part of the cycle*.’
- Thus aggregate demand would be profit-led, and not wage-led.
- This would be true for the US economy and the OECD countries taken as a whole.
- Similar results obtained or claimed by:
  - Barbosa-Filho and Taylor 2006
  - Kiefer and Rada 2016
  - Barrales and von Arnim 2017

1999 vs 2016: Any change?

- *Many economists agree that Keynesian effects are important in the short run, but question whether Keynesian analysis can safely be used to guide long run economic policy toward economic growth. These debates should presumably be settled by looking at the empirical evidence as to how strong the tendencies moving capitalist economies toward full capacity utilization actually are. But econometric techniques for answering this question are themselves in dispute, and macroeconomic evidence is limited, so the policy dilemma remains unsolved*. (Foley and Michl 1999, p. 194)

Other surveys

- General surveys
  - Onaran and Stockhammer (2013, *ROKE*)
  - Hein (2017 forthcoming, *EJEEP*), FMM 2016
- Surveys dealing with econometric issues
  - Blecker (2016, *ROKE*), FMM 2014
  - Stockhammer (2017, *ROKE*), FMM 2015
  - Skott (2017, *ROKE*), FMM 2016
- Forthcoming symposium in *Metroeconomica*

HISTORICAL PERSPECTIVE

Two *fils conducteurs* (Ariadne's thread)

A. The relevance of overhead labour costs;

B. The opposition between the Marxian-Goodwinian view

- The profit-led and profit-squeeze story;

– vs the Keynesian-Kaleckian-Kaldorian view (which includes some Marxians)

- The wage-led story and demand-driven story.

In the beginning: Boddy and Crotty 1975

- With regards to the first part of the expansion, they note a decline in the wage share.
- With regards to the second part of the expansion, they say that the ‘*labor share typically rises in the latter half of an expansion. The profit squeeze discussed by Marx does occur*’.
- ‘*The decline in gross [profit] share occurs well prior to the end of the expansion*.’
- They attribute these changes to the evolution of the unemployment rate (the reserve army), as labour militancy (quit rates, strikes, work effort) are being reduced by high and rising unemployment rates.
- So we have profit-led initial expansion, and a profit squeeze thereafter.

Weisskopf 1979

	Early expansion	Late expansion	Recession
Profit rate	+26.8	−10.1	−25.3
Profit share	+17.0	−8.8	−15.6
Utilization rate	+10.8	+0.5	−11.9
Capacity/capital	−1.1	−1.8	+2.1

Social Structure of Accumulation (SSA)

- ‘*The full-employment profit squeeze … has been analyzed in great detail by Rafford Boddy and James Crotty (in a cyclical context), by Andrew Glyn and Bob Sutcliffe (in a secular context), and it plays an important role in our individual and joint work as well*’ (Weisskopf et al. 1985: 275).
- For Weisskopf, Bowles and Gordon (1985), ‘*The most obvious exit from the crisis is that pointed to by the right: strengthen the capitalist class, restore profits and rekindle the capitalist accumulation process*’.

Stephen Marglin 1984

‘*A Left program, I would suggest, must respect the logic of the economic situation. Productivity does place limits on wages, and not just physical limits. As long as profitability remains the mainspring of investment, there are economic limits that constrain the wage share. Under capitalism, profits are indeed the geese that lay the golden eggs….A Left program must therefore accept limitations on real wages*’.

‘*The neo-Keynesian analysis leads to policies designed to stimulate investment demand or to reduce capitalists’ propensity to save; the neo-Marxian model leads … to policies that will stimulate saving, or to policies that will reduce the subsistence wage*…’

Lance Taylor

- Taylor (1983) incorporates the cyclical and profit-squeeze findings of what he then called the ‘Radical economists’. He has a table with the three phases of the cycle:
  – In the early upswing, the profit rate, profit share and rate of utilization are rising;
  – near the peak the rate of utilization is stable, but the profit rate and the profit shares fall;
  – in the downswing, all three variables fall.
- ‘*As argued by Bowles and Boyer (1995) and substantiated for the United States …, demand in modern industrial economies appears to be profit-led*’ (Taylor 2004).
- ‘*Wage increases as advocated by people on the Left cannot restore aggregate demand if it is in fact profit-led*’ (Taylor 2004).

