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# Taxation without Representation: Reconstructing Marx's Theory of Capitalist Exploitation

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This chapter presents a robust reconstruction of Marx's theory of capitalist exploitation, eschewing both his jargon and Marxology, and using largely mainstream language. However, my effort contrasts with that of Roemer (1982), who tries to fit Marxian conclusions onto the Procrustean bed of mainstream theory. Instead, it stresses that concepts and theories developed by Marx can be restated in mainstream terms only as long as key points of disagreement are noted. Perhaps the term that generates the most important disagreement is the concept of exploitation.

The word *exploitation* necessarily has a normative content. However, since the aim of clarifying the theory is positive, I use Makhijani's (1992) phrase, "taxation without representation," as summarizing the word's normative side. Just as taxation is based on coercion, capitalist exploitation is based on "institutional coercion," involving both macro-level capitalist *supremacy* (the worker's proletarianization) and the micro-level *subjection* of labor by capital. Allowing this coercion to persist is workers' conscious *submission*, but capitalist exploitation is not the same as taxation: the coercion that allows it to persist is different from the force used by the state and can work in a decentralized way. Further, unlike most coercion, capitalist "taxation" can encourage the growth of production.

For Marx, other economic systems, such as feudalism and slavery, are "exploitative." However, the only concern here is capitalism. This chapter starts with mainstream views of exploitation, in contrast to Marx's vision. Next, Marx's theory is introduced. Using Dymski and Elliott's (1989) terms, this theory centers on *primary* exploitation, the creation of a surplus product. Finally, the theory of *secondary* (merely redistributive) exploitation is explained and the chapter is summarized.

## THE MAINSTREAM AND MARX

For all authors, exploitation is a persistent economic relationship, and therefore not simple theft. Further, my dictionary sees it as "an unjust or improper use of another person for one's own profit" (*Webster's Ninth New Collegiate Dictionary*, 1991, 438). Mainstream economists see exploitation as "improper" because it goes against the public interest. Of the three mainstream perspectives, the neoclassicals dominate: exploitation is market failure, deviation of the world from an ideal vision of capitalism. The exploiter is a monopsonist or monopolist; a hired agent who uses asymmetric information to exploit the principal; or a free rider in the production of public goods. However, in a second view, exploitation can coexist with "perfect" markets: given a special position in society, a group can gain a scarcity rent, even though they serve no reasonable purpose: while George (1879) pointed to landowners, Keynes (1936) saw rentiers as fitting this picture. Roemer (1982) extends this conception to include the entire capitalist class. The third view weds imperfections with a stress on exploiters as a segment of society. The Friedmans (1980) see the government as exploitative, a rent-seeking monopoly run by special interest groups, and regularly interfering with markets.

Marx's theory combines aspects of the mainstream visions, but uses a different methodology. First, while neoclassicals see economics as concerning the allocation of scarce resources, Marx adds the notion that society produces a surplus product (Obrinsky, 1983), an aggregate output exceeding costs of production so that the average product of labor (APL) net of materials costs exceeds the wage rate. This surplus corresponds to the *surplus labor* done by workers to produce the surplus product. Under capitalism, surplus labor appears in money form as surplus value (property income), which is divided among profits, interest, rent, much of taxes, and the salaries of top managers.

Marx's second relevant deviation from the mainstream is his institutionalism: the societal process is more than atomistic agents' decisions under natural conditions. Many constraints are artificial, benefiting groups that fight to preserve them. These institutions shape individual preferences and actions. Though continually recreated by people, institutions take on a life of their own, at once alienated from, and molding, individual wills.

Nowadays, capitalism is a central institution of this sort. Whereas the mainstream sees exploitation either as a disease curable even under capitalism or as a natural part of the human condition, Marx saw it as essential to that institution and to be abolished with it: "the production of surplus-value … is the specific end and aim, the sum and substance of capitalist production" ([1867] 1967, 298). The mainstream types of exploitation are relatively secondary.

Third, Marx rejected the politics/economics distinction as artificial. The split between the "state" and the "economy" arose, he believed, only with capitalism. Further, Marx saw "politics"—including conflictual relations among people—not only in the state sphere, but also inside the capitalist firm.

## MARX'S THEORY

Though the current presentation is a reaction to Roemer, this is not the place to criticize his work (cf. Devine and Dymski 1989, 1991). It should suffice here to say that his theory suffers from a conflation of the "primary" exploitation by industrial capitalists, production of a surplus, and the "secondary," redistributional, exploitation by rentiers (paralleling Wolff and Resnick's, 1987, 146–51, distinction between "fundamental" and "subsumed" class processes).

To Marx, the exploitation story centered on a representative capitalist laying out money (*M*) to buy commodities (*C*), which are then used to get more money (*M'*). The issue is why $M' > M$ on the macrosocietal level. Profits from "buying low and selling high" are seen as mere redistributions (secondary exploitation) that cancel out on the macro level and are so ignored ([1867] 1967, ch. 5).

To understand what is at stake, examine profit theory in light of neoclassical theory. (Marx's exploitation theory *is* his profit theory.) As Obrinsky (1983, chs. 4, 11) showed, this theory has largely involved the unexplained or undertheorized assumption that profits are positive. The existence of profits—and of property income in general—has usually been a nonproblem. For many years, neoclassicals explained property income, profits, or interest (which were almost always conflated) using an aggregate production function: the profit (interest) rate equaled the marginal product of "capital." That this was an "explanation" indicates the low priority put on the problem: it is equivalent to simply assuming that profits exist, since the social role of owning capital goods (which evokes a flow of property income) is not justified by the goods themselves. This theory collapsed when Sraffa (1960) demolished the aggregate production function. Among sophisticated neoclassicals, it has been replaced by general equilibrium theory.