The origins of Bhaduri and Marglin 1990

- Wage-led models: Rowthorn 1981 and Dutt 1984
- Nell 1985 CJE critique of the 1984 Marglin CJE article:
- ‘*When output is determined by effective demand, investment governs current profitability, not the other way around… Raising wages would increase demand in consumer good markets. But, secondly, it would also increase the pressures on backward firms to modernise or go out of business… In short, under suitable conditions raising wages may stimulate growth….*
- *Marglin’s framework, since it assumes Say’s Law, cannot deal with these questions, and is forced to accept the position that austerity policies are nothing but simple ‘economic logic’, which any rational agent must accept. Conservatives could ask for no better defence*’ (Nell 1985: 178).

The 1987 Kaldor conference in New York and at the Levy Institute

- Four papers on income distribution and growth
  - Peter Skott (1989)
  - Bowles and Boyer (1991)
  - Heinz Kurz (1990)
  - Bhaduri and Marglin (1990, CJE)

Bhaduri and Marglin’s 1990 response

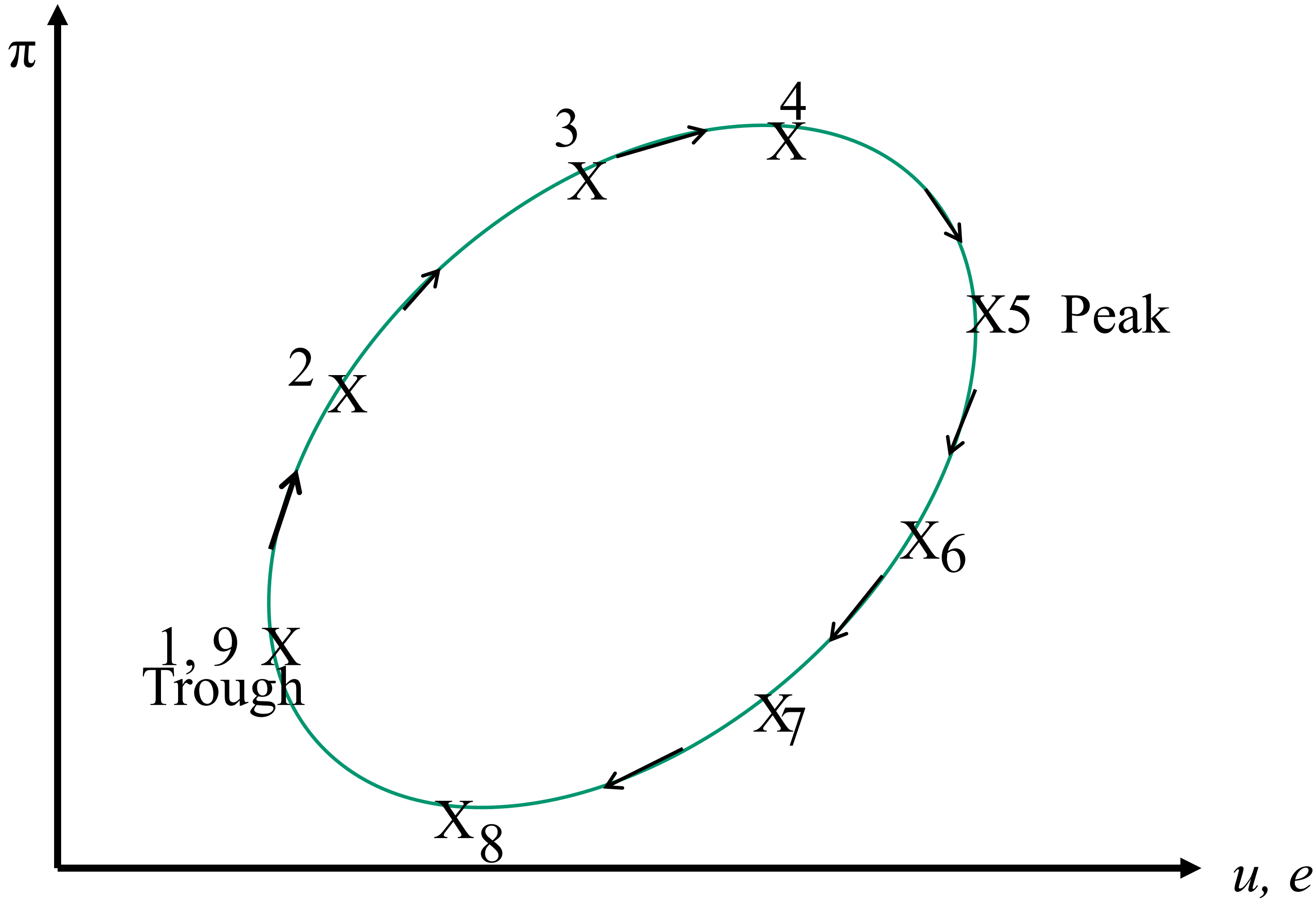
- Higher real wages raise consumption, but will lower investment and net exports (cf Blecker 1989).
- ‘*Particular models such as that of “cooperative capitalism” enunciated by the left Keynesian social democrats, the Marxian model of “profit squeeze” or even the conservative model relying on “supply-side” stimulus through high profitability and a low real wage rate, fit into the more general Keynesian theoretical scheme. They become particular variants of the theoretical framework presented here*’.
- Thus the post-Kaleckian Marglin and Bhaduri model allowed for a (partial) reunification of the Marxian and post-Keynesian strands of heterodox macroeconomics under a single umbrella, and the rest is history.