A better response has been to develop a micro theory of profits. For the individual capitalist, "normal" profits are a given, representing income needed to justify staying in the industry (with supernormal, "economic," profits adding to zero on the macro level). Still needed is a theory of why such profits exceed zero. One answer is to equate normal profits with interest that could be earned on alternative uses of a capitalist's assets, since the capitalist could decide to leave "real" production.

However, this poses the question of why the interest rate (*i*) is positive. Here a graph is drawn showing an individual's intertemporal choice between current consumption and future income. The individual's choice is shown by the intertemporal budget line's tangency with the highest indifference curve feasible and to the intertemporal production possibilities frontier below it. Often, the graph is assumed to apply equally at the micro and macro levels—or the macro/micro issue is not addressed.

Marx's theory of primary exploitation aimed to explain why the intertemporal production possibilities frontier *for the economy as a whole* has a slope such that *i* can exceed zero, in order that one individual can earn interest without that gain simply being a redistribution from another individual. (He was explaining capitalism, not piracy and not philanthropy.) Marx went beyond explaining why $i >$ zero, to help us understand all other types of property income, emphasizing the rate of *profit* ($r$, total property income divided by capital). Then, if $r >$ zero can be explained, $i > 0$ follows.

Marx's surplus problematic explains how capitalist institutions create and over time reproduce a steep ppf that constrains choice, leaving the issue of the actual choice made as secondary: in his ([1867] 1967, ch. 24, s. 3) discussion of the abstinence theory, for example, the choice of how much surplus to accumulate is subordinate to the actual existence of a surplus; abstinence alone does not explain why $r \geq i >$ zero.

Consider another etiology of surplus, which brings up a second issue, the form in which surplus appears under capitalism. Imagine an independent producer working hard now, and taking advantage of natural possibilities to produce a surplus in the future. Assuming a surplus is actually produced, there is, as yet, no exploitation or profit in the capitalist sense. Marx's exploitation excludes such concepts as the self-employed producer "exploiting herself": exploitation is a relationship between people. To understand it, it must be discovered how someone can capture the proprietor's surplus and also motivate her to continue to produce it (so that this is not simply theft). This explained, then the intertemporal ppf will be such that $r \geq i >$ zero for capitalists or moneylenders rather than simply for the proprietor.

The Austrian school, among others, has a completely different answer: a surplus arises and $i >$ zero (usually equated with $r >$ zero) due to "roundaboutness," as when wine improves with age, so that "waiting" or "abstinence" is rewarded with profit. Others suggest that "risk taking," technology, or "entrepreneurship" produce profits. A critique of these theories is beyond this chapter's scope (but see Obrinsky 1983), but one example suffices to show that the mainstream factors explaining profit are necessary, but not sufficient, at the macro level.

A professional poker player uses equipment, takes risks, delays gratification, engages in strategic behavior, tries new tricks and tactics (innovates), owns tools (e.g. marked cards), cheats, and earns large winnings—and can even do so repeatedly. However, no surplus results from such behavior; the gambler's winnings are simply redistributions from others, with no new production occurring. The poker player is not a capitalist. Thus, the mainstream factors might be necessary for an individual to receive profits, but they are far from sufficient for these winnings not to be pure redistributions. We need to understand the societal conditions that allow the risk taker (and others) to get a profit without being a mere thief or bunko artist.

## PRIMARY EXPLOITATION

To explain the production of surplus that shows up as profit received by nonworkers, Marx's theory adds involuntary elements to Roemer's purely voluntary exploitation. Since this coercion is part of the capitalist social structure, it fits with Marx's institutionalism. However, not all of the story involves coercion: an individual can make a profit (secondary exploitation) without participating directly in the production of surplus value (primary exploitation), just as a holder of treasury bonds can garner interest without participating in the state's forcible extraction of taxes. Secondary exploiters might be seen as recipients of "stolen goods" resulting from primary exploitation.

Institutional coercion's role can be understood by first examining capital's macro-supremacy and then its micro-subjection of labor.

## Supremacy

Marx emphasized "the so-called primitive accumulation" ([1867] 1967, chs. 27–33), the violent historical creation of the "fundamental conditions of capitalist production." Under these conditions, workers are "free in a double sense" in that "neither they themselves form part ... of the means of production, as in the case of slaves ... nor do the means of production belong to them, as in the case of peasant-proprietors" ([1867] 1967, 714). This capitalist supremacy (workers' proletarianization) is more profound than Roemer's capitalist "dominance" in that, not only do workers lack control over the capital goods, but their own income-producing assets are insufficient to provide them with a livelihood for any extended period. They are thus forced by their social circumstance to work for the capitalist class, no matter how unpleasant the job: "the laborer purchases the right to work for his own livelihood only by paying for it in surplus-labor" (Marx [1867] 1967, 515).

1. The two aspects of workers' freedom help produce the reserve army of unemployed labor. First, freedom from bondage allows this army to exist: there is no joblessness under slavery (for example) since the slave owner strives to use his property as intensively as possible. Second, workers lack access, not only to the means of production, but also to consumption goods, which they can get only by working for capitalists. Since they have nowhere else to work for their livelihoods (unlike in Roemer's models), the only alternative is to be unemployed (though this conclusion will be moderated later in the chapter). Marx discusses Wakefield's theory that in land-rich colonies, it is necessary to forcibly keep workers from the frontier if profits are to be garnered by hiring them ([1867] 1967, ch. 33).

The ability of workers to quit or to reject job offers (part of the first kind of freedom) does not equate the marginal disutility of worktime to the wage rate. Instead, the former is equated to the marginal disutility of becoming jobless, or roughly, the cost of job loss (COJL), a concept developed by Weisskopf, Bowles, and Gordon (1983). Labor's mobility tends to equalize wages and working conditions between sectors. However, absent alternatives to working for capitalists, even complete equalization does not abolish the capitalist supremacy that allows exploitation.

2. Other ways exist to avoid working for the capitalists besides going to the frontier, but are quite limited. Going into business for one's self is very difficult without sufficient assets and the ability to diversify one's investments. Workers lack that ability by definition (cf. Bowles and Edwards 1993, 130). There *is* a constant flux of workers into the self-employed petty bourgeoisie (and a trickle of these that become full-scale capitalists), but there is also a constant reflux into the working class as enterprises fail. Though some move between class positions, the class structure itself remains, leaving the vast majority where they started.

The difficulty of a worker going into business persists in part because of the competition from capitalist firms, which can benefit more easily from economies of scale and scope. At the same time, unemployment keeps the wages low, making it extremely difficult for workers to get sufficient income to save enough for the initial investment needed to go into business: saving for retirement or consumer durables such as houses is difficult enough. Since this blocks their ability to earn income for saving from their own businesses, they face a vicious circle.

Another place to get subsistence is from the state. But unemployment insurance benefits and other welfare state programs are paid for by redistributions from employed workers, as analyses of the incidence of payroll taxes indicate. The actual benefits are historically contingent, based on struggles: politicians and social scientists work to make sure that welfare state programs do not undermine the "incentive to work" for capitalists. Absent a strong counterpressure from working people, as in Western Europe after World War II, these programs seldom represent a viable alternative to selling labor power to the capitalists. For the United States, Tonak (1987) and Miller (1989) both found that state programs helping workers were more than paid for by taxes on wages for 1952 to 1985.

Yet another option is to live off one's peers. Even though this encourages conflicts, extended families, communities, and labor unions can and do provide (privatized) unemployment insurance. However, this simply emphasizes the redistributive nature of that insurance. Crime is another possible source of unemployed workers' livelihood, but it mostly represents a redistribution from other workers (whose incomes are limited by the reserve army of unemployed): the main victims of "street crime" are the poor.

3. Open unemployment (as measured in the United States) is less important than the more general phenomenon of the COJL. In many underdeveloped countries, there is almost no open unemployment: almost all propertyless people who can work have jobs, no matter how pathetic. However, the large gap between wages in the capitalist sector and the income earned from petty trading, street hustling, crime, and the like (and the nonexistence of unemployment insurance, etc.) imposes a large COJL on workers in the capitalist sector (cf. Schor 1987, 175). Even without open unemployment, perhaps the only thing worse than being exploited by a capitalist is *not* being exploited by one. A formal description helps us summarize:

$$\text{COJL} = C(U, W\text{gap}) \text{ where } C(0, 0) = 0 \tag{1}$$

where $C$ is a positive function of both the open unemployment rate ($U$) and $W$gap, the gap between the wage earned working for the capitalists and alternatives such as street hustling and the dole. Now suppose that there exists a minimum COJL ($C$min) necessary to result in an adequate profit rate (from a capitalist viewpoint). At this $C$min, $U$ and $W$gap substitute for each other in providing an adequate COJL. In the "first world," the $W$gap is minimal but $U$ is positive, while in the "third world," $U$ is minimal and $W$gap is large. Note the difference with Roemer's models, where it is possible for $U$ and $W$gap to both equal zero, so that the COJL is zero.

4. Before turning to alternatives to the COJL, Marx's theory must be completed. What *preserves* COJL $\geq$ $C$min over time? To avoid functionalism—the view that something exists simply because it helps the capitalists—more is needed. If the COJL's persistence can be explained, so, too, can the difficulties of workers going into business or providing privatized unemployment insurance, since a high COJL makes these difficult. The story also helps us understand the limits on welfare state measures.

In Roemer's model, workers' abundance relative to capital goods is abolished automatically (and with it, profits and exploitation) if capitalists follow market incentives and invest their profits in scarce capital goods. Marx's solution is simple here, because his theory of exploitation is so different. For Roemer, profits are quasirents. For Marx, while these goods' scarcity is not denied, the receipt of profits is not simply based on this alone. Instead, profits are akin to a tax that capitalists can impose because they control the growth process, including the pace and nature of investment and technical change.

Suppose that $C < C$min, or that this situation is anticipated soon, threatening a profit squeeze as workers are more able to push for high wages, cut back on work intensity, or even go into business for themselves. The capitalists' control over investment decisions means that they can, and will, cut investment spending (and the economy's growth rate) when profits are so threatened; this "capital strike" restores the profit-boosting situation of high unemployment by depressing the economy (cf. Marx [1867] 1967, 619; Goodwin 1967). No conspiracy is needed: profit squeezes hit all capitalists to varying degrees, encouraging a certain unity of purpose.

This theory presumes that capitalists cannot simply mark-up money wage costs: when Marx wrote, the gold standard prevented such a passing-on of costs. Today, competition faced by individual capitalists and by nations on the world market prevent complete passing-on, at least in the short run. But in a modern economy with fiat and credit money, the short-term profit squeeze could encourage accelerating inflation instead of recession (cf. Bowles and Boyer 1990). Central banks' vehement opposition to inflation (reflecting the power of property owners) encourages recession, reproducing Marx's classic scenario in a politicized form. Even without this opposition, accelerating inflation eventually encourages recession that reestablishes a COJL adequate to preserve profits.

This theory differs from that of Bowles and Gintis (1990a, 1990b; 1993) and Devine and Dymski (1991), who stressed the origins of the COJL from purely microeconomic behavior, in essence, the payment of "efficiency wages." While the idea that managers manipulate wage payments in order to motivate workers by raising the COJL is mostly reasonable and can cause unemployment by interaction with other non-Walrasian elements of the economy (cf. Devine, 1993a), the emphasis below is on the macroeconomically created COJL. In the spirit of Marx's presentation, the role of "imperfections" is largely ignored.

Threatened by high wages or low work effort, capitalists can also institute labor-saving technological change (Marx [1867] 1967, ch. 25, s. 2), while seeking new supplies of labor power at home and abroad. Indeed, they are driven to seek ways to replace labor power by the competitive battle amongst capitalists and the possibility that wages will rise in the future. Further, they may use the state, as when capitalists push the state to change immigration laws to import "guest workers" in times when labor power is scarce.