Łaski's critique of Bhaduri/Marglin

- Kazimierz Łaski (2004) himself objected to the arguments of Bhaduri/Marglin (cf. obituary by Martin Riese (2016)).
- Kalecki's distinction between investment decision and investment execution in historical time.
- Lowering wages will first lead to reduced consumption before investment can be ordered. The rate of profit will remain the same, while the rate of utilization will fall. Thus firms will reduce rather than increase investment. (cf. Łaski and Walther 2015)
- Cf. critique of Agliardi (1988) and Mott/Slattery (1994), who argued that investment depends on actual profits and not normal profits.

THE RELEVANCE OF OVERHEAD LABOUR COSTS

The Goodwin profit share/economic activity cycle



Overhead labour costs

- Overhead labour costs were included in the neo-Kaleckian growth model of Rowthorn (1981), and could be found in some of the later versions (Kurz 1990; Nichols and Norton 1991; Lavoie 1992, 1995, 2009; Dutt 2012).
- Weisskopf has a long discussion of overhead labour costs.
- So do Sherman and Evans (1984).
- Mohun (2006, 2014) has underlined the empirical importance of overhead labour costs. Also his critique of Hein and Stockhammer's (2011) edited book.

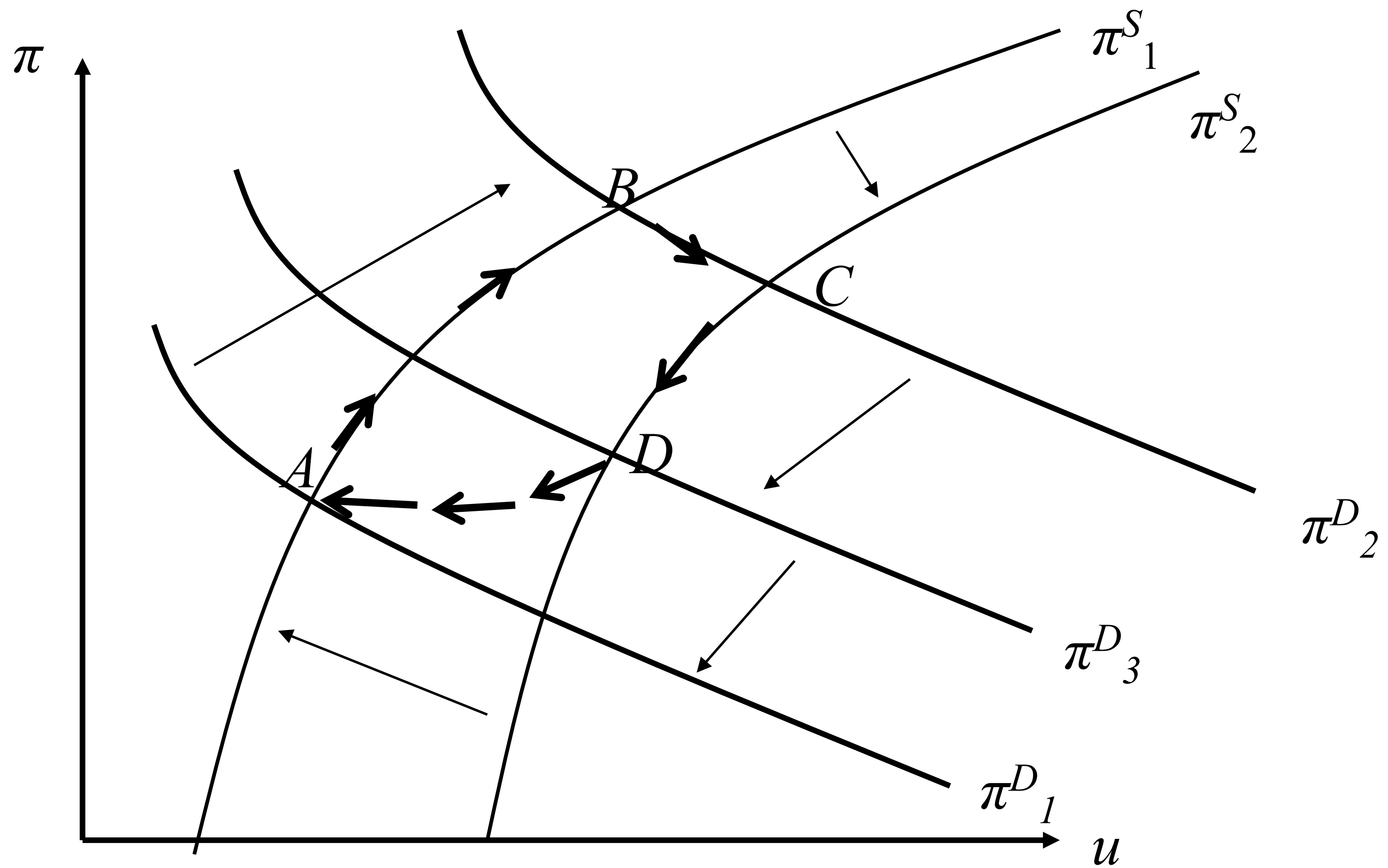
Sherman and Evans 1984

- ‘*In most of expansion, the wage share declines mostly because productivity rises, which is mainly due to falling overhead labor proportionate to all labour.*
- *Near the cycle peak of expansion, the wage share rises a little because productivity is flat or falling while real wages continue to rise; bargaining power is high because of a high level of employment.*
- *In most of contraction, the wage share rises because of falling productivity, owing mainly to a rising percentage of overhead labor to all labor.*
- *Finally, at the end of the contraction, the wage share begins to fall again because of the weakness of labor owing to high unemployment*’.

Weisskopf 1979 with overheads

	Early expansion		Late expansion		Recession	
	U	C	U	C	U	C
Profit rate	+26.8		−10.1		−25.3	
Profit share	+17.0	+3.4	−8.8	−9.7	−15.6	+4.7
Utilization rate	+10.8	+27.4	+0.5	+1.4	−11.9	−32.1
Capacity/capital	−1.1	−1.1	−1.8	−1.8	+2.1	+2.1

Kaleckian model with overhead labour



The slowdown in corporate investment is the result of stagnating or falling sales rather than the consequence of a fall in the profit share.