Governments are sites for intraclass competition and interclass conflict, and need not always serve the capitalist class interests. However, a government that attempts to lower the COJL has to face the limits created by the profit squeeze/capital strike and capitalist control over technological change. If a government promotes true full employment or institutes programs seen as undermining profitability (even if they are not truly so), eventually investment will stagnate or capital will flee to more profitable shores. This induces recession or increased inflation, falling tax revenues, foreign exchange problems, and/or long-term productivity-growth stagnation. These undermine popular support for the government and either push it out of office or to change its policies (cf. Kalecki [1943] 1971; Block [1977] 1984; Lindblom, 1982). "Automatic destabilization" cases include those against Salvador Allende in Chile and Francois Mitterand in France.

5. However, the receipt of profits is not *guaranteed* by the capitalist control of investment and technological change, since capitalists can get themselves into serious crises, such as the Great Depression, when unemployment became "too large" and hurt the realization of profits (cf. Devine, 1994). Further, workers can revolt or pressure the state in a way that lowers this tax. However, in "normal" (noncrisis) times, capitalists receive positive profits, because crises are typically not as severe as the Depression and workers compete against each other. Developing the latter point, workers often side with "their" employers in the battle of competition, or with "their" nations in international competition, in hopes of getting benefits. This divides and rules them as a class, legitimating the system and preserving capital's supremacy over time.

The existence of exploitation is partly based on workers' conscious submission, so we should turn to the possibility of a social-democratic contract that can substitute for the COJL: workers might accept exploitation in exchange for a relatively good deal in terms of the distribution of benefits (Bowles and Edwards 1993, 136, 144). Capitalists put up with this situation because of the security that the contract provides.

This possibility is based on interpretations of the history of Sweden and similar countries; to some extent, this kind of contract has also existed in the "primary labor markets" of the rest of the capitalist world. In these cases, the type of consent based on the COJL and divide and rule is replaced in part by a more democratic and popular form of legitimation. Taxation begins to edge toward being "taxation with representation" and to stop being exploitation in a normative sense.

However, such a "social contract" is partial, conditional, and temporary. It is partial because it excludes many workers, either those who produce imported inputs or the "guest workers" who do menial tasks within the nation (and are exported during bad times). Even if democratic legitimation applied in Sweden or the primary labor markets, the divide-and-rule type of legitimation still applies for capitalism as a whole.

It is conditional because as soon as the social-democratic contract stops being profitable to the capitalists, capital strike will result or capital will flee to areas that constrain profit seeking less. This implies that the contract is temporary: the normal globalization of capitalism means that greater opportunities for capital flight arise, so that the contract becomes more likely to break down.

Alternatively, the social democratic system could be transformed into socialism through the abolition of capitalism. Not only has this never happened, but it seems unlikely. The social-democratic contract was won as a compromise because of the strong organization and socialist consciousness of workers pushing for something even better. However, social democracy itself is built on the subordination of this organization and consciousness to compromise, and so slowly undermines the possibility of future working-class victories.

In the current global economy, most of the old social-democratic programs are under attack and are falling apart, while primary labor markets are shrinking. This suggests a return to relying on the COJL and divide and rule in order to preserve exploitation. However, the possibility of a social democracy, at least a temporary one, cannot be denied in the far or intermediate future.

Fascism is a second alternative within capitalism to the COJL: state violence can be wielded to directly force people to work (cf. Kalecki [1943], 1971). This type of exploitation is relatively transparent and needs no profound analysis. However, just as with slavery, fascist rule seems inadequate for promoting high-quality work, productivity growth, and the like, since forced labor is usually poor labor. A fascist economy would not do very well in market competition with nonfascist capitalist powers, and so tends toward autarchy and military competition. The societal imposition of a COJL on workers seems to be a more "efficient" way of promoting capitalist accumulation. The fascist solution has been imposed only in situations in which capitalist social and property relations were threatened.

In sum, exploitation's existence requires societal impetus on workers to "pay their taxes" to the capitalist class, where the COJL is a substitute for the direct application of force or conscious consent in allowing these revenues to be received. Turn next to the *impact* of this type of societal pressure on the actual production of surplus on the micro level.

**Subjection**

The pressure to "pay taxes" need not cause the actual production of surplus; similarly, capital's supremacy is only part of the story, being necessary but not sufficient. The "anarchy in the social division of labor," namely, the unplanned and relatively harmonious cooperation of industries and firms through the market (in the absence of fascism or social-democratic planning) is complemented by "despotism in the workshop" (Marx [1867] 1967, 356). This subjection of labor by capital is instrumental coercion (threats of firing, etc.), referring to the direct capitalist rule *in production*, as opposed to voluntary exchange (the Roemer story): the coercer can impose a significant cost on the coercee for not complying with his wishes. COJL $\geq$ *C*min makes employers' threats credible.

1. Capital's supremacy cannot be sufficient, since it does not explain the existence of surplus: capitalists could use their macro-societal power to induce a pure redistribution that reduces the standard of living and/or net worth of workers. This would make capitalists like the kleptocratic elite seen in extreme libertarian statements about government, extorting taxes in order to waste them on luxury, war, and further tax collection, and steadily depressing peoples' standard of living and/or net worth. This is also similar to Marx's vision of precapitalist usury, which "impoverishes the mode of production, paralyzes the productive forces instead of developing them, and at the same time perpetuates these miserable conditions in which the social productivity of labor is not developed." ([1894] 1967, 596).

This degenerates into a stationary state, thus differing qualitatively from the capitalist exploitation that Marx explained; instead it can produce new real assets rather than simply redistributing them from others.

To rule out this purely redistributive, and thus self-limiting, exploitation theory and to define and thus understand the production of surplus, some standard of comparison is needed. Marx assumed that the workers are paid enough to reproduce themselves as a class over time (according to the culturally based and historically determined subsistence level). This captures the fact that workers' needs are more than just a matter of subjective wants; they are a matter of survival, not just physically but as human beings in society. If paid at subsistence, they need not reduce net worth to survive.

Marx stated the micro-etiology of exploitation as follows: surplus is produced if the work-day exceeds the value of labor power (VLP), which is the socially necessary, abstract worktime required to produce the daily wage determined by the subsistence level. Workers are exploited *despite* being paid the VLP, which is the standard defining nonexploitation. This complements the assumption that capitalists do not simply profit at each others' expense; in other words, the focus is on the macro creation of surplus rather than mere redistribution of a given product.

As seems appropriate nowadays, we will use an hour rather than a day as the unit for which workers are paid: the value of an hour of labor power equals the amount of socially necessary, abstract labor time needed to produce the hourly real wage. So the VLP is the real wage (RW) for an hour of labor power divided by the average output produced by the labor done during an hour of labor power hired (output per hour hired, the APL).

To use modern language, avoid further reference to the VLP and allude to RW and APL alone. Marx's issue can be restated as whether or not APL > RW. In turn, the APL is explained by the following tautology:

$$\text{APL} = (\text{output/labor done})(\text{labor done/labor-power sold}) = q\ e \qquad (2)$$

where $q$ is the effectiveness of labor done and $e$ is the intensity of labor or the "degree of effort" (cf. Devine and Reich 1981). The ability of the capitalists to extract a surplus and exploit workers thus depends on technology and management systems, plus the ability of capitalists to depress wages.

Initially, changes in $q$ (reflecting current technology and management systems) are largely ignored. Given this, the production of surplus depends on managers' ability to evoke sufficient effort from workers. The issue of technical change is addressed in paragraph (5).

Many have criticized Marx's assumption of the exogenously given RW. Instead, Friedman (1977, 267–9), Lebowitz (1992, 119–20), and others argue that RW is the product of endogenous class struggle. To assure generality, therefore, go beyond Marx to consider the case in which wages are set by steadily changing social needs and class struggle in the context set by the supply of and demand for labor power—and can change in response to exploitation.

Marx's micro-theory of exploitation is not dependent on the fixed RW. In the Marx/Goodwin theory, wages are the "dependent variable" ([1867] 1967, 620) rather than the independent variable that they were earlier, in *Capital*. The reserve army "confines the field of action of this law (of supply and demand for labor power) within the limits absolutely convenient to the activity of exploitation and to the domination of capital" ([1867] 1967, 639). That is, the cycle, labor-saving technical change, and the like ensure that profit squeezes are abolished.

2. Now assume RW constant, with its current value determined by what was received in the previous year (roughly, their customary standard of living, as in Bowles and Edwards 1993, ch. 4). Given this assumption, return to the issue of how the capitalists can succeed in getting more out than they put in to hire workers during this period. Marx's answer is simple: workers are not paid for the actual labor they *do* but instead for the cost of bringing themselves (their labor power) to work; their actual labor has no price on the market because it is not marketed. Further, they labor more intensively than necessary to exceed the

labor needed to produce the RW, while the capitalists can capture the benefits of management systems and technology that raises labor's effectiveness.

This theory is not contradicted by marginal productivity theory (assuming it to be valid). A profit maximizing capitalist equates the marginal productivity of hiring labor-power to the RW, which is the price of labor power. However, the wage is not *determined* by the marginal product of labor (MPL). Rather, as far as a competitive capitalist is concerned, labor-power market conditions (the COJL) determine the wage; then, the capitalist determines employment given that wage. Even if the RW is constant, the COJL helps to determine the degree of effort, the amount of labor done, and thus the marginal productivity of an hour of labor power hired.

3. Given the coercion allowed by the COJL, a central question is why it is that workers get paid for providing labor power rather than labor. Workers sell their time on the market and it is that time (labor power) that has a price; once they have struck a deal, they are under the capitalist's authority, and their product is the latter's property. The social relations within the workplace are distinctly nonmarket in character, involving much more than individual exchanges.

Recent research fits with Marx's vision: as Williamson (1975), Gintis (1976), and others explain, most jobs involve more than hiring an individual to do a single and simple task: complete contingent futures contracts between employer and employee are impossible. This fact's general acceptance has encouraged economists to increasingly distinguish between "labor sold" and "services rendered" and to worry about the principal/agent (P/A) problem. With the workers as agents and the capitalist as principal, the latter must discover how to get the agent to work hard in the real world of asymmetric information. Otherwise, embezzlers will steal from their bosses while slackers and petty bureaucrats will impede operations, making them unprofitable. Without dictatorial supervision, in the Marxian view, no profits will be received since inadequate amounts of work will be done to do more than pay for the wages.

Skillman (1995) argues that the P/A problem does not add anything significant to exploitation theory; rather than explaining why profits are *positive*, dictatorial supervision explains only why profits are *higher* than with self-supervised workers organized through markets. However, this argument that subjection is merely epiphenomenal misses the limitations of the neoclassical P/A literature. The neoclassical P/A article starts with a totally hypothetical "full information" Pareto-optimal economy and then introduces asymmetric information. However, Marx's standard for comparison in his exploitation theory is not the Paretian ideal, but rather a nonexploitative ideal of simple commodity production (posited by economists of his time). Marx, like others of his era, would have considered the notion of perfect information to be irrelevant. More importantly, the neoclassical view simply avoids the theoretical issue of the origins of surplus. If anything, its existence in the full-information model is implicitly assumed, with P/A problems leading to the imperfect realization of these profits. Though on the technical level, P/A models are unobjectionable, to explain positive profits we cannot start by assuming what we are trying to explain.