- According to Fiebiger, it is the households' fixed investment fluctuations and their debt-financed consumption that drive most of the business cycle, with the cyclical evolution of the profit share being essentially explained by the existence of overhead labour costs.
- As to the investment of the corporate sector it is essentially reacting to the evolution of its sales.
- This is consistent with the econometric results of Stockhammer and Wildauer (2016) according to whom OECD countries are in a weak wage-led demand regime, with changes in aggregate demand being mostly driven by the evolution of household debt and property prices.

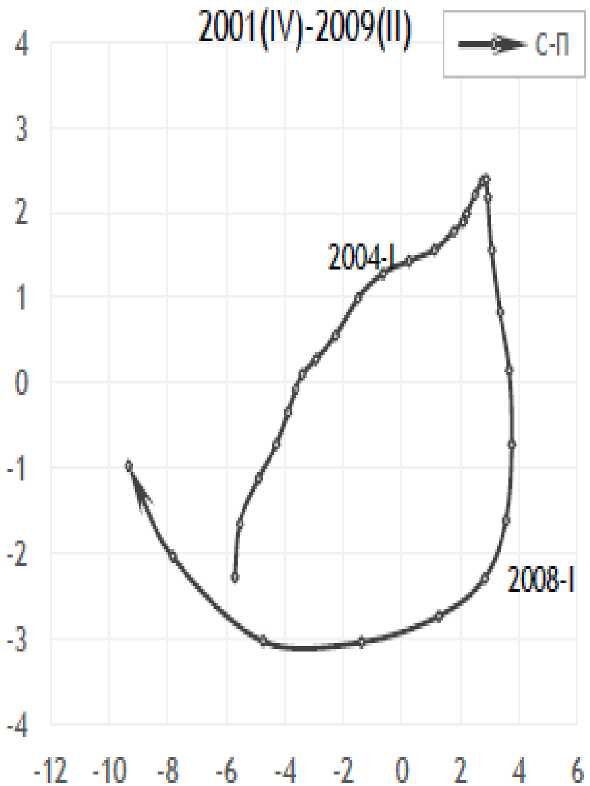
Table 2: Correlation Coefficient for Selected Variables, 1953(I)-2009(II)											
Lag	2	1	0	-1	-2	Lag	2	1	0	-1	-2
	C-Π^ Profits						Y^ PIB				
H-GFI^	0.48	0.61	<u>0.65</u>	0.55	0.35	H-GFI^	0.67	<u>0.72</u>	0.63	0.40	0.11
H-SAE^	0.39	0.62	<u>0.70</u>	0.61	0.38	H-SAE^	0.59	<u>0.71</u>	0.66	0.42	0.11
C-GFI^	-0.25	-0.01	0.30	0.53	<u>0.65</u>	C-GFI^	0.12	0.40	0.66	<u>0.78</u>	0.76
P-RFI^	0.46	0.60	<u>0.63</u>	0.52	0.33	P-RFI^	0.67	<u>0.72</u>	0.63	0.40	0.11
P-NRFI^	-0.23	0.02	0.34	0.57	<u>0.66</u>	P-NRFI^	0.14	0.43	0.70	<u>0.81</u>	0.76

^ Inflation-adjusted annualised quarter over previous year quarter growth rates. Sources: St. Louis Federal Reserve, *FRED*. U.S. BEA, *NIPA*, Tables 1.1.5, 1.1.6 & 1.14.