Skillman's (1995) effort follows the neoclassical pattern, except that he explains profits' existence with Roemer's "full information" theory. However, Roemer's theory simply assumes that APL > RW, while the scarcity of capital goods is insufficient to explain the actual production of surplus as opposed to the mere redistribution of an already-produced surplus. We need the more complete picture of institutional coercion to explain the existence of profits.

In fact, the P/A problem undermines Roemer's models, which lack any way to enforce contracts. Though the state is implicitly assumed to do the job, it lacks the resources (including information) needed to enforce each and every contract, even if it were possible to fully specify contracts ahead of time. State enforcement is thus, at most, complementary to the efforts of the contract enforcers whom capitalists hire or mechanisms that they use (including the COJL) to ensure contract compliance. Without the subjection of labor, contract compliance breaks down.

In sum, if we are trying to explain, rather than presume, the existence of a surplus, the P/A problem stops being an example of "inefficiency" defined relative to an imagined ideal but rather becomes a conflict over the amount of production—a variable.

4. Let us turn to an important practical concern that goes beyond the P/A problem and limits the effectiveness of such individual solutions to the problem as "bonding" (as happens with individual contractors) and the paying of efficiency wages to individuals. Since work occurs in groups, there are so many interdependencies—externalities *within* the workplace—amongst the various workers and their work that it is extremely difficult if not impossible to separate out the contributions of individual workers in the "team."

Alchian and Demsetz (1972) see the capitalist as a supervisor, who "monitors" the teams' inputs and outputs to avoid "shirking." The capitalist receives the "residual" gained through such monitoring. However, these authors do not note the fact that this residual accrues to the capitalist, not simply because of any supervision, but also because of ownership rights. With different ownership rights, the residual might be received by (for example) a workers' cooperative, in which workers supervise each other. Even given capitalist property rights, Alchian and Demsetz miss the way in which the reserve army of labor (and the COJL) allow the employer to threaten workers to get them to work in order to produce a surplus.

The collective nature of work suggests that workers have group interests (the production of collective goods, such as a leisurely pace of work) that conflict with the goal of the capitalist manager. This differs from Williamson (1975) or Stiglitz (1975), for whom the capitalist/manager and workers share a single collective good. However, these authors' vision is not totally wrong: while there exists a basic conflict of interests between capitalists and workers, in many cases, workers (fearing unemployment and hoping for raises) and their employers ally against the employers' competitors.

In view of the common conflict between profits and the workers' collective good, however, the capitalist tries to encourage the free-rider problem among workers, in order to divide and rule his employees (Marglin 1974; Devine and Reich 1981). Friedman (1977) and Edwards (1979) both emphasize the need for organized management systems to control workers, usually incorporating the divide-and-rule principle. In this vision, the capitalist control of production is more than simply a matter of setting up an incentive system and enforcing it; rather, it is a (micro) political problem, involving both potential and actual conflicts of interest. In this management relationship, the submission that was necessary to the perpetuation of supremacy is also needed to reproduce subjection over time. A rebellious workforce willing to throw spanners in the works or go on wildcat strikes will not allow subjection or exploitation.

In response to all this, the case of piece rates is often mentioned as a counterexample. However, as noted in Mathewson (1931) and Devine and Reich (1981), the payment of piece wages is very limited in application and, further, does not prevent political problems. Besides the problem of actually isolating an individual's contribution to the total product, one problem with market-like piece rates is that the *quality* of the pieces is impossible to contract ahead of time. Another is that workers band together to prevent the downward adjustment of piece rates that so often happens when they work harder. Unlike competitive farmers, who face a somewhat similar situation, workers find it relatively easy to do so because they often work together in a single workplace and thus find it easier to communicate and cooperate with each other, even if that cooperation is tacit while on the job. Both these considerations indicate that in addition to the piece rate, workers must submit to the authority of the employer. Piece rates and capitalist management/control systems are complements rather than substitutes.

5. As Marx realized, real wages may not be low enough (given technology, and thus the effectiveness of labor) to actually allow for exploitation to occur. Given the absolute limits set by *physical* subsistence needs, it may be impossible to reduce the RW. Increases in the intensity of labor may simply induce a higher cost of reproducing labor power, thus preventing the creation of a surplus. With undeveloped forces of production, therefore, it is quite possible that the degree of exploitation will be extremely low or even zero (Marx [1867] 1967, 511).

However, once capitalism takes hold of the production process—what Marx called the *real* subjection of labor by capital—it promotes growth in labor productivity, thus helping to assure the reproduction of exploitation over time. This real subjection is more stringent than mere supervision (formal subjection): it involves the capitalist control over technology and its introduction on the micro level. Capitalists are no longer dealing with workers who bring their own tools and knowledge to work (as with many craft workers even today, as in the construction industry); instead, they are replacing their own machinery with new and different types of capitalist-owned machinery and are monopolizing the technical knowledge developed by hired scientists and engineers.

Under real subjection, the capitalists can install the technology they want, one which raises the effectiveness of labor ($q$) without directly causing increases in real wages. Such labor-saving technological change also helps create a reserve army of labor (technological unemployment) and the economies of scale and scope that block workers' entrance into business.

Once established, the normal production of surplus can then be (for the capitalist) the basis for a virtuous circle of accumulation and the creation of further profits, even in the face of rising wages. After the initial stage, in which more overt force may be needed, the somewhat automatic Marx/Goodwin cycle and labor-saving technical change can make sure that wages do not rise too much to allow the production of profits, since the real subjection of labor implies that the capitalist controls investment and technical change. Such control is not present if production simply involves workers deploying their own tools.

At the same time, automation and similar techniques are used to lower the skill content of the work process, taking control away from craft workers (cf. Braverman 1974). In the end, workers may be relatively skilled, but both the machines and the knowledge are supplied by the capitalists or their institutions (such as technical schools) so that workers have no special advantage arising from their individual attributes. Unlike many craft workers in the building trades, for whom the ownership of skills and tools conveys certain advantages even in the absence of a union, under the real subjection of labor by capital, workers must band together to resist capital or to bargain collectively.

Despite the introduction of machinery and the deskilling of craft-based labor, exploitation remains a political problem at the micro-level. Even "unskilled" workers can devise ways to block the introduction of new machinery or to undermine its effectiveness if the capitalist has not solved the political problem. This can be done either via collective action (unions, wildcat strikes, etc.) by some subset of workers who manage to find a strategic location in the management structure (such as a bottleneck in the assembly line), or even by sabotage. Submission is still needed for exploitation to be reproduced over time.

6. Subjection is necessary but not sufficient; it is *complementary* to capitalist supremacy. First, subjection depends on supremacy, the lack of workers' options besides working for capitalists; the COJL gives subjection its force. In turn, capital's supremacy involves capitalist control over both investment and the introduction of new technology.

Completing the circle, these types of control require subjection. In an imaginary economy totally organized by self-employed craft workers using their own tools and knowledge, capitalists would have no direct control over real investment or technological change. If there were no COJL, the craft workers would face no disadvantage vis-a-vis contractors and bankers, so the latter could not force their decisions concerning investment and technology. With no direct control by capitalists over the workplace, there would be no way to get the craft workers to produce a surplus or to hand it over to the capitalists.

**Secondary Exploitation**

The six mainstream kinds of exploitation sketched out as pure cases represent "secondary exploitation." However, important "impure" cases exist, which are either mixed with and/or contribute to primary exploitation. Consequently, the simple case of "all exploitation arises out of industrial production" needs to be modified. Even so, primary exploitation sets the context in which secondary exploitation occurs.

1. Some capitalists—monopolists—have special positions that prevent the entry of competitors, meaning that their profit rate exceeds the average for the economy as a whole; they receive "super profits." Others—monopsonists—have workforces with a restricted ability to seek jobs elsewhere and are able to pay lower wages than on average, allowing the capitalists to "super exploit," to participate in exploitation more than others. In the latter case, if capital mobility is unblocked, the monopsonist will not receive an above-average profit rate in notional equilibrium, as other capitalists rush in to take advantage of below-average wages. However, it is possible that monopolistic and monopsonistic privilege are combined (as with the company town), in which case the company will receive super profits.

Unless the monopoly or monopsony is extremely important in the economy as a whole (which seems unlikely, given the magnitude of world capitalism), it will not affect the over all degree of exploitation. If this is unchanged, the monopolist or monopsonist will gain super profits only from other capitalists, who receive subnormal profits.

If these phenomena are extremely important to the operations of the economy, the capitalist economy has a significant admixture of feudalism or some other form of overt servitude, such as fascism. If these phenomena are the normal way in which business is operated, then they should raise the overall degree of exploitation, though it may hurt the long-term growth of labor productivity.

2. The P/A theory of exploitation has three levels. First, capitalist agents, such as the top managers of firms, are able to capture part of societal surplus in the form of exalted salaries, perks, stock options, and/or embezzlements, thus reducing the incomes of stock owners and creditors and getting more than justified from these principals' perspective. Their ability to do so depends on the primary exploitation of the direct producers. Though they may use their power in a way that limits the size of the surplus produced, that course will undermine their income in the long run.

Second, from the point of view of these managers, the members of the workforce are the agents. The latter can refuse to produce a surplus product. Further, if we use the customary standard of living to define the RW and, given the APL, the surplus product, workers can capture part of the latter by pushing to earn more than their customary level. This represents a central part of subjection, namely, the constant political problems that it involves.

Workers are sometimes seen as earning "employment rents," which some see as the exploitation of capitalists by workers. However, this is looking at matters backwards. Workers fear the COJL and thus produce a surplus, after which they may be able to win back some of the surplus that they created. They are not the exploiters.

Third, individual workers can gain at each others' expense. While such "opportunism" (Williamson 1975) can benefit individual workers in an "exploitative" way, this competition among workers (if kept within bounds) also divides and rules the workforce and encourages the production of profit: the back-stabbers in "office politics" can help the managers and owners by motivating workers to work hard to rise in the hierarchy rather than fight to attain collective goals. To management, such behavior must be kept within limits; doing so is part of the political problem that capitalist exploiters must face.

3. The free-rider problem is best explained in terms of a specific case, that of the destruction of nature and the exploitation of future generations. It is part of a Marxian theory of competition. In their efforts to survive the competitive battle, capitalists actively seek to internalize external benefits and externalize internal costs, often in innovative and highly creative ways that demonstrate an ability to plan ahead and delay gratification in the name of profit cf. (Hunt 1980; Devine 1993b). The successful development of new ways to dump costs on others can give a company a competitive advantage and temporary super profits that can be capitalized, allowing for further growth. Of course, on the macro-level, this behavior can eventually lead to the destruction of the natural conditions allowing capitalist exploitation to exist. However, a competitive capitalist cannot act on such knowledge. In other words, the free-rider problem is part and parcel of the way in which freely competitive capitalism works.

4. Just as for George, Marx saw the land-owning class as crucial. For both, landowners capture some surplus because they control scarce gifts from nature. The major difference is that George, having a different theory of profits, stressed a basic harmony between the urban classes. For Marx, on the other hand, landowners are able to grab a part of the aggregate surplus value, representing a redistribution from industrial capital, where surplus value is produced.

The landowner may also be an industrial capitalist (hiring farm workers to harvest the crop, etc.) In this "impure" case, the landowner is contributing to the aggregate surplus value. Further, the extent to which workers are landowners themselves (rather than being pure proletarians) limits the degree to which they can be exploited by normal capitalist means.

5. Marx's attitude toward rentiers was similar to that of Keynes, without sharing the latter's admiration of the entrepreneurs (industrial capitalists). The rentiers gain a share of the societal surplus value in the form of interest from their control of loanable money capital. However, industrial capitalists are the ones who induce the workers to produce the surplus in the first place. For Marx, unlike for Roemer, the rentier's pure money lending does not create the basis for the receipt of property income.