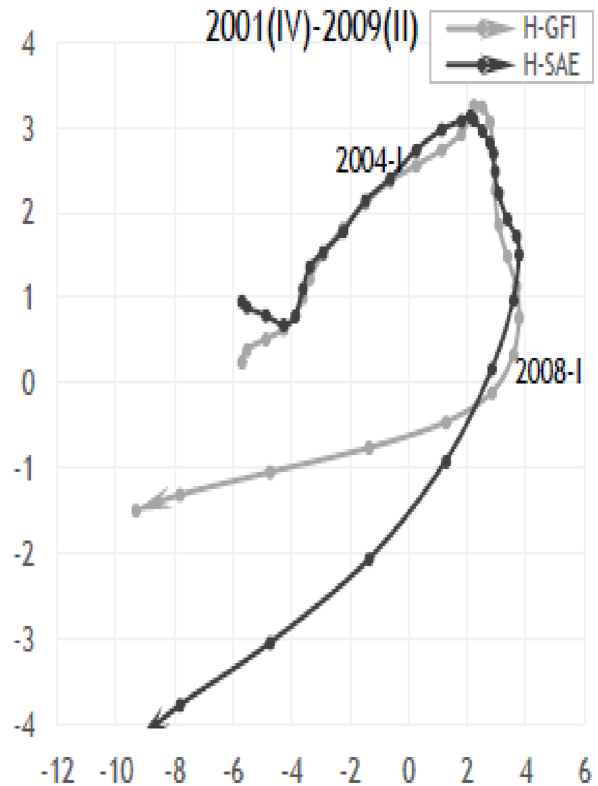
H-GFI: household gross fixed investment
H-SAE: H-GFI + change in consumer credit
C-GFI: corporate gross fixed investment
P-RFI: private residential fixed investment
P-NRFI: private non-residential fixed investment

Corporate profits, household residential investment, corporate investment vs *utilization rate*