Of course, there exist cases of impure money lending, as when a loan-shark forces a worker to work hard and long. However, the loan-shark is not a rentier but instead shares some characteristics of an industrial capitalist, namely, the direct participation in the subjection of labor. As the P/A literature on banking points out, much money lending shares this characteristic (to varying degrees): the loaners ration credit, snoop into prospective debtors' personal lives, and impose conditions concerning collateral and the like (cf. Mishkin 1992: 171–78).

Given capitalist supremacy, namely, the threat of the COJL and the absence of alternatives—this type of behavior might induce an "I owe, I owe, so it's off to work I go" response on the part of workers, complementing the industrial capitalist's subjection, which (if common enough) raises the aggregate degree of exploitation. Without supremacy, the dependence of workers on industrial capitalists for their livelihood, however, the money lenders' hold over workers would be nil. Again, it is clear that the institutional coercion of labor is central to the exploitation story.

Even many or most of the independent producers living on the edges of capitalism (the petty bourgeoisie and home workers) are subject to capital's supremacy. In the extreme, they own neither the means of production (including raw materials) nor the means of subsistence (or have very limited access to these) and must gain access to them through the agency of the capitalists. These workers may not even own the homes in which they work and may be borrowing money to finance consumption. They are also threatened by the existence of the reserve army, as a merchant can "fire" home workers and hire replacements. They may also be competing in product markets with wage workers operating much more advanced equipment (i.e., with low-cost commodities produced under conditions of the subjection of labor by capital). Of course, some independent producers are not in this kind of bind: these are not exploited and instead are on the edge of joining the capitalist class.

6. The final theory of exploitation centers on the role of the state. Contrary to the popular image of Marx as a super-statist, he was hostile to the state, striving for its "withering away" (cf. Draper, 1977–90). In Marxian theory, the state is central to the existence of both supremacy and subjection over labor, since it helps create and preserve capitalist property rights. Under feudalism and other precapitalist modes of exploitation, the use of armed force (a characteristic role of the modern state) is inseparable from the "economic" relations between the lord and the serf: the former simultaneously collects rent and taxes, two incomes that cannot be separated. However, under nineteenth-century capitalism there was a societal division of labor between those sectors "monopolizing the legitimate use of force" (Weber [1918] 1946) and those that engage in purely economic activity. Taxes on capital may be seen as partly a matter of redistribution of surplus value to the state in return for services rendered to the capitalist class.

The state can also use its force in order to raise the degree of exploitation, as under fascism, or may emulate capitalists by directly engaging in production, as with state capitalism (e.g., the U.S. Tennessee Valley Authority). To some extent the modern welfare state (like social democracy) contributes to the production of surplus value by legitimating capitalism and its social relations. In these cases, the societal division of labor is fuzzy compared to classical liberal capitalism, so that taxes are not simply a deduction from (redistribution of) surplus value.

On the other hand, the state is "relatively autonomous": that is, it is not under complete capitalist control and does not always serve the interests of the capitalist class. It might serve only a fraction of that class, or there may be a P/A problem, this time with the state bureaucracy as the agent. As the Friedmans would be the first to point out, the state may go "too far" in the collection of taxes, feathering the government bureaucrats' nests with no obvious benefit to the capitalists or anyone else besides these parasites.

Third, and finally, the working class's political activity can (and sometimes does) succeed in winning benefits from the state in excess of the taxes they pay. While this also contributes to the system's legitimation and, as noted above, can thus raise the amount of surplus produced, to some extent workers can reduce the surplus left over for capitalists. In fact, these two effects may work together (as it has in Sweden for decades), where the state works to both increase the surplus through legitimation and decrease the surplus via distribution to workers, without hurting, and perhaps actually helping profits. In the end, however, as argued, social democracy cannot escape the laws of motion of capitalism.

## CONCLUSION

The point of this chapter is to reconstruct Marx's theory of exploitation in modern terms, applying his surplus problematic, institutionalist perspective, and political-economic vision. The most profound type of exploitation—the one explained by Marx—involved, not simply the redistribution of existing assets, but the creation of new ones. The basic theory is both macro- and micro-institutional, and involves coercion. Exploitation might be likened to taxation without representation.

Whereas Roemer's effort to summarize Marx's positive theory of the capitalist exploitation of labor in a Walrasian framework severely limits the role of politics, this summary defense of Marx's theory is profoundly politicized on the complementary macro and micro levels. Nonarmed coercion based on the threat of costly job loss and the dictatorial rule of the workplace by the capitalist, including the real subjection of labor, the ability to revolutionize production by introducing new technology, form the microeconomic basis for exploitation. On the macro-level, the exclusion of workers from producing for themselves using the gifts of nature and the products of their labor (the means of production) creates the cost of job loss and the conditions allowing microeconomic subjection. Finally, there must be ideological submission by workers, in whose eyes capital's institutional coercion of labor must be legitimated if it is to continue. Further, severe economic crises must be avoided. As fits with Marx's emphasis on the nature of capitalism as historically limited, the persistence of exploitation is not *guaranteed.*

The discussion of secondary exploitation leads to the conclusion that the institutions allowing purely redistributive exploitation can be mixed up with and can sometimes even reinforce the production of surplus value.

Though it goes far beyond Marx's methodological framework, Roemer's *normative* definition (1982, 194) cannot be avoided. Any kind of criticism of "capitalist exploitation" seems somewhat futile if there exists no alternative, not only non capitalist but non exploitative, way of organizing production beyond reversions to precapitalist modes of production or to Stalinist economics. Given the importance of conscious consent, this is not just an academic matter: the absence of an alternative is clearly one of the factors that legitimates capitalist exploitation and allows its perpetuation.

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