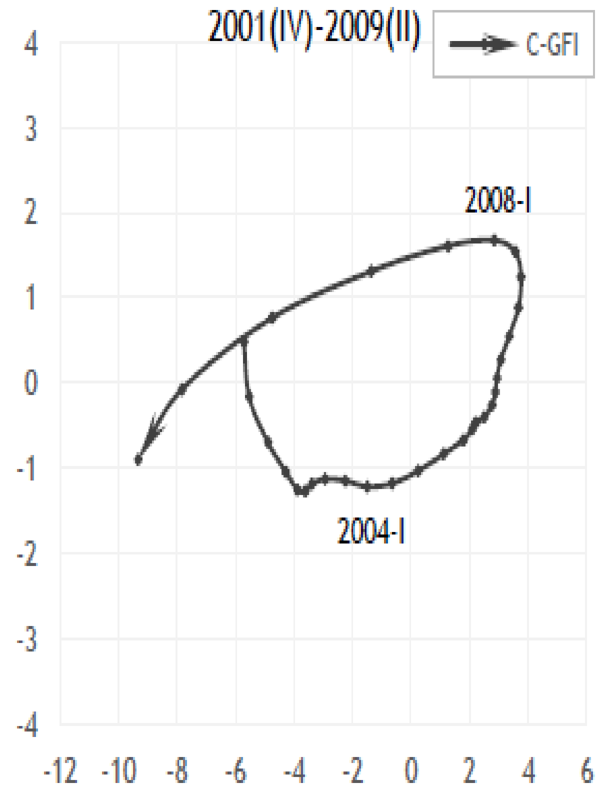
Source: Fiebiger 2016



Corporate profits



Household residential investment



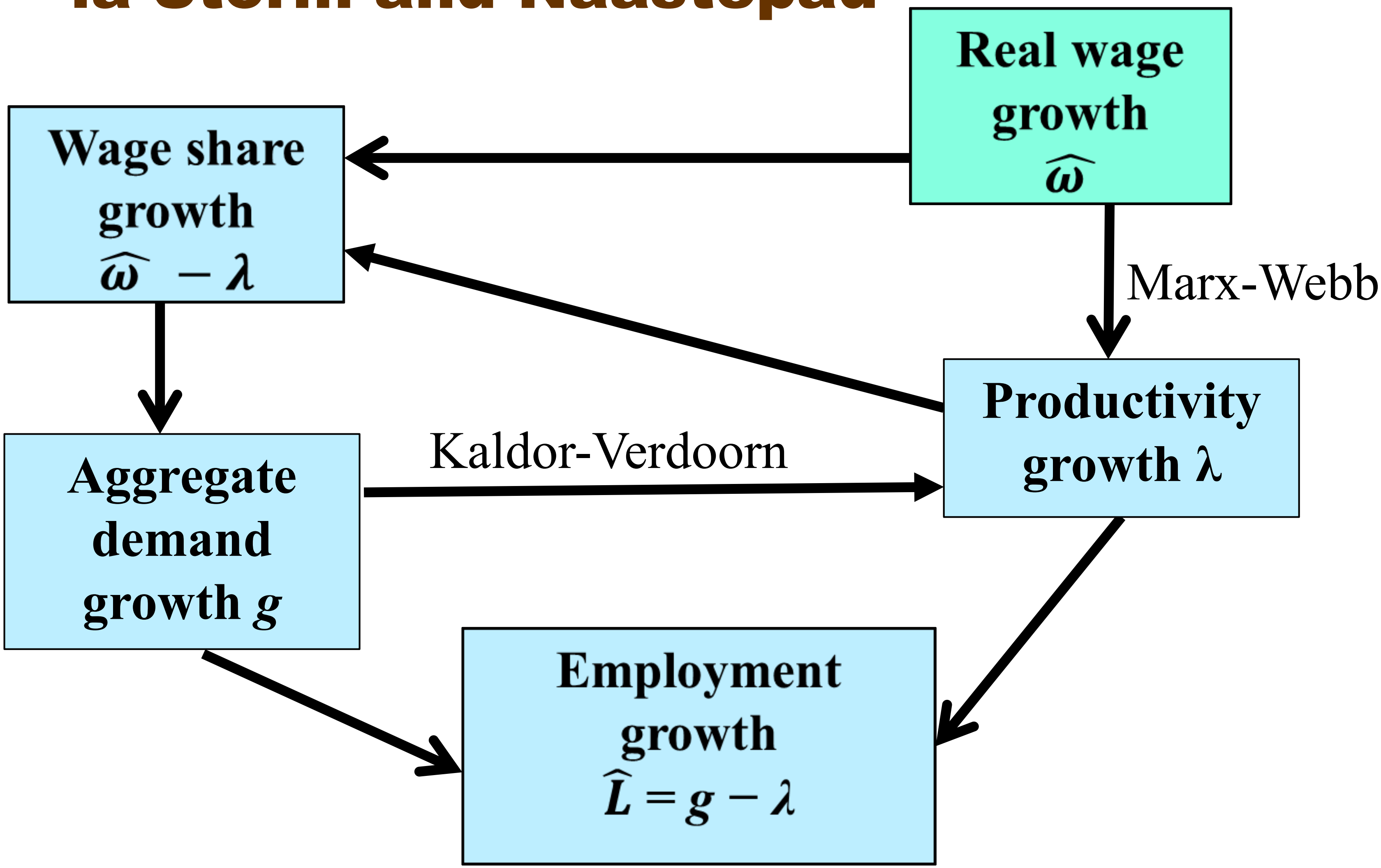
Corporate investment

THE EMPLOYMENT PUZZLE

Productivity effects

- An important distinction made by Bowles and Boyer (1995) more than 20 years ago.
  - A country could have a wage-led demand regime;
  - But simultaneously be in a profit-led employment regime.
- To observe this, one needs to take into account the effects on labour productivity.
- '*If productivity growth is strongly wage led, it is unlikely that employment will be wage led*' (Bowles and Boyer 1995)
  - Cf. Storm and Naastepad (2012; 2017)

Combining Demand and Productivity à la Storm and Naastepad



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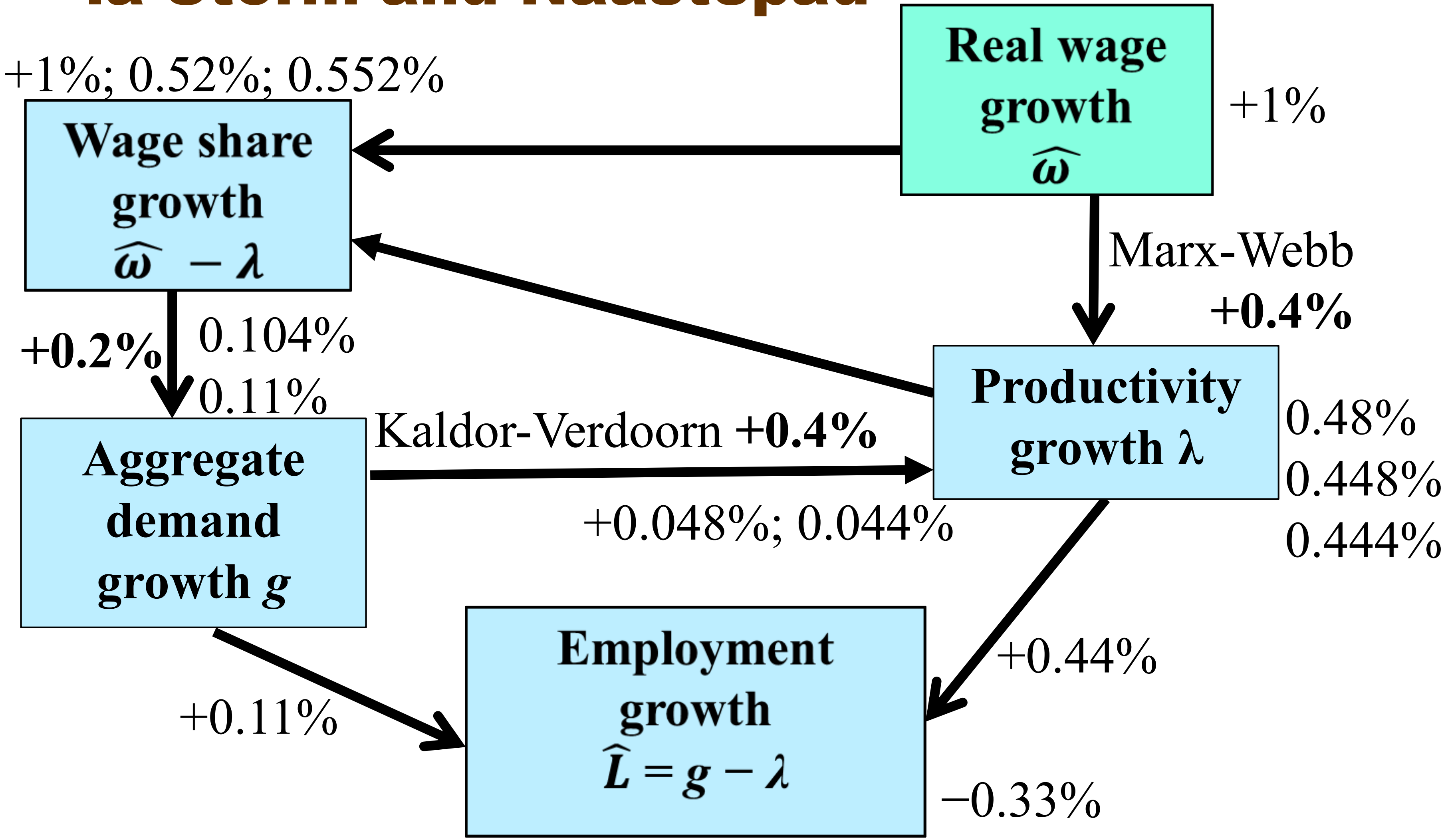

Conclusion

- Improving the wage share will not be enough to speed up growth or increase GDP (if this is the objective!)
- One needs a full-employment policy;
- Expansionary fiscal policies (cf Łaski 2004);
- Global measures (G20, OECD, Eurozone, EU)